

WELSPUN INDIA

Guidance intact amidst headwinds

India Equity Research | Midcap Textiles

Welspun India's (WLSI) Q1FY18 revenue, at INR15.4bn (estimated INR16.5bn), fell 3% YoY impacted by fall in currency and loss of orders from Target. On like-to-like basis (ex Target), WLSI mentioned growth was stable. Though pressure on margins persisted, the QoQ improvement in margins indicates moderating intensity led by fall in cotton prices. EBITDA margin stood at 21.1% and despite headwinds of currency and raw material, WLSI maintained its margin guidance at 21-22%, though it mentioned postponement of its *Vision 2020*. While we maintain our revenue/EBITDA estimates, we increase our FY18/19E EPS estimates by 3%/4% respectively on lower interest cost expectations. At unchanged target multiple of 7.0x EV/EBITDA our TP is pegged at INR101. Maintain 'BUY'.

Revenue growth muted on currency and Target impact

Revenue at INR15.4bn (estimated INR16.5bn) fell 3% YoY impacted by fall in currency and loss of orders from Target. However, growth in Brand business remained strong with 'Spaces' growing 43% YoY and 'Christy' up 24% YoY. The hospitality segment also continued to gain traction with addition of a major client. Though still nascent, WLSI is looking at enhancing focus on domestic segment and expects GST to lend fillip to sector.

Higher RM costs continued to mar margins, but intensity tapering

Gross margin corrected by 284bps YoY to 51.7% impacted by higher cotton costs and fall in realizations due currency appreciation. On QoQ basis, gross margin improved by 110bps similar to the trend seen in other textile companies, and pointing at moderating impact of cotton. EBITDA margin plunged by ~550bps YoY and 70bps QoQ to 21.1%, impacted by the spurt in power costs.

Outlook and valuations: Margin guidance maintained; retain 'BUY'

Amidst headwinds of raw material and currency, WLSI maintained its margin guidance of 21-22%. However, the company mentioned about postponing its *Vision 2020* target (FY20 revenue expectation of USD2bn) by a year or two. While we maintain our revenue/EBITDA estimates, we increase our FY18/19E EPS estimates by 3%/4% respectively on lower interest cost. We maintain 'BUY' with our unchanged target multiple of 7.0x EV/EBITDA giving us TP of INR101. Changes/modifications in export benefits post GST remains a key monitorable in ensuing months.

Financials

(INR mn)

Year to March	Q1FY18	Q1FY17	YoY (%)	Q4FY17	QoQ (%)	FY17	FY18E	FY19E
Net Revenues	15,394	15,926	(3.3)	17,572	(12.4)	66,405	72,176	78,033
EBITDA	3,242	4,225	(23.3)	3,829	(15.3)	15,834	16,403	18,359
Adjusted Profit	1,243	2,019	(38.4)	1,533	(18.9)	6,720	6,568	7,688
Adj. Dil. EPS	1.2	2.0	(38.4)	1.5	(18.9)	6.7	6.5	7.7
Diluted P/E (x)						12.1	12.3	10.5
EV/EBITDA (x)						7.1	6.6	5.7
ROAE (%)						30.5	24.7	24.0

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

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

CMP	: INR 81
Target Price	: INR 101
52-week range (INR)	: 108 / 46
Share in issue (mn)	: 1,004.7
M cap (INR bn/USD mn)	: 81 / 1,273
Avg. Daily Vol. BSE/NSE ('000)	: 4,093.0

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	73.5	73.5	73.5
MF's, FI's & BKs	1.8	2.0	2.0
FII's	11.6	11.9	11.6
Others	13.1	12.5	12.9
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	3.2	(4.3)	(7.5)
3 months	4.2	(14.8)	(18.9)
12 months	20.2	(20.9)	(41.1)

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Q1FY18 Concall highlights

Industry

- Discussion with UK for FTA is expected to begin soon

Company

- Added a major client in hospitality
- Pressure on retail industry in the US is being felt. While price cut requests are not coming, frequent promotion requests are continuing
- In case of duty drawback and other export benefits, existing benefits will continue till September.
- However, considering that company will still have to pay GST on its inputs, it is expected to have a negative 1% impact on margins in Q2FY18.

Capex

- INR2-2.5bn will be for textile, rest will be for carpet
- Towel capacity will be ramped up to 80,000 tonnes in next few months

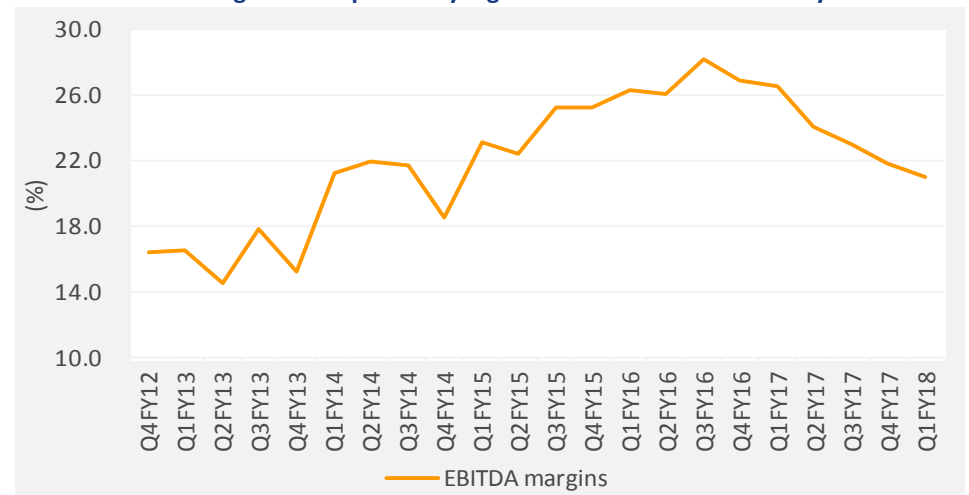
Other

- WLSI has in total filed around 27 patents of which 12 have been approved
- Received the global license for FIFA 2018 - Russia
- Sports vertical is gaining critical mass
- In relation to setting up manufacturing in other countries, WLSI mentioned it doesn't make sense to shift manufacturing to other duty-free export zones as India still remains the best manufacturing location for WLSI
- The duty differential is not high for the company, but enough to warrant the shift of manufacturing

Guidance

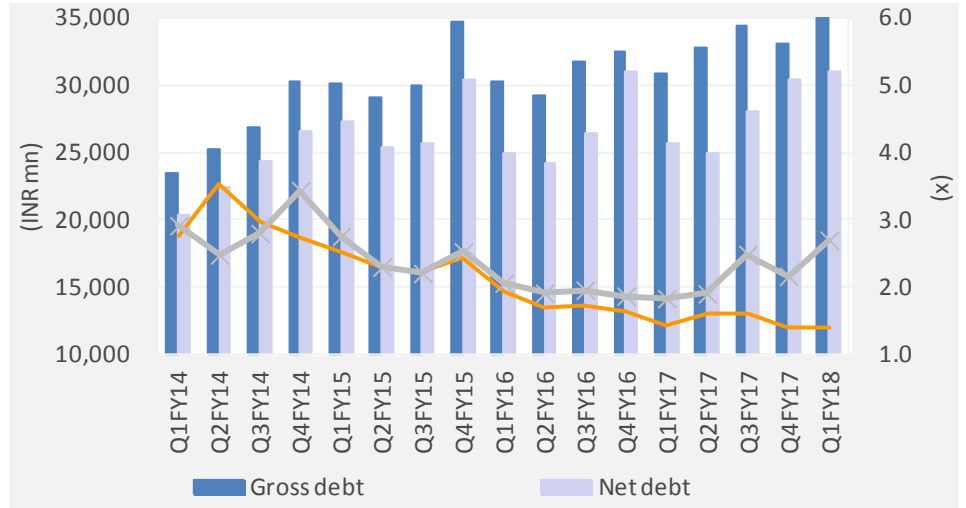
- EBITDA margin guidance to remain at 21-22% levels

Chart 1: EBITDA margin was impacted by higher cotton costs and currency



Source: Company, Edelweiss research

Chart 2: Debt is expected to increase driven by the INR6bn capex in flooring



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Net revenues	15,394	15,926	(3.3)	17,572	(12.4)	66,405	72,972	78,899
Staff costs	1,660	1,539	7.8	1,677	(1.0)	6,373	7,144	7,757
Direct costs	7,436	7,240	2.7	8,677	(14.3)	30,396	34,100	36,523
Other expenses	3,056	2,922	4.6	3,388	(9.8)	13,803	15,117	16,022
EBITDA	3,242	4,225	(23.3)	3,829	(15.3)	15,834	16,611	18,596
Depreciation	1,183	1,121	5.5	1,365	(13.4)	5,054	5,948	6,560
EBIT	2,059	3,104	(33.7)	2,464	(16.4)	10,780	10,663	12,036
Other income	132	189	(30.1)	156	(15.0)	806	905	1,074
Interest	356	353	1.0	430	(17.1)	1,583	1,674	1,519
Add: Exceptional items	-	-	-	9	(100.0)	(4,648)	-	-
Profit before tax	1,835	2,940	(37.6)	2,198	(16.5)	5,355	9,894	11,590
Provision for taxes	550	853	(35.6)	653	(15.9)	1,731	3,117	3,651
Minority interest	43	68	(37.2)	6	581.0	48	68	88
Reported net profit	1,243	2,019	(38.4)	1,539	(19.2)	3,576	6,709	7,851
Adjusted Profit	1,243	2,019	(38.4)	1,533	(18.9)	6,720	6,709	7,851
Diluted shares (mn)	1,005	10,047	-	1,005	-	1,005	1,005	1,005
Adjusted Diluted EPS	1.2	0.2	515.7	1.5	(18.9)	6.7	6.7	7.8
Diluted P/E (x)	-	-	-	-	-	12.1	12.1	10.3
EV/EBITDA (x)	-	-	-	-	-	7.1	6.5	5.6
ROAE (%)	-	-	-	-	-	30.5	25.2	24.4
Direct costs	48.3	45.5	-	49.4	-	45.8	46.7	46.3
Employee cost	10.8	9.7	-	9.5	-	9.6	9.8	9.8
Other expenses	19.9	18.3	-	19.3	-	20.8	20.7	20.3
EBITDA	21.1	26.5	-	21.8	-	23.8	22.8	23.6
Reported net profit	8.1	12.7	-	8.7	-	10.1	9.2	10.0
Tax rate	29.9	29.0	-	29.7	-	32.3	31.5	31.5

Change in Estimates

	FY18E			FY19E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	72,972	72,972	0.0	78,899	78,899	0.0	
EBITDA	16,612	16,612	0.0	18,596	18,596	0.0	
EBITDA Margin	22.8	22.8	-	23.6	23.6	-	
Adjusted PAT	6,709	6,515	3.0	7,851	7,537	4.2	
Net Profit Margin	9.3	9.0	3.3	10.1	9.7	4.6	
Capex	7,324	7,324	0.0	6,860	6,860	0.0	

Company Description

Established in 1985, Welspun India today, it 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.

Welspun 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: Welspun enjoys long standing relationships with top retailers in the US and Europe and supplies to 14 of the top 30 global retailers. It commands a 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. Welspun derives ~30% of sales from innovative products.

Margin sustainability: WLSI has consistently improved its margin. While the rise is partially attributed to currency, it has been primarily driven by increase in share of innovative products. Driven by its confidence in sustaining these margins, it has upgraded its margin guidance from 20-22% to 23-24%.

Robust free cash flow & consistently lowering leverage: WLSI is at the end of its massive INR25bn capex programme it had undertaken in FY14, with only INR8bn to be spent in FY17. The company's confidence in generating free cash is also evident from its recently announced dividend policy of 25% payout ratio. Going forward, it is expected to generate strong free cash flows and lower its leverage further. Gross debt/equity has fallen from 2.1x at FY15 end to 1.3x as of FY16. We estimate this to fall below 1.0x by FY18E.

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	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
Company				
Towel cap. (MT)	55,000	72,000	80,000	80,000
Bed-linen cap. (000 mts)	66,000	90,000	90,000	90,000
Rugs/carpets cap. (MT)	15,000	25,000	25,000	25,000
Towel utilis. (%)	101	97	91	95
Bed-linen utilis. (%)	101	73	73	76
Rugs/carpets utilis. (%)	76	72	78	84
Raw Material (% net rev)	44.9	45.8	46.6	46.2
Other exp (% net rev)	19.2	20.8	20.7	20.3
Depreciation rate (%)	7.2	8.3	8.7	8.7
Dividend per share	1.3	0.7	1.3	1.6
Capex (INR mn)	10,597	7,785	7,324	6,861
Inventory % of costs	41.5	42.1	41.0	41.0
Debtors % of revenues	14.3	14.5	14.5	14.5
OCA % of revenues	12.4	10.9	10.9	11.0
Loans & adv (% net rev)	1.8	3.9	3.9	4.0
Incremental debt	1,627	636	(3,096)	(1,950)

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	59,239	66,405	72,972	78,899
Materials costs	26,594	30,396	34,100	36,523
Gross profit	32,645	36,009	38,872	42,376
Employee costs	5,367	6,373	7,144	7,757
Other Expenses	11,352	13,803	15,117	16,022
EBITDA	15,927	15,834	16,611	18,596
Depreciation	3,718	5,054	5,948	6,560
EBIT	12,208	10,780	10,663	12,036
Add: Other income	904	806	905	1,074
Less: Interest Expense	2,368	1,583	1,674	1,519
Add: Exceptional items	-	(4,648)	-	-
Profit Before Tax	10,745	5,355	9,894	11,590
Less: Provision for Tax	3,254	1,731	3,117	3,651
Less: Minority Interest	126	48	68	88
Reported Profit	7,365	3,576	6,709	7,851
Exceptional Items	-	(3,145)	-	-
Adjusted Profit	7,365	6,720	6,709	7,851
Shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Basic EPS	7.3	6.7	6.7	7.8
Diluted shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Diluted EPS	7.3	6.7	6.7	7.8
Adjusted Cash EPS	11.6	12.0	13.1	14.9
Dividend per share (DPS)	1.3	0.7	1.3	1.6
Dividend Payout Ratio(%)	21.2	23.0	23.0	25.0

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	73.1	76.2	77.2	76.4
Materials costs	44.9	45.8	46.7	46.3
Staff costs	9.1	9.6	9.8	9.8
S G & A expenses	19.2	20.8	20.7	20.3
Depreciation	6.3	7.6	8.2	8.3
Interest Expense	4.0	2.4	2.3	1.9
EBITDA margins	26.9	23.8	22.8	23.6
Net Profit margins	12.6	10.2	9.3	10.1

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	11.7	12.1	9.9	8.1
EBITDA	25.0	(0.6)	4.9	11.9
PBT	42.6	(50.2)	84.8	17.1
Adjusted Profit	36.4	(8.8)	(0.2)	17.0
EPS	36.4	(8.8)	(0.2)	17.0

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,005	1,005	1,005	1,005	
Reserves & Surplus	18,696	22,967	28,133	34,021	
Shareholders' funds	19,701	23,972	29,138	35,026	
Minority Interest	412	355	423	512	
Short term borrowings	14,556	12,954	13,138	13,189	
Long term borrowings	17,922	20,160	17,000	15,000	
Total Borrowings	32,478	33,114	30,138	28,189	
Long Term Liabilities	1,932	2,354	2,524	2,526	
Def. Tax Liability (net)	597	1,466	1,979	2,581	
Sources of funds	55,119	61,260	64,202	68,834	
Gross Block	53,110	62,164	69,585	76,474	
Net Block	31,559	35,011	36,486	36,817	
Capital work in progress	1,832	564	466	438	
Intangible Assets	1,925	1,879	1,887	1,895	
Total Fixed Assets	35,316	37,454	38,839	39,150	
Non current investments	39	29	29	29	
Cash and Equivalents	1,490	2,857	3,038	5,441	
Inventories	11,046	12,810	13,981	14,975	
Sundry Debtors	8,499	9,601	10,550	11,407	
Loans & Advances	1,050	2,567	2,820	3,156	
Other Current Assets	7,321	7,265	7,983	8,679	
Current Assets (ex cash)	27,917	32,242	35,334	38,216	
Trade payable	6,652	7,517	8,454	9,045	
Other Current Liab	2,989	3,804	4,584	4,957	
Total Current Liab	9,641	11,321	13,038	14,002	
Net Curr Assets-ex cash	18,275	20,921	22,296	24,214	
Uses of funds	55,119	61,260	64,202	68,834	
BVPS (INR)	19.6	23.9	29.0	34.9	
Contingent Liability	414.3	414.3	414.3	414.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	7,365	3,576	6,709	7,851	
Add: Depreciation	3,718	5,054	5,948	6,560	
Interest (Net of Tax)	1,651	1,071	1,147	1,040	
Others	1,050	2,591	136	7	
Less: Changes in WC	(2,754)	2,224	1,205	1,916	
Operating cash flow	16,538	10,068	12,736	13,542	
Less: Capex	10,597	7,785	7,324	6,861	
Free Cash Flow	5,940	2,283	5,412	6,682	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Welspun India	1,273	12.1	10.3	6.5	5.6	25.2	24.4
Arvind	1,548	21.9	14.6	11.5	8.7	11.8	15.5
Himatsingka Seide	508	15.5	11.3	8.1	6.4	18.0	20.9
Median	-	15.5	11.3	8.1	6.4	18.0	20.9
AVERAGE	-	16.5	12.1	8.7	6.9	18.3	20.3

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		16,538	10,068	12,736	13,542
Investing cash flow		(8,012)	(7,962)	(6,429)	(5,797)
Financing cash flow		(9,455)	(1,721)	(6,126)	(5,342)
Net cash Flow		(929)	385	181	2,403
Capex		(10,597)	(7,785)	(7,324)	(6,861)
Dividend paid		(2,443)	(822)	(1,543)	(1,963)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	43.0	30.5	25.2	24.4
ROACE (%)	26.7	21.1	19.8	21.2
Inventory Days	122	113	114	115
Debtors Days	40	50	50	51
Payable Days	93	85	85	87
Cash Conversion Cycle	69	78	79	79
Current Ratio	3.0	3.1	2.9	3.1
Gross Debt/EBITDA	2.0	2.1	1.8	1.5
Gross Debt/Equity	1.6	1.4	1.0	0.8
Adjusted Debt/Equity	1.6	1.4	1.0	0.8
Net Debt/Equity	1.5	1.2	0.9	0.6
Interest Coverage Ratio	5.2	6.8	6.4	7.9

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.2	1.1	1.2	1.2
Fixed Asset Turnover	2.0	1.9	1.9	2.0
Equity Turnover	3.4	3.0	2.7	2.4

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	7.3	6.7	6.7	7.8
Y-o-Y growth (%)	36.4	(8.8)	(0.2)	17.0
Adjusted Cash EPS (INR)	11.6	12.0	13.1	14.9
Diluted P/E (x)	11.0	12.0	12.1	10.3
P/B (x)	4.1	3.4	2.8	2.3
EV / Sales (x)	1.9	1.7	1.5	1.3
EV / EBITDA (x)	7.1	7.0	6.5	5.6
Dividend Yield (%)	1.6	0.8	1.6	2.0

Additional Data

Directors Data

Mr. B K Goenka	Chairman	Mr. R. R. Mandawewala	Managing Director
Ms. Dipali Goenka	Executive Director	Mr. A. K. Dasgupta	Independent Director
Mr. Arun Tadarwal	Independent Director	Mr. Ram Gopal Sharma	Independent Director
Mr. Ajay Sharma	Nominee Director	Mr. Arvind Kumar Singhal	Additional Director

Auditors -

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Wasatch Advisors	2.04	Alliance Bernstein	1.91
Vanguard Group	1.21	Reliance Capital	0.72
Dimensional Fund Advisors	0.68	State of California	0.63
Birla Sun Life Insurance	0.41	Birla Sun Life Asset Mgmt	0.36
Blackrock	0.33	Prudential ICICI Asset Mgmt	0.28

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
01 Sep 2016	Wasatch Emerging Markets Small Cap Fund	Buy	6362881	50.89

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
07 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00
07 Apr 2017	PRASERT MULTIVENTURE PRIVATE LIMITED	Buy	679078913.00
06 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00
06 Apr 2017	PRASERT MULTIVENTURE PRIVATE LIMITED	Buy	679078913.00
05 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Midcap Textiles

Arvind, Himatsingka Seide, Trident Ltd, Welspun India

Recent Research

Date	Company	Title	Price (INR)	Recos
07-Aug-17	Arvind	Strong show in tough times; <i>Result Update</i>	389	Buy
25-May-17	Himatsingka Seide	New unit continues to ramp up; <i>Result Update</i>	319	Buy
12-May-17	Arvind	Margin story: Textiles takes a hit, but B&R spikes; <i>Result Update</i>	408	Buy

Distribution of Ratings / Market Cap

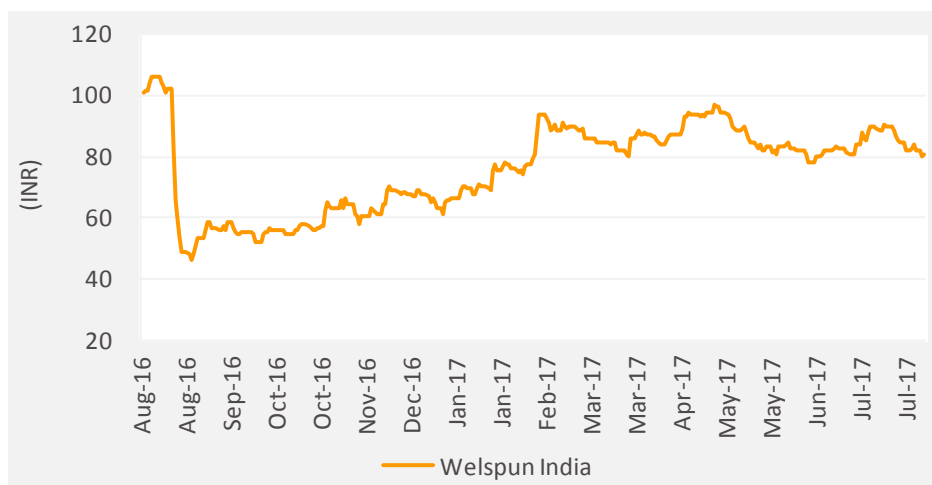
Edelweiss Research Coverage Universe

	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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