Company Focus

15 November 2007 | 8 pages

Raymond Ltd. (RYMD.BO)

Target price change ☑

Buy: Branded Retailing the Focus; Raising Target

- **Raising target to Rs475, reiterate Buy** — Raymond's thrust on branded retailing (~45% of total revenues) and core worsted fabric business will drive growth. The stock has had a 46% run over last 3-m; however we see further upside and increase our target to Rs475 based on 10.3x FY09E EV/EBITDA (vs. FY08 earlier), set at a premium to the sector given its brand positioning.
- **Thrust on branded retailing —** Plans to expand its brand portfolio and network of 430 stores in FY07 by adding 100-plus stores by Mar'08; recent launch of Park Avenue and Colorplus brands in women's wear has received an encouraging response. We forecast revenues CAGR of 15% over FY07-10E and higher EBITDA margins of 10% (vs. 5-6% of peers) given its premium positioning; however, near-term earnings could be muted due to store roll-outs.
- **Preferential issue to promoters, a sentiment positive** — The proposed 6.1m warrant issue to promoters, exercisable at Rs340/share would increase their stake to ~42% (vs. 36% earlier); these funds will be used for the company's capex in retail and other businesses – we see this as a sentiment positive.
- **Denim woes continue** — High overheads of US/EU plants are key reasons; Raymond is taking initiatives but unlikely to reduce near-term losses materially.
- **Catalyst and risks** — Catalyst would be any developments to unlock value of real estate assets (140acres in Thane). Key risks being higher losses in denim, adverse impact of rising material costs and cost pressures on earnings.

Buy/Low Risk	1L
Price (15 Nov 07)	Rs403.00
Target price	Rs475.00
from Rs365.00	
Expected share price return	17.9%
Expected dividend yield	1.2%
Expected total return	**19.1%**
Market Cap	Rs24,736M
	US$631M

Price Performance (RIC: RYMD.BO, BB: RW IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	1,361	22.17	50.2	18.2	1.9	11.1	1.2
2007A	1,400	22.82	2.9	17.7	1.8	10.5	1.2
2008E	1,141	18.58	-18.5	21.7	1.7	8.0	1.2
2009E	1,459	23.77	27.9	17.0	1.6	9.6	1.5
2010E	1,859	30.29	27.4	13.3	1.4	11.3	1.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	18.2	17.7	21.7	17.0	13.3
EV/EBITDA adjusted (x)	10.8	11.9	11.4	9.5	7.7
P/BV (x)	1.9	1.8	1.7	1.6	1.4
Dividend yield (%)	1.2	1.2	1.2	1.5	1.5
Per Share Data (Rs)					
EPS adjusted	22.17	22.82	18.58	23.77	30.29
EPS reported	22.17	22.82	18.58	23.77	30.29
BVPS	207.52	225.33	238.92	256.69	281.00
DPS	5.00	5.00	5.00	6.00	6.00
Profit & Loss (RsM)					
Net sales	17,106	20,407	22,559	24,976	27,165
Operating expenses	-15,518	-19,127	-21,072	-22,986	-24,583
EBIT	**1,588**	**1,280**	**1,487**	**1,990**	**2,582**
Net interest expense	-390	-502	-552	-510	-525
Non-operating/exceptionals	826	783	819	765	803
Pre-tax profit	**2,024**	**1,561**	**1,755**	**2,245**	**2,861**
Tax	-610	-547	-614	-786	-1,001
Extraord./Min.Int./Pref.div.	-54	387	0	0	0
Reported net income	**1,361**	**1,400**	**1,141**	**1,459**	**1,859**
Adjusted earnings	1,361	1,400	1,141	1,459	1,859
Adjusted EBITDA	2,463	2,537	2,870	3,414	4,050
Growth Rates (%)					
Sales	18.8	19.3	10.5	10.7	8.8
EBIT adjusted	82.4	-19.4	16.2	33.8	29.8
EBITDA adjusted	56.1	3.0	13.1	18.9	18.6
EPS adjusted	50.2	2.9	-18.5	27.9	27.4
Cash Flow (RsM)					
Operating cash flow	**1,961**	**1,083**	**1,208**	**3,022**	**2,646**
Depreciation/amortization	875	1,257	1,383	1,425	1,467
Net working capital	-274	-1,574	-1,315	138	-681
Investing cash flow	**-4,707**	**-4,318**	**-548**	**-1,311**	**-1,846**
Capital expenditure	-5,120	-4,680	-1,617	-1,183	-1,434
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**2,852**	**3,462**	**-933**	**-1,743**	**-243**
Borrowings	3,002	3,689	-652	-1,400	100
Dividends paid	-307	-307	-307	-368	-368
Change in cash	**107**	**227**	**-273**	**-32**	**557**
Balance Sheet (RsM)					
Total assets	**27,191**	**31,301**	**31,774**	**30,966**	**31,972**
Cash & cash equivalent	576	715	443	216	693
Accounts receivable	3,022	3,469	3,948	3,996	3,803
Net fixed assets	11,196	14,618	14,852	14,611	14,578
Total liabilities	**14,230**	**17,176**	**16,775**	**14,926**	**14,465**
Accounts payable	2,296	2,323	2,560	2,156	1,849
Total Debt	9,413	13,102	12,450	11,050	11,150
Shareholders' funds	**12,961**	**14,125**	**14,999**	**16,041**	**17,508**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.4	12.4	12.7	13.7	14.9
ROE adjusted	11.1	10.5	8.0	9.6	11.3
ROIC adjusted	6.7	3.8	3.8	5.2	6.8
Net debt to equity	68.2	87.7	80.1	67.5	59.7
Total debt to capital	42.1	48.1	45.4	40.8	38.9

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Key Points

Branded retailing the focus

Aggressive plans to add 100-plus stores (Colorplus, Park Avenue, Zapp, Raymond Shop) in FY08E

Raymond is amongst the few highly profitable players in the domestic branded apparel business. The company's retail focus is intact with aggressive plans to add 55 branded apparel stores (Colorplus, Park Avenue, Zapp) and 55 Raymond stores in FY08E. This will take the company's total store network from ~430 in FY07 (of which it owns ~100 stores) to ~540 stores in FY08E. This retail build-out is positive, however with intensifying competition and real-estate prices spiraling, risk of delays in rolling out new stores is high.

Foray in premium women's wear – targeting revenues of Rs1.5bn in 2-3 years

Raymond is exploring opportunities to widen the brand portfolio by focusing on women-wear, which we believe should enhance customer base. The company has launched western clothing range for women wear under its Park Avenue and ColorPlus brands – the response has been very encouraging. The brands will vie for a share in the Rs8bn market for premium women's western wear and the company expects to target incremental revenues of Rs1.5bn over the next 2-3 years. Besides, the company's brands Notting Hill (targeting popular price segment) and Zapp (targeting kids-wear) launched in FY07 are progressing well. Further, company JV with Italian apparel brand Grotto SpA for retailing the 'GAS' brand is targeting revenues of Rs.1bn in FY09-10E, although gestation period for profitability could be a bit longer than expectations (made losses of Rs68m in 1HFY08) – targeting to have 35 stores in next 1-2 years, vs. 6-stores today. We forecast healthy CAGR of 15% over FY07-10E and higher EBITDA margins of 10% (vs. 5-6% of peers) given its premium positioning; however near-term earnings could be muted due to store roll outs.

Steady growth in core worsted fabric

We forecast revenue CAGR of 9% over FY07-10E

Enriching product mix and increased volumes from new capacities at Vapi (6m mtrs) will drive growth for Raymond's core worsted fabric business. We forecast revenue CAGR of 9% over FY07-10E. While high wool prices remain a dampener, we see benefits of higher operating leverage for its new capacities contributing towards better profitability for this business ahead.

New subs/JV - early signs of improvement

Most of Raymond's garmenting subsidiaries and fabric joint ventures, except the denim business have showed an improved performance in 2QFY08 – we believe this could be early signs of these businesses starting to contribute towards Raymond's overall growth going forward.

Garment subs have started to break-even

- Its garment subs have started to break-even; Silver Spark the suits and trouser 100% sub, revenues of Rs241m grew 18% YoY in 2Q with earnings before tax at Rs.25m (vs. Rs15m last year). Celebrations Apparel the shirt sub revenues nearly doubled to Rs.250m with earnings before tax at Rs10m (vs. Rs30m loss last year) – this venture is expected to get a 3-yr order for high-end shirts from an Italian firm, shortly fabric for which would be sourced internally from its 50:50 shirting fabric JV.

Fabric JVs have shown reasonable growth on QoQ basis

- 50:50 fabric JVs have shown reasonable growth on QoQ basis; Its shirting fabric venture revenues grew 40% QoQ reporting profits of Rs.27m (vs. Rs10m loss in 1Q). The woollen fabric JV revenues doubled QoQ to Rs.149m with losses reducing to Rs.21m in 2Q (vs. Rs.30m in 1Q)

- The files ventures however reported moderate growth in revenues and earnings.

Proposed warrant issue to promoters

Promoters bringing in significant capital of Rs2.08bn at Rs.340/share and increasing stake, is a sentiment positive

The company has approved a proposed preferential issue of 6.14m warrant to the promoters/Promoter group for raising ~Rs.2.08bn. These warrants will be exercisable at Rs340/share within a period of 18-months. This is largely to fund the company's future capex in retailing and other businesses including its garments/fabric joint ventures. While the proposed preferential issue will increase promoters' stake to 42.1% (vs.36.4% earlier) it will result in an equity dilution of 10%, which may not be EPS accretive in the near-term. However, we see promoters bringing in significant capital into the company as positive for sentiment.

Denim woes continue

JV posted a loss of ~Rs437m in 1HFY08 – unlikely to reduce materially in near-term

Raymond's denim JV, UCO Denim, in which it has a 50% share, is running into losses. The JV posted a loss of ~Rs437m in 1HFY08. While the JV's Indian operation was cash positive, high overheads and low utilization in the US and European (Belgium) plants together with order cancellations by a couple of large customers, high cotton prices and continued appreciation of the rupee led to losses in the overall business. The company plans to improve operating efficiency by increasing utilization in low cost locations such as Romania and is also exploring opportunities to secure orders for its newly launched collections and increase realizations through value added products. However, given the difficult market situation in the US and European markets, we believe losses from this business are unlikely to reduce materially in the near-term. The management is however exploring various options to address the losses of this venture.

Raymond Ltd.

Company description

Raymond is among the top three worsted fabric players in the world, with capacity of 31m meters per annum. In India it is a leader with 60% market share, strong brand equity and a distribution network of 430 retail outlets. It also has a presence in denim and branded apparel garments, which it is looking to ramp-up. In files & tools, a non core engineering business, it is one of the largest producers with a 30% share, and dominates the domestic market with a 70% share. Its thrust on garmenting is a step toward vertically integrating its business model, leveraging off its fabric capacity. It is the flagship company of the Singhania Group, which owns a 36% stake in the company.

Investment strategy

We rate Raymond Buy/Low Risk (1L). In the near-term, earnings are likely to be depressed until the company's JVs and new retail stores become accretive. Temporary pressures aside, we are positive on the Raymond investment story given a 1) strong brand portfolio (Raymond, Park Avenue, Parx and Colorplus) - contributing ~45% of FY07 Revenues, 2) a retail network of ~430 stores and 3) Raymond's leadership in the worsted fabric business. On our forecasts, Raymond offers attractive growth potential – with an earnings CAGR of 16% over FY07-10E. Also, cash reserves are healthy at ~Rs5bn (approximately Rs.80/share), while value could be unlocked from the company's real estate assets (140 acres in Thane).

Valuation

We are increasing our target price to Rs475 (vs Rs365 earlier) based on rolling forward our target 10.3x EV/EBITDA multiple to FY09 from FY08 earlier. We believe EV/EBITDA is a suitable valuation tool since net profit will be depressed in the near-term until the company's JVs and new retail stores become accretive. Our target multiple places the stock at a 40% premium to our India textile universe, which we argue is justifiable given Raymond's strong brand portfolio, retail network and leadership in worsted fabric. Further, the stock trades at 9x EV/EBITDA for FY09E and 1.6x P/BV, at the lower end of its 2-year EV/EBITDA band of 9-14x and a P/BV band of 1.5-2.0x.

Risks

We rate Raymond Low Risk based on our quantitative risk rating system that measures the stock volatility over a 260-day period. The main company-specific risks are: 1) Slower than anticipated turnaround in the denim and other loss-making JVs, 2) Lower than anticipated margins in the branded apparel business, 3) High priced acquisitions to dilute cash reserves and adversely impact ROCEs. Acquisitions in non-core business would hinder a re-rating; 4) Sharp increase in cotton prices by 10-12% from current levels and any decline in denim price realization would impact profitability of the denim business (13% of FY07 consolidated revenues), with cotton costs constituting 43% of denim revenues. If any of these risk factors plays out, Raymond's share price will likely have difficulty attaining our target price.

Appendix A-1

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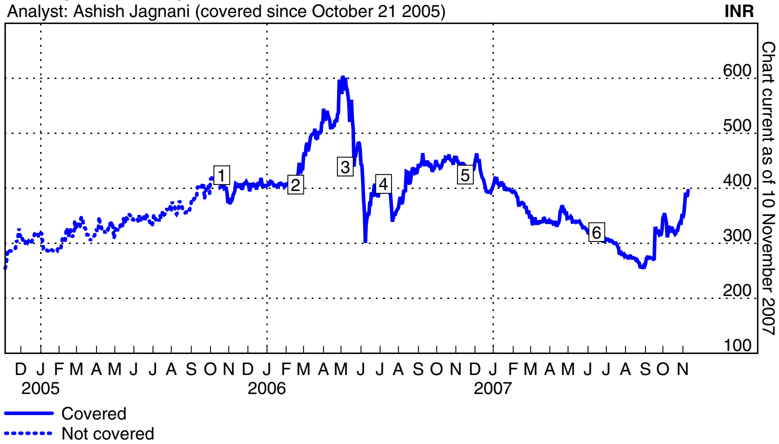
Analyst: Ashish Jagnani (covered since October 21 2005)



#	Date	Rating	Target Price	Closing Price
1:	20 Oct 05	1L	500.00	412.40
2:	16 Feb 06	1L	*540.00	416.05
3:	8 May 06	*2L	*625.00	601.00
4:	7 Jul 06	*1L	625.00	403.25
5:	16 Nov 06	1L	*570.00	438.60
6:	15 Jun 07	1L	*365.00	310.00

*Indicates change.

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