



Vardhman Textiles

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

1 November 2006

Buy

Previous Recommendation: Buy

Rs285

Equity Shares (m)	57.8
52-Week Range (Rs)	420/250
1,6,12 Rel.Per. (%)	0/-29/-59
M.Cap (Rs. b)	16.5
M.Cap (US\$ b)	0.4

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	18,892	1,964	30.7	65.5	9.3	1.7	22.4	12.5	1.4	7.7
3/07E	23,050	1,797	28.1	-4.3	10.2	1.6	17.3	11.3	1.4	7.8
3/08E	25,850	2,110	32.9	17.4	8.7	1.4	17.6	10.0	1.6	8.4

- Vardhman Textiles declared 2QFY07 results inline with our estimates. Revenues grew by 15% to Rs5.3b, while EBITDA was Rs917m v/s our estimate of Rs949m.
- PAT increased by 14.6% YoY to Rs458m v/s our estimate of Rs427m, propped by higher other income and lower-than-expected interest cost. Other income included an element of Rs35m on account of sale of property.
- EBITDA margins declined by 120bps in 2QFY07 to 17.4% YoY v/s our estimate of 17.9%. EBIT margins increased marginally for yarns by 66bp YoY and 19bp YoY for sewing thread. However, EBIT margins for fabrics and steel declined substantially by 859bps and 224bps respectively, negating gains achieved by the yarns and sewings thread division. We expect fabric margins to stabilize at around 10-12% in 3QFY07.
- We expect the company to post PAT CAGR of 18%, over FY07E-FY09E and post EPS of Rs28.1 in FY07 and Rs32.9 in FY08. The stock trades at PER of 10.2x FY07 and 8.7x FY08 earnings. Maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	4,221	4,596	5,127	4,948	4,755	5,283	6,078	6,933	18,892	23,050
Change (%)	2.0	-3.9	6.0	3.9	12.7	15.0	18.5	40.1	2.1	22.0
Total Expenditure	3,438	3,743	4,169	4,112	246	4,366	4,996	5,662	15,462	18,910
EBITDA	783	853	958	836	836	917	1,082	1,271	3,430	4,140
Change (%)	16.0	19.2	30.7	9.5	6.8	7.5	12.9	52.0	18.9	20.7
As % of Sales	18.5	18.6	18.7	16.9	17.6	17.4	17.8	18.3	18.2	18.0
Depreciation	251	251	267	244	286	301	356	426	1,013	1,369
Interest	112	98	91	93	110	99	150	217	395	575
Other Income	12	27	56	120	62	37	50	51	214	200
Extra-ordinary Income	0	0	0	270	0	35	0	0	270	35
PBT	431	531	656	888	501	590	626	679	2,506	2,396
Tax	142	132	143	127	126	132	150	191	543	599
Effective Tax Rate (%)	32.8	24.8	21.7	14.3	25.2	22.4	24.0	28.1	21.7	25.0
Reported PAT	290	399	513	762	375	458	476	488	1,963	1,797
Adj. PAT	290	399	513	492	375	423	476	488	1,693	1,762
Change (%)	62.0	62.5	64.2	4.2	29.4	5.9	-7.2	-0.7	62.6	4.1

E: MOST Estimates

Fabric margins drop sharply

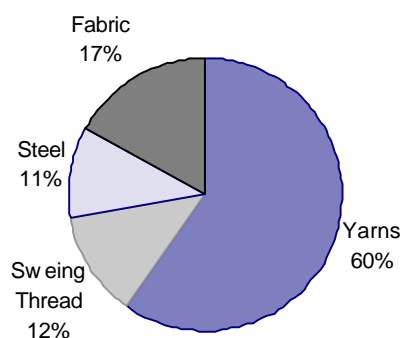
EBIT margins increased marginally for yarns by 66bp YoY and by 19bp YoY for sewing thread. However, EBIT margins for fabric declined substantially by 859bp while for steel, margins dropped by 224bp, negating gains achieved by the yarn and sewing thread division. The company has been facing teething problems in the expanded portion of their fabric capacity and is currently able to operate only at a capacity of 36m meters v/s the rated capacity of 42m meters. Management aims to stabilize their plant in 3QFY07.

The current weakness being witnessed in cotton is likely to benefit the company, as it stocks up its raw material requirements for FY08 during the current fiscal. Despite the current decline in the cotton prices and the resultant pressure on yarn prices, the margins for the yarn segment continues to remain stable.

Segmental revenue break-up

Revenues from the textile division increased by 21% YoY to Rs2.9b, fabric sales increased by 28% YoY to Rs1b, while steel and sewing thread segments witnessed marginal changes.

PRODUCT MIX IN 2QFY07



Source: Company/ Motilal Oswal Securities

SEGMENTAL RESULTS (RS M)

	2QFY06	2QFY07	% CH.
Yarns	2,985	3,619	21.2
Sewing Thread	780	754	-3.3
Steel	657	663	1.0
Fiber	0	0	0
Fabric	801	1,025	28.0
Inter Segment Revenue	626	778	24.1
Total	4,596	5,283	15.0
EBIT			
Yarns	347	445	28.1
Sewing Thread	103	101	-1.9
Steel	111	97	-12.5
Fabric	110	53	-
Total	671	695	3.7
EBIT (%)			
Yarns	11.6	12	0.7
Sewing Thread	13.2	13	0.2
Steel	16.8	15	-2.2
Fabric	13.7	5	-8.6

Source: Company/ Motilal Oswal Securities

Benefit from declining cotton prices

The current weakness being witnessed in cotton is likely to be beneficial for the company as it stocks up its raw material requirements for FY08 during the current fiscal. Despite the current decline in the cotton prices and the resultant pressure on yarn prices, yarn margins for the company are currently stable.

Capacity expansion plans

Vardhman is embarking on a significant capacity expansion program with capex outlay of close to Rs20b. Post-expansion its processed fabric capacity would increase by around 168% and spindle capacity, by around 55%. In line with its expansion plans, the company has already acquired land in Madhya Pradesh. It intends to increase fabric weaving and processing capacity from 42m meters to 102m meters and opt for a corresponding increase in spindle capacity by 234,000 spindles. This will significantly improve the company's growth prospects going forward and should positively impact margins.

CAPACITY ADDITIONS OVER FY06-08

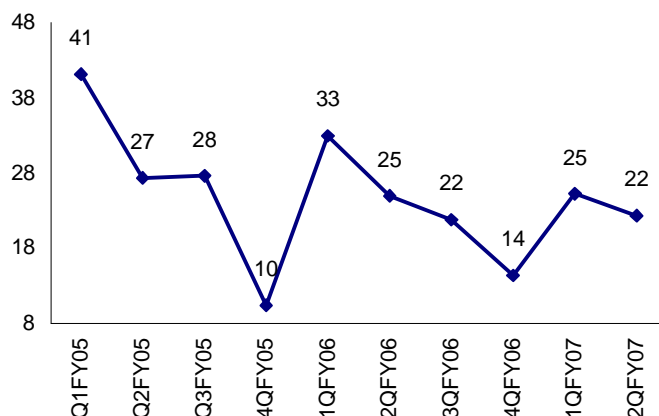
	FY06	FY07	FY08
Spindles (In No's.)			
Baddi	170,600	198,200	198,200
Other Existing Plants	307,300	307,300	307,300
Greenfield at MP	-	90,000	234,000
Total	477,900	595,500	739,500
Greige Fabric (Looms in No's.)			
Baddi	430	490	490
Greenfield at MP	-	120	400
Total	430	610	890
Processed Fabric (mm)			
Baddi	38	42	42
Greenfield at MP	-	10	60
Total	38	52	102

Source: Company/ Motilal Oswal Securities

Lower tax provisioning, going forward

Vardhman's investments of around Rs5b in its yarn and processed fabric plants at Baddi in Himachal Pradesh will attract fiscal benefits for the next few years. The company is eligible for tax breaks under Section 80IC for the incremental capex at Baddi, provided incremental investment is more than 50% of its existing plant's gross block. The upside on account of these tax savings would be even higher if the company moved its incremental production to these plants. We have assumed that the company will retain the tax benefits, which in turn could boost its bottomline.

DECLINING TAX RATES (%)



Source: Company/ Motilal Oswal Securities

Valuation and view

We expect Vardhman's earnings to witness CAGR of 18%, over FY07-FY09E. We expect margins in the yarns, fabric and sewing threads business to expand, as upstream products would benefit substantially from the surge in demand from the downstream industry (garment industry). Hence, we have a bullish view on upstream companies such as Vardhman Textiles. The stock trades at PER of 10.2x FY07 and 8.7x FY08 earnings. Maintain **Buy**.

Vardhman Textiles: an investment profile

Company description

Vardhman Textiles is the flagship company of one of the most respected textile groups in India. It has a large spindlage capacity and is the second largest sewing thread player in India. The company stands to gain substantially from the strong increase in demand from the domestic downstream sector and the robust export market. In our opinion, Vardhman is all set to emerge as one of the most cost competitive textile companies globally by virtue of its large scale capacities, world class facilities and diversified product mix.

Key investment arguments

- De-risked business model.
- Superior management quality.
- Poised to reap benefits of expansion.

Key investment risks

- Commodity nature of its business.
- Steel contribution to decline.
- New capacities to go on stream only in FY08.

Recent developments

- Has declared dividend of 40% for FY06 on an expanded equity capital of Rs577m.
- Is eligible for tax breaks under Section 80IC for the incremental capex at Baddi.

Valuation and view

- Is expanding weaving and processing capacity.
- We expect Vardhman's earnings to witness CAGR of 18%, over FY07-FY09E.
- We rate the stock a **Buy** with a price target of Rs400.

Sector view

- Exports from China are likely to be severely constrained due to safeguard measures introduced 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 who have high product development skills.
- The concern of industry overcapacity causing waves of deflation in prices is overblown.

COMPARATIVE VALUATIONS

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

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	62.2	62.2	62.2
Domestic Inst	17.1	16.2	11.8
Foreign	3.7	4.0	3.9
Others	16.9	17.5	22.0

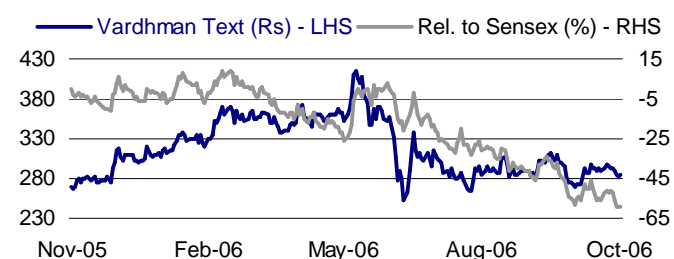
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	28.1	31.8	-11.5
FY08	32.9	37.4	-11.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
285	400	40.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	18,509	18,892	23,050	25,850	31,902
Change (%)	7.7	2.1	22.0	12.1	23.4
Total Expenditure	17,126	15,461	17,999	20,204	24,725
EBITDA	2,885	3,430	4,140	4,835	6,054
Change (%)	10.2	18.9	20.7	16.8	25.2
% of Net Sales	15.6	18.2	18.0	18.7	19.0
Depreciation	970	1,013	1,369	1,619	2,250
EBIT	1,915	2,417	2,771	3,216	3,804
Interest & Finance Charges	591	395	575	615	685
Other Income	273	214	200	250	250
Non-recurring Items/ Inc.	0	270	0	0	0
PBT	1,597	2,506	2,396	2,851	3,369
Tax	389	543	599	741	842
Effective Rate (%)	24.4	217	25.0	26.0	25.0
Reported PAT	1,208	1,964	1,797	2,110	2,526
Change (%)	32.3	62.6	-8.5	17.4	19.8
Adjusted PAT	1,208	1,694	1,797	2,110	2,526

BALANCE SHEET (Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Capital	385	578	641	641	641
Share Capital	385	578	641	641	641
Reserves	7,542	9,039	10,471	12,216	14,377
Net Worth	7,927	9,617	11,112	12,856	15,017
Loans	8,164	11,022	15,464	22,964	25,464
Deferred Tax Liability	1,092	922	1,041	1,190	1,358
Capital Employed	17,182	21,560	27,617	37,009	41,839
Gross Fixed Assets	14,887	17,599	24,599	35,099	39,599
Less: Depreciation	7,465	8,188	9,557	11,176	13,426
Net Fixed Assets	7,421	9,411	15,042	23,923	26,173
Capital WIP	132	965	965	965	965
Investments	925	684	684	684	684
Curr. Assets	10,324	12,458	13,011	13,651	16,444
Inventory	6,822	5,690	6,428	7,216	8,831
Sundry Debtors	2,260	2,220	2,660	2,983	3,681
Cash & Bank Balances	98	2,715	1,450	485	520
Loans & Advances & Other C	1,144	1,832	2,473	2,968	3,413
Current Liab. & Prov.	1,620	1,957	2,085	2,213	2,427
Sundry Creditors	349	1,636	537	606	758
Other Liabilities	1,073	1,148	1,183	1,242	1,304
Provisions	198	321	365	365	365
Net Current Assets	8,704	10,501	10,926	11,438	14,017
Application of Funds	17,182	21,560	27,617	37,010	41,839

E: MOSI Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	18.9	30.7	28.1	32.9	39.4
Cash EPS	34.0	46.9	49.4	58.2	74.6
Book Value per Share	123.8	166.5	173.5	200.7	234.5
DPS	4.5	4.5	5.0	5.0	5.0
Payout (Incl. Div. Tax) %	17.4	17.5	20.3	17.3	14.5
Valuation (x)					
P/E	15.1	9.3	10.2	8.7	7.2
Cash P/E	8.4	6.1	5.8	4.9	3.8
EV/EBITDA	9.1	7.7	7.8	8.4	7.1
EV/Sales	14	14	14	16	14
Price to Book Value	2.3	1.7	1.6	1.4	1.2
Dividend Yield (%)	16	16	18	18	18
Profitability Ratios (%)					
RoE	16.2	22.4	17.3	17.6	18.1
RoCE	11.2	12.5	11.3	10.0	9.6
Turnover Ratios					
Debtors (Days)	41	41	42	42	42
Inventory (Days)	145	126	130	130	130
Creditors (Days)	13	20	20	20	20
Working Capital (Days)	172	203	173	162	160
Asset Turnover (x)	1.1	0.9	0.8	0.7	0.8
Fixed Asset Turnover (x)	1.2	1.1	0.9	0.7	0.8
Leverage Ratio					
Debt/Equity (x)	1.03	1.15	1.39	1.79	1.70

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
PBT before E.O. Items	1,597	2,506	2,396	2,851	3,369
Add : Depreciation	970	1,013	1,369	1,619	2,250
Less : Direct taxes paid	437	445	479	593	674
Inc/Dec in WC	763	-779	1,627	1,477	2,544
CF from operations	1,366	3,854	1,659	2,400	2,400
Minority Int. & Share of Assoc	0	0	0	0	0
CF from Oper. incl. EO	1,366	3,854	1,659	2,400	2,400
(Inc)/Dec in FA	-450	-5,500	-7,000	-10,500	-4,500
(Pur)/Sale of Investments	-39	-242	0	0	0
CF from investments	-489	-5,742	-7,000	-10,500	-4,500
Inc/Dec in Networth	0	1,942	0	0	0
Inc/Dec in Debt	-850	2,859	4,442	7,500	2,500
Less: Dividend Paid	198	296	365	365	365
CF from Fin. Activity	-1,048	4,504	4,076	7,135	2,135
Inc/Dec of Cash	-170	2,617	-1,265	-965	35
Add: Beginning Balance	267	98	2,715	1,450	485
Closing Balance	98	2,715	1,450	485	520

For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement	Vardhman Textiles
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

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.