

## Industry In-Depth

3 December 2006 | 7 pages

# Indian Textiles

## Key Takeaways from Indian Home Textile Conference

- Global Home Textile market size** — Global Home Textile Industry is estimated at \$70bn of the global textile and clothing industry of \$480bn; US (\$24bn) and EU markets dominate 70% of the world's home textile imports.
- Key trends post quotas** — 1) Global retailers increase outsourcing to cut costs; 2) Manufacturing shifting from developed to developing markets; 3) Consolidation, rationalization of outsourcing countries and vendors to trigger growth for Asian's; 4) China, India, Pakistan, key Asian vendor's dominate (76% share) and gain at expense of developed markets; 4) Prices decline as competition intensifies.
- Growth drivers and retardants** — Drivers for vendors are 1) Focus on value addition through innovation, design, supply chain management, and 2) Strategic partnerships with Global Brands/Retailers; Retardants are 1) FTAs with underdeveloped countries, giving duty-free access to US and EU, and 2) Risk of excess capacity further lowering prices and adversely affecting profitability.
- India set to grow** — India is the largest vendor of terry towels (25% share) and third in bed linen (17%) to US. Self sufficiency in cotton, recent M&As/JVs/Tie-ups with global brands further strengthened India's position. While price/cost pressures remain with new capacities operational, thrust on value addition, Indian home textile exports are set to grow from \$3bn in 2005 to \$10bn by 2010.
- Key beneficiaries** — Alok Industries (ALOK.BO - Rs71.20; 1M) established player in bed-linen with scale offering rapid earnings growth. Welspun India (WLSP.BO - Rs93.20; 2M) leader in terry towels, but still establishing presence in bed linen.

**Ashish Jagnani<sup>1</sup>**

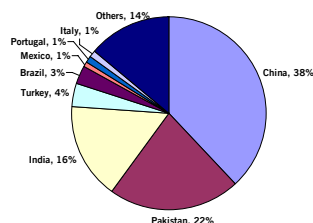
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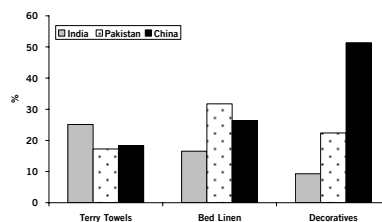
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**Figure 1. US Home Textile Import market shares**



Source: Welspun India; period Jan-Sept'2006

**Figure 2. Market share by value of Exports to US**



Source: CIR; period Jan-Sept'2006

See page 4 for Analyst Certification and important disclosures.

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## Alok Industries (ALOK.BO, Rs.71.2, 1M)

### Valuation

Our 12-month target price of Rs100 is based on 10x Sept'07E PE - on par with sector. The stock is trading at 7.6x Sept'07E PE toward the lower end of its historical P/E band of 8-10x of last two years and at a 28% discount to sector – we see this trend breaking out and expect valuations to catch up with the industry. Better earnings growth on back on recently commissioned capacities and management's assurance of no further equity dilutions are key reasons to this. Because P/E captures the earnings growth potential of a company, we consider it our primary valuation method. In our view, already announced Rs.11bn expansions (Phase III) will remain a drag on ROCE.

### Risk

We rate Alok Industries Medium Risk in view of most parts of phase II expansion now being operational and risks of further delay in commissioning of new capacities having reduced. However, risk of any equity dilutions and the prospect of the company reporting the lowest ROCE of 5% in the sector still remain. The main company specific risks include:

- Delay in commissioning of new capacity by a quarter would push back the growth we are projecting for FY07-08;
- significant increase in interest cost, would adversely impact earnings growth assumption – given its high leverage (debt/equity at 2.3x FY07E);
- Sharp increases in cotton prices by more than 10% from Rs.50/kg would impact profitability by 7-8%, on our estimates;
- appreciation of the rupee by more than 5% from the base level of Rs44 will reduce price realizations of exports, which contributed 27% of FY06 revenues but which are expected to increase sharply as new capacity goes on stream;
- Any over-priced acquisition of spinning facilities in its bid to backward integrate its home textiles business

## Welspun India (WLSP.BO, Rs.93.2, 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 10.5x 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 breakeven of the bed-linen business; and 2) Long-term sourcing tie-ups with global branded home textile retailers.

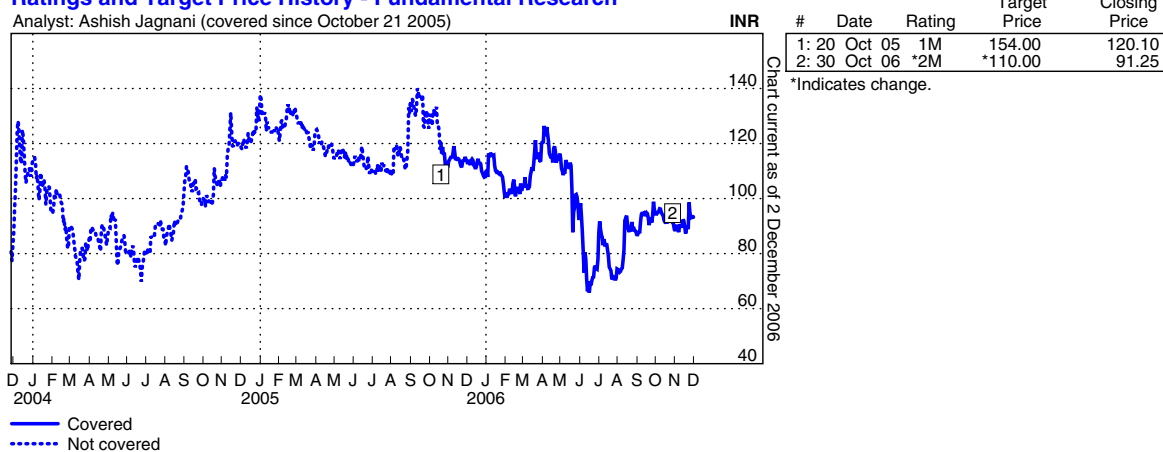
## Analyst Certification Appendix A-1

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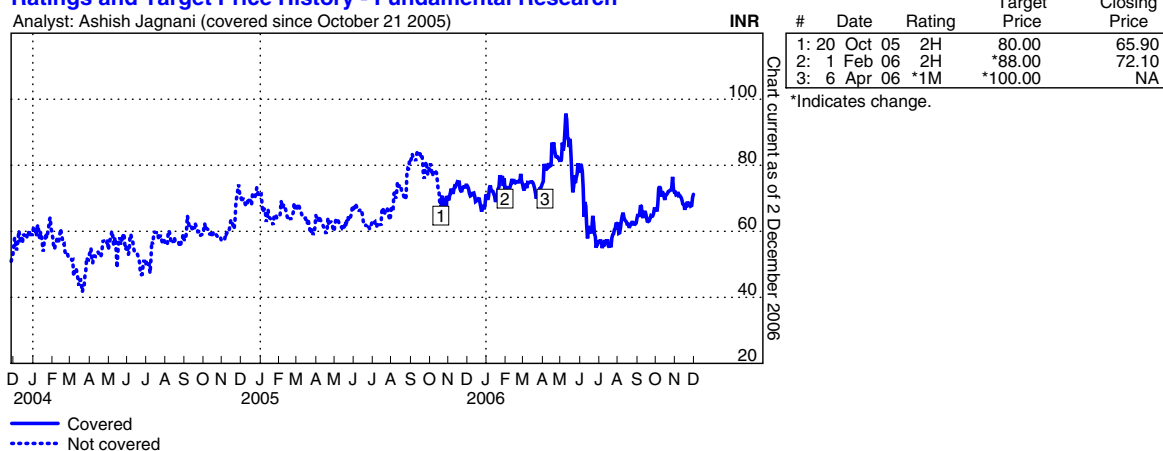
#### Welspun India Ltd (WLSP.BO) Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 21 2005)



#### Alok Industries Ltd (ALOK.BO) Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 21 2005)



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