

Gokaldas Exports

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,849	GOKL IN
	REUTERS CODE
S&P CNX: 2,975	GOKL. BO

30 January 2006

Buy

Previous Recommendation: Buy

Rs596

Equity Shares (m)	17.2
52-Week Range (Rs)	714/469
1,6,12 Rel.Per. (%)	-3/-21/-
M.Cap (Rs. b)	10.2
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
3/05A	7,241	398	28.3	2.8	21.1	5.0	25.8	14.4	1.6	20.5
3/06E	8,706	617	35.9	27.0	16.6	2.9	23.8	18.2	1.2	11.6
3/07E	10,583	770	44.8	24.7	13.3	2.4	20.0	17.7	1.0	10.2

Gokaldas Exports posted a net profit of Rs157m for 3QFY06, exceeding our estimate of Rs123m. Revenues at Rs2.19b were in line with our estimate of Rs2.16b.

Raw material cost as a percentage of revenues declined 844bp QoQ due to improved product mix. This resulted in EBITDA margins expanding 25bp QoQ to 11%.

The management is diversifying its production bases to cities such as Hyderabad, Mysore and Chennai. All its 38 plants are currently in Bangalore.

We are upgrading our net profit estimates for FY06 by 13.2% to Rs617m and for FY07 by 6.2% to Rs770m. The stock trades at 16.6x FY06E and 13.3x FY07E earnings. We reiterate **Buy** with an increased price target of Rs672 (15x FY07E EPS).

QUARTERLY PERFORMANCE

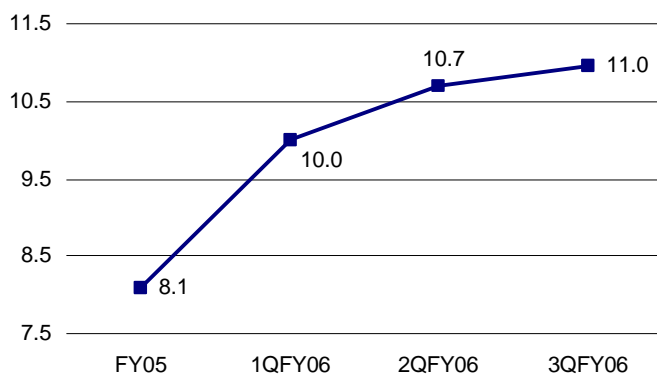
Y/E MARCH	FY 06				FY 05	FY 06 E
	1Q	2Q	3Q	4QE		
Sales	1,790	2,471	2,193	2,252	7,240	8,706
Change (%)	na	na	na	na	35.1	20.2
EBITDA	179	265	240	230	583	913.8
Change (%)	na	na	na	na		56.7
As % of Sales	10.0	10.7	11.0	10.2	8.1	10.5
Depreciation	34	42	50	46	129	172
Interest	33	38	37	32	119	140
Other Income	8	5	12	19	105	45
PBT	120	190	166	171	439	646
Tax	4	5	8	12	41	29
Effective Tax Rate (%)	2.9	2.6	5.1	7.1	9.4	4.5
Reputed PAT	116	185	157	159	398	617
Adj. PAT	116	185	157	159	398	617
Change (%)	na	na	na	na	6.6	55.1

E: MOST Estimates

Better product mix leads to margin expansion

Gokaldas Exports' EBITDA margin has expanded by 25bp QoQ 11% in 3QFY06. The management has attributed this to better product mix. The proportion of bottom wear and children wear has increased while the proportion of outwear has declined. The total capacity as at the end of 3QFY06 stood at 2.3m pieces, which is slated to increase to 2.6m pieces by March 2006. At the end of its expansion in FY07, the capacity would increase to 3m pieces. We believe that the modernization and expansion plans would result in productivity gains and further boost margins.

EBITDA MARGINS EXPANDING



Source: Company/Motilal Oswal Securities

De-risking initiatives underway

Gokaldas has been working towards reducing its dependence on its largest client, GAP. The contribution of GAP has declined from 50% of revenues in FY05 to 43% of revenues in 3QFY06. Also, the management is diversifying its production bases to cities such as Hyderabad, Mysore and Chennai. All its 38 plants are currently in Bangalore, which is fast losing its competitive edge due to reasons such as: (1) high attrition rates due to influx of large number of players, (2) increasing cost, and (3) inability to work double shifts due to a predominantly female workforce.

Status of capex under implementation

As at the end of December 2005, Gokaldas had 360 lines across its 38 plants, with a total capacity of 2.3m pieces. It is in the process of expanding the number of plants to 43 and increasing its total capacity by 100 lines to 3m pieces. The status of its expansion and new capex plans is as follows:

- ✍ The company's Doddaballapur jeans/bottoms plant christened 'Indigo Blues' has already completed 60,000 sq ft out of the planned 90,000 sq ft expansion.
- ✍ It is in the process of acquiring a 10 acre industrial plot at Hyderabad to establish a garment plant.
- ✍ It has purchased 4 acres of industrial land at Mysore to establish an apparel factory.
- ✍ The SEZ unit at Chennai is under construction and expected to start production by June 2006.
- ✍ The company's new laundry facility at Bangalore is under construction and is expected to be operational by April 2006.
- ✍ A unit at Yelahanka (Venkateswara Clothing Company - Unit 3) is under construction and is expected to start commercial production by June 2006.
- ✍ During 3QFY06, the company acquired a private limited company 'Robot Systems', located at Peenya Industrial Estate for a consideration of Rs32m. The management intends to demolish the existing structure and establish a new garment unit here.

Embargoes on China to benefit players like Gokaldas

China exports close to US\$60b of apparels, while Indian exports stand at US\$6b. Going forward, China's high growth rates in the textile industry are likely to be limited to 10-12% due to the imposition of embargoes by the USA and the EU. Indian players like Gokaldas are likely to benefit as a result.

Pricing pressure to abate

Going forward, the management has indicated that they are looking at low pricing pressure and a stable industry pricing environment. The imposition of embargos against China by USA and EU, is forcing large retailers to reduce dependence on China.

High probability of labor reforms

The industry expects that the government would allow labor flexibility in EOUs and SEZs very soon. Gokaldas, with a total employee strength of 40,500 till 3QFY06, has often indicated that lack of labor reforms is acting as a major deterrent to its aggressive growth plans. We believe that any progress on the labor reform front would be a huge boon for the Indian garment industry in general and Gokaldas in particular.

Revising estimates upwards

We are increasing our net profit estimates for FY06 and FY07 by 13.8% and 6.2%, respectively on the back of better outlook on the margin front. We are also upgrading our revenue estimates for FY06 and FY07, marginally.

REVISED ESTIMATES (RS M)

	FY06		FY07	
	OLD	NEW	OLD	NEW
Sales	8,664	8,706	10,511	10,583
Change (%)		0.5		0.7
Profit	542	617	725	770
Change (%)		13.8		6.2

Source: Motilal Oswal Securities

Valuation and view

Gokaldas Exports is one of the best proxies for playing the quota outsourcing story in the Indian textiles space. It is one of the largest and most respected garment manufacturers in India. We anticipate sharp improvements in productivity levels, aided by longer runs, implementation of modern scientific shop floor management techniques and increased mechanization.

The management has indicated a strong order book of around Rs2.3b for 4QFY06. It has also hinted at a stable pricing environment, with the possibility of price increases for some of its key categories in 4QFY07. We expect the company to register revenue CAGR of 21% and profit CAGR of 22% over FY06-08. The stock trades at 16.6x FY06E and 13.3x FY07E earnings. We rate the stock a **Buy** with a price target of Rs672, an upside of 12.7%.

Gokaldas Exports: an investment profile

Company description

Gokaldas Exports is one of the best proxies for the quota outsourcing story in the Indian textiles sector. It is one of the largest and most respected garment manufacturers in India. It has world-class capacities and has established relationships with major international retailers and buyers, which, we believe, it can leverage to its advantage in the post-quota era.

Key investment arguments

- ✍ 'Preferred vendor' for some of the world's largest brands.
- ✍ Global sourcing capabilities and integrated facilities.
- ✍ Superior design capabilities.
- ✍ Specialization in outerwear enables it to earn higher margins.
- ✍ High non-quota country sales.

Key investment risks

- ✍ High dependence on GAP.
- ✍ Margins under pressure.
- ✍ Differential tariffs to be a crucial issue.
- ✍ Constricting labor laws.

Recent developments

- ✍ Has expanded capacity to 296 lines.
- ✍ Plans to set up two factories in FY06 and change its product mix to cover all categories.
- ✍ Likely to benefit substantially from safeguard measures against China by USA and EU.

Valuation and view

- ✍ Expected to register revenue and PAT CAGR of 21% and 22%, over FY06-08.
- ✍ The stock trades at 16.6x FY06E and 13.3x FY07E earnings. We rate the stock a **Buy** with a price target of Rs672, an upside of 12.7%.

Sector view

- ✍ Exports from China are likely to be severely constrained due to safeguard measures imposed by the US and EU.
- ✍ India registered robust export growth rates to the US and EU in the post-quota era.
- ✍ Global buyers are focusing on building vendor partners who have high product development skills.
- ✍ Concern of industry overcapacity causing waves of deflation in prices is overblown.

COMPARATIVE VALUATIONS

		GOKALDAS	ARVIND	HIMATSINGKA
P/E (x)	FY06E	16.6	13.0	26.2
	FY07E	13.3	11.5	21.9
P/BV (x)	FY06E	2.9	1.3	2.3
	FY07E	2.4	1.1	2.2
EV/Sales (x)	FY06E	1.2	2.0	5.7
	FY07E	1.0	1.7	4.8
EV/EBITDA (x)	FY06E	11.6	7.8	15.7
	FY07E	10.2	7.3	13.0

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05
Promoters	76.9	76.9
Domestic Institutions	6.6	5.8
FII's/FDIs	5.1	3.7
Others	11.4	13.6

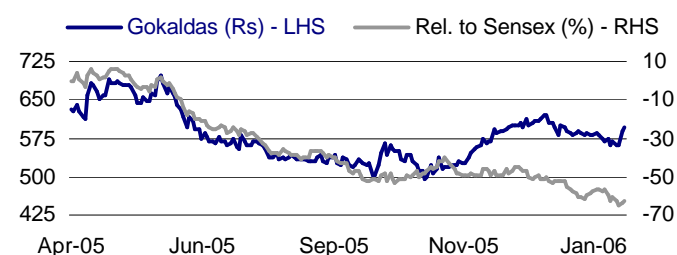
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	35.9	31.3	14.9
FY07	44.8	42.1	6.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
596	672	12.7	Buy

STOCK PERFORMANCE (FROM APRIL 2005)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2007E
Net Sales	5,361	7,240	8,706	10,583	12,719
Change (%)	14.5	35.1	20.2	21.6	20.2
Total Expenditure	4,918	6,657	7,792	9,544	11,511
EBITDA	525	583	914	1,039	1,208
Change (%)	17.3	11.1	56.7	13.7	16.3
% of Net Sales	9.8	8.1	10.5	9.8	9.5
Depreciation	107	129	172	187	207
EBIT	418	454	741	852	1,002
Interest & Finance Charges	76	119	140	81	56
Other Income	34	105	45	75	75
PBT	376	439	646	846	1,020
Tax	3	41	29	76	102
Effective Rate (%)	0.7	9.4	4.5	9.0	10.0
Reported PAT	373	398	617	770	918
Change (%)	7.8	6.6	55.1	24.7	19.3
Adjusted PAT	373	398	617	770	918

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Capital	136	141	172	172	172
Share Capital	136	141	172	172	172
Reserves	1,281	1,525	3,361	4,013	4,814
Net Worth	1,417	1,666	3,533	4,185	4,986
Loans	1,241	1,906	956	856	706
Deferred Tax Liability	43	35	42	61	86
Capital Employed	2,700	3,606	4,530	5,101	5,778
Gross Fixed Assets	1,196	1,448	1,948	2,198	2,348
Less: Depreciation	364	410	582	769	975
Net Fixed Assets	832	1,038	1,366	1,429	1,373
Capital WIP	0	29	0	0	0
Investments	1	1	1	1	2
Curr. Assets	2,333	3,135	3,899	4,653	5,576
Inventory	1,466	1,870	2,135	2,745	3,311
Sundry Debtors	248	590	596	725	871
Cash & Bank Balances	308	225	626	532	613
Loans & Advances & Other	312	451	542	651	781
Current Liab. & Prov.	467	598	736	981	1,173
Sundry Creditors	467	598	736	981	1,173
Net Current Assets	1,867	2,537	3,163	3,672	4,403
Application of Funds	2,700	3,606	4,530	5,101	5,778

E: Most Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	27.5	28.3	35.9	44.8	53.4
Cash EPS	35.4	37.5	46.0	55.7	65.5
Book Value per Share	104.4	118.4	205.6	243.6	290.2
DPS	0.0	0.0	4.0	5.0	6.0
Payout (Incl. Div. Tax) %	0.0	0.0	12.7	15.3	12.8
Valuation (x)					
P/E		21.1	16.6	13.3	11.2
Cash P/E		15.9	13.0	10.7	9.1
EV/EBITDA		20.5	11.6	10.2	8.6
EV/Sales		16	12	10	0.8
Price to Book Value		5.0	2.9	2.4	2.1
Dividend Yield (%)		0.0	0.7	0.8	1.0
Profitability Ratios (%)					
RoE	22.8	25.8	23.8	20.0	20.0
RoCE	17.0	14.4	18.2	17.7	18.4
Turnover Ratios					
Debtors (Days)	17	30	25	25	25
Inventory (Days)	109	103	100	105	105
Creditors (Days)	52	23	25	30	30
Working Capital (Days)	127	128	133	127	126
Asset Turnover (x)	2.0	2.0	1.9	2.1	2.2
Fixed Asset Turnover (x)	4.5	5.0	4.5	4.8	5.4
Leverage Ratio					
Debt/Equity (x)	0.9	1.1	0.3	0.2	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
PBT before E.O. Items	376	439	646	846	1,020
Add : Depreciation	107	129	172	187	207
Interest	76	119	140	81	56
Less : Direct taxes paid	3	41	29	76	102
(Inc)/Dec in WC	-445	-753	-225	-603	-650
CF from Operations	2	-307	527	298	425
CF from Oper. Incl. EO	2	-307	527	298	425
(Inc)/dec in FA	-291	-222	-529	-250	-150
CF from Investments	-291	-281	-471	-250	-150
(Inc)/Dec in Shares	29	0	-1,328	0	0
(Inc)/Dec in Debt	-125	-665	950	100	150
Less : Interest Paid	76	119	140	81	56
Dividend Paid	0	32	78	118	118
CF from Fin. Activity	130	506	345	-142	-193
Inc/Dec of Cash	-159	-83	401	-94	82
Add: Beginning Balance	467	308	225	626	532
Closing Balance	308	225	626	532	614



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Gokaldas Exports

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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 |

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