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MF Global Sector – Textile

Pradip Overseas

IPO Note: Subscribe

Pradip Overseas (POL) is one of the few textile manufacturers with focus on Home Linen products of both wider width and narrow width. In addition to the sales in domestic market, the company's products are being exported to markets in more than twenty countries (directly and indirectly). From beginning, the company has focused on asset light business model with focus on processing, which lead to high asset turnover of 12.7x (Ex trading) and RoCE of 29.7% in FY09. POL doesn't own any manufacturing unit, it sources gray fabric from small weavers, processes it and converts it into various home linen products. The company has a capacity to process 136.5 mn mtr fabric in a year, which is running at 96% utilization level currently. It also sells its home linen products under the brand name of Lucy B Linens in India through 800 retail outlets.

Promoter, Mr. Pradipkumar Karia, has over two decades of business experience in textile with specific focus on the home linen business in last fifteen years. POL has capability to manufacture wide range of fabrics up to 126" width and has inventory of over 8,000 designs. The company's products have been certified by ISO 9001:2008 and Oeko-Tax, Germany.

The company manufactures a range of home linen products, which include the following:

- Flat and fitted sheets for double and single beds both in narrow width and wider width
- Quilt covers and pillow covers
- Mattress covers
- Quilts poly / cotton filled
- Curtains

Valuation: At upper band of Rs110 it is available at just 5.7x FY11E EPS of Rs19.3 and 3.8x FY12E EPS of Rs28.9. We expect, the company to report high RoCE of 23.9% and 26% in FY12E. However, real growth would be visible from FY12 onwards, post commencement of SEZ. Considering strong return ration and lower valuation we recommend subscribe to IPO, with long term horizon.

Sensex	17616
Nifty	5263

Issue at a Glance

Issue Opens	11th March'10
Issue Closes	15th March'10
Price Band	100-110
No of shares to be issued	10.6 mn
Issue Size (Rs mn)	1,060-1,166

Shareholding pattern (%)

	Pre-issue	Post-issue
Promoters group	80.06	59.04
QIB	0.00	12.51
NIB	16.63	37.29
Retail	3.31	3.68
Total	100.0	100.0

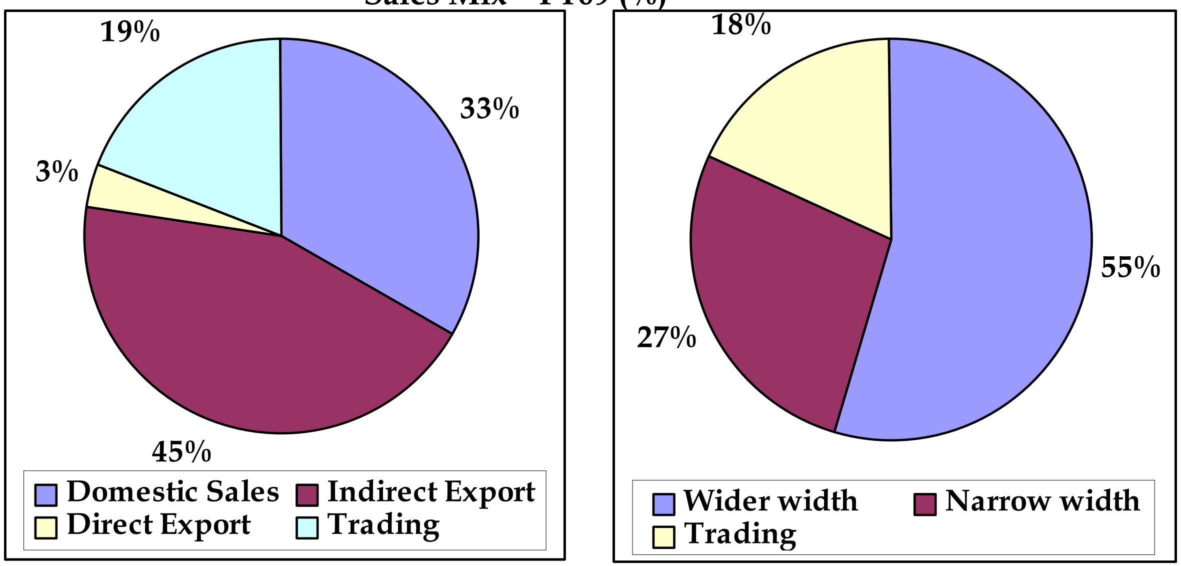
Key Financials	FY09	FY10E	FY11E
Net sales (Rs mn)	11,706	16,166	17,956
Opm (%)	9.7	10.2	10.5
Adj PAT (Rs mn)	444	679	778
Adj EPS (Rs)	14.9	16.8	19.3
P/E (x)	7.4	6.5	5.7
EV/EBIDTA (x)	5.1	4.4	4.4
RoNW (%)	41.5	30.7	22.1

Note: At upper band of Rs110

Revenue Break up (FY09)

The company has increased its revenue by 72.7% CAGR to Rs11,706 mn over FY07-09, on back of capacity expansion. The company started its operation to serve need of merchant export houses. At present it is selling its product to over 20 countries directly or indirectly. It caters to economic segment of US and European markets and serves clients like Domestic Franco, Spring, Ross, Big Lots, Kiks etc. 45% of sales happened through indirect export, while only 3% of sales happened through direct export in FY09. As the company grows and achieve necessary size, we expect share of direct export to increase. The company sold 33% of its sales to domestic market of which around 10% is sold under brand of Lucy B Lenins through 800 retail outlets. In next two years, we expect the company to increase its retail reach to 2,000 outlets from 800 at present. Of total sales 55% is contributed on account of wider width products, while 27% is contributed from narrow width.

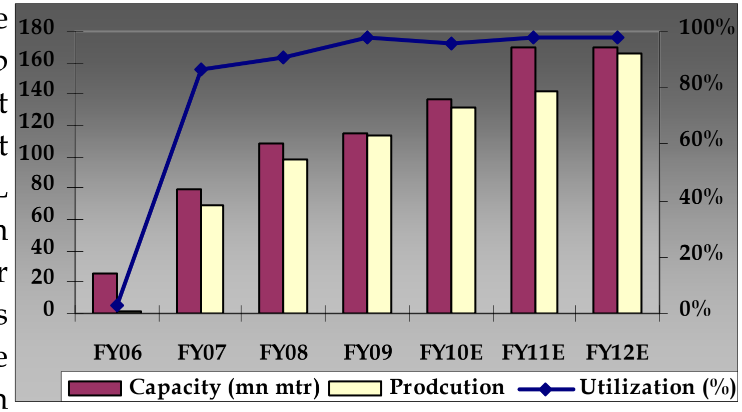
Sales Mix – FY09 (%)



Source: MF Global PCG Research, Company RHP

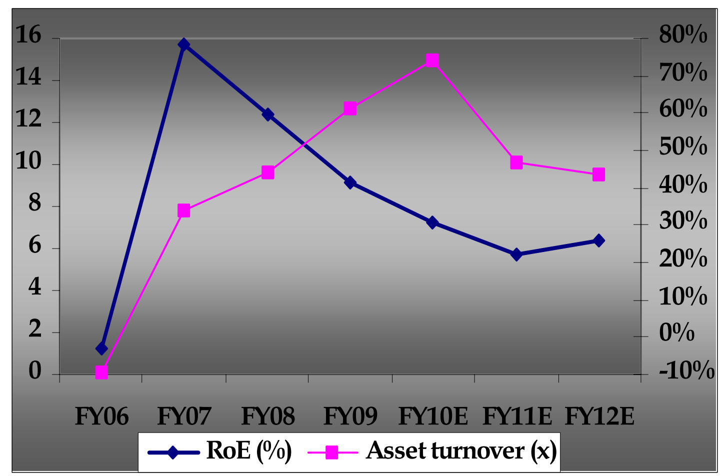
Production and utilization level

In the year 1985, Mr.Pradip commenced business as a supplier of various textile products in the domestic market. Anu Implex was established in 1993 and Pradip export was established in 1995 to supply home linen products to merchant exporters. In 2004, Pradip Overseas acquired a defunct textile processing unit at Changodar, Ahmedabad from bank through an auction process. POL operationalized that unit to manufacture narrow width home linen products, with installed capacity of 22 mn mtrs per annum. In Feb'06, the company set up wider width facility with capacity of 24.96 mn mtrs. The company has ramped up its production in FY07 to 86.3% utilization level. On account of buoyant demand the company gradually expanded its capacity to 136.5mn mtrs in FY10 from 79.2 mn mtrs in FY07. At present the company is operating at 96% utilization level. In order to meet its requirement the company started outsourcing from FY09 onwards. The company has outsourced almost 19% of its requirement in FY09. These should give enough comfort for capacity expansion.



Scalable business model with high return ratio:

From beginning the company has focused on asset light but scalable business model. The company acquired sick unit in 2004 and turned it around. As a result its initial investment was very low, compared to its peers. In addition, the company has increased its capacity by 5.5 times to 136.5 mn mtrs in last four years at cost of just Rs660 mn only. The company has high RoCE of 29.7% and RoE of 41.5% in FY09. Even fixed asset turnover is very high at 12.7x (Ex trading) in FY09. On account of low capex the company operates at very slim long term debt of just Rs700 mn on sales of Rs11,706 mn. Lower long-term debt has given enough comfort during downturn when majority of the peers were bleeding.



Source: MF Global PCG Research, Company RHP

SEZ – the crux of story

The company is planning to set up first ever textile SEZ over 110 acre land near Ahmedabad, Gujarat, which would be the key trigger for the company. The company has already acquired 84.56 acre land out of 110 acre and balance would be acquired in near future. POL would set up processing facility for 33mn mtrs in one third of land, while it would set up necessary infrastructure and invite small weavers to set up weaving facility in remaining area. In turn weavers would get buyback commitment from POL. It will be win-win situation for both, since inter sales to SEZ is treated as deemed export and doesn't attract excise, VAT and other taxes. In addition the company would get interest subvention of 2%. These should reduce gray fabric cost for POL, in addition it would reduce raw material inventory by two months and have better control over quality of gray fabric. As per RHP, SEZ should be operational by Jan'10. We expect SEZ to add Rs4bn to top line in FY12E. Since profit from SEZ doesn't attract tax it would reduce overall tax rate to 25-27% in FY12E from 33.3% at present. In addition the company would get lease rent from weavers for providing SEZ infrastructure, which we haven't consider in our forecasts.

Capex plan and means of funding

The company is planning to invest Rs1,000 mn to set up textile SEZ along with 33mn mtrs processing facility. The company would require additional Rs1,000 mn for working capital needs. Of total requirement of Rs2,000 mn, debt is tied up to the tune of Rs650 mn, rest would be financed through IPO proceeding and internal accruals.

Fund requirement (Rs mn)	
Land	45
Factory Building	135
Other Infra	140
Plant & Machinery	
Imported	272
Indigenous	298
Preliminary and pre-operative expenses	110
Total	**1,000**
Working Capital	1,000
Total Requirement	**2,000**

Means of Finance (Rs mn)	
IPO	1,060-1,166
Debt	650
Internal Accruals	184-290
Total	**2,000**

Risk:

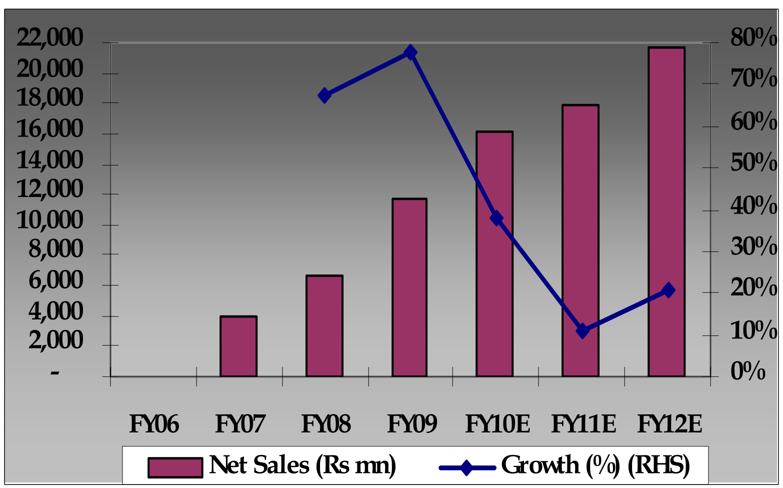
- Major part of sales happens through indirect export, which put company in vulnerable position against other organized competitors. In addition, the company is not able to get benefit, which an EoU (Export oriented unit) can get.
- The company is completely dependent on its raw material i.e. gray fabric requirement, which constitute 80% of the sales. Any issue with quality or timely availability of gray fabric may affect quality and delivery schedule of its home linen products.
- Timely completion of SEZ is key trigger for the company, and any delay in schedule completion can hamper its growth rate.
- Mammoth investment to the tune of ~Rs22bn would be required from weavers to set up weaving facilities in the SEZ, it would be challenge to the company get commitment of such large investment from various weavers.
- Top ten customers constituted 63% of domestic revenue and 66% of export revenue in FY09. The company does not have any legally binding agreements or commitments to supply to them in the future.

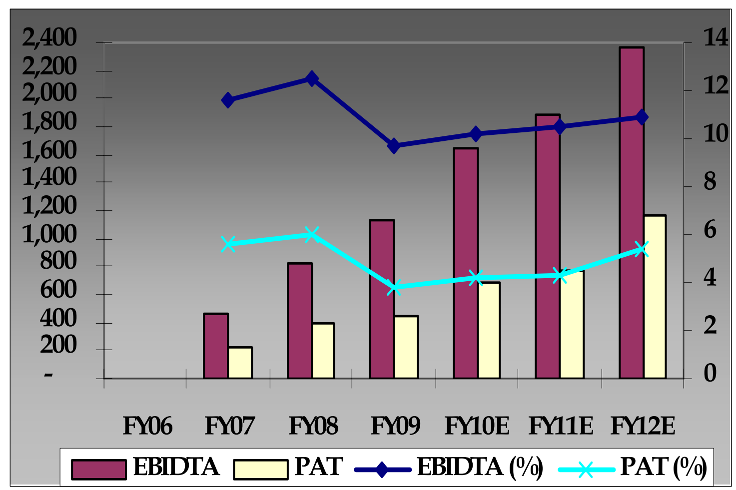
Financials

The company has increased its revenue by 72.7% CAGR to Rs11,706 mn over FY07-09, on back of capacity expansion and higher realization. Production volume has increased at pace of 28.6% CAGR while realization has increased by 20.3% CAGR over same period. The company is able to increase its realization from Rs71 per meter to Rs116 per meter in 9mFY10. At present the company is utilizing its capacity to full extent, leaving limited scope for growth. Hence we expect growth to tapper down in FY11E to 11.1% however, foray into textile SEZ would provide necessary growth momentum from FY12E onwards, which lead to higher growth of 20.8% in FY12E. On account of capacity constraint the company is outsourcing around 16% of its requirement on which operating margin is just 1-2%. Operating margins in FY09 was lower by 278 bps due to higher outsourcing and economic meltdown. Once the SEZ is operational we expect share of outsourcing to go down, which should improve margins. In addition due benefit of no direct and indirect taxes net profit should grow at healthy pace of 50.1% in FY12E.

At upper band of Rs110 it is available at just 5.7x FY11E EPS of Rs19.3 and 3.8x FY12E EPS of Rs28.9. We expect, the company to report high RoCE of 23.9% and 26% in FY12E. However, real growth would be visible from FY12 onwards, post commencement of SEZ. Considering strong returns rations and lower valuations we recommend subscribe to IPO, with long term horizon

Sales and Margins trend





Source: MF Global PCG Research, Company RHP

Profit & Loss and Balance Sheet – Rs mn

Income Statement	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	**6,580**	**11,706**	**16,166**	**17,956**	**21,685**
Raw materials	5,098	7,481	10,896	12,066	14,529
Employee expenses	37	54	65	72	87
Other Exp	624	812	905	1,006	1,171
Op profit	**820**	**1,132**	**1,650**	**1,885**	**2,364**
Opm(%)	12.5	9.7	10.2	10.5	10.9
Other income	58	53	40	45	54
Depreciation	49	54	67	93	133
Interest	221	456	605	670	728
PBT	**608**	**676**	**1,018**	**1,167**	**1,557**
Tax	216	232	339	389	389
PAT	**392**	**444**	**679**	**778**	**1,168**
Extraordinary item	-	-	-	-	-
Adj PAT	**392**	**444**	**679**	**778**	**1,168**
Npm(%)	6.0	3.8	4.2	4.3	5.4

Balance Sheet	FY08	FY09	FY10E	FY11E	FY12E
Equity capital	**149**	**298**	**404**	**404**	**404**
Reserves	702	992	2,731	3,509	4,677
Networth	**851**	**1,290**	**3,134**	**3,913**	**5,081**
Total debt	1,837	3,278	4,378	4,678	5,028
Deferred tax	43	46	62	85	109
Total liabilities	**2,731**	**4,614**	**7,575**	**8,676**	**10,218**
Gross fixed assets	**723**	**768**	**1,037**	**2,057**	**2,137**
Less: Cum depreciation	127	175	243	335	468
Net fixed assets	596	593	794	1,722	1,669
Capital WIP	10	9	20	30	20
Investments	-	-	-	-	-
Net current assets	2,123	4,011	6,760	6,925	8,529
Total assets	**2,731**	**4,614**	**7,575**	**8,676**	**10,218**

Cash Flow and Ratios – Rs mn

Cash flow	FY08	FY09	FY10E	FY11E	FY12E
PBT & extraord. Items	391	442	1,018	1,167	1,557
Add: Int. depn. & oth. Exp.	261	488	672	763	861
Cash flow from op.	**653**	**930**	**1,690**	**1,930**	**2,418**
Net chg in w/c, tax, int.	(944)	(1,359)	(2,279)	(1,186)	(1,946)
Net cash flow frm op.	**(292)**	**(430)**	**(589)**	**744**	**472**
Capital expenditure	(76)	(45)	(280)	(1,030)	(70)
Sale/ purchase of inv	7	18	-	-	-
Net cash from inv.	**(69)**	**(27)**	**(280)**	**(1,030)**	**(70)**
Issue of eq/pref sh/warr.	384	985	1,661	(370)	(378)
Dividend paid	-	-	-	-	-
Net cash from financing	**384**	**985**	**1,661**	**(370)**	**(378)**
Net chg in cash	24	529	792	(656)	24
Op. cash bal	206	229	758	1,551	895
Cl. Cash bal	229	758	1,551	895	919

Ratios	FY08	FY09	FY10E	FY11E	FY12E
Growth(%)					
Net Sales	67.6	77.9	38.1	11.1	20.8
Adj PAT	79.5	13.1	52.9	14.7	50.1
Adj EPS	79.5	13.1	12.8	14.7	50.1
Per share data (Rs.)					
Adj EPS	13.2	14.9	16.8	19.3	28.9
Book value	28.6	43.3	77.6	96.9	125.9
DPS	0.0	0.0	0.0	0.0	0.0
Valuation(x) *					
P/E	8.3	7.4	6.5	5.7	3.8
P/BV	3.8	2.5	1.4	1.1	0.9
EV/EBIDTA	6.0	5.1	4.4	4.4	3.6
Performance(%)					
RoCE	35.2	29.7	26.2	22.3	23.9
RoNW	59.8	41.5	30.7	22.1	26.0

Note: At upper band of Rs110

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