Alok Industries

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,936	ALOK IN
	REUTERS CODE
S&P CNX: 4,346	ALOK BO

Equity Shares	199.1
52-Week Range	78/50
1,6,12 Rel.Per. (%)	4/-14/-37
M.Cap (Rs. b)	12.6
M.Cap (US$ b)	0.3

1 August 2007

Neutral

Previous Recommendation: Neutral

Rs63

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS* (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/07A	18,290	1,419	8.3	32.7	7.6	1.0	16.5	6.5	2.0	8.6
3/08E	22,397	1,828	9.2	28.9	6.9	0.9	13.2	7.0	2.1	8.8
3/09E	27,334	2,049	10.3	12.1	6.2	0.8	13.2	7.1	2.1	8.7

** Fully Diluted EPS*

- 1QFY08 results came in below our estimates with EBITDA at Rs1b v/s our estimate of Rs1.2b. EBITDA margins stood at 24.2% (our est. 21.9%), which is one of the highest in the textile industry.
- Revenues increased by 17% YoY to Rs4.2b, primarily due to sharp increase in exports by 85% YoY to Rs1.9b. Exports accounted for ~45% of total revenues of Alok in 1QFY08.
- Reported PAT jumped by 104% YoY to Rs550m, boosted by forex gains of Rs395.5m (sale of dollars to the tune of US$72m for hedging) and DEPB benefits to the tune of Rs100m. Adjusted PAT increased by 5.9% YoY to Rs285m v/s expectation of Rs344m.
- Alok's gross debt in FY07 was Rs33b and will increase to Rs45b by FY09. We view Alok's high leverage (2.6x DER in FY08) as concerning given the increasing interest rate scenario.
- The stock trades at a PER of 6.9x FY08 EPS of Rs9.2 and 6.2x FY09 EPS of Rs10.3. We believe the company's ambitious capex plans are likely to keep it in a phase of negative free cash flow for the next few years. This coupled with the fact that the company has huge net debt of close to Rs40b in FY08 (debt/equity ratio of 2.6x) is likely to limit upside. We maintain **Neutral.**

QUARTERLY PERFORMANCE (Rs Million)

Y/E MARCH	FY07				FY08E				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Sales	**3,579**	**4,172**	**4,799**	**5,741**	**4,189**	**5,487**	**5,823**	**6,897**	**18,290**	**22,397**
Change (%)	*19.6*	*20.8*	*31.0*	*40.8*	*17.1*	*31.5*	*21.3*	*20.1*	*28.9*	*22.4*
Total Expenditure	2,772	3,204	3,726	4,420	3,173	4,176	4,426	5,212	14,123	16,988
EBITDA	**806**	**968**	**1,073**	**1,321**	**1,016**	**1,311**	**1,398**	**1,685**	**4,168**	**5,409**
Change (%)	*37.1*	*36.7*	*32.5*	*50.8*	*26.0*	*35.5*	*30.2*	*27.6*	*40.7*	*29.8*
As % of Sales	*22.5*	*23.2*	*22.4*	*23.0*	*24.2*	*23.9*	*24.0*	*24.4*	*22.8*	*24.2*
Depreciation	246	280	325	354	358	391	407	474	1,205	1,630
Interest	170	213	242	269	270	316	329	402	893	1,318
Other Income	-4	-16	32	19	2	36	38	75	32	151
Non Recurring Expense	0	0	0	334	396	0	0	0	334	396
PBT	**386**	**459**	**539**	**1,051**	**785**	**640**	**698**	**818**	**2,435**	**3,007**
Tax	117	132	168	265	235	185	204	254	682	879
Effective Tax Rate (%)	*28.2*	*28.9*	*31.2*	*25.2*	*30.0*	*29.0*	*29.2*	*31.0*	*28.0*	*30.0*
Repoted PAT	**269**	**326**	**371**	**787**	**550**	**454**	**494**	**564**	**1,753**	**2,129**
Change (%)	*31.0*	*28.1*	*25.7*	*139.4*	*104.3*	*39.3*	*33.4*	*-28.3*	*61.8*	*21.4*
Adj. PAT	**269**	**326**	**371**	**452**	**285**	**454**	**494**	**564**	**1,419**	**1,828**
Change (%)	*31.0*	*28.1*	*25.7*	*30.4*	*5.9*	*39.3*	*33.4*	*24.7*	*30.9*	*28.9*

E: MOSt Estimates

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Results below estimates

Alok reported 1QFY08 EBITDA at Rs1b vs our estimate of Rs1.2b. Revenues increased by 17% YoY to Rs4.2b, primarily due to sharp increase in exports by 85% YoY to Rs1.9b. EBITDA margins stood at 24.2% (our est 21.9%), which is one of the highest in the textile industry. Reported PAT jumped by 104% YoY to Rs550m, boosted by forex gains of Rs395m (sale of dollars to the tune of US$72m for hedging) and DEPB benefits to the tune of Rs100m. Adjusted PAT increased by 5.9% YoY to Rs285m v/s our expectation of Rs344m.

EBITDA margin one the highest in industry

Alok enjoys one of the highest EBITDA margins in the industry at 24.2%, with contribution from home textiles increasing since 1QFY06, EBITDA margins have been constantly improving. However, considering that apparel fabric and polyester yarns still account for almost 73% of total sales, with sales from high-value segments accounting for merely 27% of 1QFY08 revenues, sustainability of these margins would be a challenge.

New developments

Management has announced several new initiatives, which it has plans to aggressively pursue, going forward. In this regard, the company has launched two new subsidiaries namely, Alok Infrastructure and Alok International to focus on the real estate and retail industries respectively. Management has medium-term plans to list both these 100% subsidiaries over the next six to nine months.

A) **Foray into real estate sector:** Alok through its 100% subsidiary Alok Infrastructure Private Ltd. plans to diversify into real estate sector. In this regard, it has acquired the following properties: (i) commercial office premises admeasuring around 575,000 sq. ft. at Lower Parel, Mumbai in an office complex called 'Peninsula Business Park" being developed by Peninsula Land Holdings Ltd. at the erstwhile "The Dawn Mills Limited" at a cost of ~Rs19,000/sq ft (current market value close to ~Rs19b, implying underlying pre-tax gains of ~Rs8b); (ii) commercial office premises at Ashford Centre admeasuring about 57,000 sq. ft. at Lower Parel, Mumbai being developed by Ashford Universal at a cost of ~Rs14,000/sq ft. The management has indicated that there are some more development projects, which the subsidiary already has, which would be shared with the investors in due course. While entry in real estate could create value for the company, it could lead to increase of leveraging (capex requirement of Rs14b over next three years) and further increase the risk profile of the company.

B) **Expansion plans in retail:** Alok through its 100% owned subsidiary, Alok Industries International Ltd. (AIIL), incorporated in the British Virgin Islands, has signed an exclusive license agreement with New York, NY headquartered AISLE 5, LLC for its portfolio of lifestyle brands like aworld, Cotton + Clay etc. Under this multi-year license, it has the rights to manufacture and distribute home textile products through supermarket retail stores in the United States and Canada.

C) **Foray into contract organic cotton farming:** Alok has tied up for contract farming spread over 140,000 acres for exclusive supply of Organic and Fair Trade Cotton (approx. 175,000 bales) duly certified by SKAL and ECO CERT. Yarns produced from organic cotton sell at a substantial premium to yarns produced from ordinary cotton

Interest cost to jump sharply

Alok's high leverage (2.6x DER in FY07) is concerning, especially in the context of an increasing interest rate scenario. A majority of the company's debt has been borrowed under the TUF scheme, where the effective cost of debt worked out to 3.5-4%. However, as most of these loans have been taken at floating rates, the cost of servicing the TUF loans could jump by 200-250bp, which could sharply increase interest costs. Furthermore, Alok is currently capitalizing a majority of its interest and depreciation as its new capacities were yet to get commercially operational. However going forward, with a majority of the company's capacities going on stream by FY08, it would have to account for the entire interest and depreciation cost.

Fresh capex initiative of Rs11b

Alok has announced plans to embark on a fresh capex initiative of Rs11b to further augment its capacities and set up a 50MW power unit. It hopes to finance its entire Rs11b capex initiative through TUF loans of Rs9.5b and internal accruals of Rs2.3b.

Valuation and view

The stock trades at a PER of 6.9x FY08 EPS of Rs9.2 and 6.2x FY09 EPS of Rs10.3. It enjoys an EV/EBITDA of 8.8x FY08 and 8.7x FY09. We believe the company's ambitious capex plans are likely to keep it in a phase of negative free cash flow for the next few years. This coupled with the fact that the company has huge net debt of close to Rs40b in FY08 (debt/equity ratio of 2.6x) is likely to limit upside. Maintain **Neutral.**

Alok Industries: an investment profile

Company background

Alok Industries has one of the most modern and technologically advanced plants in India. It has integrated facilities from fabric, texturised yarn, knitting and processing to home textiles and garmenting. It plans to focus on the home textiles business, which will throw up tremendous opportunities in the post-quota scenario. It has already established relationships with large global retailers and brands.

Key investment arguments

- Focus on Home Textiles (made-ups) for growth ahead.
- Has a large customer base of international retailers and Indian garment exporters including DKNY, Tommy Hilfiger, Britannica and Federated Merchandising Group.
- Has large capacities across the entire textile chain from fabrics to made-ups and is set to witness strong growth across all its product lines.

Key investment risks

- Texturising, which is a very low-margin activity, accounts for almost one-thirds of its business.
- Continuous capex, high leverage and frequent equity dilution.

Recent developments

- Low-margin trading business declining steadily over the last couple of quarters.
- During 2QFY07, Alok acquired 60% stake in Mileta International (Mileta) at a cost of €13.96m.
- Alok has formed two new subsidiaries namely, Alok Infrastructure and Alok International to focus on the real estate and retail industries respectively.

Valuation and view

- Alok's revenues and net profit are expected to witness 22% and 20% CAGR respectively over FY07-FY09.
- Margins are likely to expand from 22.8% in FY07 to 23.7% in FY08.
- The stock trades at a PER of 6.9x FY08 EPS of Rs9.2 and 6.2x FY09 EPS of Rs10.3. We maintain **Neutral.**

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.

COMPARATIVE VALUATIONS

		ALOK IND	VARDHMAN	ARVIND
P/E (x)	FY08E	6.9	6.4	29.1
	FY09E	6.2	5.1	11.3
P/BV (x)	FY08E	2.1	0.7	0.6
	FY09E	2.1	0.7	0.6
EV/Sales (x)	FY08E	8.8	1.5	1.3
	FY09E	8.7	1.3	1.1
EV/EBITDA (x)	FY08E	3.2	8.4	9.1
	FY09E	2.6	6.9	7.6

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	30.6	29.9	27.5
Domestic Inst	19.4	20.5	23.3
Foreign	38.1	38.9	38.0
Others	12.0	10.7	11.3

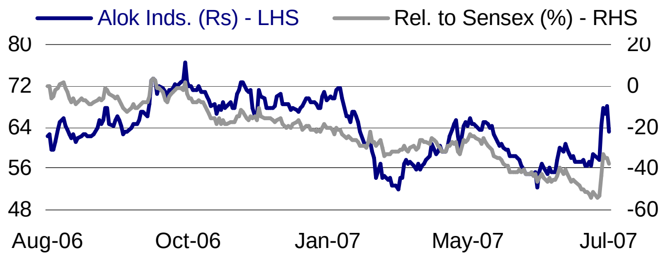
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	9.2	9.6	-4.4
FY09	10.3	11.7	-11.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
63	72	14.3	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**11,960**	**14,188**	**18,290**	**22,397**	**27,334**
Change (%)	*11.9*	*18.6*	*28.9*	*22.4*	*22.0*
Total Expentiture	9,910	11,226	13,986	17,964	21,058
EBITDA	**2,050**	**2,961**	**4,168**	**5,409**	**6,489**
Change (%)	*-3.4*	*44.4*	*40.7*	*29.8*	*20.0*
% of Net Sales	17.1	20.9	22.8	24.2	23.7
Depreciation	576	758	1,205	1,630	2,078
EBIT	**1,475**	**2,204**	**2,963**	**3,779**	**4,411**
Interest & Finance Charges	798	697	893	1,318	1,433
Other Income	558	37	32	151	121
Non-recurring Items/ Income	3	15	334	0	0
PBT	**1,232**	**1,525**	**2,435**	**2,612**	**3,100**
Tax	343	442	682	784	1,051
Effective Rate (%)	*27.8*	*29.0*	*28.0*	*30.0*	*30.0*
Reported PAT	**889**	**1,084**	**1,753**	**1,828**	**2,049**
Change (%)	*25.1*	*21.9*	*61.8*	*4.3*	*12.1*
Adjusted PAT	**886**	**1,069**	**1,419**	**1,828**	**2,049**
Change (%)	*24.6*	*20.7*	*32.7*	*28.9*	*12.1*

BALANCE SHEET					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Capital	1,340	1,575	1,704	1,991	1,991
Share Capital	2,217	2,255	1,704	1,991	1,991
Reserves	4,607	6,501	8,926	11,851	13,555
Net Worth	**6,824**	**8,755**	**10,629**	**13,842**	**15,546**
Loans	13,189	21,445	33,495	40,120	45,320
Deferred Tax Liability	751	1,001	1,547	2,095	2,831
Capital Employed	**20,764**	**31,201**	**45,671**	**56,057**	**63,697**
Gross Fixed Assets	8,694	14,034	23,034	35,034	45,034
Less: Depreciation	1,683	2,477	3,682	5,312	7,389
Net Fixed Assets	**7,011**	**11,558**	**19,352**	**29,722**	**37,645**
Capital WIP	1,782	7,185	7,185	7,185	7,185
Investments	79	397	750	750	751
Curr. Assets	**13,592**	**14,039**	**20,507**	**21,131**	**21,388**
Inventory	3,633	3,582	4,454	5,660	6,635
Sundry Debtors	4,030	3,545	4,631	5,829	7,114
Cash & Bank Balances	4,968	5,330	8,349	5,188	1,403
Loans & Advances & Other C	962	1,582	3,072	4,454	6,236
Current Liab. & Prov.	**1,699**	**1,977**	**2,077**	**2,732**	**3,271**
Sundry Creditors	1,397	1,540	1,868	2,460	2,885
Other Liabilities	71	173	0	0	0
Provisions	232	263	209	272	387
Net Current Assets	**11,893**	**12,062**	**18,430**	**18,399**	**18,117**
Application of Funds	**20,764**	**31,201**	**45,717**	**56,057**	**63,697**

E: MOSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	**6.6**	**6.8**	**8.3**	**9.2**	**10.3**
Cash EPS	10.7	13.6	18.6	20.1	24.4
Book Value per Share	44.4	51.3	62.4	69.5	78.1
DPS	1.0	1.0	1.5	1.5	1.5
Payout (Incl. Div. Tax) %	15.1	14.6	14.6	16.3	14.6
Valuation (x)					
P/E		9.3	7.6	6.9	6.2
Cash P/E		4.7	3.4	3.2	2.6
EV/EBITDA		9.0	8.6	8.8	8.7
EV/Sales		1.9	2.0	2.1	2.1
Price to Book Value		1.2	1.0	0.9	0.8
Dividend Yield (%)		1.6	2.4	2.4	2.4
Profitability Ratios (%)					
RoE	13.0	12.4	16.5	13.2	13.2
RoCE	9.8	7.2	6.5	7.0	7.1
Turnover Ratios					
Debtors (Days)	123	91	92	95	95
Inventory (Days)	67	66	65	65	65
Creditors (Days)	67	66	65	65	65
Working Capital (Days)	363	310	368	300	242
Asset Turnover (x)	0.6	0.5	0.4	0.4	0.4
Fixed Asset Turnover (x)	1.4	1.0	0.8	0.6	0.6
Leverage Ratio					
Net Debt/Equity (x)	1.3	1.9	2.4	2.5	2.8

CASH FLOW STATEMENT					(Rs Million)
Y/E MARCH	2005	2006	2007E	2008E	2009E
PBT before EO Items	1,232	1,525	2,435	2,612	3,100
Add : Depreciation	576	758	1,205	1,630	2,078
Less : Direct Taxes Paid	96	134	136	235	315
Inc/Dec in WC	1,531	-193	3,349	3,131	3,502
CF from operations	**180**	**2,342**	**155**	**876**	**1,360**
CF from Op. incl. EO	**180**	**2,342**	**155**	**876**	**1,360**
(Inc)/dec in FA	-3,567	-10,743	-9,000	-11,650	-10,002
(Pur)/Sale of Investments	-38	-319	-353	0	0
CF from Investments	**-3,605**	**-11,062**	**-9,353**	**-11,650**	**-10,002**
Inc/Dec in Networth	1,968	1,006	460	1,333	0
Inc/Dec in Debt	5,005	8,256	12,050	6,624	5,200
Less: Dividend Paid	153	180	294	343	343
CF from Fin. Activity	**6,820**	**9,082**	**12,216**	**7,614**	**4,857**
Inc/Dec of Cash	**3,395**	**362**	**3,018**	**-3,161**	**-3,785**
Add: Beginning Balance	1,573	4,968	5,330	8,349	5,188
Closing Balance	**4,968**	**5,330**	**8,349**	**5,188**	**1,403**

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Disclosure of Interest Statement	Alok Industries
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