



Vardhman Textiles

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,978	VTEX IN
	REUTERS CODE
S&P CNX: 5,906	MHSP.BO

29 October 2007

Buy

Previous Recommendation: Buy

Rs142

Equity Shares (m)	64.1
52-Week Range (Rs)	298/132
1,6,12 Rel.Per. (%)	-24/-71/-104
M.Cap (Rs. b)	9.1
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	5.3	0.8	16.6	9.3	1.1	6.8
3/08E	23,759	1,429	22.3	-16.8	6.3	0.7	12.2	7.8	1.5	8.3
3/09E	29,817	1,792	28.0	25.4	5.1	0.7	13.7	8.0	1.3	6.9

- ✎ Vardhman Textiles' 2QFY08 results were below our expectations. EBITDA stood at Rs883m (v/s est Rs1,004m). EBITDA margin declined 176bp YoY to 15.6% (v/s est of 17.6%), as a result of poor performance from the steel and sewing thread division.
- ✎ During 2QFY08, Vardhman witnessed margin declines across all segments, with the exception of fabric. EBIT margin in the yarn division dropped 119bp YoY to 11.1%, in the steel division it dropped 365bp YoY to 11% and in the sewing thread division, it dropped by 240bp YoY to 11%.
- ✎ We expect yarn margins to continue to face margin pressure in the near term due to rising 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 segment.
- ✎ During 2QFY08, the company installed ~30,000 spindles at its new plant at Satlapur, which increased the total spindle capacity at Satlapur to ~90,000 spindles.
- ✎ 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 trades at 6.3x P/E on FY08E EPS of Rs22.3 and at 5.1x P/E on FY09E EPS of Rs28. Maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	4,755	5,283	5,438	5,400	5,276	5,661	6,177	6,645	20,876	23,759
Change (%)	12.7	15.0	6.1	9.1	10.9	7.1	13.6	23.1	10.5	13.8
Total Expenditure	133	4,366	4,470	4,632	4,380	4,778	5,035	5,390	17,388	19,582
EBITDA	836	917	968	768	896	883	1,143	1,255	3,488	4,177
Change (%)	6.8	7.5	1.0	-8.2	7.2	-3.7	18.0	63.5	1.7	19.7
As % of Sales	17.6	17.4	17.8	14.2	17.0	15.6	18.5	18.8	16.7	17.6
Depreciation	286	301	290	317	346	354	413	446	1,194	1,559
Interest	110	99	87	81	165	131	247	444	377	988
Other Income	62	37	77	129	66	116	75	43	340	300
Extra-ordinary Income	0	35	0	1	0	0	0	0	35	0
PBT	501	590	668	500	451	514	558	408	2,292	1,931
Tax	126	132	152	131	134	140	146	82	541	502
Effective Tax Rate (%)	25.2	22.4	22.8	26.2	23.7	25.1	26.2	20.1	23.6	26.0
Reported PAT	375	458	516	369	317	374	412	326	1,752	1,429
Adj. PAT	375	423	516	369	317	374	412	326	1,717	1,429
Change (%)	29.4	5.9	0.5	-24.9	-15.5	-11.6	-20.2	-11.7	1.4	-16.8

E: MOST Estimates

Segmental result analysis

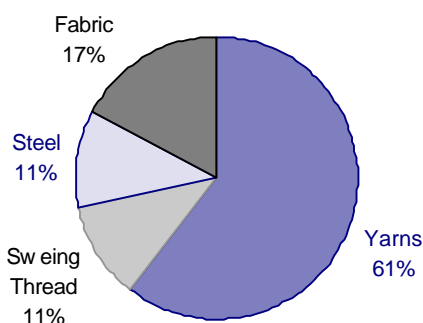
Revenues increased by 7.1% YoY to Rs5.6b, led primarily by increase in yarn revenues by 12% YoY to Rs4b and increase in fabric revenues by 12.7% YoY to Rs1.1b. In 2QFY08, Vardhman reported margin declines across all key segments other than fabrics. EBIT margin in the yarn division dropped 119bp YoY to 11.1%, while in the steel division it dropped 365bp YoY to 11% and in the sewing thread division, it dropped by 240bp YoY to 11%. Meanwhile, margins in the fabric division increased to 5.4% in 2QFY08 v/s 5.2% in 2QFY07. The charts below depict the revenue and EBIT break-up of the company in 2QFY08. The continued poor performance of the company in the fabric division is the key concern.

SEGMENTAL RESULTS (RS M)

	2QFY07	2QFY08	% CHANGE
Revenues			
Yarns	3,619	4,036	11.5
Sewing Thread	754	735	-2.5
Steel	663	737	11.2
Fabric	1,025	1,155	12.7
Less: Inter Segment Revenue	778	1,002	28.8
Total	5,283	5,661	7.1
EBIT			
Yarns	445	448	0.7
Sewing Thread	101	81	-20.0
Steel	97	81	-16.6
Fabric	53	63	18.7
Total	695	672	-3.3
EBIT Margins (%)			
Yarns	12.3	11.1	-9.68
Sewing Thread	13.4	11.0	-18.0
Steel	14.6	11.0	-25.0
Fabric	5.2	5.4	5.3
Total	13.2	11.9	-9.8

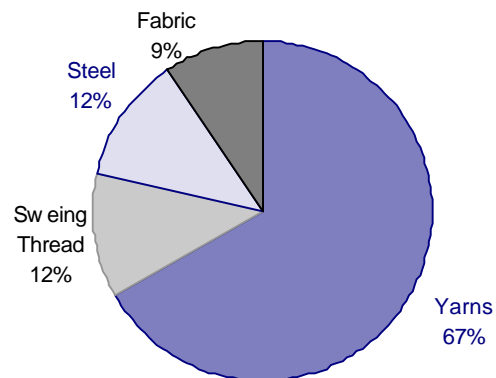
Source: Company/Motilal Oswal Securities

REVENUE MIX 2QFY08



Source: Company/Motilal Oswal Securities

EBIT BREAK-UP 2QFY08



Source: Company/Motilal Oswal Securities

Sharp rupee appreciation a concern

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 are 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.

Capacity increase in Yarns segment

During 2QFY08, the company installed ~30,000 spindles at its new plant at Satlapur, which increased the total spindle capacity at Satlapur to ~90,000 spindles.

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 to 234,000 spindles by 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 pressures, we remain bullish on the stock over the medium to long term, due to healthy

growth opportunity in the upstream textile sector. The stock trades at an undemanding valuation of 6.3x P/E on FY08E EPS of Rs22.3 and at 5.1x P/E on FY09E EPS of Rs28. Maintain **Buy**.

Vardhman Textiles: an investment profile

Company description

Vardhman Textiles has a 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-FY09.

Recent developments

- ✍ Plans to hive off sewing thread business to a JV.
- ✍ Increased spindle capacity by 30,000 spindles at its new plant at Satlapur.

Valuation and view

- ✍ Is expanding weaving and processing capacity.
- ✍ The stock trades at 6.3x P/E on FY08E EPS of Rs22.3 and at 5.1x P/E on FY09E EPS of Rs28. Maintain **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 was 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	6.3	49.1	7.5
	FY09E	5.1	18.6	6.7
P/BV (x)	FY08E	0.7	1.0	2.2
	FY09E	0.7	0.9	2.1
EV/Sales (x)	FY08E	1.5	1.5	9.0
	FY09E	1.3	1.3	8.9
EV/EBITDA (x)	FY08E	8.3	11.0	3.4
	FY09E	6.9	9.4	2.8

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	62.2	62.2	62.2
Domestic Inst	20.0	20.0	17.1
Foreign	1.5	1.3	3.8
Others	16.3	16.5	16.9

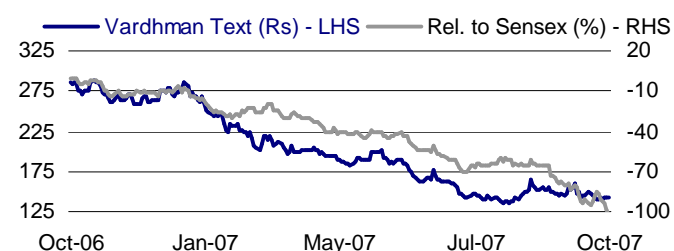
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	22.3	30.3	-26.5
FY09	28.0	37.3	-24.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
142	200	40.1	Buy

STOCK PERFORMANCE (1 YEAR)



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

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2,006	2007	2008E	2009E	
Equity Capital	578	641	641	641	
Share Capital	578	641	641	641	
Reserves	9,039	10,463	11,673	13,173	
Net Worth	9,617	11,104	12,314	13,814	
Loans	11,022	15,464	26,464	29,464	
Deferred Tax Liability	922	1,030	1,130	1,250	
Capital Employed	21,560	27,597	39,907	44,527	
Gross Fixed Assets	17,599	25,599	38,099	42,599	
Less: Depreciation	8,188	9,382	10,941	13,006	
Net Fixed Assets	9,411	16,217	27,158	29,592	
Capital WIP	965	965	965	965	
Investments	684	684	684	684	
Curr. Assets	12,458	11,744	13,192	15,665	
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	
Current Liab. & Prov.	1,957	2,012	2,091	2,378	
Sundry Creditors	1,636	537	630	783	
Other Liabilities	1,148	1,183	1,242	1,304	
Provisions	321	292	219	292	
Net Current Assets	10,501	9,732	11,100	13,286	
Application of Funds	21,560	27,597	39,907	44,527	

E: MOS t Estimates

RATIOS					
Y/E MARCH	2006	2007	2008E	2009E	
Basic (Rs)					
EPS	30.7	26.8	22.3	28.0	
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	
Valuation (x)					
P/E	4.6	5.3	6.3	5.1	
Cash P/E	3.0	3.1	3.0	2.4	
EV/EBITDA	5.1	6.8	8.3	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 (%)	3.2	2.8	2.1	2.8	
Profitability Ratios (%)					
RoE	22.3	16.6	12.2	13.7	
RoCE	12.7	9.3	7.8	8.0	
Turnover Ratios					
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	
Leverage Ratio					
Debt/Equity (x)	1.15	1.39	2.15	2.13	

CASH FLOW STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007	2008E	2009E	
PBT before E.O. Items	2,506	2,257	1,931	2,389	
Add : Depreciation	1,013	1,194	1,559	2,066	
Less : Direct taxes paid	581	433	402	478	
Incl/Dec in WC	670	1,025	1,565	2,025	
CF from operations	2,269	1,994	1,523	1,953	
Minority Int. & Share of Asso	0	0	0	0	
CF from Oper. incl. EO I	2,269	1,994	1,523	1,953	
(Incl)/Dec in FA	-4,680	-8,000	-12,500	-4,500	
(Pur)/Sale of Investments	-273	0	0	0	
CF from investments	-4,953	-8,000	-12,500	-4,500	
Incl/Dec in Networth	1,942	0	0	0	
Incl/Dec in Debt	3,526	4,442	11,000	3,000	
Less: Dividend Paid	296	292	219	292	
CF from Fin. Activity	5,172	4,149	10,781	2,708	
Incl/Dec of Cash	2,488	-1,857	-196	160	
Add: Beginning Balance	227	2,715	858	662	
Closing Balance	2,715	859	662	822	



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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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