Company Report

Textiles

March 21, 2007

ICICIdirect Code: GOKEXP

Company Profile
Registered Office 70, Mission Road, P B No. 2717, Bangalore - 560 027, Karnataka Tel: 91-80-22223600 Fax: 91-80-22274869 Website: www.gokaldasindia.com

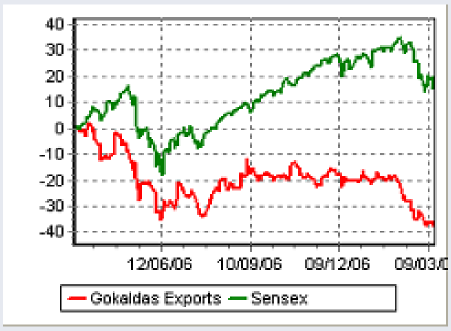
Managing Director: **Madanlal Hinduja**
Business Group: **NA**

Shareholding Pattern as on 31/12/2006

Major Holders	%
Promoters	70.10
Institution Investors	22.75
Other Investors	4.26
General Public	2.89

Stock Data	
Market Cap (Rs crore)	817
Shares Outstanding (in crore)	3.44
Face value (Rs)	5
52-week High (Rs)	404
52-week Low (Rs)	226
Avg. Volume	9248
Absolute Return 3 mth (%)	-22.31
Absolute Return 12 mth (%)	-34.29
Sensex Return 3 mth (%)	-4.75
Sensex Return 12 mth (%)	16.51

Performance Chart



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Gokaldas Exports

OUTPERFORMER

Price (14/03/07) Rs 236	Target Price Rs 315
Potential upside 33%	Time Frame 12-15 mths

Gokaldas Exports Ltd (GEL), India's largest garment exporter, has drawn up an extensive roadmap for growth. It is expanding capacity by setting up three new factories and diversifying its client and product mix. Big global retailers are consolidating their vendor base and the company will be optimally positioned to capitalize on the opportunity with its expanded capacities. We initiate coverage on the stock with an OUTPERFORMER rating.

KEY TRIGGERS

- **Capacity boost to aid volume growth**

  GEL is expanding garmenting capacity from 24 million pieces per annum to 36 million pieces by FY09E. This will aid volume growth and translate into revenue growth. We expect revenues to grow at a CAGR of 15% over FY06-09E.

- **Diversifying into niche categories**

  The company is diversifying its product mix by entering into new categories like structured suits, industrial and work wear, innerwear and sleepwear. This foray would enable the company improve realizations.

- **Strong relationship with global retailers**

  Renowned brands like GAP, Nike, Sears, Marks and Spencer, and Tommy Hilfiger among others, are consolidating their vendor base and increasing purchases from suppliers with large integrated capacities like GEL.

- **Favourable policy initiatives**

  The company is likely to be a key beneficiary of policy initiatives for the textiles sector like extension of Technology Upgradation Fund Scheme (TUFS), labour law changes and setting up of integrated textile parks.

VALUATIONS

At the current price of Rs 236, the stock discounts its FY08E EPS of Rs 24.99 by 9.4x and FY09E EPS of Rs 31.46 by 7.5x. On an EV/EBITDA basis, it trades at 8.0x for FY08E and 6.7x for FY09E. Peers like Bombay Rayon Fashions and Kewal Kiran Clothing trade at a P/E multiples of 9.6x and 9.7x their FY08E earnings. We believe the current valuations do not capture the premium discounting that the stock deserves owing to its leadership position and significantly higher realizations. Liquidity in the scrip has improved after a stock split from a face value of Rs 10 to Rs 5. We value the stock at 10x its FY09E EPS of Rs 31.46, giving us a 12-15 month price target of Rs 315, an upside of 33% from current levels.

Exhibit 1: Key Financials

(Rs Crore)

Year to March 31	FY06	FY07E	FY08E	FY09E
Net Profit (Rs crore)	60.97	70.09	85.93	108.18
Shares in issue (in crore)	3.44	3.44	3.44	3.44
EPS (Rs)	17.73	20.39	24.99	31.46
% Growth	25.60	14.90	22.60	25.90
P/E (x)	13.30	11.60	9.40	7.50
Price / Book (x)	2.35	1.98	1.66	1.38
EV/EBITDA (x)	10.30	9.18	7.97	6.71
RoNW (%)	17.63	17.09	17.57	18.35
RoCE (%)	17.31	17.13	17.52	18.19

Source: ICICIdirect Research

COMPANY BACKGROUND

Gokaldas Exports Ltd (GEL) was incorporated in 1979 by Madanlal J Hinduja. It is India's leading manufacturer and exporter of apparel. The company has 43 factories spread out across Bangalore and employs more than 45,000 people. It also stands out due to its fully integrated in-house facilities for manufacture of apparel components such as labels, tags, elastics, cords and woven tapes with value added services of poly-fill quilting, embroidery, printing and laundry.

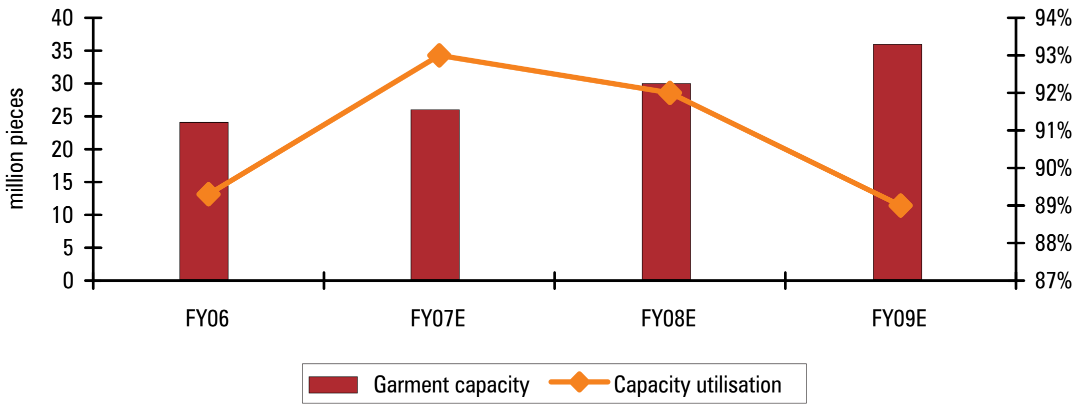
At present, the company has a capacity to manufacture 2.4 million pieces of apparel per annum. It designs and manufactures a wide range of garments for men, women and children. The company earns more than 95% of its revenues through exports and supplies its products to top brands like GAP, Sears, Marks and Spencer, Nike etc. The company has a proven track record of executing large orders.

INVESTMENT RATIONALE

I) Capacity expansion to drive volume growth

GEL has drawn a roadmap for ramping-up capacities. It is setting up three new factories in Chennai, Mysore and Hyderabad. It plans to increase its garmenting capacity from 24 million pieces per annum to 36 million pieces per annum by FY09E. Post-expansion, the company will have a mammoth capacity. Further, its successful record in executing large projects should enable it achieve sustained growth in volumes. We expect sales to grow at a CAGR of 15% over FY06-09E to Rs 1,356.43 crore.

Exhibit 2: Installed capacity and utilisation



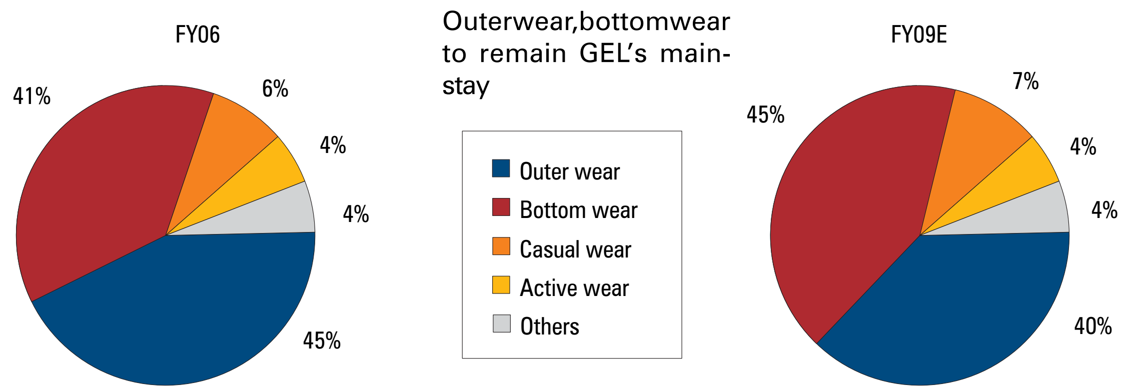
Source: Company, ICICIdirect Research

II) Change in product mix

GEL has a product portfolio that is fairly untapped by other organised players, with jackets, coats, windcheaters, ski wear, sportswear forming a significant portion of its exports. Given the fashion edge these products tend to have, the company is less vulnerable to severe price undercutting that takes place in volume-based segments such as cotton knitwear. It has, however, been diversifying its product portfolio and ramped up the contribution of trousers, chinos and other bottomwear and casual wear and babywear.

Currently, outwear contributes about 45% to revenues, while bottomwear contributes 41%. Others including casual wear and active wear contribute around 14%. Its major markets are the US and Canada, which account for around 64% of revenues. Exports to Europe constitute about 34% of revenues and domestic sales and others contribute about 2%.

Exhibit 3: Product mix



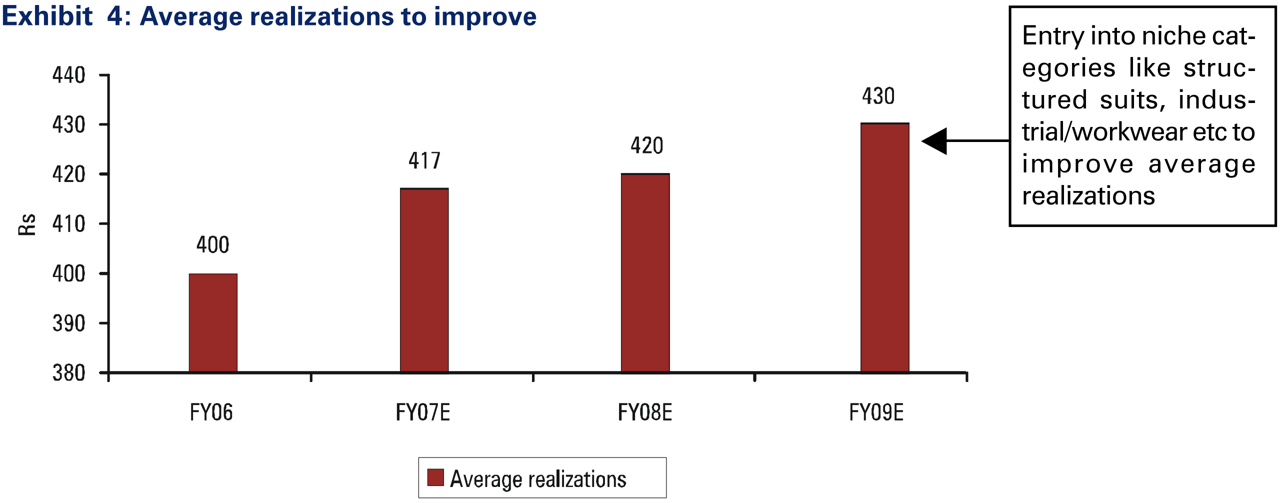
Source: Company, ICICIdirect Research

III) Value addition to improve realization

GEL is expanding its product profile by entering into niche product categories like structured suits, industrial/ workwear, innerwear and sleepwear. Structured suits command significantly higher realizations in the price range of Rs 1,000-1,100. The company's current average realization during FY06 was about Rs 400 (US$9) per piece. Its foray into the high-end niche products will help the company improve realizations.

The company has also set up a state-of-the-art laundry facility in Bangalore for providing special washes to garments as a value-added service to the customers, which would result in improving its realizations further. We expect the average realizations to move up from Rs 400 in FY06 to Rs 430 in FY09E.

Exhibit 4: Average realizations to improve

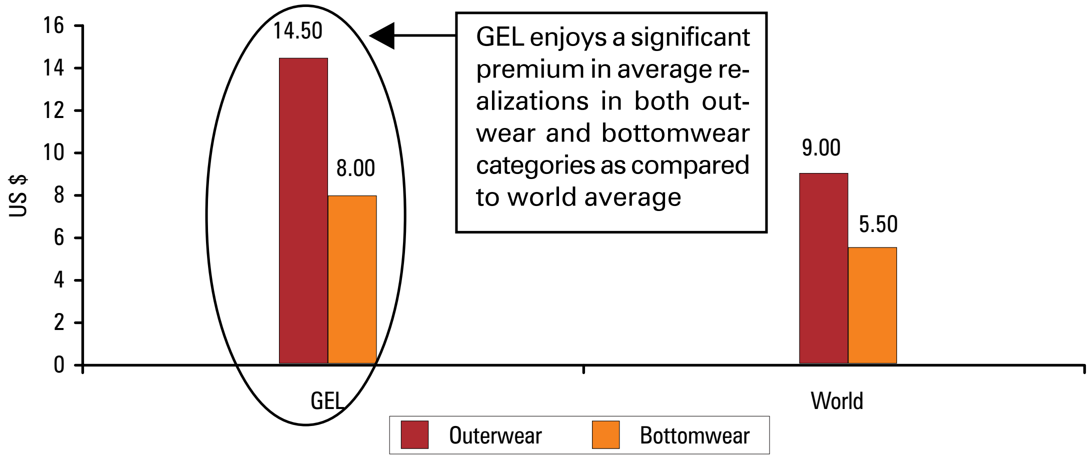


Source: Company, ICICIdirect Research

IV) Insulated against input cost escalation

The levy of quota restrictions on Chinese textile exports to the US and EU has eased pricing pressure experienced by Indian players to a great extent. Realizations across categories have started stabilizing. GEL, which works on a cost plus model and does not take any input cost risk, enters into back-to-back contracts with suppliers as and when buyers place an order. This virtually insulates it from the risks associated with fluctuations in input costs, and protects its margins. The company enjoys a premium in its pricing. In the outerwear segment, its average realization is about $14.50, which is well above the world average of about $9. Even in the more competitive bottomwear category, its average realization is about $8, which is at a significant premium over the world average of around $5.50.

Exhibit 5: GEL commands a premium on realizations



Source: Industry, ICICIdirect Research

Stable and improving price realizations along with de-risked input cost structure would enable GEL to improve its margins due to its premium positioning in the world market. We expect the company to improve its operating margin from 11.13% in FY06 to 11.94% in FY09E.

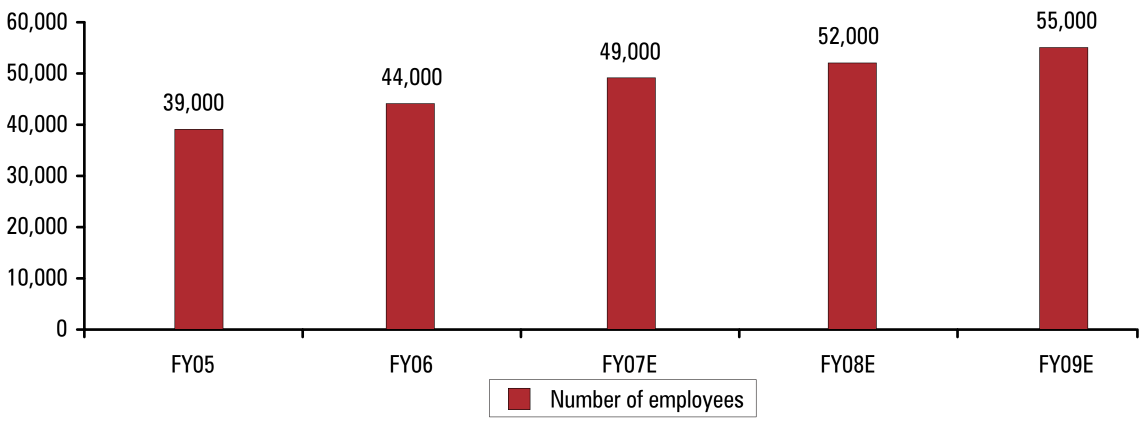
V) Government initiatives, labour reforms to provide thrust

The textile sector is the second largest employment generating industry in India after agriculture. The industry is on the priority list of the government and in the 2007-08 budget, the sector has been provided sops like the extension of Technology Upgradation Fund Scheme (TUFS) till 2012, and an increase in allocation for the Scheme of Integrated Textile Park (SITP) from Rs 190 crore to Rs 425 crore. These initiatives would enable the sector to expand and upgrade and become more competitive in the international market.

The government has launched the SITP, under which it intends to create 25 textile parks. Already 7 parks have been sanctioned and 10 more have been identified for development. SITP's will enable Indian companies improve their supply chain efficiency and reduce the order cycle time, further enhancing their competitiveness.

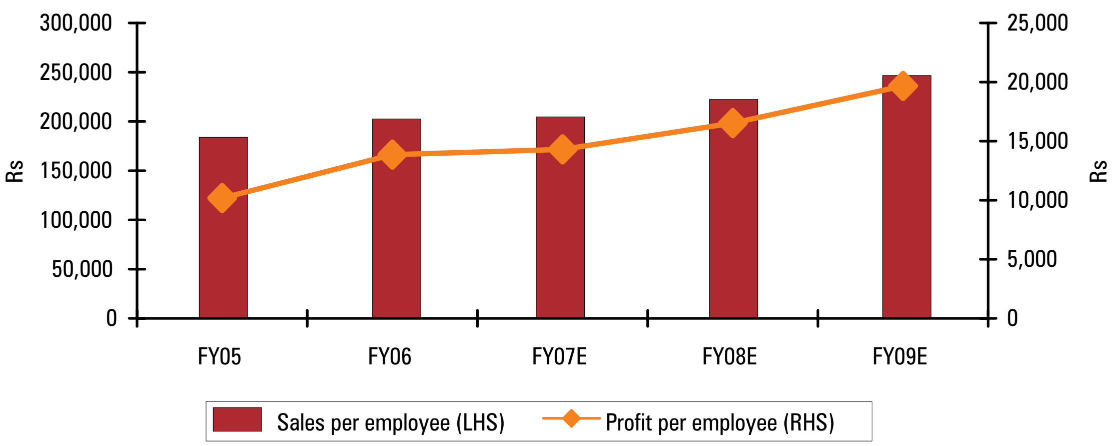
Garmenting is a labour-intensive industry and labour costs and productivity per employee are the key variables that decide a company's competitiveness. India scores high on the cost front because of its low labour cost compared to other countries. However, productivity per employee has been hampered due to rigid labour laws like restrictions on removal of unproductive employees and hiring temporary labour. The government has started amending the labour laws like allowing second shift for women workers, provided the employer arranges for the drop facilities. Other amendments like hiring temporary workers for a fixed period for core activities and freedom to hire and fire based on industrial productivity criterion will help GEL in improving its productivity levels and reduce its wage cost.

Exhibit 6: Employee strength to rise



Source: Company, ICICIdirect Research

Exhibit 7: Productivity to increase



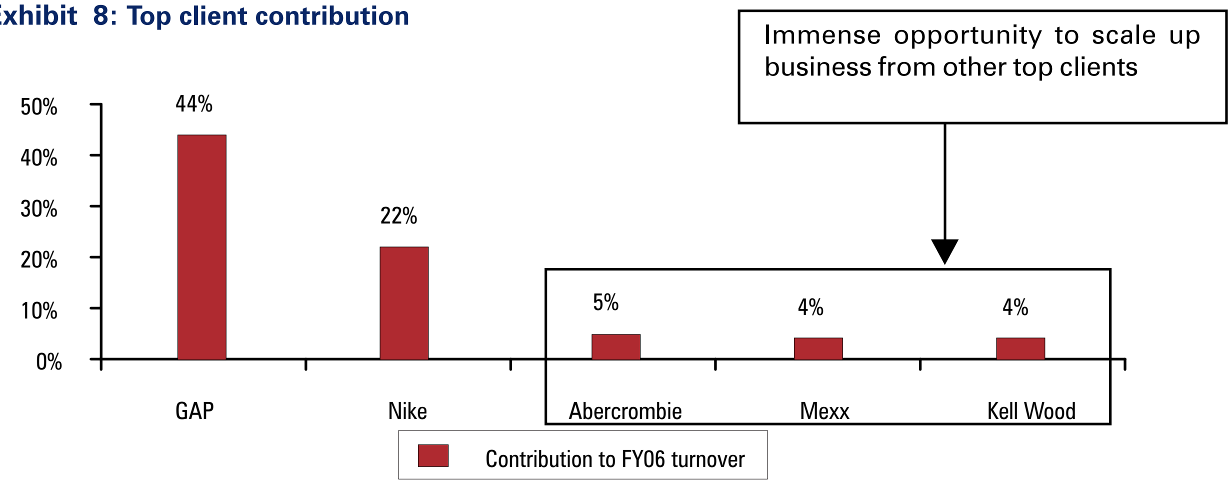
Source: Company, ICICIdirect Research

VI) Vendor rationalization

Global buyers are rationalizing their vendor base and entering into long-term sourcing pacts with large strategic vendors. These international buyers are looking for large manufacturers with low lead time and proven capability to execute large-scale orders. GEL, with its massive manufacturing capacities and record of successfully executing large orders, will be a key beneficiary of the flow of apparel business to Indian apparel manufacturers. It has a strong reputation with clients and is a core vendor to giant retailers like Nike and Gap Inc. We believe the company is optimally positioned to become a "vendor of choice" to other global brands as well.

GEL's top 5 clients contributed about 79% of its FY06 revenues, with GAP alone contributing 44% and Nike 22%. Apart from these two, the company's clientele includes other reputed names like Abercrombie, Mexx and Kell Wood. The company can leverage its relationship with these clients and secure more business from them.

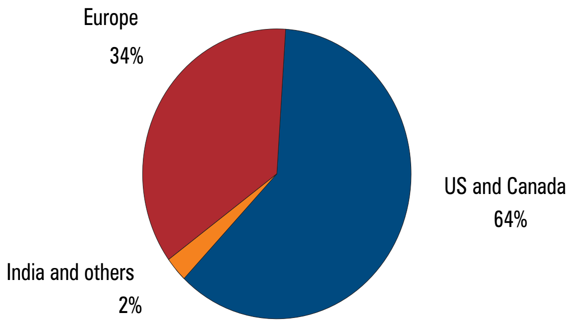
Exhibit 8: Top client contribution



Source: Company, ICICIdirect Research

Other than the top 5 clients, the company's client base also includes renowned names as Marks and Spencer, Sears, Tommy Hilfiger, Reebok, Addidas, etc. Going forward, we believe the company will scale-up its business with these companies in a bid to avoid client concentration.

Exhibit 9: Sales by geographical location in FY06



Source: Company, ICICIdirect Research

GEL exports to the US, Mexico, Canada, Germany, Netherlands, Spain, France, South Africa, Middle East, Taiwan and Hong Kong. It enjoys a good rapport with its clients due to the quality of its products and timely execution of orders, which acts as entry barrier for new entrants.

INDUSTRY OUTLOOK

Apparel export industry on upswing

According to World Trade Organization (WTO), after the dismantling of the quota system, India's textile and apparel exports are projected to increase at a CAGR of 29% from nearly $14 billion in 2005 to over $50 billion by 2010, and account for 10% of the global market share.

Readymade garments accounted for approximately 50% of the country's total textile exports in April-November 2005. During April-November 2005, the segment recorded exports of US$4.19 billion, recording an increase of 19%, compared to corresponding period in 2003-04.

Apparel exports entering high-growth phase

Exhibit 10 : Indian textile exports

	US$ million		
	Apr-Nov 2004	Apr-Nov 2005	% change
Readymade garments	**3,519**	**4,185**	**19**
Cotton textiles	2,223	2,311	4
Man-made textiles	1,309	1,141	-13
Wool & Woolen	295	290	-2
Silk	371	398	7
Total	**7,717**	**8,325**	**8**

Source: Ministry of Textiles, Annual Report 2005-06, ICICIdirect Research

The global apparel industry has shifted base several times over the last 50 years and concentrated in those countries that offered most competitive labour costs. In the 1950s, the manufacture of apparel began shifting away from the western countries to eastern countries with lower labour costs, such as South Korea and Taiwan. In the 1980s and 1990s, production began shifting to other countries in South-East Asia. In 2004-05, 55% of the US textile imports and 17% of the EU textile imports came from Asia (Source: WTO International Trade Statistics, 2005)

The American Textile Manufacturing Institute estimates that more than US$40 billion in customer orders will be outsourced to lower cost countries. China and India will be the biggest beneficiaries of this outsourcing trend.

Exhibit 11 : India's country wise export of readymade garments (in US$ million)

				Apr - July			
Country	2003-2004	2004-2005	2005-2006	2005-2006	2006-2007	% increase	% of total
World	**6,259.65**	**6,587.38**	**8,642.93**	**2,664.74**	**3,055.36**	**14.66**	**100**
USA	1,622.21	1,996.82	2,859.16	831	988.58	18.96	32.36
UK	539.48	658.85	946.5	337.97	320.34	-5.22	10.48
Germany	498.45	451.51	679.96	219.59	249.59	13.66	8.17
France	437.46	475.19	641.02	206.22	247.41	19.97	8.1
UAE	615.34	524.31	448.19	132.68	166.85	25.75	5.46
Italy	223.58	291.74	384.13	123.59	146.47	18.51	4.79
Netherlands	225.3	205.56	294.08	83.09	118.68	42.83	3.88
Spain	153.72	209.57	361.22	115.95	115.12	-0.72	3.77
Canada	241.81	251.82	275.24	86.5	99.5	15.03	3.26
Saudi Arabia	165.22	169.21	196.74	61.95	62.05	0.16	2.03
Denmark	94.08	107.71	185.1	52.82	60.2	13.96	1.97
Belgium	90.95	93.95	133.17	44.59	53.65	20.32	1.76

Source: Ministry of Textiles, ICICIdirect Research

RISKS & CONCERNS

Client concentration

GEL has a high dependence on a few clients for its revenues as its top 10 clients contribute about 80% of the revenues. GAP alone accounts 44% of its revenues. Any slowdown of orders from the top clients could impact the company's growth prospects.

Labour problems

At present, the company has over 45,000 employees. Any labour unrest could impact the operations and productivity of the company leading to a negative impact on the financials of the company.

Foreign exchange transaction

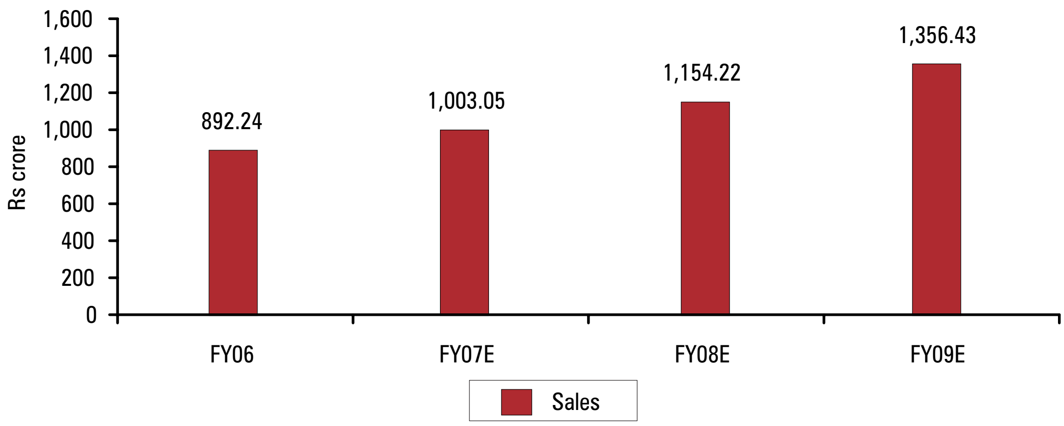
GEL earns about 98% of its revenues from exports. Any appreciation of the rupee against the dollar could impact the earnings of the company negatively.

FINANCIALS

Stable growth in sales

The capacity expansion and uptrend in the apparel export industry would enable GEL attain a steady growth in sales across all apparel categories. We expect sales to grow at a CAGR of 15% over FY06-09E to Rs 1,356.43 crore. We expect outerwear segment to contribute about 40% in FY09E from 45% in FY06 and bottomwear segment 45%, up from 41% in FY06. The balance 15% will come from casual wear, activewear, etc.

Exhibit 12: Sales to grow at steady clip



Source: ICICIdirect Research

EBIDTA margin to improve

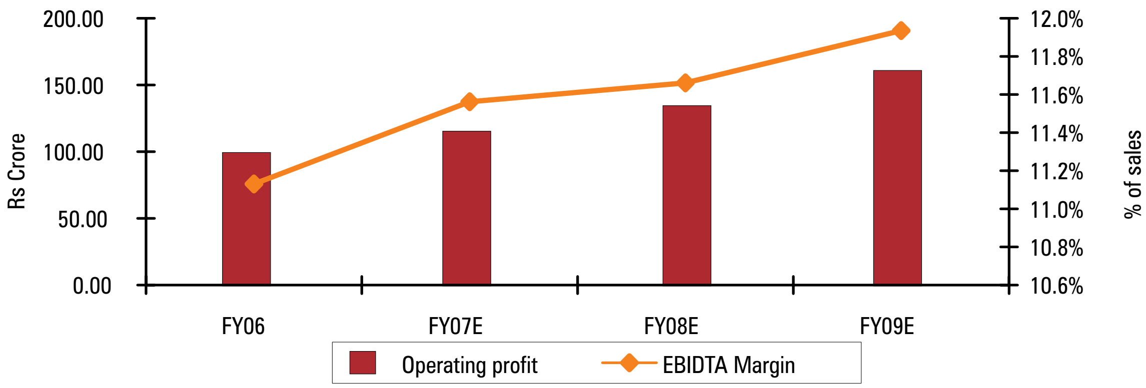
GEL's entry into higher realization and more value-added structured suits would enable it to fetch better realizations and improve margins. We expect EBIDTA to grow at a CAGR of 17.7% over FY06-FY09E to Rs 161.90 crore. Increased contribution from value-added products would enable the company achieve an incremental EBIDTA margin of 13%, and result in an improvement in EBIDTA margin from 11.13% in FY06 to 11.94% in FY09E.

Exhibit 13 : Incremental sales and EBIDTA

	FY06	FY09E
Sales (Rs crore)	892.24	1356.43
EBIDTA (Rs crore)	99.31	161.9
Incremental sales (Rs crore)		464.19
Incremental EBIDTA (Rs crore)		62.59
Incremental EBIDTA margin (%)		13%

Source: ICICIdirect Research

Exhibit 14: EBIDTA margin to expand

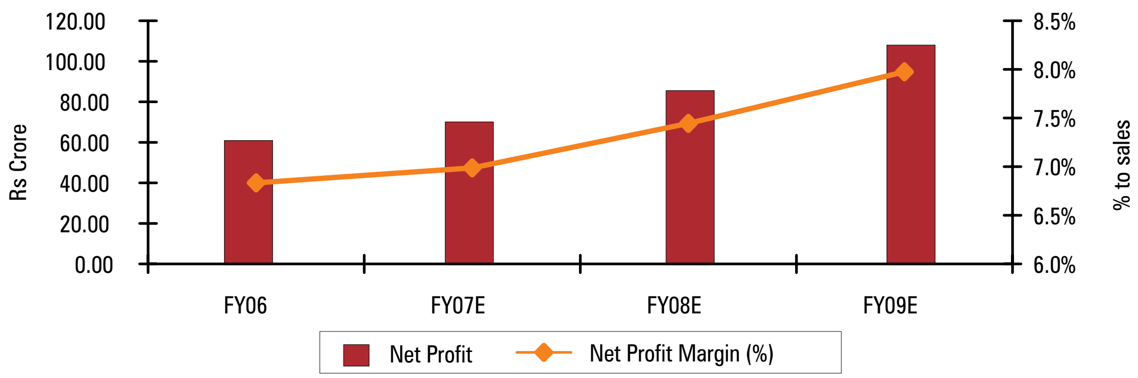


Source: ICICIdirect Research

Net profit, NPM to increase

We expect net profit to grow at a CAGR of 21% over FY06-FY09E to Rs 108.18 crore. Improvement in EBIDTA margin would enable the company to achieve a 114 basis points improvement in the net profit margin from 6.83% in FY06 to 7.97% in FY09E.

Exhibit 15: Net profit, NPM to increase



Source: ICICIdirect Research

Return ratios to improve

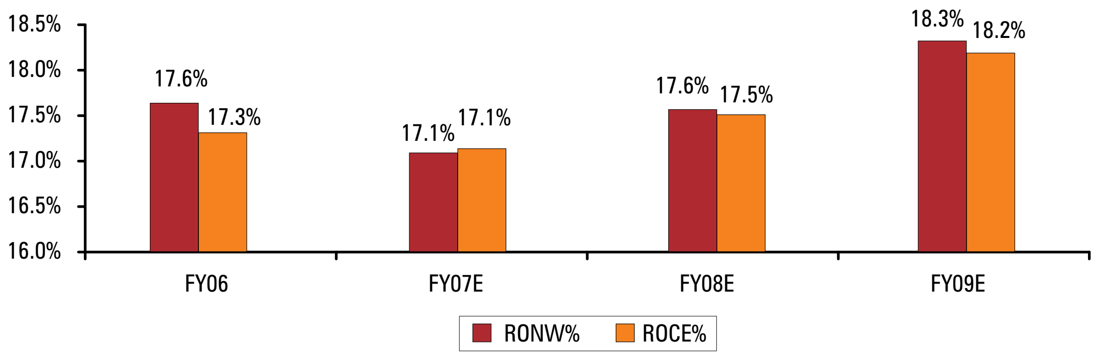
The steady growth in profitability on account of an improvement in EBIDTA margin would enable GEL to improve its RoNW from 17.63% in FY06 to 18.35% in FY09E. Higher return of 20% on incremental capital employed during FY06-FY09E would result in the RoCE improving from 17.31% in FY06 to 18.19% in FY09E.

Exhibit 16 : Incremental RoCE

	FY06	FY09E
Capital employed (Rs crore)	573.78	890.16
EBIDTA (Rs crore)	99.31	161.9
Incremental capital employed (Rs crore)		316.38
Incremental EBIDTA (Rs crore)		62.59
Return on additional capital employed (%)		20%

Source: ICICIdirect Research

Exhibit 17: Return ratio improving

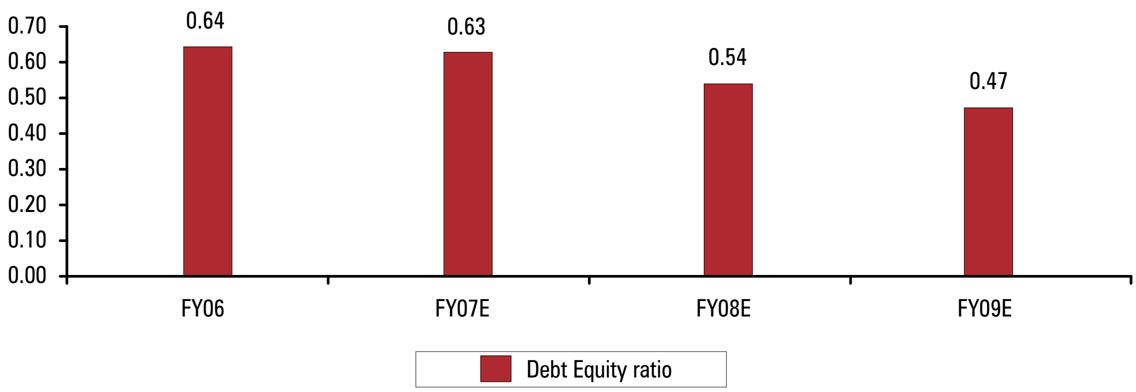


Source: ICICIdirect Research

Low debt-equity ratio

The company will be able to maintain a comfortable debt-equity position with its debt equity ratio being quite low at 0.47 for FY09E. This will enable it to raise debt easily to fund its expansion plans further without diluting the equity.

Exhibit 18: Comfortable debt-equity position



Source: ICICIdirect Research

VALUATION

GEL's capacity expansion, enriched product mix and favourable macro scenario will provide the company sustained earning visibility. It is already the leading apparel exporter and enjoys significant premium in realizations over domestic and global peers. Its entry into premium realization products and cost initiatives would enable it improve margins going forward.

At the current price of Rs 236, the stock discounts its FY08E EPS of Rs 24.99 by 9.4x and FY09E EPS of Rs 31.46 by 7.5x. On an EV/EBITDA basis, it trades at 8.0x for FY08E and 6.7x for FY09E. Peers like Bombay Rayon Fashions and Kewal Kiran Clothing trade at a P/E multiples of 9.6x and 9.7x their FY08E earnings. We believe the current valuations do not capture the premium discounting that the stock deserves owing to its leadership position and significantly higher realizations. Liquidity in the scrip has improved after a stock split from a face value of Rs 10 to Rs 5. We value the stock at 10x its FY09E EPS of Rs 31.46, gives us a 12-15 month price target of Rs 315, an upside of 33% from current levels.

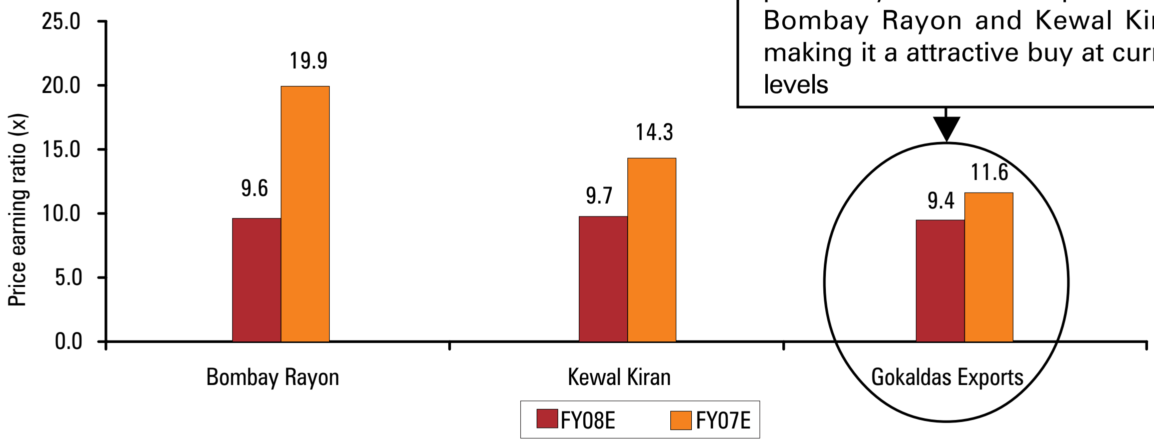
Exhibit 19 : Peer group valuation

Company	Net Sales (Rs cr)		OPM(%)		RoNW		RoCE		EPS (Rs)		P/E (x)	
	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E
Bombay Rayon	796.9	451.36	19.60%	18.30%	32.10%	22.00%	26.95%	17.94%	17.71	8.53	9.6	19.9
Kewal Kiran	180.35	122	24.40%	23.40%	16.70%	13.20%	24.36%	18.91%	20.71	13.98	9.7	14.3
GEL	**1,154.22**	**1,003.05**	**11.66%**	**11.56%**	**17.57%**	**17.09%**	**17.52%**	**17.13%**	**24.99**	**20.39**	**9.4**	**11.6**

Source: ICICIdirect Research

Exhibit 20: Comparative P/E valuations

GEL is available at a discount to comparatively smaller companies like Bombay Rayon and Kewal Kiran, making it a attractive buy at current levels



Source: ICICIdirect Research

FINANCIAL SUMMARY

Profit and Loss Account

Sales CAGR at 15% over FY06-FY09E

Net profit CAGR of 21% over FY06-FY09E

(Rs Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
Net Sales	**1,356.43**	**1,154.22**	**1,003.05**	**892.24**
% Growth	17.52%	15.07%	12.42%	24.28%
Raw Materials	769.3	657.82	574.43	501.05
Employee Expenses	280.78	238.92	210.64	199.93
Power & Fuel	27.81	23.08	19.06	15.29
Sell. & Admin. Expenses	116.64	99.81	82.95	76.66
Total Expenses	**1,194.53**	**1,019.63**	**887.07**	**792.93**
% Growth	17.15%	14.94%	11.87%	21.01%
Operating Profit	**161.9**	**134.59**	**115.97**	**99.31**
Depreciation	31.3	28.4	23.83	21.03
Interest expense	20	20	18	14.45
PBT excluding Other Income	**110.6**	**86.19**	**74.14**	**63.83**
Other Income	10	9.5	5.5	5.13
PBT after Other Income	**120.6**	**95.69**	**79.64**	**68.96**
Tax	12.42	9.76	9.56	7.99
Net Profit	**108.18**	**85.93**	**70.09**	**60.97**
% Growth	25.88%	22.61%	14.95%	53.60%
Equity	17.19	17.19	17.19	17.19
Dividend %	40%	35%	30%	30%
EPS (Rs)	31.46	24.99	20.39	17.73

Balance Sheet

Increase in net block on account of capital expenditure to enhance production capacities

(Rs Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
Share Capital	17.19	17.19	17.19	17.19
Reserves & Surplus.	572.36	471.99	392.95	328.69
Secured Loans	215	200	190	154.78
Unsecured Loans	65	65	67.5	67.91
Deferrred Tax	20.61	14.22	9.24	5.26
Less : Miscellaneous Exp Not W/off	0	0	0	0.05
Total Liabilities	**890.16**	**768.39**	**676.88**	**573.78**
Net Block	330.45	288.15	235.24	187.23
Investments	85	75	70	59
Inventories	334.46	294.09	261.07	275.76
Sundry Debtors	81.76	72.73	82.44	58.98
Cash & Bank	5.01	4.17	4.62	11.14
Loans & Adv.	120	100	90	56.33
Current Assets	541.23	470.99	438.13	402.21
CL & Prov.	66.52	65.74	66.49	74.66
Net Current Assets	474.71	405.24	371.64	327.55
Total Assets	**890.16**	**768.39**	**676.88**	**573.78**

Cash Flow Statement

(Rs Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
Opening Cash	**4.17**	**4.62**	**11.14**	**22.48**
Profit after Tax	108.18	85.93	70.09	60.97
Dividend Paid	7.8	6.89	5.83	6.01
Depreciation	31.3	28.4	23.83	21.03
Cash Profit	138.07	112.41	92.07	79.68
Changes in WCI				
Net Increase in CL	0.77	-0.74	-8.17	14.82
Net Increase in CA	69.4	33.31	42.44	100.02
CF after changes in WCI	69.45	78.36	35.03	-5.52
Cash Flow from Investing Activities				
Purchase of FA	73.6	81.31	71.84	101.49
Cash from Financing Activites				
Increase /(Decrease) in Loan Funds	15	7.5	34.81	32.14
Closing Cash	5.01	4.17	4.62	11.14

Ratios

(Rs Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
EPS (Rs)	31.46	24.99	20.39	17.73
Book Value (Rs crore)	171.48	142.28	119.3	100.61
Operating Margin (%)	**11.94**	**11.66**	**11.56**	**11.13**
Net Profit Margin (%)	7.97	7.44	6.99	6.83
RoNW	18.35%	17.57%	17.09%	17.63%
RoCE	**18.19%**	**17.52%**	**17.13%**	**17.31%**
Debt/Equity	0.47	0.54	0.63	0.64
FA Turnover Ratio	4.67	4.75	5.14	5.16
Enterprise Value (Rs crore)	1,086.36	1,072.20	1,064.25	1,022.92
EV/EBIDTA	6.71	7.97	9.18	10.3
Sales to Equity	78.91	67.15	58.35	51.9
Market Cap to Sales	0.6	0.7	0.81	0.91
Price to Book Value	1.38	1.66	1.98	2.35

Improvement in operating margin on account of change in product mix and higher realisations

Improvement in return on capital employed on account of efficient utilisation of incremental capital employed

RATING RATIONALE

ICICIdirect endeavours to provide objective opinions and ecommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;
Performer: Between 10% and 20%;
Hold: ±10% return;
Underperformer: -10% or more.

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