

Company In-Depth

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Welspun India (WLSP.BO)

Hold: High Earnings Volatility

- Maintain Hold/Medium Risk** — We rate Welspun Hold/Medium Risk (2M) with a target price of Rs110 based on 12x Sept'07E P/E. With production still ramping-up at newly commissioned plants, margin pressures and the adverse impact of forex fluctuations, we see high earnings volatility in the near-term; Medium Risk rating leaves moderate upside.
- Margins under pressure** — EBITDA is under pressure despite strong revenue growth, due to: 1) higher RM costs and overheads on bed-linen with production still ramping up; 2) some price pressure on towels and 3) increased power costs. Initiatives to improve bed linen utilization and switch to gas for power are positive, but benefits should take a couple more quarters to reflect.
- Bed linen, growth driver** — Favorable response from buyers and increasing order flows drive bed linen growth; however, utilization levels are still below breakeven. We see share of bed linen revenues increase to 39% by FY09E (vs. 9% in FY06); Terry towels witness steady volume growth with some price pressure.
- Expansion progressing as scheduled** — Phase I expansion (Rs.5.7bn) is fully commissioned; the company is progressing on course with phase II (Rs.6.5bn), due by 4QFY07, which will step up capacity and backward integration – timely ramp-up of production at new plants will be the key to earnings growth.
- Why not Sell?** — We see limited downside due to: a) earnings CAGR still strong at 34% for FY06-09E; b) vertical integrated model with scale and presence in branded home textile exports; c) bed-linen scale up to 60% utilization, encouraging; and d) stock trading at 9.8x Sept'07E earnings, at par with sector.

See page 5 for Analyst Certification and important disclosures.

Figure 1. Statistical Snapshot

Year to	Net Profit	FD EPS	EPS Gr.	P/E	P/BV	EV/EBITDA	ROCE
31-Mar	(Rs)	(Rs)	(%)	(x)	(x)	(x)	(%)
2005	337	5.6	-7%	16.4	1.7	12.7	6%
2006	440	5.7	3%	16.0	1.3	12.3	5%
2007E	618	8.1	40%	11.4	1.2	8.1	6%
2008E	815	10.6	32%	8.7	1.1	6.6	7%
2009E	1,068	13.9	31%	6.6	0.9	5.7	8%

Source: Company Reports and CIR Estimates

Hold/Medium Risk	2M
Price (16 Nov 06)	Rs91.85
Target price	Rs110.00
Expected share price return	19.8%
Expected dividend yield	0.0%
Expected total return	19.8%
Market Cap	Rs6,713M
	US\$148M

Price Performance (RIC: WLSP.BO, BB: WLSI IN)



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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	16.4	16.0	11.4	8.7	6.6
EV/EBITDA adjusted (x)	10.6	10.9	7.2	5.9	5.2
P/BV (x)	1.7	1.3	1.2	1.1	0.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	5.58	5.74	8.05	10.61	13.90
EPS reported	5.58	4.97	8.05	10.61	13.90
BVPS	55.37	68.32	76.37	86.99	100.89
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	4,763	6,537	8,839	10,889	12,520
Operating expenses	-4,072	-5,833	-7,556	-9,279	-10,524
EBIT	692	705	1,283	1,610	1,996
Net interest expense	-170	-246	-485	-525	-515
Non-operating/exceptionals	85	234	145	130	105
Pre-tax profit	606	692	943	1,215	1,586
Tax	-221	-217	-302	-389	-508
Extraord./Min.Int./Pref.div.	-48	-93	-23	-11	-11
Reported net income	337	381	618	815	1,068
Adjusted earnings	337	440	618	815	1,068
Adjusted EBITDA	969	1,191	1,978	2,500	2,921
Growth Rates (%)					
Sales	29.9	37.2	35.2	23.2	15.0
EBIT adjusted	28.0	1.9	82.1	25.5	24.0
EBITDA adjusted	40.9	22.9	66.1	26.4	16.9
EPS adjusted	-7.2	2.7	40.4	31.8	31.0
Cash Flow (RsM)					
Operating cash flow	1,269	-565	2,640	1,576	465
Depreciation/amortization	277	486	695	890	925
Net working capital	606	-1,466	1,304	-140	-1,538
Investing cash flow	334	-942	-302	0	0
Capital expenditure	0	0	0	0	0
Acquisitions/disposals	134	-805	826	0	0
Financing cash flow	-1,645	-727	-1,284	-474	-368
Borrowings	-3,490	-2,362	-1,284	-474	-368
Dividends paid	0	0	0	0	0
Change in cash	-42	-2,234	1,054	1,102	97
Balance Sheet (RsM)					
Total assets	11,580	15,509	18,048	19,528	20,426
Cash & cash equivalent	799	810	137	168	192
Accounts receivable	348	417	575	708	876
Net fixed assets	8,286	10,256	13,105	14,184	14,046
Total liabilities	7,880	10,001	12,009	12,764	12,595
Accounts payable	1,318	747	2,058	2,349	1,824
Total Debt	6,022	8,395	9,006	9,511	9,903
Shareholders' funds	3,700	5,508	6,039	6,764	7,831
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	20.3	18.2	22.4	23.0	23.3
ROE adjusted	12.2	10.3	11.1	13.0	14.8
ROIC adjusted	7.2	4.4	7.2	8.1	9.1
Net debt to equity	141.2	137.7	146.9	138.1	124.0
Total debt to capital	61.9	60.4	59.9	58.4	55.8

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Welspun India

Company description

Welspun India is among Asia's largest terry towels manufacturer and the fourth largest in the world. A wide product range, fully integrated scaleable capacities and ability to offer value-added products make it a preferred supplier to global retailers in the EU and US. It already has a presence in retailing, having the license to market under Nautica, Umbra in the US and Tommy Hilfiger in India, and owns the Chirsty brand in UK, SPACES brand in India. The company's foray into bed-linen is a step to position itself as a single-point vendor in home textiles. Exports constitute 95% of revenues. Given company's vertically integrated business model in home textiles, most expansion now operational, we expect Welspun to deliver high growth. It is a flagship company of the Welspun Group (34% holding).

Investment thesis

We rate Welspun Hold/Medium Risk (2M) with a target price of Rs110. With most expansions phased in, initiatives to move up the value chain with a focus on branded home textiles and backward integration, we believe Welspun offers a strong business model for growth. The company's strategy to expand to bed linen and decorative bed sets would enrich product mix and improve profitability, in our view. However, with production at new expansions still ramping-up, initial high overheads in bed-linen, some price pressure on towels and adverse impact of forex fluctuations - we see high earnings volatility in the near-term. That said, with post revision earnings CAGR still strong at 34% for FY06-09E and stock trading at reasonable valuations of 9.8x Sept'07E P/E, at par with sector, downside appears limited – hence we rate the stock a Hold (2M).

Valuation

Our target price of Rs110 is based on 12x P/E for Sept 07E earnings. We believe Welspun will trade at a premium to Citigroup's textile universe (which include key players like Raymond, Arvind Mills, Gokaldas Exports, Alok Industries, Vardhman Textiles) valuations of 9.8x Sept 07E P/E. The premium is a function of Welspun's rapid earnings growth, leadership in terry towels and being a proxy for playing the outsourcing theme in home textiles, given its thrust on exports. P/E is our primary valuation tool as we see it as best capturing the company's strong earnings growth potential. With earnings CAGR of 34% over FY06-09E, global scale capacities in terry towels and a more dynamic business model, we see upside potential to stock valuations and trading closer to the median of its 3-year historical trading band of 7.5-13x. We expect the stock to continue trading at a premium as growth plays out.

Risk

We rate Welspun Medium Risk, as opposed to the High Risk rating assigned by our quantitative risk-rating system. The key reasons we opt for a Medium Risk rating include: (1) Secular growth prospects in home textiles post quotas and shrinking capacities in the US; (2) Rapid growth on account of new capacity expansion; (3) Welspun's leadership position in India and its relationships with

global brands; and (4) Peer stocks are rated Low or Medium Risk. The downside risks to our target price include: (1) Appreciation of the rupee; (2) Sharp increases in cotton prices; and (3) Delays in commissioning new projects. The upside risks to our target price include: 1) Faster than expected break even of the bed-linen business; and 2) Long-term sourcing tie-ups with global branded home textile retailers.

Analyst Certification Appendix A-1

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Welspun India Ltd (WLSP.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 21 2005)



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