TEXTILE

A growth story retold

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Textile stocks have underperformed benchmark indices over the last year owing to delays in capacity expansion, slower than expected exports growth, and concerns on pricing. While we believe that the concerns on the sector are justified, there are companies who are making good progress in these areas. Hence, we do like these stocks from a long term value perspective. These are the companies which are likely to earn superior RoEs and operating cash flows, which should allow them to fund the next phase of growth without equity dilution. We believe, this is likely to be the case for companies which are (a) likely to achieve higher value-added sales through better design capabilities and marketing/ distribution presence in end consumer markets (EU/ US) (b) building *smart* capacities (c) benefit from scale and subsidized debt through the TUF scheme. These companies are approaching the end of the current capex phase and should see spikes in profitability and returns in FY09 or even earlier. We would recommend investors to accumulate these stocks from a long-term value perspective.

We like Bombay Rayon Fashions (P/E of 5.6x for FY09E), Spentex India (P/E of 5.3x for FY09E), Himatsingka Seide (P/E of 8.8x for FY09E), Alok Industries (P/E of 3.2x for FY09E) and Welspun India (P/E of 4.2x for FY09E) from this perspective.

The story so far

China, Pakistan, India, Indonesia, and Bangladesh have been the biggest beneficiaries of the quota removal on textile imports by the US and EU after the expiry of textiles and clothing agreement on January 1, 2005. Global retailers, accounting for the bulk of imports into their countries, are now consolidating their vendor base. They are developing closer relationships with select vendors with proven delivery capabilities, to reduce procurement cost, order cycle, and ensure a seamless supply chain.

Companies adopting multi-pronged strategies to garner superior returns

While the opportunity space, in terms of demand, remains the same for all, we find that companies have adopted various strategies to deliver superior steady state returns. These strategies, though diverse, can be broadly classified into: (a) higher value-added sales; (b)building smart capacities; and (c) financial and operating leverage. In this, we find companies have been playing on their existing strengths or developing newer ones to deliver higher RoEs.

Major capex phase nearing completion; profitability to spike in FY09

Post quota abolition, all textile companies had launched major capacity expansion drives to capture the market opportunity and benefit from the subsidized access to capital through the TUF scheme. There was a dip in asset turns and returns as the companies were undergoing a major capex phase.We expect quite a few of the companies under our coverage to demonstrate a spike in margins, profitability, returns, and cash flows as they approach the end of a capex cycle and reap consolidation benefits. Also, we expect the returns to be higher than historical levels because of higher-value added sales, smart capacities, and vertical integration benefits. We expect the bulk of the next round of capex to be funded through the companies' internal accruals (due to improved operational cash flows) and through the now extended TUF scheme.

Companies covered

Alok Industries

Bombay Rayon

Himatsingka Seide

Spentex Industries

Vardhman Textiles

Welspun India

ATAGLANCE

Textiles — At a glance

Company	Price (INR)	Mkt cap (INR mn)	Reco		Financials (INR mn) Revenue	EBITDA	Net profit	EPS (INR)	Growth (%) Revenue	EBITDA	Net profit	Valuation (x) P/E	EV/ EBITDA	EV/ sales	Price/ book
Alok Industries Ltd	54	10,751	BUY	FY06	14,207	2,961	1,092	6.9	16	24	22	7.8	9.1	1.9	1.2
				FY07E	17,569	3,940	1,451	7.3	24	33	33	7.4	6.9	1.6	0.9
				FY08E	22,823	5,497	2,127	10.7	30	40	47	5.1	6.0	1.5	0.7
				FY09E	29,451	7,083	3,376	17.0	29	29	59	3.2	4.4	1.0	0.6
Bombay Rayon Fashions Ltd	160	10,105	BUY	FY06	1,990	318	167	3.4	92	208	167	47.2	34.4	5.5	6.6
				FY07E	4,673	953	490	7.8	135	199	194	20.6	12.0	2.4	2.1
				FY08E	9,024	2,031	1,053	15.2	93	113	115	10.5	5.9	1.3	1.5
				FY09E	16,141	3,536	1,983	28.7	79	74	88	5.6	3.2	0.7	1.2
Himatsingka Seide Ltd	115	11,219	BUY	FY06	1,509	518	483	5.0	9	(7)	6	23.2	16.8	5.8	2.0
				FY07E	1,784	579	592	6.1	18	12	23	18.9	18.8	6.1	1.8
				FY08E	3,947	1,067	836	8.6	121	84	41	13.4	12.4	3.3	1.7
				FY09E	5,539	1,569	1,279	13.1	40	47	53	8.8	8.2	2.3	1.5
Vardhman Textiles Ltd	210	12,140	ACCU	FY06	18,892	3,429	1,962	34.0	2	18	61	6.2	6.0	1.1	1.3
				FY07E	21,002	3,687	1,782	30.8	11	8	(9)	6.8	6.2	1.1	1.1
				FY08E	24,108	4,304	1,944	33.6	15	17	9	6.2	5.8	1.0	0.9
				FY09E	30,238	5,539	2,375	41.1	25	29	22	5.1	4.9	0.9	0.8
Welspun India Ltd	69	5,036	BUY	FY06	6,537	1,228	416	5.7	37	15	8	12.1	10.9	2.0	0.9
				FY07E	10,039	1,773	585	8.0	54	44	41	8.6	8.8	1.6	0.8
				FY08E	13,122	2,531	882	12.1	31	43	51	5.7	7.1	1.4	0.7
				FY09E	14,645	2,857	1,187	16.2	12	13	35	4.2	6.9	1.4	0.6
Spentex Industries Ltd	59	4,206	BUY	FY06	3,523	185	101	1.7	(3)	23	(3)	33.6	63.8	3.3	3.1
				FY07E	10,153	1,359	254	3.5	188	635	152	16.6	11.5	1.5	2.0
				FY08E	14,530	2,353	753	10.5	43	73	197	5.6	6.1	1.0	1.7
				FY09E	14,853	2,436	801	11.2	2.2	3.5	6.3	5.3	5.0	0.8	1.5

Investment Rationale

The story so far

China, Pakistan, India, Indonesia and Bangladesh have been the biggest beneficiaries of the quota removal on textile imports by the US and EU after the expiry of textiles and clothing agreement on January 1, 2005. Global retailers, accounting for the bulk of imports into their countries, are now consolidating their vendor base. They are developing closer relationships with select vendors with proven delivery capabilities, to reduce procurement cost, order cycle, and ensure a seamless supply chain.

As per our expectations, China has been the biggest beneficiary of the global consolidation in production because of its low cost of production and efficiencies of scale. India has been amongst the most favored sourcing destinations for global retailers because of its demonstrated strengths in cotton wovens, high design content, and short-run manufacturing.

Table 1: US imports of textile & clothing (USD mn): India vs. China and world

	India YTD Dec-06	Change (%)	China YTD Dec-06	Change (%)	Market Share YTD Dec-06 India	Market Share YTD Dec-06 China	Market Share YTD Dec-06 India	Market Share YTD Dec-06 China
Apparel	**3,187**	**7.1**	**18,518**	**22.3**	**4.4**	**25.9**	**4.3**	**22.0**
Cotton	2,636	14.3	7,855	30.8	6.1	18.1	5.6	14.6
Non Cotton	551	(17.7)	10,662	16.7	2.0	37.8	2.4	33.1
Fabric	**174**	**14.3**	**900**	**7.3**	**3.2**	**16.4**	**2.7**	**14.7**
Cotton	82	11.5	269	14.1	5.8	19.1	4.7	15.0
Non Cotton	581	12.5	631	4.6	14.3	15.5	12.5	14.5
Yarn	**63**	**100.8**	**72**	**23.5**	**3.9**	**4.5**	**1.8**	**3.4**
Cotton	30	184.8	6	(25.9)	9.0	1.8	3.1	2.4
Non Cotton	33	57.7	66	31.5	2.6	5.2	1.5	3.6
Other Misc.	**1,607**	**10.3**	**7,578**	**19.0**	**11.0**	**52.0**	**11.2**	**48.7**
Cotton	1,091	10.2	2,685	30.6	16.7	41.1	17.5	36.3
Non Cotton	516	10.6	4,893	13.5	6.4	60.9	6.3	58.3
Total	**5,031**	**9.0**	**27,067**	**20.8**	**5.4**	**29.0**	**5.2**	**25.1**
Total Cotton	3,840	13.6	10,816	30.2	7.4	20.9	6.9	17.0
Total Non-Cotton	1,191	(3.6)	16,251	15.3	2.9	39.1	3.1	34.8

Source: OTEXA

Companies adopting various strategies to garner superior returns

While the opportunity space, in terms of demand, remains the same for all, we find that companies have adopted various strategies to deliver superior steady state returns. These strategies, though diverse, can be broadly classified into the following categories (in the order of importance in a long-term perspective):

(A) **Higher value-added sales:** The objective of this effort is to capture greater share of the yarn to retail profit pool, largely through the following two methods:

1. **Forward integration:-** This is in order to derive higher Average Selling Price (ASP) for one's products by:

   a. Creating brands/ marketing presence in end-consumer countries, to differentiate one's products on retailers' shelves.

   b. Adding more value to retailers (beyond just manufacturing), particularly through partnerships in design or helping the retailer manage his supply chain better.

We especially like Welspun's efforts in creating brands and marketing presence in end consumer markets. Himatsingka's move to become an integrated player, by manufacturing low-cost bed-linen in India and selling it through high-end boutiques in Italy/ other parts of Europe, is a step ahead. This move is likely to enable the company to earn best-in-class profitability. Important thing to be noted is that a major share (70-80%) of the yarn to retail profit pool lies in the retail part. We believe, going forward, successful forward integration will be one of the key levers to create sustainable and scalable global competitive advantage for companies that have already created and demonstrated their off-shore manufacturing and delivery capabilities out of India.

2. **Backward integration:** Textile companies such as BRFL, Welspun, and Alok have backward integrated into weaving and spinning from garmenting/ processing. They have also started setting up captive power plants to earn higher margins and have better control on their supply chain so as to ensure lower lead-time of order deliveries.

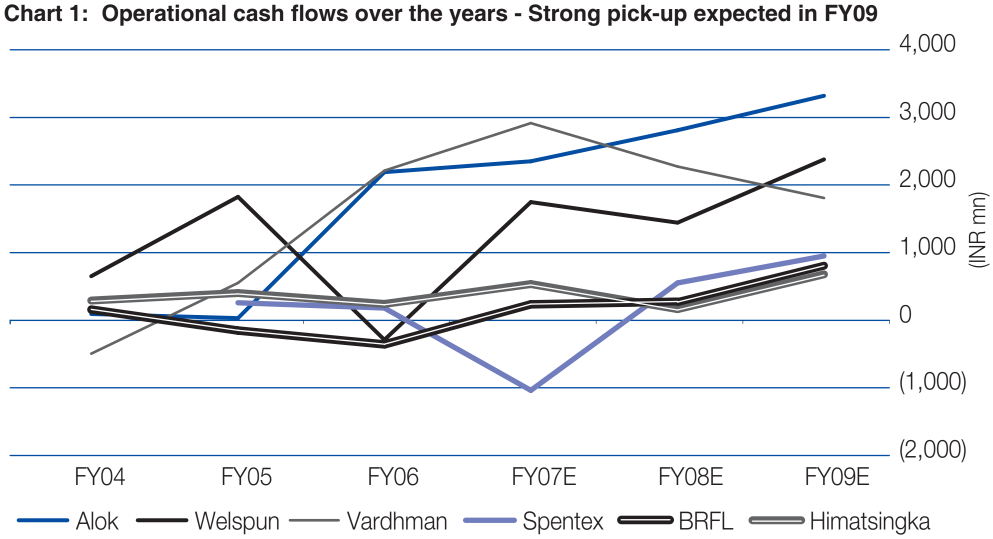
(B) Building smart capacities

Some companies have created/ bought assets that are likely to give superior returns. Spentex has bought assets at upto 50% discount to replacement cost and obtained major input cost benefits in its Uzbek acquisition. This strategy will enable Spentex to earn superior RoCE. BRFL has created an integrated fabric processing and garmenting facility at Dodaballapur as part of its on-going expansion. This should cut down turn-around times to ~30 days per order which allows clients to have a higher responsiveness to changing fashion cycles, thereby allowing BRFL to earn a price premium.

(C) Financial and operational leverage

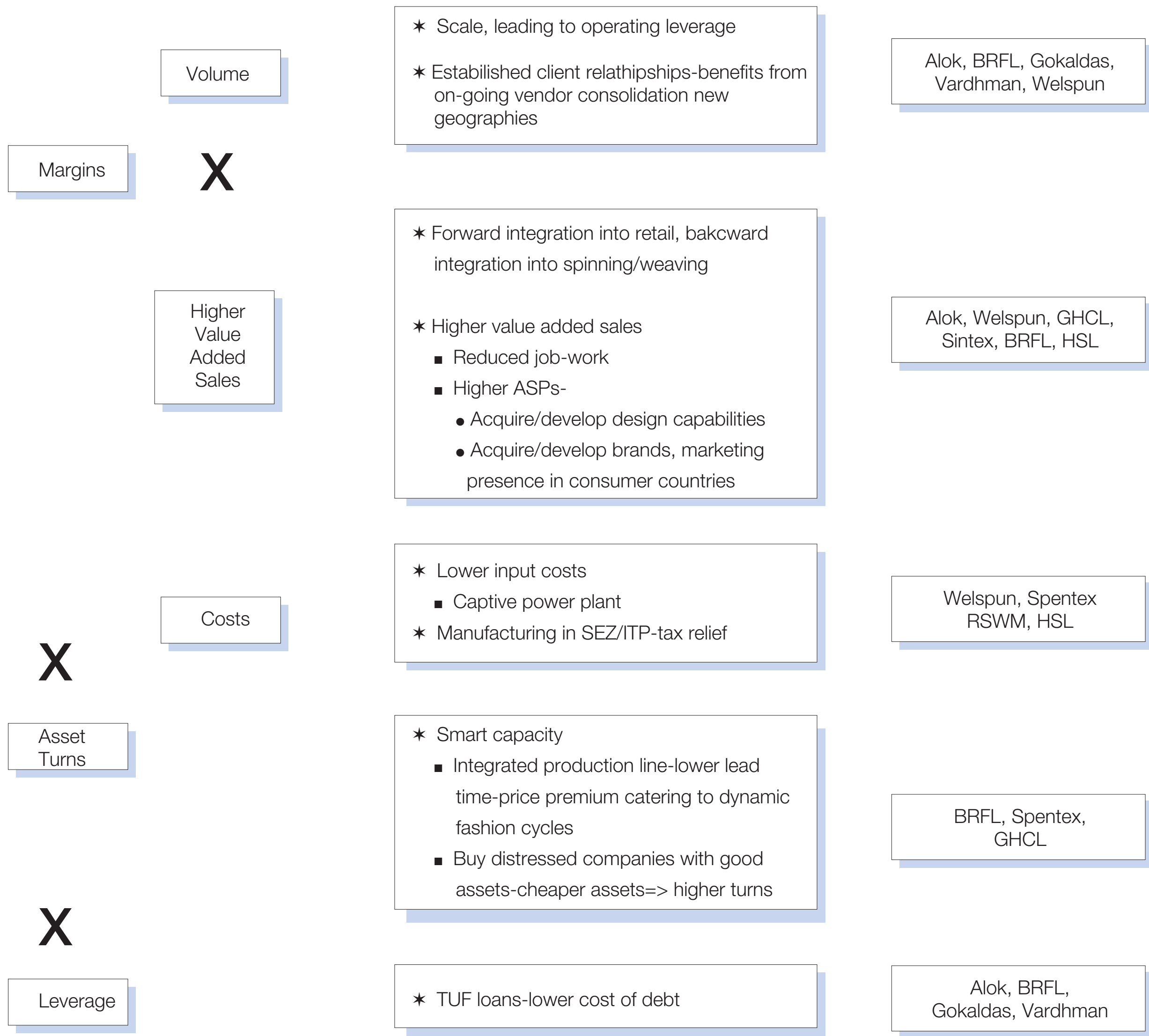
Companies like Vardhman Textiles, Welspun, Gokaldas, and BRFL have sufficiently large operations to enjoy scale benefits vis-à-vis competitors. Most importantly, the sector has enjoyed subsidised debt through the TUF schem e. Key players have taken advantage of this to raise loans, which will allow them to earn higher RoE due to higher leverage and lower interest costs. With the TUF scheme extended till FY12, we believe that most of our coverage universe is likely to consolidate its current major phase of capex over FY08 and FY09 and will see substantial spikes in free-cash flows in FY09. This is likely to enable the companies to fund most of their next round of capex (FY10 onwards), keeping their return ratios at healthy levels.

Chart 1: Operational cash flows over the years - Strong pick-up expected in FY09



Source: Edelweiss research

Fig. 1: RoE decomposition



Source: Edelweiss research

While we have laid out the strategies that incumbents have followed to generate superior returns, companies have differed in the extent and number of strategies adopted. In the following table, we have scored the companies on the strategies adopted.

Fig. 2: : Company-wise score sheet

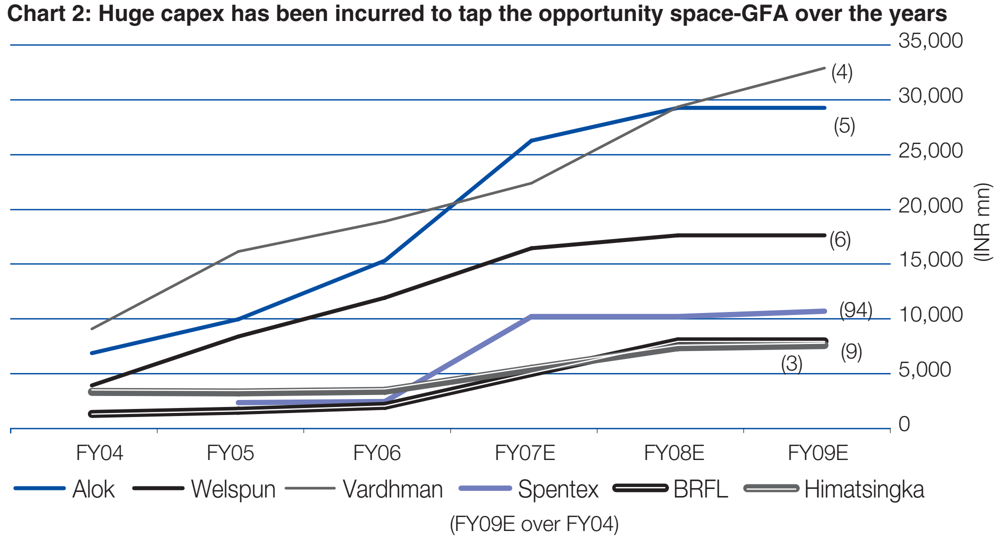
	Scale	Client relns	Design	SEZ/ lower input costs	Smart capacity	TUF loan	Onshore retail /mktg. presence
Alok	✓	✓		✓		✓	✓
Arvind	✓						
BRFL	✓	✓	✓	✓	✓	✓	
GHCL	✓	✓			✓		✓
Sintex		✓	✓	✓		✓	✓
Spentex	✓	✓		✓	✓	✓	
Welspun	✓	✓		✓		✓	✓
Vardhman	✓	✓		✓		✓	
HSL		✓	✓	✓		✓	✓
Gokaldas	✓	✓		✓			
RSWM				✓		✓	
HOPF	✓		✓		✓		✓

Source: Edelweiss research

Major capex cycle nearing completion; profitability to spike in FY09

Post quota abolition, all textile companies launched major capacity expansion drives to capture the market opportunity and take advantage of subsidized access to capital through TUF. These capex programmes, upon completion, are expected to grow these companies' gross blocks manifold over FY05 levels. With such capex programmes, the companies have been able to execute the strategies chosen by them (as outlined earlier) to earn superior returns.

Chart 2: Huge capex has been incurred to tap the opportunity space-GFA over the years

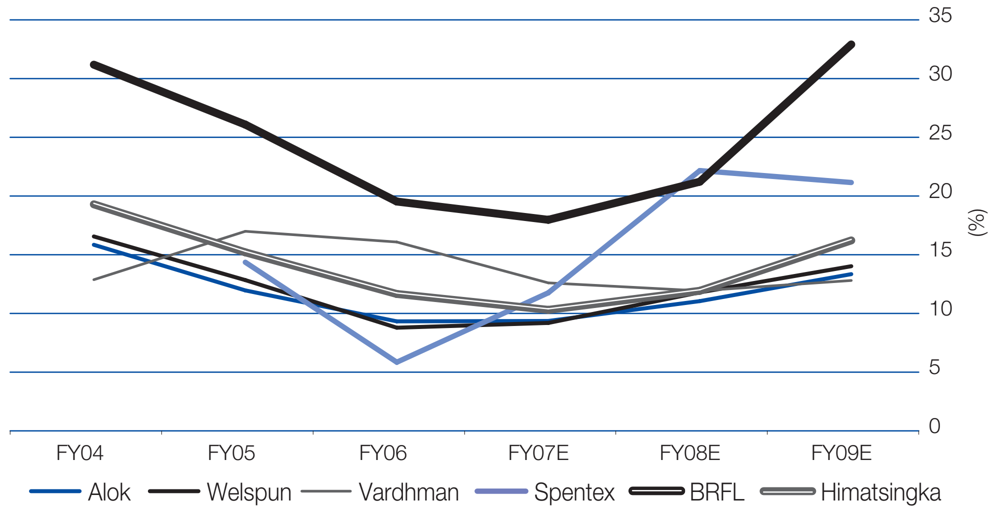


Source: Edelweiss research

We expect the majority among our coverage to demonstrate a spike in margins, profitability, returns, and cash flows, as they approach the end of a capex phase and reap consolidation benefits. Also, we expect the returns to be higher than historical levels because of high-value added sales, smart capacities, and vertical integration benefits. We expect lower capex going forward, and if there is any, a bulk of it is likely to be funded through internal accruals (due to improved operational cash flows).

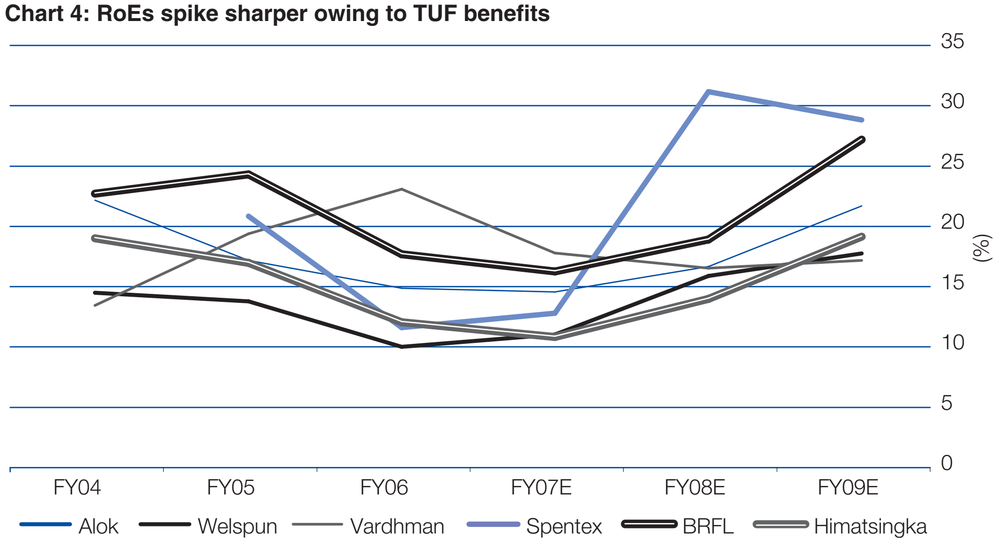
We believe that FY09 will see our set of companies reaping the benefits of their current capex programmes and various strategies adopted to earn superior returns (compared with the historical levels).

Chart 3: RocEs set to spike in FY08/FY09 as major capex phase nears end



Source: Edelweiss research

Chart 4: RoEs spike sharper owing to TUF benefits



Source: Edelweiss research

Valuations look attractive, we like select bottom-up stories based on strategy, execution, and potential returns.

To arrive at our preferences in the coverage universe, we have taken into account the companies' adopted strategies (see Fig. 1 Fig. 2) and their execution track records (companies have differed significantly in delivery of their stated execution plans). We prefer companies that are likely to generate higher returns (RoCEs and RoEs).

Based on this analysis, we like the following stocks in the sector from a long-term value perspective:

(a) Bombay Rayon (P/E of 5.6x for FY09E)

(b) Himatsingka Seide (P/E of 8.8x for FY09E)

(c) Spentex (P/E of 5.3x for FY09E)

(d) Alok Industries (P/E of 3.2x for FY09E)

(e) Welspun India (P/E of 4.2x for FY09E)

Annexure – I

Key factors affecting the textile space are:

1. **TUF benefits:** The sector has enjoyed subsidized debt through the textile up-gradation scheme fund scheme (TUFS). Key players have taken advantage of this to raise loans, which will allow them to earn higher RoE due to higher leverage and lower interest costs. The TUF scheme has been extended for the next five years in the current budget. However, since most companies in our coverage universe are through with a major phase of capex, they will see substantial spikes in operational cash flows in FY09, which should fund most of the incremental capex. Moreover, given that TUF is now available for the next five years, we expect our coverage companies to first focus on consolidating their current expansions before going for a fresh round of TUF funding.

2. **India's market share growth being slower than expected:** Although India has underperformed the great expectations post quota removals and other Asian countries have surged (including China, Pakistan, Bangladesh and Indonesia), we believe that our coverage set has been more aggressive in pursuing growth. It has adopted differentiated strategies to earn superior returns (see chart 1 and the discussion preceding it) and not aimed at mind-less capacity addition to target a greater share of the mass- market, which is likely to be a far less profitable strategy.

3. **Vendor consolidation by the US and European retail chains:** Our interactions with the textile industry suggest an on-going trend for vendor consolidation, especially in low involvement purchase items like terry towels. US retailers, after having outsourced a substantial portion of their sourcing to low cost off-shore bases, are now finding it difficult to manage the disaggregated supply-chain. Increasingly, they are looking at consolidating their vendor base in favour of vendors with large scale, proven delivery capabilities, own design capabilities, and low lead-time supply capabilities. This should help the retailers in; (a) focus on their core business; (b) managing their supply chain with better control and reliability; and (c) improve business ownership for vendors.

4. **Indian domestic demand, an inflection point ahead:** With the impending boom in domestic organized retail in India and continued strong growth in consumption, domestic textile manufacturers, especially garment manufacturers, clearly have another opportunity window opening up. Some of the companies we interacted with are already at various stages of negotiating/ formulating plans to tap this opportunity. Bulk of this opportunity is likely to be in the mass market segment, which manufacturers would try and exploit through putting up large-scale units. Home textile players are also seeking to forward integrate in to retail to tap this opportunity (further encouraged by the ongoing housing boom in India).

5. **Trend in cotton prices going ahead**: Cotton prices till December had been flat Y-o-Y and have shown some increase since then owing to lower production in the US, resulting in higher export demand and higher domestic demand. We expect Indian companies to end this buying season with a marginal increase in their average purchase costs over the previous year. In this context, we would like to mention that we prefer companies doing value-added sales with low susceptibility to swings in cotton prices (as is true for most of our coverage companies except Spentex, which has substantial discounts on cotton purchase in Uzbekistan).

Self sufficiency to keep domestic prices stable, mild increase expected in the current season

India is the only major producer of textiles in Asia having surplus cotton production; India has the largest cotton acreage (9.13 mn hectares) in the world. The improvement in cotton yields has marked a structural shift for cotton production in India. From being stuck between 300 kg/ha and 320 kg/ha through the 90s, yields have risen to 503 kg/ha in 2006-07 (E),achieved through the combined efforts of India's Technology Mission on Cotton (TMC) and the introduction of Bt cotton in 2002-03. India is witnessing another bumper crop in the current year with production expected to touch 4.6 mn tones in 2006-07- a 10.6% increase over the previous year. On current projections, India will surpass the US as the second largest producer of cotton in the next five years. India has moved from being the third largest destination of US cotton in CY02 to being forecast as the third largest global exporter of cotton in CY07.This abundance creates a downward pressure on cotton prices, benefiting cotton textile producers in the country as cotton accounts for 10-15% of the final cost price of the garment/made-up and 50-60% of the cost of yarn.

Although cotton prices have risen in the recent weeks, mirroring global rises and due to increased exports, strong fundamentals are likely to keep a check on this rise and give advantage vis-à-vis global prices. Also, most domestic players have done bulk of their purchases for this year, which should limit financial impact.

Table 2: India cotton balance sheet (Mn kgs)

	2003-04	2004-05	2005-06	2006-07
Acreage (mn ha)	7.61	8.92	8.82	9.13
Yield (kg/ha)	404	463	467	503
Production	3043	4131	4148	4590
Consumption	2987	3265	3689	3995
Exports	225	170	799	850
Ending stock	349	1251	979	792
Stock/ Availability ratio	9.8	26.7	17.9	14.1

Source: Cotton Advisory Board (CAB), CRISIL research

In the medium term, cotton prices will be impacted more by China's demand for imports, especially given that US exports are likely to decline. In India, the growing sufficiency partially buffers domestic prices, given that India has the largest cotton acreage and a very high (~30% lower than the world average) but narrowing yield gap, there is still some potential to increase cotton production in India, which we believe would keep prices stable. Going forward, abundant supply and stable prices of cotton would augur well for Indian textile companies, in our view.

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India Equity Research | Textile

Company Update

ALOK INDUSTRIES

INR 54

Scale play

BUY

March 20, 2007

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Massive capex across various product divisions nearing end

With its INR 23 bn capacity expansion across various product divisions nearing completion, Alok Industries (Alok) is set to become one of the largest integrated textile weaving and processing companies in India. This expansion will enhance the company's capacity 3.2x (GFA growth), giving it the required scale to compete in the global market. Alok's processing facilities are among the largest and most modern in the country, giving the company an edge over its peers in the domestic market. Going forward, the company is likely to reap the benefits of scale and diversified product portfolio comprising apparel fabric, home textiles, garments, and knitted products.

Growing exports and stronghold in the domestic market

Alok currently derives approximately 30% of its revenues from exports that is growing healthily each quarter. Its entire home textile production is exported. Further, the company has established relationships with global retailers such as *JC Penney, Elite Home Products, Walmart,* and *DKNY,* using which it intends to expand its export product profile going forward. It also has a stronghold in the domestic market through relationships with all major garment exporters. We consider Alok to be the biggest beneficiary of strong growth in apparel exports from India and rising demand for quality processed apparel fabric.

Improving return ratios and cash flows

We expect Alok to see a marked improvement in its ROE (20% in FY09E from 14% in FY06) and cash flow position on account of the tapering off of the capex cycle and benefits of integration, and scale coming in from FY09E.The company will be able to fund any future capex FY09 onwards, largely through internal accruals and minimal debt under TUF that stands extended for another five years. Thus, further dilution to fund future capex seems unnecessary.

Valuations provide strong upside

At INR 54, the stock trades at a P/E of 5.1x and 3.2x for our FY08 and FY09 EPS estimates of INR 10.7 and 17.0, respectively. We believe that these valuations (amongst the cheapest in the industry) do not entirely capture benefits accruing from the large scale capacities coming on-stream and integration benefits. These factors will drive a 28% revenue CAGR accompanied by a 34% EBITDA CAGR and 35% EPS CAGR over FY06-09E. We maintain our **'BUY'** recommendation with the belief that stock price movement will be contingent upon scale-up in capacity utilization.

Reuters	:	ALOK.BO
Bloomberg	:	ALOK IN

Market Data

52-week range (INR)	:	99 / 50
Share in issue (mn)	:	170.3
M cap (INR bn/USD mn)	:	9.2 / 209.0
Avg. Daily Vol. BSE/NSE ('000)	:	1,122.9

Share Holding Pattern (%)

Promoters	:	28.9
MFs, FIs & Banks	:	23.2
FIIs	:	37.1
Others	:	10.8

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	14,207	17,569	22,823	29,451
Growth (%)	*16.0*	*23.7*	*29.9*	*29.0*
EBITDA (INR mn)	2,961	3,940	5,497	7,083
Net profit (INR mn)	1,092	1,451	2,127	3,376
Shares outstanding	157.47	198.72	198.72	198.72
EPS (INR)	6.9	7.3	10.7	17.0
EPS growth (%)	*4.2*	*5.2*	*46.6*	*58.8*
PE (x)	7.8	7.4	5.1	3.2
EV/EBITDA (x)	8.3	6.9	6.0	4.4
ROE (%)	14.1	13.7	15.8	20.9

Financial Outlook

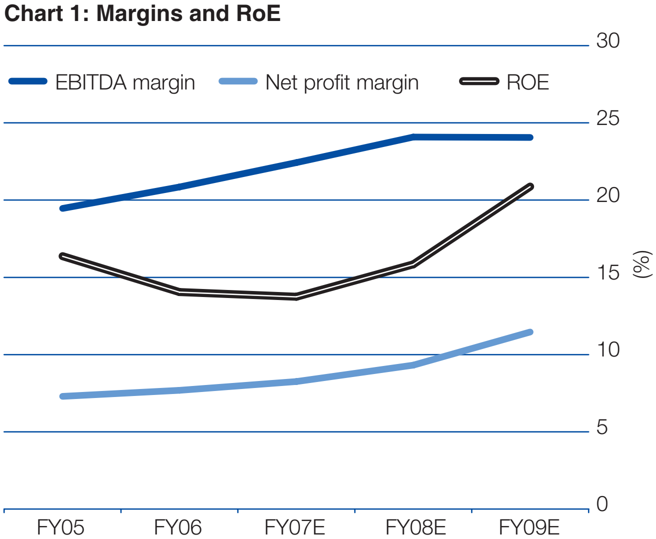
Changing product mix to boost topline

We expect revenues to grow at a CAGR of 28% over FY06-09E. Additional spinning, weaving, and processing capacities will reduce outsourcing and lead to better realizations and higher margins in the apparel fabric and bed-linen divisions.

Strong operating cash flow growth

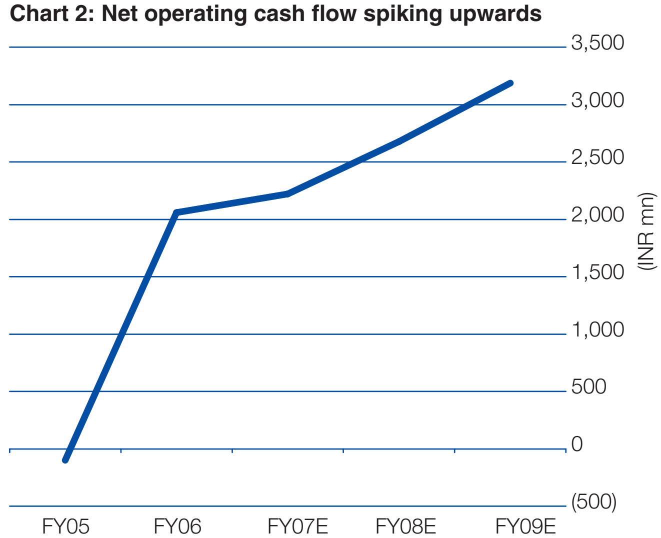
Alok's cash flows are expected to be on a strong growth trajectory going forward too, following the strong trend shift in FY06. We believe Alok will be able to finance its future capex programmes through its internal accruals and TUF funding. Alok's cash flow from operations is expected to be INR 2.7 bn and INR 3.2 bn in FY08 and FY09 respectively. Assuming a capex of INR 10 bn over 2-3 years, clearly Alok will generate enough cash internally to finance this capex with some debt funding thrown in. We therefore believe that future equity dilutions are unnecessary and, hence, unlikely.

Chart 1: Margins and RoE



Source: Edelweiss research

Chart 2: Net operating cash flow spiking upwards



Source: Edelweiss research

Improving utilizations in current capex to pull up RoCE

As Alok's expansions keep moving towards optimal utilization going forward and improvements in EBITDA and PAT margins continue, we expect strong up tick in RoE.

Company Description

Alok Industries has emerged as one of the largest textile weaving and processing players after it undertook an INR 23 bn capacity expansion. It has a diversified product mix comprising of apparel fabrics, home textile, texturized yarn, and garments. It has a strong hold in the domestic market with relationships with all major garment exporters. An increasing share of its revenues (currently ~30% overall, 100% for home textiles) comes from exports. It has one of the country's largest and modern processing facilities. Alok has made two acquisitions in Europe to bolster its marketing presence there.

Investment Theme

Alok has proactively used the TUFs benefit to set up large scale modern capacities. Its investments have resulted in a diversified product mix enabling it to cater to a variety of requirements. Alok, with its large scale facilities, fully integrated operations and a diversified rich product mix, is likely to continue to benefit from both overseas and domestic opportunities. We expect revenue CAGR of 28% and a profit CAGR of 35% over FY06-09. Further equity dilutions look unlikely with operational cash flow spiking from FY08 as well as TUF being available till FY12 now.

Key Risks

Any delay in expansion plans over and above our assumptions will be a key risk to our recommendation.

Foreign exchange fluctuation will impact the hedged positions of the company and impact profitability.

Any future equity dilution beyond the assumed 199 mn shares will be a big negative.

Financial Statements

Income statement (INR mn)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Net revenues	12,245	14,207	17,569	22,823	29,451
Manufacturing expenses	8,647	9,791	11,789	14,858	19,202
Employee expenses	194	280	538	689	870
S G & A expenditure	1,020	1,174	1,302	1,779	2,296
EBITDA	2,384	2,961	3,940	5,497	7,083
Depreciation	576	805	1,171	1,590	1,540
EBIT	1,808	2,157	2,769	3,907	5,543
Interest expenditure	637	668	818	1,024	936
Other income	64	51	50	50	50
Profit before tax	1,235	1,540	2,001	2,933	4,657
Provision for taxation	343	448	550	807	1,281
Profit after tax	892	1,092	1,451	2,127	3,376
Recurring net profit	892	1,092	1,451	2,127	3,376
Reported profit	892	1,092	1,451	2,127	3,376
EPS (INR) fully diluted	6.7	6.9	7.3	10.7	17.0
CEPS (INR) fully diluted	11.0	12.0	13.2	18.7	24.7
Dividend per share	1.9	1.6	-	-	-

Common size metrics as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Manufacturing expenses	70.6	68.9	67.1	65.1	65.2
Employee expenses	1.6	2.0	3.1	3.0	3.0
S G &A expenses	8.3	8.3	7.4	7.8	7.8
Depreciation	4.7	5.7	6.7	7.0	5.2
Interest expenditure	5.2	4.7	4.7	4.5	3.2
EBITDA margin	19.5	20.8	22.4	24.1	24.1
EBIT margin	14.8	15.2	15.8	17.1	18.8
Net profit margin	7.3	7.7	8.3	9.3	11.5

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Net revenues	14.6	16.0	23.7	29.9	29.0
EBITDA	23.9	24.2	33.1	39.5	28.9
EBIT	17.4	19.3	28.4	41.1	41.9
Net profit	25.6	22.4	32.8	46.6	58.8
EPS	61.1	4.2	5.2	46.6	58.8

Balance sheet (INR mn)

As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Share capital	2,217	2,255	1,987	1,987	1,987
Equity share capital	1,340	1,575	1,987	1,987	1,987
Preference share capital	843	680	-	-	-
Share warrants	33	-	-	-	-
Reserves	4,607	6,501	10,373	12,500	15,876
Secured loans	12,395	18,002	21,000	26,000	26,000
Unsecured loans	794	3,443	-	-	-
Deferred tax liability	751	1,001	1,401	1,988	2,919
Sources of funds	**20,764**	**31,201**	**34,762**	**42,475**	**46,783**
Gross assets	8,694	14,034	25,000	28,000	28,000
Less: Depreciation	1,683	2,477	3,648	5,238	6,778
Net fixed assets	7,011	11,558	21,352	22,762	21,222
Capital WIP	1,782	7,185	1,000	6,000	6,000
Investments	79	397	397	897	1,897
Current assets	13,592	14,039	14,697	16,302	22,163
Debtors	4,030	3,545	4,573	5,628	7,262
Cash and bank balance	4,968	5,330	4,479	3,655	5,842
Inventory	3,633	3,582	4,573	5,628	7,262
Current liabilities	1,699	1,977	2,684	3,487	4,499
Creditors	1,397	1,540	2,684	3,487	4,499
Other liabilities	71	173	-	-	-
Provisions	232	263	-	-	-
Uses of funds	**20,764**	**31,201**	**34,762**	**42,475**	**46,783**
BV (INR)	51	56	62	73	90

Cash flow statement (INR mn)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Cash flow from operations	1,430	1,866	3,022	4,303	5,848
Cash for working capital	1,531	(193)	802	1,627	2,660
Net operating cash flow (A)	(101)	2,059	2,220	2,676	3,187
Net purchase of fixed assets	3,573	10,755	4,781	8,000	-
Net purchase of investments	38	319	-	500	1,000
Net cash flow for investing (B)	3,611	11,073	4,781	8,500	1,000
Proceeds from LTB/STB	5,005	8,256	(445)	5,000	-
Dividend payments/increase in capital	2,317	1,154	2,155	-	-
Net cash flow from financing	7,322	9,409	1,710	5,000	-
Free cash flow	**(3,674)**	**(8,695)**	**(2,561)**	**(5,324)**	**3,187**

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROE (%)	16.4	14.1	13.7	15.8	20.9
ROCE (%)	11.2	8.5	8.5	10.2	12.5
Debtors days	120	91	95	90	90
Inventory days	108	92	95	90	90
Fixed assets t/o	1.4	1.0	0.9	0.9	1.1
Debt/equity	1.2	1.8	1.3	1.5	1.1
Inerest coverage	2.9	3.3	3.4	3.9	6.0

Valuation parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS (diluted) (INR)	6.7	6.9	7.3	10.7	17.0
Y-o-Y growth (%)	*61.1*	*4.2*	*5.2*	*46.6*	*58.8*
CEPS	11.0	12.0	13.2	18.7	24.7
PE (x)	8.1	7.8	7.4	5.1	3.2
FCFPS (INR)	(27.7)	(57.2)	(12.9)	(29.3)	11.0
Price/BV (x)	1.1	1.0	0.9	0.7	0.6
EV/sales (x)	1.3	1.7	1.6	1.5	1.0
EV/EBITDA (x)	6.5	8.3	6.9	6.0	4.4
Dividend yield(%)	28.0	22.3	0.0	0.0	0.0

Edelweiss
Ideas create, values protect

BOMBAY RAYON FASHIONS

INR 160

Strong growth on robust fundamentals

BUY

March 20, 2007

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Rapid build-up in capacity resulting in strong growth

Bombay Rayon Fashion (BRFL) is the only garment manufacturer in India with strong expertise in fabric development. The company is adding aggressively to its fabric and garmenting capacities and is also integrating backwards into yarn dyeing and fabric processing, to become an integrated garment manufacturer. BRFL has also announced another huge expansion plan which will take its fabric capacity to 120 MMPA and garments capacity to 150,000 pieces/day by the end of 2007. This increases the visibility on growth going forward.

Robust business model, established relationships provide an edge

BRFL's expertise in fashion fabric development and its design capabilities result in higher realizations. Its short turnaround time (65 days) also helps as turn around time is a critical factor in the fashion industry which faces contracting fashion cycles. These, along with strong customers like *Liz Clairborne, DKNY, Tom Taylor, Next, C&A, Wrangler, Federated Stores*, etc. will, we believe, help BRFL earn superior margins amongst garment manufacturers.

Over all growth best in class

We expect BRFL's PAT to grow at a CAGR of 128% over FY06-09E, continuing the current traction. The stock has corrected a lot recently and at a CMP of INR 160, it trades at a P/E of 10.5x and 5.6x our FY08E and FY09E revised EPS estimates of INR 15.2 and 28.7, respectively (fully diluted). We maintain our **'BUY'** recommendation based on continued momentum in earnings growth.

Reuters	:	BRFL.BO
Bloomberg	:	BRFL IN

Market Data

52-week range (INR)	:	276 / 104
Share in issue (mn)	:	49.0
M cap (INR bn/USD mn)	:	7.9 / 178.2
Avg. Daily Vol. BSE/NSE ('000)	:	939.2

Share Holding Pattern (%)

Promoters	:	55.9
MFs, FIs & Banks	:	7.0
FIIs	:	14.1
Others	:	23.1

Financials

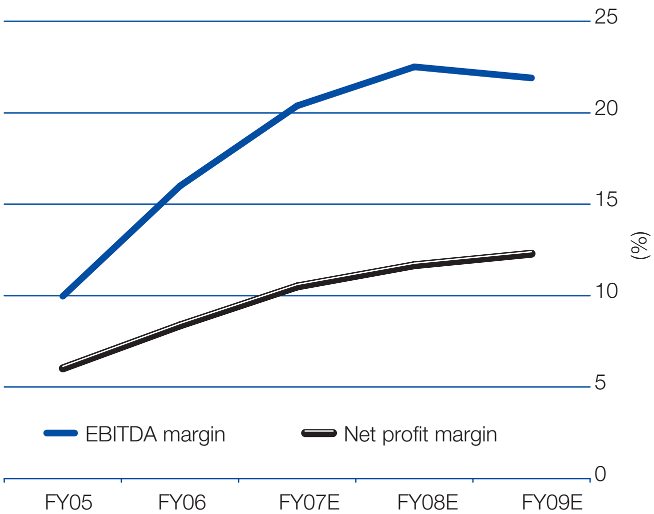
Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	1,990	4,673	9,024	16,141
Growth (%)	*91.6*	*134.9*	*93.1*	*78.9*
EBITDA (INR mn)	318	953	2,031	3,536
Net profit (INR mn)	167	490	1,053	1,983
Shares outstanding (mn)	49	63	69	69
EPS (INR)	3.4	7.8	15.2	28.7
EPS growth (%)	*81*	*127*	*96*	*88*
PE (x)	46.8	20.6	10.5	5.6
EV/EBITDA (x)	27.3	12.0	6.4	3.5
ROE (%)	16.9	15.4	18.1	26.4

Financial Outlook

Capacity addition to drive growth

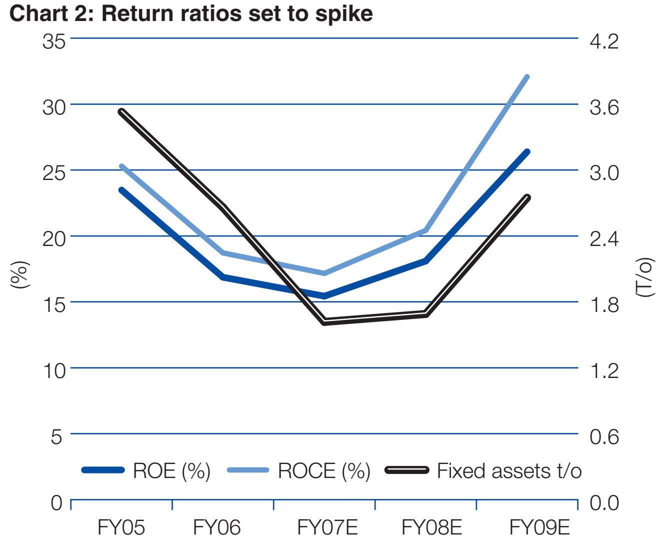
BRFL is likely to benefit from continued expansion in its fabric processing and garment manufacturing capacities through FY08. As a result, the company is likely to expand its operating margin (due to leverage benefits) and net margin (due to capital costs getting spread over a larger revenue base). With asset turns too likely to improve going forward, as the expanded capacities attain scale, we expect strong improvements in return ratios going forward.

Chart 1: Margins growth over the years



Source: Edelweiss research

Chart 2: Return ratios set to spike



Source: Edelweiss research

Company Description

BRFL has been one of the most ambitious Indian textile companies to take advantage of the removal of quotas from 2005 onwards. It has added garments as a product segment from 2005, besides growing its fabric capacity. This has resulted in its revenues doubling every year since FY04 and profits multiplying at a much faster rate. It has focused on developing design capabilities, vertical integration and lower lead-time production to push up ASPs of its products. It offers industry highest RoCE, growth and profitability margin.

Investment Theme

BRFL is one of the best in class in the textile space—a unique business model offering a high growth play (PAT expected to grow at a CAGR of 128% for FY06-09E) coupled with proven delivery capabilities, and available at attractive valuations. Amongst our basket of textile stocks, it has been among the few which have consistently delivered on the great expectations that had been built-up in the investor community post the quota removal. The recently announced expansion plans of the company add to the visibility on further growth prospects. At INR 172, the stock trades at 11.3x and 6.0x of our FY08E and FY09E revised EPS estimates of INR 15.2 and 28.7, respectively (fully diluted)).

Key Risks

Any major delays in capacity addition plans.

Any major demand slow-down in the end consumer countries resulting in dip in realizations.

Over capacity and hence, over-supply build-up in the global garment manufacturing industry.

Garmenting being a labor intensive industry, BRFL may find it difficult to keep expanding its man-power base at a fast enough pace in sync with its capacity growth.

Financial Statements (Consolidated)

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1,039	1,990	4,673	9,024	16,141
Manufacturing expenses	847	1,438	3,006	5,130	9,038
Employee expenses	23	102	404	1,234	2,520
S G & A expenditure	65	132	310	630	1,047
EBITDA	104	318	953	2,031	3,536
Depreciation	19	29	114	366	468
EBIT	85	289	839	1,664	3,068
Interest expenditure	26	64	129	126	129
Other income	24	14	30	50	50
Profit before tax	82	238	739	1,588	2,989
Provision for taxation	19	71	249	535	1,006
Minority interest	-	-	-	-	-
Profit after tax	63	167	490	1,053	1,983
Recurring net profit	63	167	490	1,053	1,983
Extraordinary items	(0)	1	-	-	-
Reported profit	62	168	490	1,053	1,983
EPS (INR)	1.9	3.4	7.8	15.2	28.7
CEPS (INR)	2.5	4.0	9.6	20.5	35.5

Common size metrics as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	81.6	72.2	64.3	56.8	56.0
Employee expenses	2.2	5.1	8.7	13.7	15.6
S G &A expenses	6.2	6.6	6.6	7.0	6.5
Depreciation	1.8	1.5	2.4	4.1	2.9
Interest expenditure	2.5	3.2	2.8	1.4	0.8
EBITDA margin	10.0	16.0	20.4	22.5	21.9
EBIT margin	8.2	14.5	17.9	18.4	19.0
Net profit margin	6.0	8.4	10.5	11.7	12.3

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	107.3	91.6	134.9	93.1	78.9
EBITDA	147.8	207.5	199.3	113.1	74.1
EBIT	136.3	241.1	190.4	98.5	84.3
Net profit	420.4	168.8	191.9	114.9	88.2
EPS	(21.1)	80.9	126.9	95.9	88.2

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	330	490	630	691	691
Reserves	129	1,044	4,191	6,130	7,519
Shareholders funds	459	1,534	4,821	6,821	8,210
Secured loans	266	841	2,750	2,300	2,000
Unsecured loans	6	109	-	-	-
Deferred tax liability	3	15	51	51	52
Sources of funds	**735**	**2,498**	**7,622**	**9,173**	**10,263**
Gross assets	321	784	3,784	6,684	6,684
less accumulated depreciation	69	97	211	577	1,045
Net fixed assets	252	687	3,573	6,106	5,639
Capital WIP	42	515	1,000	-	1
Investments	1	100	150	200	250
Current assets	685	1,585	3,847	4,634	7,584
Debtors	208	346	896	1,731	3,096
Cash and bank balance	9	117	1,427	425	750
Inventory	384	834	1,024	1,978	3,538
Advances	84	288	500	500	200
Other current assets	-	-	-	-	-
Current liabilities	250	389	947	1,768	3,211
Creditors	186	294	947	1,768	3,211
Other liabilities	31	9	-	-	-
Provisions	33	86	-	-	-
Working capital	436	1,196	2,900	2,866	4,373
Misc expenditure	4	-	-	-	-
Uses of funds	**735**	**2,498**	**7,622**	**9,173**	**10,263**
BV (INR)	14	31	77	99	119

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	73	158	494	1104	1857
Cash for working capital	364	652	394	968	1,182
Net operating cash flow (A)	(291)	(494)	100	136	675
Net purchase of fixed assets	261	937	3,485	1,900	1
Net purchase of investments	-	99	50	50	50
Net cash flow for investing (B)	261	1,036	3,535	1,950	51
Proceeds from LTB/STB	232	677	1,800	(450)	(300)
Change in equity	310	949	2,944	1,263	1
Net cash flow from financing	542	1,626	4,744	813	(299)
Free cash flow	**(552)**	**(1,431)**	**(3,385)**	**(1,764)**	**674**

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	23.5	16.9	15.4	18.1	26.4
ROCE (%)	25.3	18.7	17.2	20.4	32.1
Debtors Days	73.1	63.5	70.0	70.0	70.0
Inventory Days	134.9	152.9	80.0	80.0	80.0
Fixed assets t/o	3.5	2.7	1.6	1.7	2.7
Debt/equity	0.6	0.5	0.3	0.3	0.2
Inerest coverage	4.1	4.7	6.7	13.6	24.2

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	1.9	3.4	7.8	15.2	28.7
Y-o-Y growth (%)	*(21.1)*	*80.9*	*126.9*	*95.9*	*88.2*
CEPS	2.5	4.0	9.6	20.5	35.5
PE (x)	84.6	46.8	20.6	10.5	5.6
FCFPS (INR)	(16.7)	(31.2)	(54.5)	(26.3)	9.0
Y-o-Y growth (%)	*(776.4)*	*86.5*	*74.6*	*(51.8)*	*NA*
Price/BV	11.5	5.1	2.1	1.6	1.3
EV/sales	5.3	4.4	2.4	1.4	0.8
EV/EBITDA	53.6	27.3	12.0	6.4	3.5
Dividend yield (%)	-	0.6	1.9	4.0	7.6

Himatsingka Seide

INR 115

Unique business model justifies premium valuation

BUY

March 20, 2007

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Bed linen business: Made in India, sold in Europe

Himatsingka Seide (HSL) is poised to enter the high-end cotton bed linen business with the acquisition of Bellora. We believe this business will supplement HSL's core silk furnishings business. Through the Bellora acquisition, HSL is not only playing the entire fabric-to-retail value chain, but also getting the best of both worlds through low-cost manufacturing in India and selling the produce as high-end products through Italian and other European boutiques. Because of its size and continued focus on luxury products, HSL is uniquely placed to go for this business model which cannot be replicated by other bed linen majors as they produce more mass market products which sell through large retailers. We have factored in RoIC of 11-12.5% for the overseas retail/brands acquisitions. HSL has acquired a 70% equity stake in the EUR 29.8 mn (FY06 revenue) *Bellora* for EUR 11.5 mn at an EV/ Revenue of 0.67. We believe the synergistic benefits justify the premium.

Returns to spike over the next two years leading to high earnings growth

With the bed linen facility at Hasan starting operations from April and gradually acquiring scale, we expect HSL's asset turns and hence RoCEs to spike strongly upwards from their FY07 lows (see chart overleaf). This will further be aided by the fact that bulk of the capacity is likely to be sold through the acquired stores (Bellora and future acquisitions). We expect HSL's earnings to grow at a CAGR of ~47% over FY07-09E. Moreover, HSL's retail business (HWPL) has been reporting strong growth and some upside is expected from it as well, going forward.

Unique business model, strong long-term play on high yield business

At CMP of 115, HSL is trading at a P/E of 13.4x and 8.8x our FY08E and FY09E EPS, respectively, which is at premium to other textile stocks. We believe that the unique/non-replicable business model and high RoE of 18.3% in FY09E justifies the premium. The key factor which will drive earnings growth and upsides from current valuations will be HSL's ability to derive high returns on the on-going European acquisitions. We maintain our '**BUY**' recommendation on HSL on likely benefits from the bed linen project and forward integration into retail and brands.

Reuters	:	HMSD.BO
Bloomberg	:	HSS IN

Market Data

52-week range (INR)	:	172 / 82
Share in issue (mn)	:	97.4
M cap (INR bn/USD mn)	:	11.2 / 254.5
Avg. Daily Vol. BSE/NSE ('000)	:	80.5

Share Holding Pattern (%)

Promoters	:	50.4
MFs, FIs & Banks	:	12.4
FIIs	:	13.9
Others	:	23.2

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	1,509	1,784	3,947	5,539
Growth (%)	*9.4*	*18.2*	*121.2*	*40.4*
EBITDA	518	579	1,067	1,569
Net profit (INR mn)	483	592	836	1,279
Shares outstanding	97.4	97.4	97.4	97.4
EPS (INR)	5.0	6.1	8.6	13.1
EPS growth (%)	*4.1*	*22.6*	*41.2*	*52.9*
PE (x)	23.2	18.9	13.4	8.8
EV/EBITDA (x)	16.8	18.8	12.4	8.2
ROE (%)	11.2	10.0	13.2	18.3

Addendum: About Bellora acquisition

HSL has recently acquired a 70% equity stake in Giuseppe Bellora SpA, Italy at a EV/ Sales multiple of ~0.7. Established in 1883, *Bellora* is a pan-European luxury brand in the bed linen segment. Apart from exclusive stores in Italy and other parts of Europe such as Spain, Portugal, Switzerland, Germany, and France, the brand has a presence in up market departmental stores like *Harrods* (London), *La Rinascente* (Milan), *Bonne Marche* (Paris), among others.

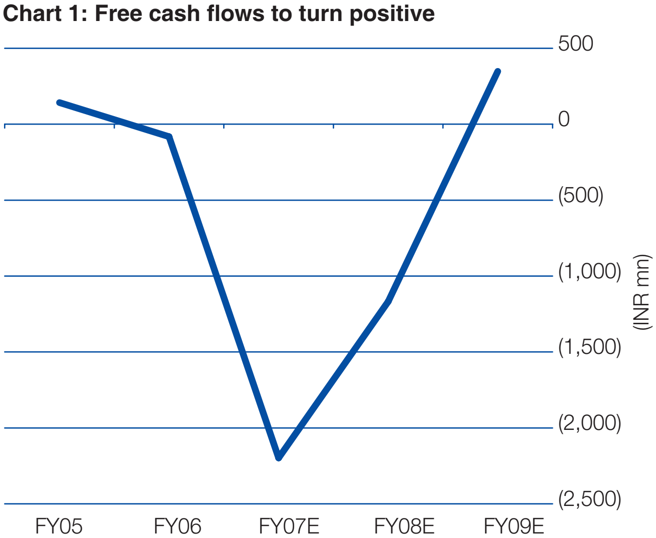
During 2006, *Bellora* generated revenues of about Euros 29 mn and is a profit making entity. It has 17 own stores—most of them in Italy—and also in Spain and Portugal. 60% of sales were through their own stores in FY06, the rest were through high-end multi-brand retail stores and franchisee stores. 90% of its sales are in bed linen (mostly cotton and linen) and the rest in bath products, including robes and bathing liquids.

The current owners have an option to sell the remaining 30% in two tranches of 15% each at the end of the second year and the fifth year from the close of the acquisition. We expect HSL to derive synergy benefits through low cost sourcing from its own bed-linen facility thus driving Bellora's margin upwards. We expect this and the other acquisitions to be done to give returns of 10-12% on the invested capital.

Financial Outlook

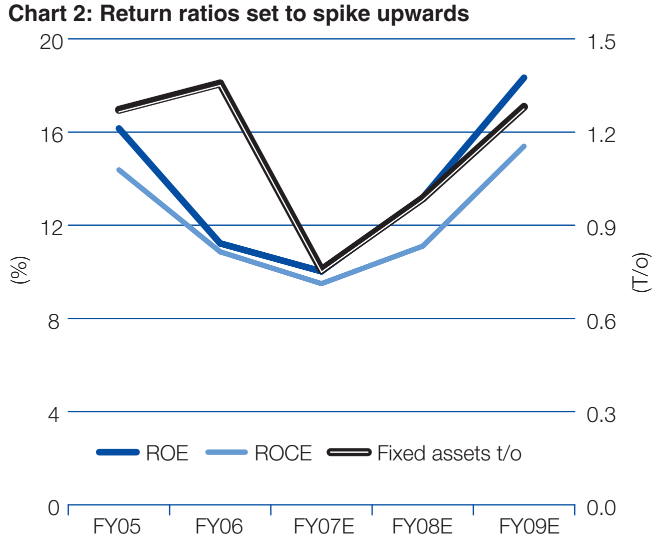
HSL is close to the end of its current capex phase with the bed linen project coming on-stream and the European acquisitions close to being finalised over the coming two quarters. This should result in increase in return ratios going forward as asset turns spike from their current lows.HSL is also expected to start generating positive free cash flows from FY09 onwards which should help it finance part of its future capex. It also has a low leverage of 0.3, and hence should be able to use the now extended TUF scheme if need be.

Chart 1: Free cash flows to turn positive



Source: Edelweiss research

Chart 2: Return ratios set to spike upwards



Source: Edelweiss research

Company Description

Himatsingka Seide (HSL) is India's premium silk furnishings manufacturer/ exporter. The company has historically delivered excellent margins (historical EBITDA margin of up to 40%). HSL is a niche player with strong designing skills for manufacturing premium silk fabrics as also a strong global customer base (exports account for more than 85-90% of its revenues). While the silk furnishings business is expected to grow at a steady 8-10 % going forward, HSL is currently focusing on cotton bed-linen manufacturing (through a project at the Hassan SEZ) as well as retail (through acquisition of brand and retail companies in Europe). It has also entered into a luxury home furnishings retail initiative through its Atmosphere stores which is its wholly owned subsidiary-Himatsingka wovens private ltd. It will soon have 15 stores in India and one in Dubai.

Investment Theme

HSL historically has had very high margins as well as RoCEs (~18%) because of its presence in the premium segment of the market. It did a GDR of USD 60 mn in FY06 for acquisitions in Europe and took TUF sanctions for its bed-linen manufacturing project. Since then, it has been sitting on a lot of cash (INR 3500 mn as of now). This cash when deployed, through the bed-linen project and the European acquisitions, is expected to push its RoCE back close to the historical levels of premium brand & retail. We believe the on-going expansion in bed-linen, retail acquisitions in Europe and *Atmosphere* will keep earnings growing at the steady pace, with a likely spike in FY09E. We expect an EPS CAGR of ~38% over FY06-09E and the stock price to track this growth.

Key Risks

Any decrease in its contribution margin in the core silk furnishing business either due to pricing pressure or raw material (yarn) price increases.

Lower-than-expected returns from the expansion and acquisitions.

Financial Statements

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1,380	1,509	1,784	3,947	5,539
Manufacturing expenses	523	638	769	1,824	2,665
Employee expenses	159	183	223	549	736
S G & A expenditure	139	170	214	507	569
EBITDA	559	518	579	1,067	1,569
Depreciation	125	138	161	355	400
EBIT	434	380	418	712	1,169
Interest expenditure	12	11	5	37	70
Other income	65	143	255	267	342
Profit before tax	488	512	667	942	1,441
Provision for taxation	32	29	75	106	162
Profit after tax	456	483	592	836	1,279
Recurring net profit	456	483	592	836	1,279
Extraordinary items/ Prior period items	(8)	-	-	-	-
Reported profit	448	483	592	836	1,279
EPS (INR) fully diluted	4.8	5.0	6.1	8.6	13.1
CEPS (INR) fully diluted	6.0	6.4	7.7	12.2	17.2
Dividend per share	2.0	2.5	2.4	3.4	5.3
Dividend payout ratio (%)	32.5	39.3	31.5	28.1	30.5

Common size metrics as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	37.9	42.3	43.1	46.2	48.1
Employee expenses	11.6	12.1	12.5	13.9	13.3
S G &A expenses	10.0	11.3	12.0	12.8	10.3
Depreciation	9.0	9.1	9.0	9.0	7.2
Interest expenditure	0.9	0.8	0.3	0.9	1.3
EBITDA margin	40.5	34.3	32.4	27.0	28.3
EBIT margin	31.5	25.2	23.4	18.0	21.1
Net profit margin	33.0	32.0	33.2	21.2	23.1

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1.8	9.4	18.2	121.2	40.4
EBITDA	(0.2)	(7.4)	11.8	84.4	47.1
EBIT	5.2	(12.5)	10.0	70.3	64.3
Net profit	(11.4)	7.9	22.6	41.2	52.9
EPS	(8.2)	4.1	22.6	41.2	52.9

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	191	487	487	487	487
Reserves	2,680	5,249	5,604	6,106	6,874
Shareholders funds	2,872	5,736	6,092	6,593	7,361
Secured loans	585	398	1,898	3,000	2,625
Deferred tax liability	18	27	27	27	27
Sources of funds	3,475	6,160	8,016	9,620	10,012
Gross assets	1,999	2,152	4,152	6,152	6,352
Less: Depreciation	1,078	1,212	1,373	1,728	2,128
Net fixed assets	921	940	2,779	4,424	4,224
Capital WIP	164	200	800	-	-
Investments	1,643	1,266	1,266	2,416	2,416
Current assets	1,092	4,187	3,592	3,315	3,992
Debtors	232	306	293	649	911
Cash and bank balance	147	2,922	2,224	1,009	981
Inventory	294	425	440	973	1,366
Advances	420	534	634	684	734
Current liabilities	345	442	430	544	628
Creditors	52	93	81	195	280
Other liabilities	10	12	12	12	12
Provisions	283	337	337	337	337
Working capital	747	3,745	3,161	2,771	3,363
Misc expenditure	-	9	9	9	9
Uses of funds	3,475	6,160	8,016	9,620	10,012
BV (INR)	29	59	63	68	76

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	371	334	516	857	1,167
Cash for working capital	103	223	114	825	620
Net operating cash flow (A)	268	111	402	32	547
Net purchase of fixed assets	(125)	(193)	(2,600)	(1,200)	(200)
Net purchase of investments	(460)	377	-	(1,150)	-
Net cash flow from investing (B)	(585)	184	(2,600)	(2,350)	(200)
Proceeds from LTB/STB	447	(188)	1,500	1,103	(375)
Proceeds from equity /Dividend payments	-	2,709	(2,640)	-	-
Net cash flow from financing	447	2,522	(1,140)	1,103	(375)
Free cash flow	**143**	**(82)**	**(2,198)**	**(1,168)**	**347**

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE	16.2	11.2	10.0	13.2	18.3
ROCE	14.4	10.9	9.5	11.1	15.4
Debtors days	61.3	74.1	60.0	60.0	60.0
Inventory days	77.8	102.8	90.0	90.0	90.0
Fixed assets t/o	1.3	1.4	0.8	1.0	1.3
Debt/equity	0.2	0.1	0.3	0.5	0.4
Inerest coverage	41.8	45.5	122.9	26.6	21.5

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	4.8	5.0	6.1	8.6	13.1
Y-o-Y growth (%)	*(8.2)*	*4.1*	*22.6*	*41.2*	*52.9*
CEPS	6.0	6.4	7.7	12.2	17.2
PE (x)	24.2	23.2	18.9	13.4	8.8
FCFPS (INR)	1.5	(0.8)	(22.6)	(12.0)	3.6
Y-o-Y growth (%)	*19.2*	*(157.5)*	*2572.9*	*(46.9)*	*(129.7)*
Price/BV	3.9	2.0	1.8	1.7	1.5
EV/sales	1.2	5.8	6.1	3.3	2.3
EV/EBITDA	3.1	16.8	18.8	12.4	8.2
Dividend yield (%)	1.7	2.2	2.1	3.0	4.6

India Equity Research | Textile

Company Update

Spentex Industries

INR 59

Smart growth

BUY

Edelweiss
Ideas create, values protect

March 20, 2007

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Smart growth strategies

Spentex has been acquiring distressed spinning assets at cheap valuations, to benefit from spindles' long operating life (~30 years). By these means the company has become one of the largest spinning companies based out of India, with ~550,000 spindles across India and Uzbekistan. Spentex, through its established operational processes and strong relationships with customers (being a textile trader for 30 years), has been able to turnaround most of these assets to normalize their efficiencies in a short time span. We expect Spentex to continue on this growth strategy going forward.

Uzbekistan acquisition is especially lucrative

Spentex's recent acquisition in Uzbekistan (220,000 spindles and 236 air jet looms) will improve its performance further. Raw material benefits and lower operating costs in Uzbekistan combined with Spentex's track record of integrating acquisitions is likely to enhance its profitability. It has already scaled up performance of the two units significantly achieving ~80% utilisation level.

Financials expected to improve

Spentex's topline has been growing strongly on account of the new acquisitions. Going forward, strong Q-o-Q topline growth is likely to come from the Baramati expansion coming on-stream and Ahmedabad unit beginning to deliver profits, as it continues to scale-up. Scale-up of the Uzbekistan operations will also contribute to the topline growth. With improvement in utilisation levels of the spinning mills, margins will likely expand and assets turnover will likely improve. A low capital base (due to acquisition of capacities at inexpensive valuations) is likely to lead to spike in return ratios too.

Valuations: Ample scope for re-rating

Spentex trades at a P/E of 5.6x and 5.3x on consolidated EPS of INR 10.5 and INR 11.2 for FY08E and FY09E, respectively. Considering its aggressive growth, diversified risk profile, and higher RoEs, we believe its valuations have room for expansion, as the company's acquisitions are integrated.

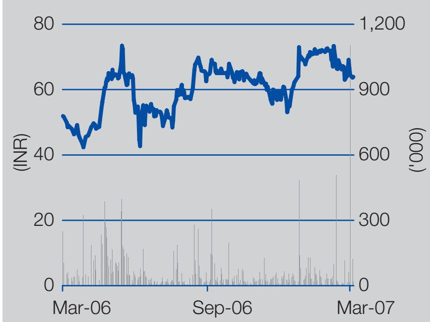
Reuters	:	SPTI.BO
Bloomberg	:	SPTI IN

Market Data

52-week range (INR)	:	77 / 38
Share in issue (mn)	:	66.7
M cap (INR bn/USD mn)	:	3.9 / 89.0
Avg. Daily Vol. BSE ('000)	:	69.4

Share Holding Pattern (%)

Promoters	:	45.8
MFs, FIs & Banks	:	6.0
FIIs	:	38.5
Others	:	9.7



Financials (Consolidated — Incl. Uzbekistan)

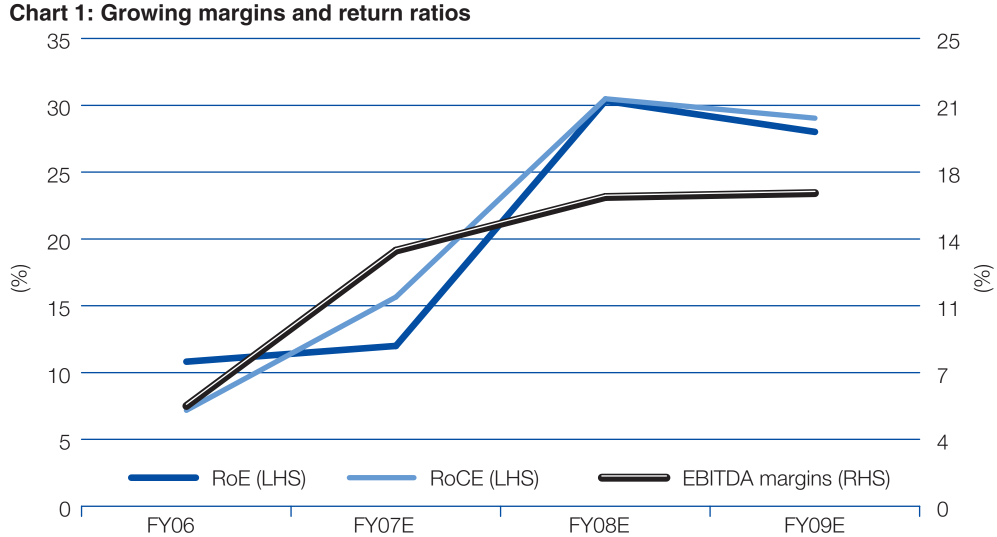
Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	3,523	10,153	14,530	14,853
Growth (%)	*(3.3)*	*188.2*	*43.1*	*2.2*
EBITDA	185	1,359	2,353	2,436
Net profit (INR mn)	101	254	753	801
Shares outstanding	57.5	71.5	71.5	71.5
EPS (INR)	1.4	3.5	10.5	11.2
EPS growth (%)	*(2.9)*	*152.3*	*197.0*	*6.3*
PE (x)	41.8	16.6	5.6	5.3
EV/EBITDA (x)	25.4	8.3	5.3	5.2
ROE (%) (Standalone)	10.8	11.2	16.0	14.1

Financial Outlook

Strong surge in return ratios expected

Based on Spentex's current set of capacities, we expect it to deliver one of the best return ratios in the textile industry. We expect RoCE of ~20% and RoE of ~28% in FY09 on the consolidated operations (including Uzbekistan). This is primarily on the back of: (a) a low capital base due to acquisition of capacities at inexpensive valuations, (b) raw material cost subsidy, advantages in terms of power, and labour costs as well as tax benefits in Uzbekistan; and (c) likelihood of improvement in utilizations of the acquired assets, which will strengthen margins and asset turnover.

Chart 1: Growing margins and return ratios



Source: Edelweiss research

Company Description

Spentex Industries Limited (Spentex) is engaged in the production of cotton, synthetic, and blended yarns. Since its acquisition by CLC Group in January 2004, Spentex has diversified into spinning from its earlier trading focus. It has continued to add capacity through the inorganic route- wherein it has identified and acquired productive assets which were being under-utilized at a 30-50% discount to replacement cost. It has thus built up a capacity of 550,000 spindles, including the latest acquisition in Uzbekistan which is also its largest at 220,000 spindles and 236 air jet looms. Spentex also has significant cost advantages in Uzbekistan through considerations from the Uzbek government including a 15% subsidy on cotton (raw material), lower power and labor costs and lower tax rate at 6%. After acquiring the assets, Spentex turns around the productivity of these assets fast to optimum (~90%) levels within a period of 3-6 months, thereby making them profitable.

Investment Theme

Spentex has been able to scale up its spinning operations at a faster rate than any other Indian player through its inorganic growth route. Since, spinning machinery has productive life of 30-40 years, Spentex is able to get a long enough life by acquiring even 10 year old spindles (age of its acquired spindles ranges from 8-10 years). Since it buys these assets at a low cost, it is able to generate a higher RoCE than its peers. Also, the subsidies and tax break in Uzbekistan (which at 220,000 spindles is a significant chunk of its 550,000 spindles capacity) will add to its profitability and RoCE, which at a consolidated level should be amongst the highest in the Indian textiles space.

Key Risks

Any significant increases in prices of raw material (cotton and PSF/ VSF) would impact its profitability adversely.

Political risk owing to presence in Uzbekistan- Any big political change leading to withdrawal/ reduction of the benefits will impact its profitability.

Financial Statements (Standalone — India)

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	3,644	3,523	8,494	9,912	9,976
Manufacturing expenses	3,252	3,044	6,725	7,779	7,807
Employee expenses	72	97	268	341	358
S G & A expenditure	168	196	491	523	543
EBITDA	151	185	1,050	1,309	1,308
Depreciation	60	76	421	410	412
EBIT	91	109	629	899	896
Interest expenditure	84	81	397	411	398
Other income	87	105	40	40	40
Profit before tax	93	133	273	528	538
Provision for taxation	(10)	32	63	121	124
Minority interest	-	-	16	38	38
Profit after tax	103	101	194	368	376
Recurring net profit	103	101	194	368	376
Extraordinary items	-	-	-	-	-
Reported profit	103	101	194	368	376
EPS (INR) fully diluted	1.4	1.4	2.7	5.2	5.3
CEPS (INR) fully diluted	14.7	3.1	8.6	10.9	11.0
Consolidated EPS (INR) fully diluted	1.4	1.4	3.5	10.5	11.2
Dividend per share	-	-	-	-	-
Dividend payout ratio (%)	-	-	-	-	-

Common size metrics as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	89.3	86.4	79.2	78.5	78.3
Employee expenses	2.0	2.8	3.2	3.4	3.6
S G &A expenses	4.6	5.6	5.8	5.3	5.4
Depreciation	1.7	2.1	5.0	4.1	4.1
Interest expenditure	2.3	2.3	4.7	4.1	4.0
EBITDA margin	4.1	5.2	12.4	13.2	13.1
EBIT margin	2.5	3.1	7.4	9.1	9.0
Net profit margin	2.8	2.9	2.3	3.7	3.8

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	902.7	(3.3)	141.1	16.7	0.6
EBITDA		22.6	467.9	24.7	(0.1)
EBIT		20.7	475.4	42.9	(0.3)
Net profit		(2.9)	93.2	89.6	2.1
EPS		(2.9)	93.2	89.6	2.1

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	372	575	715	715	715
Reserves	145	768	1,399	1,768	2,144
Shareholders funds	517	1,342	2,114	2,482	2,858
Secured loans	722	1,106	4,106	3,806	3,806
Unsecured loans	70	599	607	619	619
Minority interest	-	-	89	127	165
Sources of funds	**1,309**	**3,047**	**6,916**	**7,034**	**7,449**
Gross assets	1,069	1,189	5,594	5,624	5,654
less Depreciation	443	516	2,864	3,173	3,484
Net fixed assets	626	673	2,730	2,451	2,170
Capital WIP	66	760	10	10	10
Net goodwill	-	-	907	807	706
Investments	0.2	561	565	902	1,238
Current assets	934	1,432	3,014	3,237	3,756
Debtors	407	226	349	407	410
Cash and bank balance	76	385	234	0	450
Inventory	300	535	2,094	2,444	2,460
Advances	151	286	336	386	436
Current liabilities	317.92	377	310	372	431
Creditors	293	304	269	269	265
Other liabilities	25	74	41	103	166
Working capital	616	1,054	2,704	2,865	3,324
Uses of funds	**1,309**	**3,047**	**6,916**	**7,034**	**7,449**
BV (INR)	47	23	26	31	36

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	164.2	196	663	879	889
Cash for working capital	(39.8)	149	1,832	458	72
Net operating cash flow (A)	124.4	47	(1,169)	420	817
Net purchase of fixed assets	(96.4)	816	2,563	30	30
Net purchase of investments	0.2	560	4	337	337
Net cash flow from investing (B)	(96.2)	1,376	2,567	367	367
Proceeds from LTB/STB	(96.4)	912	3,008	(288)	-
Dividend payments/Equity buyback	(96.4)	725	577	-	-
Net cash flow from financing	(192.7)	1,637	3,586	(288)	-
Free cash flow	28.1	(768)	(3,732)	390	787

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	20.0	10.8	11.2	16.0	14.1
ROCE (%)	13.6	5.0	12.6	12.9	12.4
Debtors Days	40.8	23.4	15.0	15.0	15.0
Inventory Days	30.1	55.4	90.0	90.0	90.0
Fixed assets t/o (x)	5.3	3.3	4.1	3.8	4.3
Debt/equity (x)	1.5	1.3	2.2	1.8	1.5
Inerest coverage (x)	2.1	2.6	1.7	2.3	2.4

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	1.4	1.4	2.7	5.2	5.3
Y-o-Y growth (%)		*(2.9)*	*93.2*	*89.6*	*2.1*
Consolidated EPS (diluted) (INR)			3.5	10.5	11.2
Y-o-Y growth (%)				*197.0*	*6.3*
PE (x)	40.6	41.8	21.7	11.4	11.2
Consolidated PE (x)			16.6	5.6	5.3
Price/BV		2.5	2.0	1.7	1.5
EV/sales	0.4	1.3	1.0	0.9	0.8
EV/EBITDA (x)	9.1	25.4	8.3	6.6	6.3
Consolidated EV/EBITDA (x)			8.3	5.3	5.2

VARDHMAN TEXTILES

INR 210

Edelweiss
Ideas create, values protect

Yarn to fabric

ACCUMULATE

March 20, 2007

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A scale player in yarn, sewing thread, and fabric

Vardhman is India's largest cotton yarn spinner and the second-largest manufacturer of sewing thread. It has been in the process of expanding its spinning capacity by ~50% (to 750,000 spindles) and weaving capacity by ~90% (to 830 looms by FY08). We expect higher operating margins and lower risk for Vardhman due to high contribution of fabric and high value-added yarns to revenues.

Vardhman derives its strength also from the strong demand for Indian yarn in the global market as India has a cost advantage in cotton (due to the abundant cotton supply situation in India). It is also in a position to benefit from the growth in exports from India of fabrics and ready-mades, as it is a key supplier to these manufacturers.

Back-ended capacity addition to reflect in financials

We estimate that the major part of the impact of Vardhman's capacity expansions on revenue growth will be seen in FY09. We expect operating margins to improve with higher contribution from specialized yarn and fabrics to the total revenue. However, capital costs due to capex are likely to keep net margins suppressed going forward.

Valuation:- Upside contingent on capacity addition

Delays continue in the ambitious capacity ramp-up program, whereby the benefits from the same are expected to come mostly in FY09 onwards now. The stock has been on a downward slump for the past At CMP of INR 210, Vardhman trades at a P/E of 6.2x and 5.1x and EV/EBITDA of 5.8x and 4.9x our FY08E and FY09E, respectively. We maintain our **'ACCUMULATE'** recommendation, with the belief that stock price performance would be contingent on capacity ramp up.

Reuters	:	MHSP.BO
Bloomberg	:	MSM IN

Market Data

52-week range (INR)	:	420 / 196
Share in issue (mn)	:	57.7
M cap (INR bn/USD mn)	:	12.1 / 275.0
Avg. Daily Vol. BSE ('000)	:	21.1

Share Holding Pattern (%)

Promoters	:	62.2
MFs, FIs & Banks	:	17.9
FIIs	:	3.4
Others	:	16.4

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	18,892	21,002	24,108	30,238
Growth (%)	*2.2*	*11.2*	*14.8*	*25.4*
EBITDA	3,429	3,687	4,304	5,539
Net profit (INR mn)	1,963	1,782	1,944	2,375
EPS (INR)	34.0	30.8	33.6	41.1
EPS growth (%)	*(27.5)*	*(9.2)*	*9.1*	*22.2*
PE (x)	6.2	6.8	6.2	5.1
EV/EBITDA (x)	6.0	6.2	5.8	4.9
ROE (%)	22.3	17.0	15.7	16.3

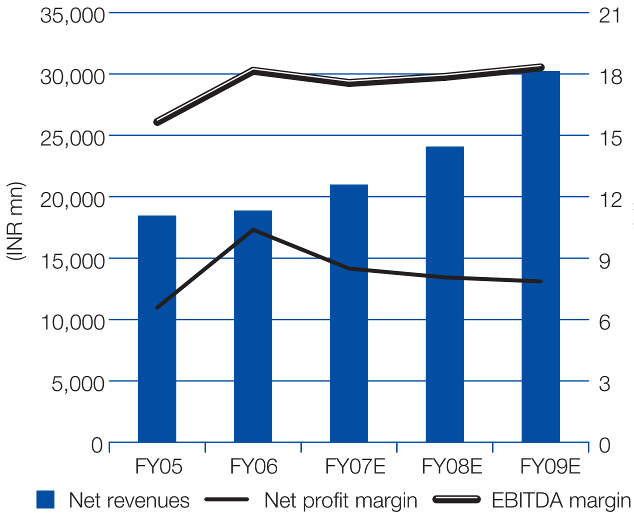
Financial Outlook

Growth likely to be significantly back-ended, due to delayed capacity expansion

Most of Vardhman's capacities are now expected to come on stream during H2FY08 and FY09, because of which we expect revenue growth to be back-ended to FY09. We estimate revenues to grow at 14.8% in FY08 over FY07 and 25.4% in FY09 over FY08. We expect realizations of yarn, fabric, and thread to remain largely flat and growth will be mainly led by volumes.

We expect operating margins to improve with higher contribution from specialized yarn and fabrics to the total revenue. However, capital costs due to capex are likely to keep net margins suppressed going forward.

Chart 1: Revenue and margins



Source: Edelweiss research

Chart 2: Return ratios slump as capex continues

Source: Edelweiss research

Lower asset turns, due to back-ended capacity expansion, is likely to keep return ratios subdued in FY08 with a recovery expected in FY09.

Key Risks

(a) **Fluctuation in prices of raw material (cotton):** -Cotton being the primary raw material for yarns, sewing threads and fabrics, any increase in the prices of cotton or a variation in the supply/availability of cotton, will impact its business adversly. Cotton constitues about 55-60% of its yarn realisations as compared to ~25% for fabrics. Cotton being an agricultural commodity is subject to the vagaries of nature, any fluctuation in the prices thereof will have direct implications on yarn as well as fabric margins.

(b) Delays in the commissioning of expanded capacities and in-ability to manage growth will lower forecast revenue growth.

Company Description

Vardhman is the largest spinner of cotton yarn in India and one of the largest manufacturer of sewing threads, with a strong presence in fabrics as well. It has a capacity of about 500,000 spindles, making it a big player, who, we believe, will be able to capitalize on opportunities emerging in the sector on the back of an abundant raw material supply base (cotton). The company is further enhancing its total spinning capacity to 750,000 spindles by FY08 by way of a mix of brownfield expansion at existing unit in Baddi, Himachal Pradesh, and greenfield expansion at Mandideep, Madhya Pradesh, (this is an integrated unit with fabric weaving and processing capacities). It is in the process of expanding its fabric manufacturing capacity from 42 mn meters p.a. to 90 mn meters p.a. Moving up the value chain, Vardhaman is increasing the production of specialized yarns, which we believe will generate significant proportion of revenues for the company going forward, and will enable it to command a premium on a commodity kind of product as well.

Investment Theme

There have been delays in the expansion program due to which we estimate that the impact of the expansion plans will be felt only in FY09 and FY10. In the interim we expect growth to continue to be tepid. At CMP of INR 219, Vardhaman trades at a P/E of 6.5x and 5.3x and EV/EBITDA of 5.9x and 4.9x our FY08E and FY09E, respectively. We maintain our **'ACCUMULATE'** recommendation, with the belief that stock price performance would be contingent on capacity ramp up.

Key Risks

Any further major delays in the capacity addition plans.

Any major demand slow-down in the end consumer countries resulting in dip in realizations.

Any sharp hikes in cotton prices resulting in margin compression.

Financial Statements

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	18,483	18,892	21,002	24,108	30,238
Manufacturing expenses	12,844	12,411	13,891	15,956	19,951
Employee expenses	996	1,102	1,277	1,407	1,717
S G & A expenditure	1,749	1,949	2,147	2,440	3,031
EBITDA	2,894	3,429	3,687	4,304	5,539
Depreciation	970	1,013	1,108	1,405	1,896
EBIT	1,924	2,416	2,579	2,899	3,643
Interest expenditure	591	395	480	550	515
Other income	273	484	230	208	38
Profit before tax	1,606	2,505	2,329	2,558	3,167
Provision for taxation	389	543	547	614	792
Profit after tax	1,217	1,962	1,782	1,944	2,375
Recurring net profit	1,217	1,962	1,782	1,944	2,375
Extraordinary items	(9)	1	-	-	-
Reported profit	1,207	1,963	1,782	1,944	2,375
EPS (INR) fully diluted	46.9	34.0	30.8	33.6	41.1
CEPS (INR) fully diluted	84.6	51.5	50.0	58.0	73.9
Dividend per share	6.7	4.0	-	-	-

Common size metrics as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	69.5	65.7	66.1	66.2	66.0
Employee expenses	5.4	5.8	6.1	5.8	5.7
S G &A expenses	9.5	10.3	10.2	10.1	10.0
Depreciation	5.2	5.4	5.3	5.8	6.3
Interest expenditure	3.2	2.1	2.3	2.3	1.7
EBITDA margin	15.7	18.2	17.6	17.9	18.3
EBIT margin	10.4	12.8	12.3	12.0	12.0
Net profit margin	6.6	10.4	8.5	8.1	7.9

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	70.9	2.2	11.2	14.8	25.4
EBITDA	74.8	18.5	7.5	16.7	28.7
EBIT	76.8	25.5	6.8	12.4	25.7
Net profit	100.6	62.6	(9.2)	9.1	22.2
EPS	100.6	(27.5)	(9.2)	9.1	22.2

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	257	578	578	578	578
Reserves	7,746	9,039	10,821	12,765	15,140
Shareholders funds	8,003	9,617	11,399	13,342	15,718
Secured loans	6,716	8,311	10,000	12,000	11,000
Unsecured loans	781	2,711	3,700	3,700	3,700
Deferred tax liability	959	922	922	922	922
Sources of funds	**16,459**	**21,560**	**26,020**	**29,964**	**31,339**
Gross assets	14,857	17,599	21,099	28,099	31,599
Less: Depreciation	7,281	8,188	9,295	10,700	12,596
Net fixed assets	7,576	9,411	11,802	17,396	18,999
Capital WIP	511	965	2,500	-	-
Investments	957	684	684	684	684
Current assets	*8,879*	*12,458*	*12,549*	*13,458*	*13,347*
Debtors	2,084	2,220	2,014	2,312	2,900
Cash and bank balance	227	2,715	3,142	2,780	(46)
Inventory	5,269	5,690	5,754	6,605	8,284
Advances	1,298	1,832	1,639	1,761	2,209
Current liabilities	*1,465*	*1,957*	*1,515*	*1,574*	*1,691*
Creditors	500	605	415	474	591
Other liabilities	752	1,030	900	900	900
Provisions	213	321	200	200	200
Working capital	7,414	10,501	11,034	11,884	11,656
Uses of funds	**16,458**	**21,560**	**26,020**	**29,964**	**31,339**
BV (INR)	-	-	-	-	-

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	2,393	2,676	2,890	3,349	4,271
Cash for working capital	1,972	599	106	1,211	2,597
Net operating cash flow (A)	420	2,078	2,784	2,138	1,674
Net purchase of fixed assets	4,700	3,302	5,035	4,500	3,500
Net purchase of investments	(7)	(273)	-	-	-
Net cash flow from investing (B)	4,693	3,029	5,035	4,500	3,500
Proceeds from LTB/STB	2,322	3,526	2,678	2,000	(1,000)
Dividend payments/Equity buyback	-	320	-	-	-
Net cash flow from financing	2,322	3,846	2,678	2,000	(1,000)
Free cash flow	**(4,280)**	**(1,224)**	**(2,252)**	**(2,362)**	**(1,826)**

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	18.6	22.3	17.0	15.7	16.3
ROCE (%)	16.2	15.3	11.8	11.1	12.0
Debtors days	41.2	42.9	35.0	35.0	35.0
Inventory days	104.1	109.9	100.0	100.0	100.0
Fixed assets t/o	2.3	1.8	1.5	1.4	1.6
Debt/equity	0.9	1.1	1.2	1.2	0.9
Inerest coverage	3.7	7.3	5.9	5.7	7.2

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	46.9	34.0	30.8	33.6	41.1
Y-o-Y growth (%)	*100.6*	*(27.5)*	*(9.2)*	*9.1*	*22.2*
CEPS	84.6	51.5	50.0	58.0	73.9
PE (x)	4.5	6.2	6.8	6.2	5.1
FCFPS (INR)	(165.9)	(16.5)	(39.0)	(40.9)	(31.6)
Y-o-Y growth (%)	*737.6*	*(90.1)*	*136.8*	*4.9*	*(22.7)*
Price/BV	0.7	1.3	1.1	0.9	0.8
EV/sales	0.7	1.1	1.1	1.0	0.9
EV/EBITDA	4.4	6.0	6.2	5.8	4.9

India Equity Research | Textile

Company Update

Edelweiss
Ideas create, values protect

WELSPUN INDIA

INR 69

Capex done, looking for value

BUY

March 20, 2007

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Terry towels major diversifying into bed linen

At 31,000 MTPA, Welspun's terry towel capacity is amongst the largest in the world. It has strong established client relationships with major retailers like *Walmart, Target, Kohl's, Tesco* and *Macy's*.Welspun has also put up a 45 MMPA bed linen facility, which is driving growth now and will continue to do so in FY08 as well; currently, it is utilizing ~55% of the available capacity. We expect a Q-o-Q improvement in the utilization going forward, which should drive top line and profitability growth.

Welspun to focus efforts on creating marketing/distribution presence in end-customer countries

Having established itself as a global major in off-shore manufacturing of home textiles, Welspun is now focused on going up the value chain to establish its marketing/distribution presence in European/US markets. For this, it has acquired/established its own brands which it sells through majors retailers in the US. In a step forward, it has also acquired *Christy*, UK's leading retailer supplier of branded and private label towels. Own brand sales gives it higher stickiness on the retailers' preferred vendors list and higher ASPs. *Christy* is also helping Welspun penetrate European markets through its established relationships.

Spinning and captive power to improve margins

Welspun has recently commissioned its power plant in Vapi. It is also catering to a portion of its fabric requirements through its captive spindles (~107,000 spindles). These, combined with the tax concessions, owing to manufacturing in Anjar, are likely to help improve margins.

Valuations: Strong growth ahead

Welspun's profits and returns are likely to spike in FY08 itself as the company has almost finished its current capex with only the decorative bedding part left. We expect earnings to continue to show good traction in FY08, contingent on ramp-up in bed linen capacity utilization. We believe that the current price will track this and the resultant profit growth in the next few quarters. At INR 69, Welspun trades at P/E of 5.7x and EV/EBITDA of 4.2x our FY09E estimates. We maintain our **'BUY'** recommendation.

Reuters	:	WGSR.BO
Bloomberg	:	WGS IN

Market Data

52-week range (INR)	:	135 / 63
Share in issue (mn)	:	73.1
M cap (INR bn/USD mn)	:	5.0 / 114.2
Avg. Daily Vol. BSE/NSE ('000)	:	97.0

Share Holding Pattern (%)

Promoters	:	36.5
MFs, FIs & Banks	:	37.8
FIIs	:	5.7
Others	:	20.1

Financials

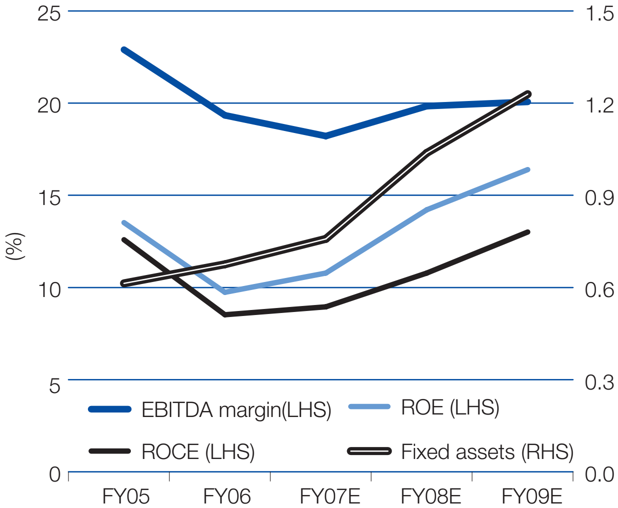
Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	6,537	10,039	13,122	14,645
Growth (%)	*37.3*	*53.6*	*30.7*	*11.6*
EBITDA	1,228	1,773	2,531	2,857
Net profit (INR mn)	416	585	882	1,187
Shares outstanding	73	73	73	73
EPS (INR)	5.7	8.0	12.1	16.2
EPS growth (%)	*(16.8)*	*40.8*	*50.8*	*34.5*
PE (x)	12.1	8.6	5.7	4.2
EV/EBITDA (x)	10.3	9.3	6.0	4.5
ROE (%)	9.2	10.2	13.7	15.8

Financial Outlook

Spike in profits imminent

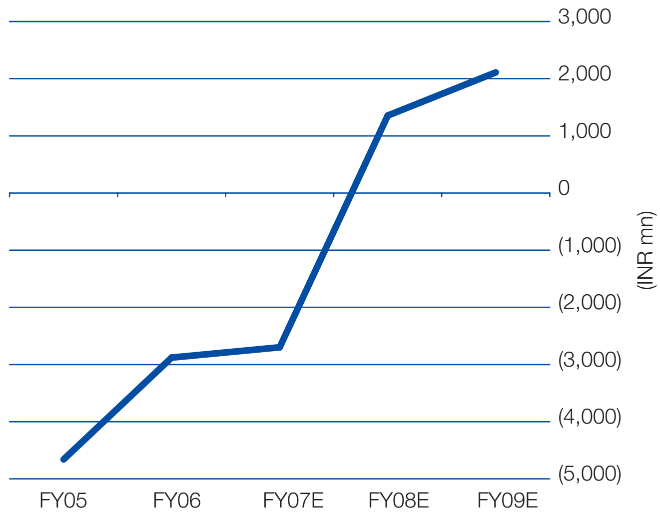
With most of Welspun's new capacities complete and especially given the expected traction in the bed linen business, the company's earnings growth is likely to be strong in FY08 (at ~68%). More importantly, we expect a strong Y-o-Y spike in return ratios in FY08E with RoCE increasing to 11% (versus 8.4% in FY07) and RoE to 15.1% (versus 10.2% in FY07). We believe that the growth and return ratio improvement will continue into FY09 based on the current capex. Future growth is likely to come from improved realizations on current capacities (owing to marketing/distribution presence in US/EU) as also, though less likely, through further capacity expansions which should be funded through internal accruals as well as loans under the now extended TUF scheme. In this context, it is important to note that Welspun's free cash flows are also likely to spike significantly FY09 onwards.

Chart 1: Capex over improvements imminent



Source: Edelweiss research

Chart 2: Free cash flow flows to turn positive



Source: Edelweiss research

Company Description

Welspun has aggressively expanded capacities post the easing of quota restrictions in January 2005 and has almost completed an INR 5.7 bn worth of capex phase in terry towels, bed linen as well as spinning and captive power plant. This should allow it to grow earnings at a CAGR of 47% over FY06-09E. Also, it is nearing the end of its capex cycle and should see a spike in margins and RoCE as early as FY08. Welspun has identified creating brands and marketing & distribution presence in end-customer companies as a key differentiator going ahead and hence this is a thrust area for the company. We believe this strategy should help it earn superior returns sooner than later. Moreover, it is likely to be a key beneficiary of the on-going vendor consolidation exercise undertaken by big retail chains due to its scale and strong relationships.

Investment Theme

Welspun has aggressively expanded capacities post the easing of quota restrictions in January 2005 and has almost completed an INR 5.7 bn worth of capex phase in terry towels, bed linen as well as spinning and captive power plant. This should allow it to grow earnings at a CAGR of 47% over FY06-09E. Also, it is nearing the end of its capex cycle and should see a spike in margins and RoCE as early as FY08. Welspun has identified creating brands and marketing & distribution presence in end-customer companies as a key differentiator going ahead and hence this is a thrust area for the company. We believe this strategy should help it earn superior returns sooner than later. Moreover, it is likely to be a key beneficiary of the on-going vendor consolidation exercise undertaken by big retail chains due to its scale and strong relationships.

Key Risks

Inability to fructify brand and marketing presence in consumer countries into tangible benefits.

Major slow-down in consumer countries' domestic consumption.

Competition from other companies/countries leading to major dent in realizations.

Major hikes in input prices, in this case, cotton.

Financial Statements

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	4,763	6,537	10,039	13,122	14,645
Manufacturing expenses	3,071	4,262	6,611	8,281	9,242
Employee expenses	296	566	863	1,275	1,391
S G & A expenditure	332	481	792	1,035	1,155
EBITDA	1,064	1,228	1,773	2,531	2,857
Depreciation	266	486	632	788	818
EBIT	799	742	1,141	1,743	2,039
Interest expenditure	277	343	502	547	460
Other income	85	234	248	144	219
Profit before tax	606	633	886	1,340	1,798
Provision for taxation	221	217	301	458	611
Minority interest	-	-	-	-	1
Profit after tax	386	416	585	882	1,187
Extraordinary items	-	-	-	-	-
Reported profit	386	416	585	882	1,187
EPS (INR) fully diluted	6.8	5.7	8.0	12.1	16.2
CEPS (INR) fully diluted	11.5	12.3	16.7	22.8	27.4
Dividend per share	-	-	-	-	-
Dividend payout ratio	-	-	-	-	-

Common size metrics as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	64.5	65.2	65.9	63.1	63.1
Employee expenses	6.2	8.7	8.6	9.7	9.5
S G &A expenses	7.0	7.4	7.9	7.9	7.9
Depreciation	5.6	7.4	6.3	6.0	5.6
Interest expenditure	5.8	5.2	5.0	4.2	3.1
EBITDA margin %	22.3	18.8	17.7	19.3	19.5
EBIT margin	16.8	11.4	11.4	13.3	13.9
Net profit margin	8.1	6.4	5.8	6.7	8.1

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	30.0	37.3	53.6	30.7	11.6
EBITDA	41.9	15.4	44.3	42.7	12.9
EBIT	32.4	(7.0)	53.6	52.8	17.0
Net profit	28.5	7.7	40.8	50.8	34.6
EPS	4.7	(16.8)	40.8	50.8	34.5

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	992	1,042	1,042	1,042	1,042
Reserves	2,708	4,467	5,051	5,933	7,119
Shareholders funds	3,700	5,508	6,093	6,975	8,161
Secured loans	5,950	7,972	11,700	10,195	8,195
Unsecured loans	4	423	-	-	-
Deferred tax liability	454	662	886	1,224	1,678
Sources of funds	**10,107**	**14,566**	**18,679**	**18,394**	**18,034**
Gross assets	7,124	10,655	15,155	16,355	16,355
Less: Depreciation	1,409	1,870	2,502	3,290	4,108
Net fixed assets	5,715	8,785	12,653	13,065	12,247
Capital WIP	2,492	1,390	1,200	-	-
Investments	115	1,057	2,187	2,187	2,187
Current assets	3,179	4,196	4,280	5,290	5,998
Debtors	348	417	641	838	935
Cash and bank balance	799	810	287	135	245
Inventory	1,299	1,951	2,750	3,595	4,012
Advances	733	1,017	602	722	805
Current liabilities	1,473	944	1,722	2,229	2,480
Creditors	1,286	747	1,650	2,157	2,407
Other liabilities	100	72	72	72	72
Provisions	87	124	-	-	-
Working capital	1,706	3,252	2,558	3,060	3,518
Misc expenditure	79	81	81	81	81
Uses of funds	**10,107**	**14,566**	**18,679**	**18,394**	**18,034**
BVPS (INR)	64	74	82	94	111

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Cash flow from operations	981	1,110	1,441	2,008	2,459
Cash for working capital	(710)	1,535	(171)	654	348
Net operating cash flow (A)	1,690	(425)	1,612	1,354	2,111
Net purchase of fixed assets	6,351	2,454	4,310	-	-
Net purchase of investments	(334)	942	1,130	-	-
Net cash flow from investing (B)	6,017	3,396	5,440	-	-
Proceeds from LTB/STB	3,749	2,442	3,305	(1,505)	(2,000)
Dividend payments/Equity buyback	289	48	-	-	-
Net cash flow from financing	4,038	2,490	3,305	(1,505)	(2,000)
Free cash flow	**(4,661)**	**(2,880)**	**(2,698)**	**1,354**	**2,111**

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	13.0	9.2	10.2	13.7	15.8
ROCE (%)	12.0	8.0	8.4	10.2	12.5
Debtors days	26.7	23.3	23.3	23.3	23.3
Inventory days	99.5	108.9	100.0	100.0	100.0
Fixed assets t/o	0.6	0.6	0.7	1.0	1.2
Debt/equity	1.4	1.4	1.9	1.5	1.0
Inerest coverage	3.2	2.8	2.8	3.4	4.9

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	6.8	5.7	8.0	12.1	16.2
Y-o-Y growth (%)	*4.7*	*(16.8)*	*40.8*	*50.7*	*34.5*
CEPS	11.5	12.3	16.7	22.8	27.4
PE (x)	10.1	12.1	8.6	5.7	4.2
Price/BV	1.1	0.9	0.8	0.7	0.6
EV/sales	1.9	1.9	1.6	1.2	0.9
EV/EBITDA	8.5	10.3	9.3	6.0	4.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

NOTES

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Naresh Kothari - 22864246	Head, Institutional Equities
Vikas Khemani - 22864206	Co-Head, Head Institutional Equities

INDIA RESEARCH			SECTOR	INSTITUTIONAL SALES		
Shriram Iyer	-	2286 4256	Head – Research	Nischal Maheshwari	-	2286 4205
GautamRoy	-	2286 4305	Airlines, Textile	Rajesh Makharia	-	2286 4202
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components	Shabnam Kapur	-	2286 4394
Vishal Goyal	-	2286 4370	Banking & Finance	Ashish Maheshwari	-	2286 4418
Revathi Myneni	-	2286 4413	Cement	Amish Choksi	-	2286 4201
Sumeet Budhraja	-	2286 4430	FMCG, Power	Deepak Rao	-	2286 4204
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps	Balakumar V	-	(044) 4263 8283
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom	Monil Bhala	-	2286 4400
Hitesh Zaveri	-	2286 4424	Information Technology	Ashish Agrawal	-	2286 4301
Pritesh Vinay	-	2286 4429	Metals, Mining	Nikhil Garg	-	2286 4282
Priyank Singhal	-	2286 4302	Media, Retail	Neha Shahra	-	2286 4276
Prakash Kapadia	-	2286 4432	Mid Caps	Priya R	-	2286 4389
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals	Johann Rodrigues	-	2286 4551
Nimish Mehta	-	2286 4295	Pharmaceuticals	AnubhavKanodia	-	2286 4361
Pakhi Jain	-	2286 4427	Pharmaceuticals, Agrochemicals	Tushar Mahajan	-	2286 4439
Swati Khemani	-	2286 4266	Textile	Harsh Biyani	-	2286 4419
Manika Premsingh	-	4019 4847	Economist	Nirmal Ajmera	-	2286 4258
Sachin Arora	-	2286 4512	Alternative & Quantitative	Ankit Doshi	-	2286 4671
Sunil Jain	-	2286 4308	Alternative & Quantitative	Ravi Pilani	-	4009 4533
Yogesh Radke	-	2286 4328	Alternative & Quantitative	Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	**Reduce**	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	**Sell**	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period		