



Alok Industries

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,976	ALOK IN
	REUTERS CODE
S&P CNX: 5,932	ALOK BO

2 November 2007

Neutral

Previous Recommendation: Neutral

Rs67

Equity Shares	199.1
52-Week Range	79/50
1,6,12 Rel.Per. (%)	-15/-38/-59
M.Cap (Rs. b)	13.4
M.Cap (US\$ b)	0.3

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
3/07A	18,290	1,419	8.3	32.7	8.1	1.1	16.5	6.6	2.0	8.8
3/08E	22,397	1,828	9.2	28.9	7.3	1.0	13.2	7.0	2.2	8.9
3/09E	27,334	2,049	10.3	12.1	6.5	0.9	13.2	7.1	2.1	8.8

* Fully Diluted EPS

- Alok Industries' 2QFY08 results were more-or-less in line with our estimates. Revenues grew 17% YoY to Rs4.2b, primarily driven by 57% YoY growth in exports to Rs2b. The company posted an EBITDA of Rs1.1b. EBITDA margins were 24.2% (higher than our estimate of 21.9%) – amongst the highest in the textiles industry. Reported PAT jumped 32% YoY to Rs430m, boosted by forex gains of Rs100m and DEP benefits.
- During the quarter, the company installed 25,000 spindles, taking its total spinning capacity to 75,000 spindles.
- Alok's gross debt in FY07 was Rs33b, which is likely to increase to Rs45b by FY09. We view its high leverage (2.6x DER in FY08) as concerning, given the scenario of rising interest rates.
- We expect 22% CAGR in Alok's revenue and 20% CAGR in its net profit over FY07-09. The stock trades at 7.3x FY08E EPS of Rs9.2 and 6.5x FY09E EPS of Rs10.3. We believe that the company's ambitious capex plans are likely to keep it in a phase of negative free cash flows for the next few years. This coupled with the company's huge net debt of about Rs40b (debt/equity ratio of 2.6x) is likely to limit upside. We maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	3,579	4,172	4,799	5,741	4,189	4,648	6,047	7,569	18,290	22,397
Change (%)	19.6	20.8	31.0	40.8	17.1	11.4	26.0	31.8	28.9	22.4
Total Expenditure	2,772	3,204	3,726	4,420	3,173	3,562	4,596	5,724	14,123	16,988
EBITDA	806	968	1,073	1,321	1,016	1,086	1,451	1,845	4,168	5,409
Change (%)	37.1	36.7	32.5	50.8	26.0	12.3	35.2	39.7	40.7	29.8
As % of Sales	22.5	23.2	22.4	23.0	24.2	23.4	24.0	24.4	22.8	24.2
Depreciation	246	280	325	354	358	364	407	474	1,205	1,630
Interest	170	213	242	269	270	283	329	402	893	1,318
Other Income	-4	-16	32	19	2	139	38	75	32	151
Non Recurring Expense	0	0	0	334	396	0	0	0	334	396
PBT	386	459	539	1,051	785	579	752	1,044	2,435	3,007
Tax	117	132	168	265	235	149	220	300	682	879
Effective Tax Rate (%)	28.2	28.9	31.2	25.2	30.0	29.0	29.2	28.7	28.0	30.0
Reported PAT	269	326	371	787	550	430	532	744	1,753	2,129
Change (%)	31.0	28.1	25.7	139.4	104.3	31.8	43.7	-5.4	61.8	21.4
Adj. PAT	269	326	371	452	285	430	532	744	1,419	1,828
Change (%)	31.0	28.1	25.7	30.4	5.9	31.8	43.7	64.4	30.9	28.9

E: MOST Estimates

Results in line with estimates

Alok Industries' 2QFY08 results were more-or-less in line with our estimates. Revenues grew 17% YoY to Rs4.2b, primarily driven by 57% YoY growth in exports to Rs2b. The company posted an EBITDA of Rs1.1b. EBITDA margins were 24.2% (higher than our estimate of 21.9%) – amongst the highest in the textiles industry. Reported PAT jumped 32% YoY to Rs430m, boosted by forex gains of Rs100m and DEPB benefits.

EBITDA margins amongst the highest in the industry

Alok's EBITDA margins are amongst the highest in the textiles industry at 23-24%. With contribution from home textiles increasing since 2QFY06, the company's 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 2QFY08 revenues, sustainability of these margins would be a challenge.

New developments

The management has undertaken several new initiatives, which it plans to aggressively pursue, going forward. It has launched two new subsidiaries – Alok Infrastructure and Alok Industries International – to focus on the real estate and retailing, respectively. The management intends to list both these 100% subsidiaries in the next 6-9 months.

A) Foray into real estate: Alok Industries plans to diversify into the real estate sector through its 100% subsidiary, Alok Infrastructure Private Limited. It has acquired the following properties: (i) commercial office premises admeasuring around 575,000sft at Lower Parel, Mumbai in an office complex called Peninsula Business Park being developed by Peninsula Land Holdings at the erstwhile The Dawn Mills Limited at a cost of ~Rs19,000/sft (current market value ~Rs19b, implying underlying pre-tax gains of ~Rs8b); (ii) commercial office premises at Ashford Centre admeasuring about 57,000sft at Lower Parel, Mumbai

being developed by Ashford Universal at a cost of ~Rs14,000/sft. The management has indicated that the subsidiary already has some more development projects, information about which would be shared with investors in due course. While entry into real estate could create value for the company, it could lead to increase in leveraging (capex requirement of Rs14b over the next three years) and further increase the company's risk profile.

B) Expansion plans in retailing: Through its 100% subsidiary, Alok Industries International Limited (AAIL), incorporated in the British Virgin Islands, Alok Industries 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 (about 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 (debt/equity ratio of 2.6x 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 is 3.5-4%. However, as most of these loans have been taken at floating rates, the cost of servicing the TUF loans could jump 200-250bp, which could sharply increase interest costs. Furthermore, Alok is currently capitalizing a majority of its interest and depreciation, as its new capacities are yet to get commercially operational. With a majority of its capacities going on stream by FY08, Alok would have to account for the entire interest and depreciation cost.

Fresh capex initiative of Rs11b

Alok Industries 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.

STATUS OF CAPACITY EXPANSION

DIVISIONS	CURRENT CAPACITY P.A.	ADDITIONAL CAPACITY FROM 2008	ADDITIONAL CAPACITY FROM 2009	CAPACITY POST EXPANSION
Spinning				
Ton	5,250	15,000	9,750	30,000
Spindle	50,400	201,600	100,800	352,800
Home Textiles				
Sheeting Fabric (M Mtr)	60.00	22.50	-	82.50
Terry Towels (Ton)	-	6,700	-	6,700
Apparel Fabrics				
Woven (M Mtr)	82.50	-	22.50	105.00
Knits (Ton)	16,800	-	50,400	67,200
Garments (Mn. Pc.)	8.00	7.00	7.00	22.00
Polyester Yarn				
Texturising (Ton)	7,150	82,800	27,600	117,550
Poy (Ton)	54,000	-	54,000	108,000
Pet (Ton)	-	-	185,000	185,000
Investment (Rs M)	19,070		21,430	40,500

Source: Company/Motilal Oswal Securities

Valuation and view

The stock trades at 7.3x FY08E EPS of Rs9.2 and 6.5x FY09E EPS of Rs10.3, and an EV of 8.9x FY08E and 8.8x FY09E EBITDA. We believe that the company's ambitious capex plans are likely to keep it in a phase of negative free cash flows for the next few years. This coupled with the company's huge net debt of about Rs40b (debt/equity ratio of 2.6x) is likely to limit upside. We maintain **Neutral**.

Alok Industries: an investment profile

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, post-quotas. 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.

COMPARATIVE VALUATIONS

		ALOK	ARVIND MILLS	VARDHMAN
P/E (x)	FY08E	7.3	44.5	6.3
	FY09E	6.5	16.9	5.1
P/BV (x)	FY08E	2.2	0.9	0.7
	FY09E	2.1	0.8	0.7
EV/Sales (x)	FY08E	8.9	1.5	1.5
	FY09E	8.8	1.3	1.3
EV/EBITDA (x)	FY08E	3.3	10.5	8.3
	FY09E	2.8	8.9	6.9

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	34.3	30.6	28.7
Domestic Inst	13.4	19.4	22.6
Foreign	35.7	38.1	8.7
Others	16.6	12.0	40.0

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 7.3x FY08E EPS of Rs9.2 and 6.5x FY09E 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.

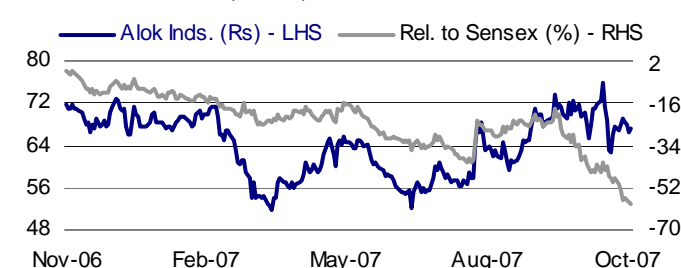
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	9.2	-	-
FY09	10.3	-	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
67	-	-	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	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 Expenditure	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	2007	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	45,671	56,057	63,697

E: M OSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	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	10	10	15	15	15
Payout (Incl. Div. Tax) %	15.1	14.6	14.6	16.3	14.6
Valuation (x)					
P/E		9.9	8.1	7.3	6.5
Cash P/E		5.0	3.6	3.3	2.8
EV/EBITDA		9.2	8.8	8.9	8.8
EV/Sales		19	2.0	2.2	2.1
Price to Book Value		13	1.1	10	0.9
Dividend Yield (%)		15	2.2	2.2	2.2
Profitability Ratios (%)					
RoE	13.0	12.4	16.5	13.2	13.2
RoCE	9.8	7.2	6.6	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)	14	10	0.8	0.6	0.6
Leverage Ratio					
Net Debt/Equity (x)	13	19	2.4	2.5	2.8

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	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

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|---|----|
| 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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