



## Vardhman Textiles

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,936	VTEX IN
	REUTERS CODE
S&P CNX: 4,346	MHSP.BO

1 August 2007

Buy

Previous Recommendation: Buy

Rs144

Equity Shares (m)	64.1
52-Week Range (Rs)	345/140
1,6,12 Rel.Per. (%)	-16/-47/-88
M.Cap (Rs. b)	9.2
M.Cap (US\$ b)	0.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	20,876	1,717	26.8	-12.5	5.4	0.8	16.6	9.3	1.1	6.8
3/08E	23,759	1,429	22.3	-16.8	6.4	0.7	12.2	7.8	1.5	8.4
3/09E	29,817	1,792	28.0	25.4	5.1	0.7	13.7	8.0	1.3	6.9

- Vardhman reported 1QFY08 results above our expectations. EBITDA during 1QFY08 stood at Rs896m (v/s est. Rs825m). EBITDA margin declined 59bp YoY to 17% (v/s est. of 15.1%), as a result of poor performance from the fabric division.
- For 1QFY08, Vardhman reported margin declines across all its key segments - fabric, yarn and steel. EBIT margin in the yarn division dropped 80bp YoY to 11.2%, while in the fabric division it dropped 16bp YoY to 6.6% and for the sewing thread division, by 237bp YoY to 10.4%.
- We expect yarn margins to continue to face margin pressure near term due to weak cotton prices and increased capacities in the domestic market. Further, even the fabric business could continue to face margin pressure due to oversupply in trouser fabric.
- The appreciation of the rupee v/s the US\$ by more than 7~9% is likely to negatively impact the company in the next few quarters. Although actual exports of the company is only around Rs4b, indirect exports or sales to garment exporters constitute almost 60% of its business. Hence, the company expects margin pressure across verticals, going forward.
- We expect the interest cost for the company to increase significantly, going forward. Almost 60% of the company's debt is in TUF loans, a majority of which has floating interest rates. As a result, the effective cost of TUF loans has increased from 3.5% to around 5-5.5%, substantially increasing the interest cost.
- The stock is trading at an undemanding valuation of 6.4x PER on FY08E EPS of Rs22.3 and at 5.1x PER on FY09E EPS of Rs28. **Maintain Buy.**

### QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY07				FY08E				FY07	FY08
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
<b>Sales</b>	<b>4,755</b>	<b>5,283</b>	<b>5,438</b>	<b>5,400</b>	<b>5,276</b>	<b>5,702</b>	<b>6,177</b>	<b>6,604</b>	<b>20,876</b>	<b>23,759</b>
Change (%)	12.7	15.0	6.1	9.1	10.9	7.9	13.6	22.3	10.5	13.8
Total Expenditure	133	4,366	4,470	4,632	4,380	4,699	5,035	5,470	17,388	19,582
<b>EBITDA</b>	<b>836</b>	<b>917</b>	<b>968</b>	<b>768</b>	<b>896</b>	<b>1,004</b>	<b>1,143</b>	1,135	<b>3,488</b>	<b>4,177</b>
Change (%)	6.8	7.5	1.0	-8.2	7.2	9.4	18.0	47.8	1.7	19.7
As % of Sales	17.6	17.4	17.8	14.2	17.0	17.6	18.5	18.8	16.7	17.6
Depreciation	286	301	290	317	346	374	413	426	<b>1,194</b>	<b>1,559</b>
Interest	110	99	87	81	165	237	247	338	377	988
Other Income	62	37	77	129	66	72	75	87	340	300
Extra-ordinary Income	0	35	0	1	0	0	0	0	35	0
<b>PBT</b>	<b>501</b>	<b>590</b>	<b>668</b>	<b>500</b>	<b>451</b>	<b>465</b>	<b>558</b>	<b>458</b>	<b>2,292</b>	<b>1,931</b>
Tax	126	132	152	131	134	117	146	105	541	502
Effective Tax Rate (%)	25.2	22.4	22.8	26.2	23.7	25.1	26.2	27.7	23.6	26.0
<b>Reported PAT</b>	<b>375</b>	<b>458</b>	<b>516</b>	<b>369</b>	<b>317</b>	<b>348</b>	<b>412</b>	<b>353</b>	<b>1,752</b>	<b>1,429</b>
<b>Adj. PAT</b>	<b>375</b>	<b>423</b>	<b>516</b>	<b>369</b>	<b>317</b>	<b>348</b>	<b>412</b>	<b>353</b>	<b>1,717</b>	<b>1,429</b>
Change (%)	29.4	5.9	0.5	-24.9	-15.5	-17.7	-20.2	-4.4	1.4	-16.8

E: MOST Estimates

## Segmental result analysis

Revenues increased by 10.9% YoY to Rs5.3b, led primarily by increase in yarn revenues by 11.2% YoY to Rs3.6b and increase of fabric revenues by 10.5% YoY to Rs1.1b. In 1QFY08, Vardhman reported margin declines across all its key segments - fabric, yarn and steel. EBIT margins dropped 80bp YoY in the yarn division to 11.2%, while EBIT margins in the fabric division dropped 16bp YoY to 6.6%, the sewing thread division recorded 237bp YoY drop in EBIT margins to 10.4%.

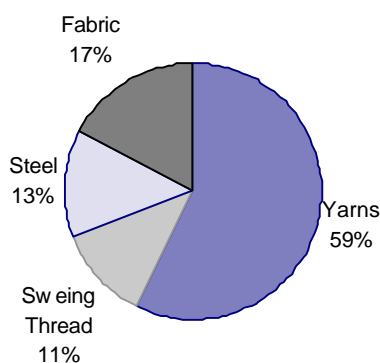
### SUMMARY OF SEGMENTAL REVENUES (RS M)

SEGMENT REVENUES	1QFY07	1QFY08	% CH.
Yarns	3244	3608	11.2
Sewing Thread	625	700	12.0
Steel	738	820	11.1
Fabric	971	1073	10.5
Less: Inter Segment Revenue	822	926	12.6
<b>Total</b>	<b>4755</b>	<b>5276</b>	<b>10.9</b>
<b>EBIT</b>			
Yarns	389	403	3.8
Sewing Thread	80	73	-8.8
Steel	110	100	-8.3
Fabric	66	71	7.9
<b>Total</b>	<b>644</b>	<b>648</b>	<b>0.6</b>
<b>EBIT margins (%)</b>			
Yarns	12.0	11.2	-6.71
Sewing Thread	12.8	10.4	-18.6
Steel	14.8	12.2	-17.4
Fabric	6.8	6.6	-2.4
<b>Total</b>	<b>13.5</b>	<b>12.3</b>	<b>-9.3</b>

Source: Company/ Motilal Oswal Securities

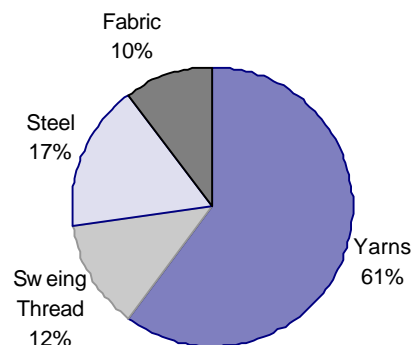
The charts below depicts the revenue and EBIT break-up of the company in 1QFY08. The poor performance of the company in the fabric division is the key concerns.

### REVENUE BREAK-UP 1QFY08



Source: Company/Motilal Oswal Securities

### EBIT BREAK-UP 1QFY08



Source: Company/ Motilal Oswal Securities

## Capex schedule

Vardhman is currently executing a significant capacity expansion program with capex outlay of close to Rs20b. Post expansion its processed fabric capacity would increase by around 168% and spindle capacity, by around 55%. In line with its expansion plans, the company has already acquired land in Madhya Pradesh. It intends to increase fabric weaving and processing capacity from 42m meters in FY07 to 102m meters by FY09 and opt for a corresponding increase in spindle capacity by 234,000 spindles to FY09. This will significantly improve the company's growth prospects going forward and should positively impact margins.

## Valuation and view

Although near term outlook on the stock remains negative as a result of multiple margin pressure, we remain bullish on the stock over the medium to long term, due to healthy growth opportunity in the upstream textile sector. The stock is trading at an undemanding valuation of 6.4x PER on FY08E EPS of Rs22.3 and at 5.1x PER on FY09E EPS of Rs28. Maintain **Buy**.

## Vardhman Textiles: an investment profile

### Company description

Vardhman Textiles is the flagship of one of the most respected textile groups in India. It has large spindlage capacity and is the second largest sewing thread player in India. The company stands to gain substantially from the strong increase in demand from the domestic downstream sector and the robust export market. In our opinion, Vardhman is all set to emerge as one of the most cost competitive textile companies globally by virtue of its large scale capacities, world class facilities and diversified product mix.

### Key investment arguments

- ✍ De-risked business model.
- ✍ Superior management quality.
- ✍ Poised to reap benefits of expansion.

### Key investment risks

- ✍ Commodity nature of its business.
- ✍ Steel contribution to decline.
- ✍ New capacities to go on stream only from mid-FY08.

### Recent developments

#### Recent developments

- ✍ Is eligible for tax breaks under Section 80IC for the incremental capex at Baddi.
- ✍ Has plans to hive off its sewing thread business to a JV.

### Valuation and view

- ✍ Is expanding weaving and processing capacity.
- ✍ The stock is trading at an undemanding valuation of 6.4x PER on FY08E EPS of Rs22.3 and at 5.1x PER on FY09E EPS of Rs28. Maintain **Buy**.
- ✍ We rate the stock a **Buy** with a price target of Rs200.

### Sector view

- ✍ Exports from China are likely to be severely constrained due to safeguard measures introduced by the US and the EU.
- ✍ Indian exports to the US and EU were muted in FY07 and recorded flat growth rates.
- ✍ Global buyers are focusing on building vendor partners who have high product development skills.

#### COMPARATIVE VALUATIONS

		VARDHMAN	ARVIND	ALOK
P/E (x)	FY08E	6.4	29.1	6.9
	FY09E	5.1	11.3	6.2
P/BV (x)	FY08E	0.7	0.6	2.1
	FY09E	0.7	0.6	2.1
EV/Sales (x)	FY08E	1.5	1.3	8.8
	FY09E	1.3	1.1	8.7
EV/EBITDA (x)	FY08E	8.4	9.1	3.2
	FY09E	6.9	7.6	2.6

#### SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	62.2	62.2	62.2
Domestic Inst	20.0	18.2	16.2
Foreign	1.3	3.1	4.0
Others	16.5	16.5	17.6

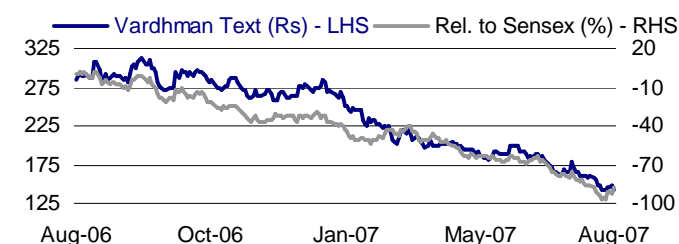
#### EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	22.3	32.0	-30.2
FY09	28.0	37.7	-25.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
144	200	38.9	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
<b>Net Sales</b>	<b>18,892</b>	<b>20,876</b>	<b>23,759</b>	<b>29,817</b>	
Change (%)	2.1	10.5	13.8	25.5	
Total Expenditure	15,461	17,388	20,820	25,352	
<b>EBITDA</b>	<b>3,430</b>	<b>3,488</b>	<b>4,177</b>	<b>5,458</b>	
Change (%)	18.9	1.7	19.7	30.7	
% of Net Sales	18.2	16.7	17.6	18.3	
Depreciation	1,013	1,194	1,559	2,066	
<b>EBIT</b>	<b>2,417</b>	<b>2,294</b>	<b>2,618</b>	<b>3,392</b>	
Interest & Finance Charges	395	377	988	1,303	
Other Income	214	340	300	300	
Non-recurring Items/ Inc.	270	0	0	0	
<b>PBT</b>	<b>2,506</b>	<b>2,257</b>	<b>1,931</b>	<b>2,389</b>	
Tax	543	541	502	597	
Effective Rate (%)	21.7	24.0	26.0	25.0	
<b>Reported PAT</b>	<b>1,964</b>	<b>1,717</b>	<b>1,429</b>	<b>1,792</b>	
Change (%)	62.6	-2.6	-16.8	25.4	
<b>Adjusted PAT</b>	<b>1,694</b>	<b>1,717</b>	<b>1,429</b>	<b>1,792</b>	

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2,006	2007E	2008E	2009E	
Equity Capital	578	641	641	641	
Share Capital	578	641	641	641	
Reserves	9,039	10,463	11,673	13,173	
<b>Net Worth</b>	<b>9,617</b>	<b>11,104</b>	<b>12,314</b>	<b>13,814</b>	
Loans	11,022	15,464	26,464	29,464	
Deferred Tax Liability	922	1,030	1,130	1,250	
<b>Capital Employed</b>	<b>21,560</b>	<b>27,597</b>	<b>39,907</b>	<b>44,527</b>	
Gross Fixed Assets	17,599	25,599	38,099	42,599	
Less: Depreciation	8,188	9,382	10,941	13,006	
<b>Net Fixed Assets</b>	<b>9,411</b>	<b>16,217</b>	<b>27,158</b>	<b>29,592</b>	
Capital WIP	965	965	965	965	
Investments	684	684	684	684	
<b>Curr. Assets</b>	<b>12,458</b>	<b>11,744</b>	<b>13,192</b>	<b>15,665</b>	
Inventory	5,690	5,875	6,864	8,358	
Sundry Debtors	2,220	2,354	2,611	3,277	
Cash & Bank Balances	2,715	858	662	823	
Loans & Advances & Other C	1,832	2,656	3,055	3,207	
<b>Current Liab. &amp; Prov.</b>	<b>1,957</b>	<b>2,012</b>	<b>2,091</b>	<b>2,378</b>	
Sundry Creditors	1,636	537	630	783	
Other Liabilities	1,148	1,183	1,242	1,304	
Provisions	321	292	219	292	
<b>Net Current Assets</b>	<b>10,501</b>	<b>9,732</b>	<b>11,100</b>	<b>13,286</b>	
<b>Application of Funds</b>	<b>21,560</b>	<b>27,597</b>	<b>39,907</b>	<b>44,527</b>	

E: MOST Estimates

RATIOS					
Y/E MARCH	2006	2007E	2008E	2009E	
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>30.7</b>	<b>26.8</b>	<b>22.3</b>	<b>28.0</b>	
Cash EPS	46.9	45.4	46.6	60.2	
Book Value per Share	166.5	173.4	192.3	215.7	
DPS	4.5	4.0	3.0	4.0	
Payout (Incl. Div. Tax) %	15.1	17.0	15.3	16.3	
<b>Valuation (x)</b>					
P/E	4.7	5.4	6.4	5.1	
Cash P/E	3.1	3.2	3.1	2.4	
EV/EBITDA	5.1	6.8	8.4	6.9	
EV/Sales	0.9	1.1	1.5	1.3	
Price to Book Value	0.9	0.8	0.7	0.7	
Dividend Yield (%)	3.1	2.8	2.1	2.8	
<b>Profitability Ratios (%)</b>					
RoE	22.3	16.6	12.2	13.7	
RoCE	12.7	9.3	7.8	8.0	
<b>Turnover Ratios</b>					
Debtors (Days)	43	41	40	40	
Inventory (Days)	134	123	120	120	
Creditors (Days)	23	20	20	20	
Working Capital (Days)	203	170	171	163	
Asset Turnover (x)	0.9	0.8	0.6	0.7	
Fixed Asset Turnover (x)	1.1	0.8	0.6	0.7	
<b>Leverage Ratio</b>					
Debt/Equity (x)	1.15	1.39	2.15	2.13	

CASH FLOW STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
<b>PBT before E.O. Items</b>					
Add: Depreciation	1,013	1,194	1,559	2,066	
Less: Direct taxes paid	581	433	402	478	
Inc/Dec in WC	670	1,025	1,565	2,025	
<b>CF from operations</b>	<b>2,269</b>	<b>1,994</b>	<b>1,523</b>	<b>1,953</b>	
Minority Int. & Share of Asso	0	0	0	0	
<b>CF from Oper. incl. EO I</b>	<b>2,269</b>	<b>1,994</b>	<b>1,523</b>	<b>1,953</b>	
(Inc)/Dec in FA	-4,680	-8,000	-12,500	-4,500	
(Pur)/Sale of Investments	-273	0	0	0	
<b>CF from investments</b>	<b>-4,953</b>	<b>-8,000</b>	<b>-12,500</b>	<b>-4,500</b>	
Inc/Dec in Networth	1,942	0	0	0	
Inc/Dec in Debt	3,526	4,442	11,000	3,000	
Less: Dividend Paid	296	292	219	292	
<b>CF from Fin. Activity</b>	<b>5,172</b>	<b>4,149</b>	<b>10,781</b>	<b>2,708</b>	
<b>Inc/Dec of Cash</b>	<b>2,488</b>	<b>-1,857</b>	<b>-196</b>	<b>160</b>	
Add: Beginning Balance	227	2,715	858	662	
<b>Closing Balance</b>	<b>2,715</b>	<b>859</b>	<b>662</b>	<b>822</b>	

**N O T E S**



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

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**Disclosure of Interest Statement**

**Vardhman Textiles**

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|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

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