



Gokaldas Exports

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,033	GEXP IN
	REUTERS CODE
S&P CNX: 3,767	GOKL. BO

1 November 2006

Buy

Previous Recommendation: Buy

Rs633

Equity Shares (m)	17.2
52-Week Range (Rs)	809/452
1,6,12 Rel.Per. (%)	-5/-22/-43
M.Cap (Rs. b)	10.9
M.Cap (US\$ b)	0.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	8,845	609	35.4	25.2	17.9	3.1	23.5	19.1	1.3	11.7
3/07E	10,583	735	42.7	20.6	14.8	2.6	19.2	19.5	1.1	9.5
3/08E	12,719	918	53.4	25.0	11.8	2.2	20.2	20.6	0.9	7.9

- 2QFY07 results came in below our expectations. Revenues increased 13.7% YoY to Rs2.8b v/s our estimate of Rs3b, while PAT increased 12.4% YoY to Rs208m v/s our estimate of Rs237m. Revenue growth for the company is in general not consistent quarterwise, and we expect 3Q, 4Q to record strong numbers.
- EBITDA margins increased by 54bp YoY to 11.2%, which was higher than our estimate at 11%. This improvement in margins is largely on account of better product mix and higher price realization.
- Despite robust growth in EBITDA margins, PAT growth was subdued due to higher depreciation and interest cost.
- The company has a robust order book for 3QFY07 and 4QFY07, with 3QFY07 order book at around Rs2.6b.
- Due to increased capex in FY07, depreciation and interest have been higher than our estimates. We are lowering our profit estimates to factor in 2QFY07 results and the impact of capex. We have lowered our EPS estimates for FY07 by 4.6% to Rs42.7. We are keeping our FY08 EPS estimate of Rs53.4 unchanged. The stock trades at 14.8x FY07E and 11.8x FY08E earnings. We reiterate **Buy**.

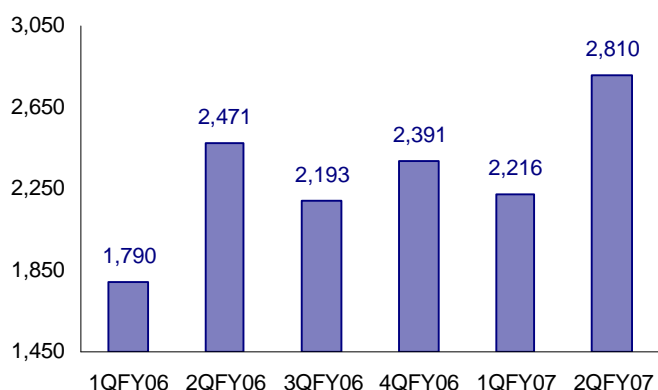
QUARTERLY PERFORMANCE										(Rs Million)
Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	1,790	2,471	2,193	2,391	2,216	2,810	2,582	2,974	8,845	10,583
Change (%)	N.A.	N.A.	N.A.	N.A.	23.8	13.7	17.8	24.4	22.2	19.7
Total Expenditure	1,611	2,207	1,952	2,115	1,991	2,494	2,289	2,634	7,885	9,409
EBITDA	179	265	240	276	225	316	293	340	960	1,175
Change (%)	N.A.	N.A.	N.A.	N.A.	26	19	22	23	65	22
As % of Sales	10.0	10.7	11.0	11.5	10.2	11.2	11.3	11.4	10.9	11.1
Depreciation	34	42	50	54	52	60	62	65	181	239
Interest	33	38	37	35	46	54	53	55	143	208
Other Income	8	5	12	17	22	16	17	21	43	75
PBT	120	190	166	204	150	218	194	241	679	803
Tax	4	5	8	54	14	10	20	24	71	68
Effective Tax Rate (%)	2.9	2.6	5.1	26.3	9.7	4.4	10.2	10.0	10.4	8.5
Reported PAT	116	185	157	150	135	208	175	217	609	735
Change (%)	N.A.	N.A.	N.A.	N.A.	16.3	12.4	11.0	44.3	53.0	20.6

E: M O S t Estimates

Revenue growth lower versus expectations

2QFY07 results came in below our expectations. Revenues increased by 13.7% YoY to Rs2.8b v/s our estimate of Rs3b. Revenue growth for the company is in general not consistent quarterwise, and we expect 3Q, 4Q to record strong numbers.

QOQ REVENUES NOT CONSISTENT (RS M)



Source: Company/ Motilal Oswal Securities

Order book robust

Gokaldas has a robust order book for 3QFY07 and 4QFY07, with 3QFY07 order book at around Rs2.6b. Management has indicated that the earlier seasonality, which was prevalent in the garment manufacturing business, appears to have disappeared. Earlier, the first half would account for around 60% of full year revenue whilst the second half would account for the remaining 40%. Going forward, management expects near equal contribution by each half year. Management has given guidance for an optimistic business outlook ahead, primarily as a result of quota constraints on China and the enormous business prospects owing to the booming retail market in India.

Manufacturing capacity to go up 40%

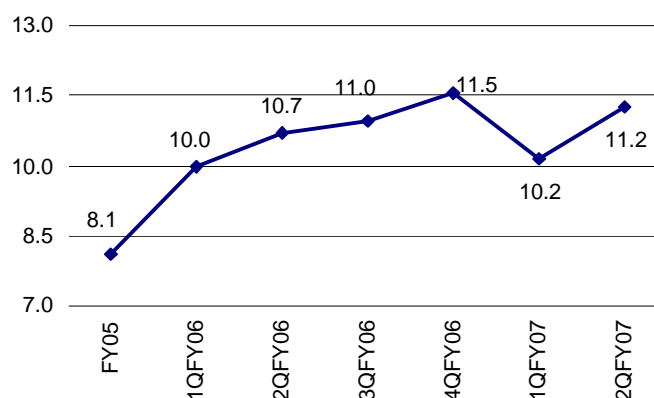
The company is following an aggressive expansion mode and aims to increase its total garment manufacturing capacity from 22m pieces in FY06 to around 30m pieces by FY08. During 2QFY07, the company started trial runs at its new SEZ unit in Chennai, which is expected to be

fully operational by January 2007. In an attempt to diversify its product mix it is also setting up a structured suits unit, which is also expected to be fully functional by January 2007. The company's total employee headcount at the end of 2QFY07 stood at almost 46,500 people.

EBITDA margins improve

EBITDA margins increased by 54bp to 11.2%, higher than our estimate of 11%. We expect EBITDA margins to remain robust, going forward. Key factors leading to the improvement in margins are absence of quota cost, better product mix and improved utilization levels.

TREND IN EBITDA MARGIN (%)



Source: Company/ Motilal Oswal Securities

Supply side constraints to benefit India

The Chinese Ministry of Commerce (Mofcom) has estimated that nearly 20% of China's export quotas to the US and EU could remain unutilized in FY06 owing to Mofcom's distribution policy. In accordance with the current system, Beijing distributes 70% of the total annual EU and US quotas to those enterprises with sound export history. The remaining 30% of the quotas are awarded on the basis of two rounds of bidding. However, smaller firms found it difficult to bid for the quotas in the 30% category, as they were expensive. The above-stated supply constraints are in addition to the quota constraints that are already imposed by the US and EU on China until CY08. China's existing trade agreements with the US and EU limit its textile exports

over the next three years to 8%-12% per annum. In our opinion, these circumstances would significantly benefit India, and Gokaldas in particular, due to its leadership position in the Indian garment industry.

‘Preferred vendor’ for some of the world’s largest brands

Gokaldas Exports is one of the largest and most respected garment manufacturers in India. It has been accorded Preferred Vendor status by some of the world’s best known brands – GAP, Nike, Old Navy, Tom Tailor and Lebek International. With quotas now abolished, international trade in apparel is expected to increase significantly. Most studies indicate that India and China will be the biggest beneficiaries. We believe that Gokaldas Exports is well placed to leverage this huge opportunity.

Pricing pressure to reduce

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

Revising FY07 EPS estimate

Due to increased capex in FY07, depreciation and interest has been higher than our estimates. We are lowering our profit estimates to factor the 2QFY07 results and impact of the capex. We have lowered our EPS estimate for FY07 by 4.6% to Rs42.7. However, we are keeping our FY08 EPS estimate of Rs53.4 unchanged.

Valuation and view

Gokaldas Exports is one of the best proxies to play the quota-outsourcing story in the Indian textiles space. It is one of the largest and most respected garment manufacturers in India. We anticipate sharp improvements in productivity levels, aided by longer runs, implementation of modern scientific shop floor management techniques and increased mechanization. Management has indicated a strong order book for FY07. It has also hinted at a stable pricing environment, with the possibility of price increases for some of its key categories in FY07. We expect the company to register revenue CAGR of 20% and profit CAGR of 23% over FY06-FY08E. The stock trades at 14.8x FY07E and 11.8x FY08E earnings. We reiterate **Buy**.

Gokaldas Exports: an investment profile

Company description

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

Key investment arguments

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

Key investment risks

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

Recent developments

- ✍ Has expanded capacity to 296 lines.
- ✍ Plans to set up three factories in FY07 and change its product mix to cover all categories.
- ✍ Likely to benefit substantially from safeguard measures against China by USA and EU.

Valuation and view

- ✍ Expected to register revenue and PAT CAGR of 20% and 23%, over FY06-FY08.
- ✍ The stock trades at 14.8x FY07E and 11.8x FY08E earnings. We reiterate **Buy**.

Sector view

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

COMPARATIVE VALUATIONS

		GOKALDAS	WELSPUN	VARDHMAN
P/E (x)	FY07E	14.8	11.4	10.2
	FY08E	11.8	8.7	8.7
P/BV (x)	FY07E	2.6	1.1	1.6
	FY08E	2.2	1.0	1.4
EV/Sales (x)	FY07E	1.1	1.7	1.4
	FY08E	0.9	1.7	1.6
EV/EBITDA (x)	FY07E	9.5	9.6	7.8
	FY08E	7.9	8.5	8.4

SHAREHOLDING PATTERN (%)

	SEP:06	JUN:06	SEP05
Promoter	70.1	76.9	76.9
Domestic Inst	11.4	7.1	5.8
Foreign	10.4	6.4	3.7
Others	8.1	9.5	13.7

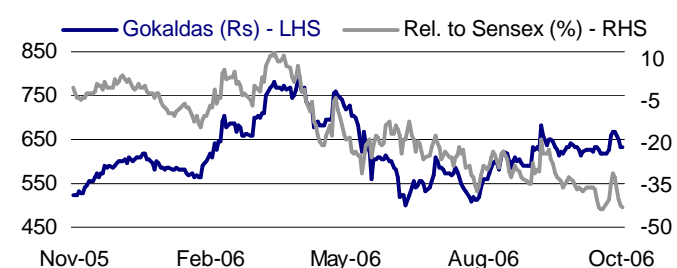
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	42.7	43.3	-1.3
FY08	53.4	53.9	-1.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
633	801	26.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	7,240	8,845	10,583	12,719	14,885
Change (%)	35.1	22.2	19.7	20.2	17.0
Total Expenditure	6,657	7,885	9,435	11,386	13,472
EBITDA	583	960	1,175	1,371	1,585
Change (%)	11.1	64.6	22.4	16.7	15.6
% of Net Sales	8.1	10.9	11.1	10.8	10.7
Depreciation	129	181	239	256	296
EBIT	454	779	936	1,115	1,289
Interest & Finance Charges	119	143	208	185	180
Other Income	105	43	75	90	90
PBT	439	679	803	1,020	1,199
Tax	41	71	68	102	122
Effective Rate (%)	9.4	10.4	8.5	10.0	10.2
Reported PAT	398	609	735	918	1,077
Change (%)	6.6	53.0	20.6	25.0	17.3
Adjusted PAT	398	609	735	918	1,077

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Capital	141	172	172	172	172
Share Capital	141	172	172	172	172
Reserves	1,525	3,352	3,969	4,770	5,729
Net Worth	1,666	3,524	4,141	4,942	5,901
Loans	1,906	956	856	706	556
Deferred Tax Liability	35	52	69	95	125
Capital Employed	3,606	4,532	5,066	5,742	6,582
Gross Fixed Assets	1,448	1,948	2,198	2,348	2,499
Less: Depreciation	410	591	830	1,086	1,382
Net Fixed Assets	1,038	1,357	1,368	1,262	1,117
Capital WIP	29	0	0	0	0
Investments	1	1	0	0	0
Curr. Assets	3,135	3,916	4,670	5,647	6,844
Inventory	1,870	2,160	2,714	3,276	3,876
Sundry Debtors	590	606	725	871	1,019
Cash & Bank Balances	225	608	580	719	1,012
Loans & Advances & Other C	451	542	651	781	937
Current Liab. & Prov.	598	742	972	1,167	1,379
Sundry Creditors	598	742	972	1,167	1,379
Net Current Assets	2,537	3,174	3,697	4,480	5,465
Application of Funds	3,606	4,533	5,066	5,742	6,582

E: Most Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	28.3	35.4	42.7	53.4	62.7
Cash EPS	37.5	46.0	56.7	68.3	79.9
Book Value per Share	118.4	205.1	241.0	287.6	343.4
DPS	0.0	4.0	6.0	6.0	6.0
Payout (Incl. Div. Tax) %	0.0	12.9	16.0	12.8	10.9
Valuation (x)					
P/E		17.9	14.8	11.8	10.1
Cash P/E		13.8	11.2	9.3	7.9
EV/EBITDA		11.7	9.5	7.9	6.6
EV/Sales		1.3	1.1	0.9	0.7
Price to Book Value		3.1	2.6	2.2	1.8
Dividend Yield (%)		0.6	0.9	0.9	0.9
Profitability Ratios (%)					
RoE	25.8	23.5	19.2	20.2	19.9
RoCE	14.4	19.1	19.5	20.6	20.9
Turnover Ratios					
Debtors (Days)	30	25	25	25	25
Inventory (Days)	103	100	105	105	105
Creditors (Days)	23	25	30	30	30
Working Capital (Days)	128	131	128	129	134
Asset Turnover (x)	2.0	2.0	2.1	2.2	2.3
Fixed Asset Turnover (x)	5.0	4.5	4.8	5.4	6.0
Leverage Ratio					
Debt/Equity (x)	1.1	0.3	0.2	0.1	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
PBT before E.O. Items	439	679	803	1,020	1,199
Add : Depreciation	129	181	239	256	296
Less : Direct taxes paid	41	71	68	102	122
(Inc)/Dec in WC	-753	-254	-551	-644	-692
CF from Operations	-307	510	365	466	623
CF from Oper. Incl. EO I	-307	510	365	466	623
(Inc)/dec in FA	-222	-529	-250	-150	-151
CF from Investments	-281	-471	-250	-150	-151
(Inc)/Dec in Shares	0	-1,328	0	0	0
(Inc)/Dec in Debt	-665	950	100	150	150
Less : Interest Paid	0	0	0	0	0
Dividend Paid	32	78	118	118	118
CF from Fin. Activity	506	344	-143	-177	-179
Inc/Dec of Cash	-83	383	-28	139	293
Add: Beginning Balance	308	225	608	580	719
Closing Balance	225	608	580	719	1,012

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Disclosure of Interest Statement	Gokaldas Exports
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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