

WELSPUN INDIA

Expands capacity, reduces leverage

India Equity Research | Textiles

Welspun India's (WLSI) Q2FY15 numbers beat estimates with PAT coming in at INR 1,299mn. Revenue grew 22% YoY to INR14,135mn, primarily led by 14% YoY surge in production. Gross debt fell to INR29.1bn in Q2FY15 from INR30.0bn in Q1FY15 (INR30.3bn in Q4FY14), a positive. The company continued to maintain its high pre-tax RoCE and RoE at 36.1% and 42.1%, respectively. While the stock has run up 2.15x since our initiating coverage, a controlled capex will trigger further re-rating. Maintain 'BUY' with a revised target price of INR426.

Revenue spurt led by enhanced capacity and utilisation

WLSI's overall revenue grew 22.0% YoY and 20.1% QoQ to INR14,135mn as production surged 14% YoY and 15% QoQ (estimate). The production spurt was on account of increased capacity in towels and bed linen and 100% utilisation in the latter (85% in Q1FY15). Utilisation in the rugs segment will improve as production of carpets has started. Average USD realisation was INR64 for the quarter. EBITDA margin jumped 50bps YoY to 22.4%. All the 170K spindles have been commercialised now and impact of the same will reflect from the next quarter. The power business reported positive PAT during the quarter.

Prudent use of cash for capex and debt repayment

In H1FY15, the company spent INR3.4bn on capex and reduced gross debt by INR1.2bn. It also improved its cash flows by reducing working capital by INR123mn. This is a clear positive as WLSI has generated cash and expended it to simultaneously increase capacity and cut debt. It also declared an interim dividend of INR3/share and intends to announce a dividend policy once balance capex of INR13bn is completed.

Outlook and valuations: Growth triggers intact; maintain 'BUY'

Current RoE of 42% is commendable. We have revised up FY15E EPS 11.2% to account for better H1FY15 numbers. We had valued WLSI giving a discount of 25% to the fair EV/EBITDA multiple of 6.0x due to high levels of gross debt and the company's continued focus on capital expenditure. Since WLSI has been reducing gross debt and its D/E has moved lower to 2.28x in Q2FY15 from 2.73x in Q4FY14, we are increasing the EV/EBITDA multiple to 5.0x (from 4.5x) and hence our target price to INR426 (earlier INR315). We would revisit the target multiples as we see further reduction in leverage. We maintain 'BUY'.

Financials		(INR mn)						
Year to March	Q2FY15	Q2FY14	YoY	Q1FY15	QoQ	FY14	FY15E	FY16E
Net revenues	14,135	11,589	22.0	11,773	20.1	44,954	53,643	64,964
EBITDA	3,169	2,540	24.8	2,727	16.2	9,211	11,758	14,728
Profit after tax	1,299	-1,890	NA	1,050	23.7	921	4,656	5,947
Diluted EPS (INR)	12.9	-18.9	NA	10.5	23.7	9.2	46.4	59.3
Diluted P/E (x)						36.6	7.2	5.7
EV/EBITDA (x)						6.7	5.5	4.6
ROAE (%)						8.8	35.6	33.8

EDELWEISS RATINGS			
Absolute Rating	BUY		
Investment Characteristics	None		
MARKET DATA (R: WLSP.BO, B: WLSI IN)			
CMP	: INR 336		
Target Price	: INR 426		
52-week range (INR)	: 355/ 62		
Share in issue (mn)	: 100.4		
M cap (INR bn/USD mn)	: 34 / 550		
Avg. Daily Vol. BSE/NSE ('000)	: 254.1		
SHARE HOLDING PATTERN (%)			
	Current	Q1FY14	Q4FY14
Promoters *	73.4	73.1	68.8
MF's, FI's & BKs	5.9	10.9	16.8
FII's	0.2	0.0	0.0
Others	20.5	16.0	14.4
* Promoters pledged shares (% of share in issue)	:	NIL	
PRICE PERFORMANCE (%)			
	BSE Midcap Index	Stock	Stock over Index
1 month	1.9	(0.1)	(2.0)
3 months	5.9	25.1	19.2
12 months	61.3	373.6	312.2

Niraj Mansingka, CFA
 +91 22 6623 3315
 niraj.mansingka@edelweissfin.com

November 5, 2014

Q2FY15 conference call: Key highlights

Capacity utilisation:

- Capacity
 - Towel : 50,000MT (to be expanded to 60,000MT).
 - Sheets: 60mn mtrs (to be expanded to 72mn mtrs).
 - Rugs/carpets: 15,000MT (capacity of carpet and rugs is fungible).
- Capacity utilisation
 - Towel : 100%
 - Sheets: 100%
 - Rugs/Carpets: 60%
- The company is debottlenecking by increasing towel and sheet capacities.
- Added capacity to make bigger floor carpets.

Revenue:

- 55% from towels, 27% from sheets, 8% from bath robes and 10% from others.
- 25% contribution from innovative products; focus on innovative products to continue.
- The company posted its strongest ever quarter in sheeting.
- Volume growth in Q2FY15: 14%.
- Rugs/carpets revenues:
 - Current revenue is USD55mn with potential of USD100mn.
 - See promising signs from Indian market.

Hedging:

- USD realisation of INR 64 in the quarter.

Geography/exports:

- Geography breakup:
 - USA: 62%, Europe: 18%, ROW: 15% and India: 5%.
- Geography wise growth:
 - US: 17%, Europe: 25%, RoW: 25% and India: 40%.
- The company is not witnessing any slowdown in the US and is not concerned about it. However, it is looking at other markets as America is well penetrated.
- Though Japan contributes 1% to revenue, the company has increased focus on Japanese market due to FTA with it and has already established contact with all the major retailers there.

Margins:

- WLSI expects margins to be around 21-22% in the long term despite backward integration as it plans to pass on benefits to customers.
- Margins and pricing across countries are the same.

Interest / debt:

- Despite capex of INR340Cr, the company had free cash flow of INR122Cr which helped reduce debt.
- Interest jumped from INR59Cr to INR73Cr YoY as the 3% interest subvention on working capital scheme was not renewed.
- Interest in Q3FY15 is expected to be the same as Q2FY15.
- The company does not expect total debt to go beyond INR3,300Cr with plans to keep it below INR3,000Cr.
- WLSI has applied for Gujarat government's benefit scheme now once major capex has been undertaken. The scheme is applicable from October 1, 2014, for 5 years.

Cotton prices and raw material stock:

- WLSI has stocks until end of November from last season.
- This year's crop prices are down from INR39,000-40,000/candy to INR33,000/candy and the company expects this to stay in this range.
- The cotton crop was delayed this season and has been arriving now.
- Any impact of low prices will only be seen next year/later part of Q4FY15.

Capex and expansion:

- Capex of INR340Cr in H1FY15.
- INR1200 Cr spent till June 2014; remaining INR1300 Cr to be spent till March 2016.
- Spindles:
 - All 170K spindles have started production compared to 60K at the end July 2014.
 - Will stabilise in the next one/two quarters.
- 50% of capex has been capitalised.
- Remaining capex will be utilised for:
 - Modernise Vapi plant and capacity expansion.
 - Increase in capacity at Anjar.
 - Capacity expansion in sheet from 60mn mtrs to 72mn mtrs.
 - Technology upgradation.
- The company has guided that the expansion will be without increase in employees.
- Maintenance capex to be around INR100Cr /year.
- The company will not add any capacity in anticipation of demand and capex spending is going to be calibrated going ahead.
- As majority of the capex is spent in spinning and weaving (~60%), the company plans to set up ancillary units to outsource this. Also, these units can take advantage of the favourable policies in Gujarat.

Power plant:

- Capacity utilisation of 75% in Q2FY15 which is expected to increase to 85-90%.
- Made a net profit in Q2FY15.

Competition:

- The company has not seen any effect of increase in capacity of Trident plant on its business; Trident plant increased capacity in Q4FY14.
- WLSI believes it gets repeat business because of:
 - Its delivery record.
 - Quality.
 - 360 degree solution (value added services) like market research, consumer research etc. which help clients to improve business.

Spaces:

- Relaunched 'Spaces' brand in the domestic market.
- Focus is on domestic market.
- Available online and most e-commerce websites.

Christy:

- WLSI launched the Christy brand in India with a test launch in Mumbai.
- Pricing: INR1000/Towel; INR3000/Sheet.
- The company was happy with the initial response and is positive about the brand.

Dividend:

- WLSI declared first ever interim dividend of INR3/share.
- It plans to put a dividend policy in place once balance capex requirement is met

Other:

- The company does not expect movement on FTA with Europe as the government's focus is on 'made in India' and it is worried about losing manufacturing in certain segments.
- Cash conversion cycle reduced from 65 to 56 days.

Chart 1: EBITDA margins remain stable

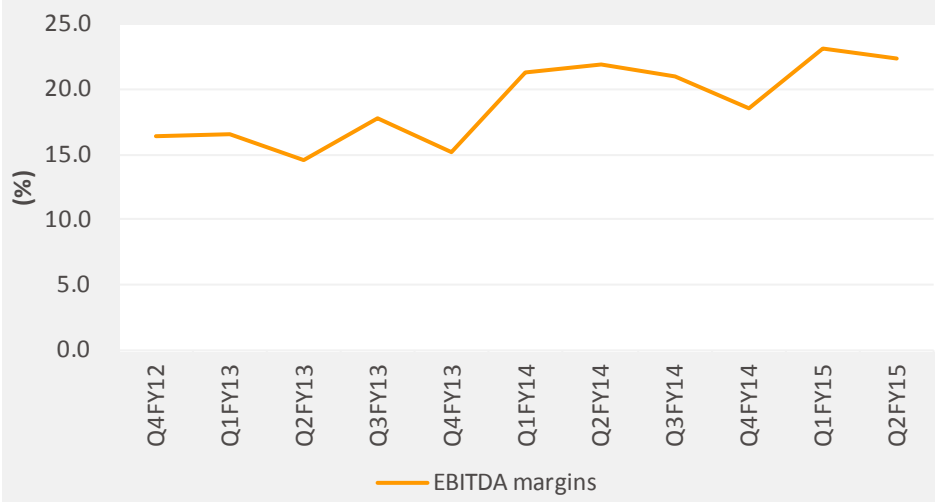
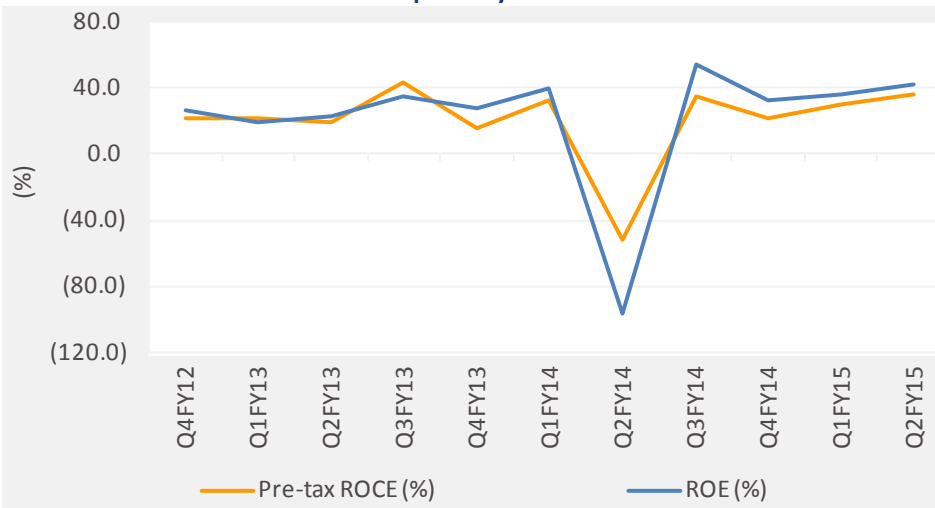
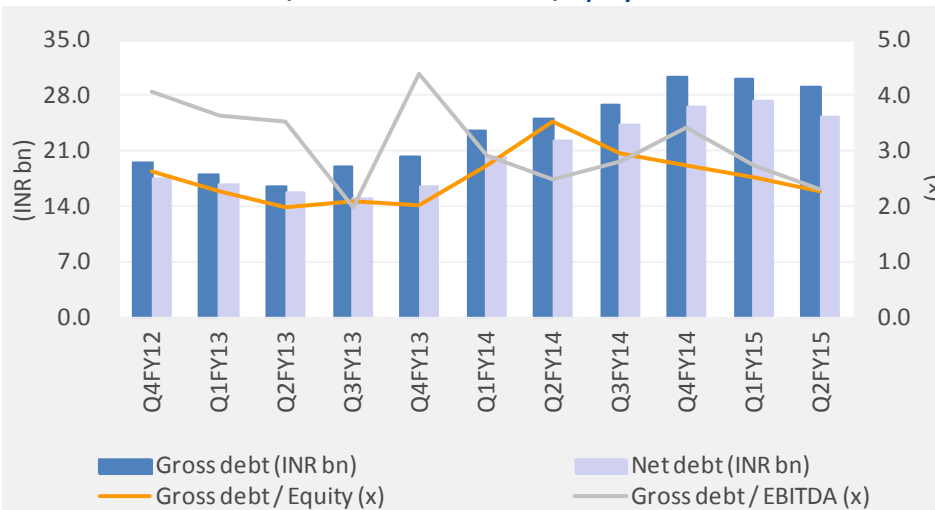


Chart 2: ROCE and ROE based on the quarterly numbers



Increased integration in next two quarters will sustain WLSI's ROE and ROCE.

Chart 3: Stable Gross Debt/EBITDA and Gross debt/Equity levels



Gross Debt/EBITDA and Gross Debt/Equity remain at comfortable levels

Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q2FY15	Q2FY14	YoY (%)	Q1FY15	QoQ (%)	YTD15	FY15E	FY16E
Net revenues	14,135	11,589	22.0	11,773	20.1	25,908	53,643	64,964
Direct costs	7,223	5,980	20.8	5,564	29.8	12,787	25,314	30,079
Employee expenses	1,143	831	37.5	1,004	13.8	2,147	4,516	5,178
Other expenses	2,600	2,238	16.2	2,478	4.9	5,078	12,055	14,979
EBIDTA	3,169	2,540	24.8	2,727	16.2	5,896	11,758	14,728
Depreciation & Amortisation	717	5,109	(86.0)	686	4.5	1,403	3,004	3,696
EBIT	2,452	(2,569)	NA	2,041	20.1	4,493	8,754	11,032
Interest Expense	731	593	23.3	713	2.5	1,444	2,969	2,810
Other income	191	245	(21.9)	322	(40.6)	513	1,175	725
Profit before tax	1,913	(2,917)	NA	1,650	15.9	3,563	6,960	8,947
Tax	591	(996)	NA	622	(5.0)	1,213	2,366	3,042
PAT before minority interest	1,322	(1,920)	NA	1,028	28.6	2,349	4,594	5,905
Profit from associates/Minority	(23)	30	(175.9)	22	(203.1)	(1)	62	42
Reported PAT	1,299	(1,890)	NA	1,050	23.7	2,348	4,656	5,947
Diluted EPS	12.9	(18.9)	NA	10.5	23.7	23.4	46.4	59.3

As % of net revenue

Direct costs	51.1	51.6		47.3		49.4	47.2	46.3
Employee expenses	8.1	7.2		8.5		8.3	8.4	8.0
Other expenses	18.4	19.3		21.0		19.6	22.5	23.1
EBIDTA	22.4	21.9		23.2		22.8	21.9	22.7
Net profit	9.2	(16.3)		8.9		9.1	8.7	9.2
Tax rate	30.9	34.2		37.7		34.1	34.0	34.0

Change in estimate table

(INR mn)

	FY15E			FY16E			Comments
	New	Old	% change	New	Old	% change	
Sales	53,643	50,908	5.4	64,964	62,770	3.5	Better H1FY15 performance
EBITDA	11,758	11,031	6.6	14,728	14,286	3.1	Better H1FY15 performance
EBITDA margin	21.9	21.7		22.7	22.8		
PAT	4,656	4,189	11.2	5,947	5,566	6.8	Better H1FY15 performance
PAT margin	8.7	8.2		9.2	8.9		

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 ~25% of sales from innovative products.

Capex underway to bolster already formidable capacity: The company is undertaking a major capex programme to enhance its cost base, lending it pricing power and opportunities to increase market share globally. This will propel vertical integration to ~75% (~35% currently). The capex is being funded by low-cost subsidised debt, which will increase capacity without substantial interest burden.

Returns: Better integration and continued high capacity utilisation will drive 220bps expansion in EBITDA margin over FY14-16E. Similarly, RoEs are likely to maintain upward trend and cross the 34% mark in FY16E (750bps expansion over FY13-16E).

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.

Leveraged balance sheet: Welspun ended FY14 with a net debt/equity of 2.5x. It is in the midst of a capex programme with a total potential outlay of INR24bn. This is likely to keep leverage levels high in the future and may pressurise profitability.

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.

Financial Statements

Key Assumptions

Year to March	FY13	FY14	FY15E	FY16E
Macro				
GDP(Y-o-Y %)	5.0	4.8	5.4	6.3
Inflation (Avg)	7.4	6.2	5.5	6.0
Repo rate (exit rate)	7.5	8.0	7.8	7.3
INR/USD	54.5	60.5	58.0	56.0
Company				
Terry towel capacity (MT)	43,800	45,000	50,000	60,000
Bed Linen capacity (000 Mts)	52,000	55,000	60,000	72,000
Rugs/carpets capacity (MT)	10,151	12,000	15,000	20,000
Terry towel capacity utilisation (%)	90	99	95	85
Bed linen capacity utilisation (%)	96	89	91	85
Rugs/carpets capacity utilisation (%)	59	68	52	70
Raw material costs (% of sales)	48.5	50.4	47.2	46.3
Employee costs (% of sales)	7.6	7.6	8.4	8.0
Other expenses (% of sales)	27.6	21.5	22.5	23.1
Avg. depreciation rate (%)	5.4	5.5	6.5	6.7
Capex (INR mn)	2847	13679	9284	9357
Increase in debt (INR mn)	657	10014	2061	2382
inventory as % of RM costs (%)	46.4	44.5	44.0	44.0
Receivables as % of net revenues (%)	7.5	9.2	9.0	9.0
Other curr.assets as % of net rev. (%)	5.7	6.8	7.0	7.0
Loans/advances as % of net rev. (%)	11.8	12.0	12.0	12.0
Dividend per share (INR)	4.0	3.0	6.0	7.0

Income statement

(INR mn)

Year to March	FY13	FY14	FY15E	FY16E
Net revenues	36,473	44,954	53,643	64,964
Raw material costs	17,684	22,673	25,314	30,079
Gross profit	18,789	22,281	28,329	34,884
Employee expenses	2,766	3,400	4,516	5,178
Other expenses	10,077	9,670	12,055	14,979
EBITDA	5,946	9,211	11,758	14,728
Depreciation & amortisation	1,449	6,863	3,004	3,696
EBIT	4,497	2,348	8,754	11,032
Interest expense	1,977	2,352	2,969	2,810
Other income	492	1,042	1,175	725
Profit before tax	3,013	1,037	6,960	8,947
Current tax	417	1,785	1,601	2,058
Deferred tax	450	(1,465)	766	984
Other tax	(133)	(121)	0	0
Total tax	733	199	2,366	3,042
Core profit	2,279	838	4,594	5,905
Extraord./ Prior period items	31	0	0	0
Profit after tax	2,248	838	4,594	5,905
Minority Interest	0	(82)	(62)	(42)
Profit after minority interest	2,248	921	4,656	5,947
Equity shares outstand. (mn)	100.0	100.3	100.3	100.3
EPS (INR) basic	22.8	9.2	46.4	59.3
Diluted shares (mn)	100.0	100.3	100.3	100.3
Diluted EPS (INR)	22.8	9.2	46.4	59.3
CEPS	41.8	63.0	84.0	105.9
DPS	4.0	3.0	6.0	7.0
Dividend payout (%)	17.6	32.7	12.9	11.8

Common size metrics (% net revenues)

Year to March	FY13	FY14	FY15E	FY16E
Gross margins	51.5	49.6	52.8	53.7
EBITDA margins	16.3	20.5	21.9	22.7
EBIT margins	12.3	5.2	16.3	17.0
Net profit margin	6.2	1.9	8.6	9.1

Growth metrics (%)

Year to March	FY13	FY14	FY15E	FY16E
Revenues	13.3	23.3	19.3	21.1
EBITDA	62.4	54.9	27.7	25.3
Net profit	NA	(59.0)	405.7	27.7
EPS	206.5	(59.7)	405.7	27.7

Balance sheet				
	(INR mn)			
Year to March	FY13	FY14	FY15E	FY16E
Total equity capital	1,000	1,003	1,003	1,003
Reserves & surplus	8,901	10,093	14,045	19,171
Shareholder's equity	9,902	11,097	15,049	20,174
Minority Interest	250	316	254	211
Long term borrowings	11,113	18,944	20,517	28,299
Short term borrowings	9,166	11,349	11,838	6,438
Loan funds	20,279	30,293	32,355	34,737
Deferred tax liability	1,917	434	1,200	2,184
Sources of funds	32,347	42,140	48,857	57,306
Tangible assets	16,267	18,395	28,853	34,732
Intangible assets	1,806	1,890	1,895	1,903
CWIP (incl. intangible)	542	5,324	1,148	932
Total net fixed assets	18,615	25,609	31,896	37,567
Non current investments	537	473	500	500
Current Investments	394	641	750	750
Cash and cash equivalents	1,724	2,332	505	36
Inventories	8,205	10,094	11,138	13,235
Sundry debtors	2,750	4,117	4,828	5,847
Loans & advances	4,286	5,376	6,437	7,796
Other assets	2,067	3,041	3,755	4,547
Current assets	19,033	24,960	26,663	31,460
Trade payable	4,929	6,144	7,120	8,540
Other current liabilities and prov	1,303	3,399	3,832	4,432
Total current liabilities & provisi	6,232	9,544	10,953	12,972
Net current assets (ex-cash)	11,077	13,085	15,206	18,453
Uses of funds	32,347	42,140	48,857	57,306
Book value per share	99	111	150	201

Free cash flow				
Year to March	FY13	FY14	FY15E	FY16E
Net profit	2,248	921	4,656	5,947
Add: Depreciation	1,449	6,863	3,004	3,696
Add: Deferred tax	450	(1,465)	766	984
Add: Others	(2,366)	(2,705)	(2,448)	(4,409)
Gross cash flow	1,781	3,614	5,978	6,218
Less: Changes in WC	(1,928)	(2,008)	(2,121)	(3,247)
Operating cash flow	3,709	5,622	8,099	9,465
Less: Capex	2,847	13,679	9,284	9,357
Free cash flow	862	(8,057)	(1,185)	108

Cash flow metrics				
Year to March	FY13	FY14	FY15E	FY16E
Operating cash flow	3,709	5,622	8,099	9,465
Financing cash flow	(1,502)	7,228	(1,674)	(1,292)
Investing cash flow	(1,542)	(12,821)	(8,252)	(8,642)
Net cash flow	664	29	(1,827)	(469)
Capex	(2,847)	(13,679)	(9,284)	(9,357)
Dividends paid	(207)	(352)	(704)	(822)

Profitability ratios (%)				
Year to March	FY13	FY14	FY15E	FY16E
ROACE	15.2	6.5	19.8	21.3
ROAE (%)	26.3	8.8	35.6	33.8
Receivables (days)	26.2	27.9	30.4	30.0
Inventory (days)	159.9	147.3	153.1	147.9
Payables (days)	104.9	89.1	95.6	95.0
Cash conversion cycle (days)	81	86.0	87.9	82.8
Net debt-equity (x)	1.8	2.5	2.1	1.7

Operating ratios (x)				
Year to March	FY13	FY14	FY15E	FY16E
Total asset turnover	1.2	1.2	1.2	1.2
Fixed asset turnover	2.0	2.0	1.9	1.9
Equity turnover	4.2	4.3	4.1	3.7

Valuation parameters				
Year to March	FY13	FY14	FY15E	FY16E
Diluted EPS (INR)	22.8	9.2	46.4	59.3
Y-o-Y growth (%)	206.5	(59.7)	405.7	27.7
CEPS (INR)	41.8	63.0	84.0	105.9
Diluted P/E (x)	14.8	36.6	7.2	5.7
P/BV (x)	3.4	3.0	2.2	1.7
EV/Sales (x)	1.4	1.4	1.2	1.0
EV/EBITDA (x)	8.8	6.7	5.5	4.6
Dividend yield(%)	1.2	0.9	1.8	2.1

Additional Data

Directors Data

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

Auditors - Price Waterhouse

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Krishiraj trading It	50.11	Welspun mercantile l	11.2
Welspun wintex ltd	8.39	Reliance capital tru	2.83
Welspun infratech It	2.74	Bank of baroda	1.99
Industrial dev bank	1.77	State bk bikaner & j	1.63
Tata asset managemen	1.21	Welspun finance ltd	0.54

**as per last available data*

Bulk Deals

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

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
15 May 2014	KRISHIRAJ TRADING LIMITED	Buy	66179.00
08 May 2014	Krishiraj Trading Limited	Buy	216506.00
06 Mar 2014	IDBI Bank Limited	Sell	3130192.00
06 Mar 2014	Welspun Infra Developers Private Limited	Buy	1849773.00

**as per last available data*