

Welspun India

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,617	WLSP IN
	REUTERS CODE
S&P CNX: 3,110	WLSP.BO

26 July 2006

Neutral

Previous Recommendation: Neutral

Rs72

		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
Equity Shares	76.8	3/06A	6,537	415	5.4	5.3	13.2	1.0	9.2	5.9	2.0	10.6
52-Week Range	145/63	3/07E	8,701	560	7.3	34.8	9.8	0.9	9.4	6.9	2.0	9.1
1,6,12 Rel.Per. (%)	-10/-44/-76	3/08E	9,911	720	9.4	28	7.6	0.8	11.2	6.9	1.8	8.4
M.Cap (Rs b)	5.5											
M.Cap (US\$ b)	0.1											

- Welspun's revenues increased by 38% to Rs1.99b, in line with our estimate of Rs1.96b. EBITDA increased by 33% to Rs417m v/s our estimate of Rs413m.
- EBITDA margins declined by 104bp to 20.8% v/s our estimate of 21.3% on the back of lower export incentives and decline in towel realizations.
- During the quarter, Welspun took a Rs100m hit on account of provisioning for mark to market margin on account of outstanding forex loans (rupee depreciated by Rs1.33/US\$ in 1QFY07).
- The capacity utilization levels for Welspun's terry towel division stood at 85%, while its sheets division reported revenues of Rs505m and operated at 40% utilization levels.
- In 1QFY07, Welspun acquired an 85% stake in CHT Holdings Limited for Rs1.1b, the holding company of the UK's leading towel brand *Christy*, gaining access to the EU market, which is the second largest home textiles market after US.
- We are lowering our FY07 PAT estimates by 5% from Rs586m to Rs560m, primarily on the back of increase in interest expense by 10% to Rs425m.
- The stock trades at a PER of 9.8x FY07 EPS and 7.6x FY08 EPS. We maintain **Neutral**.

QUARTERLY PERFORMANCE										(Rs Million)	
Y/E MARCH	FY06				FY07				FY06	FY07	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
Sales	1,441	1,547	1,544	2,051	1,989	2,140	2,262	2,309	6,583	8701	
Change (%)	50.7	37.2	35.1	39.0	38.1	38.3	46.5	12.6	33.1	32	
EBITDA	314	320	380	314	413	462	486	500	1,328	1862	
Change (%)	58.7	-0.9	32.0	20.4	31.5	44.6	27.8	59.1	51.6	40	
As % of Sales	21.8	20.7	24.6	15.3	20.8	21.6	21.5	21.7	20.2	21.4	
Depreciation	102	115	120	149	144	171	178	191	486	683	
Interest	74	81	86	102	112	106	111	96	343	425	
Other Income	23	59	-43	95	-38	36	36	56	134	90	
PBT	161	182	131	158	119	221	234	269	633	844	
Tax	53	56	57	51	43	74	79	87	217	284	
Effective Tax Rate (%)	32.9	30.6	43.7	32.4	36.3	33.6	33.6	32.4	34.4	33.6	
Adj. PAT	108	127	74	107	76	147	155	182	416	560	
Change (%)	156.3	14.7	-31.2	5.0	-29.9	16.0	110.4	69.6	5.3	35	

E: MOST Estimates

Note: In the interest of timeliness, this report has not been edited.

MTM provisioning hits PAT

During the quarter, Welspun took a Rs100m hit on account of provisioning for mark to market margin on account of outstanding forex loans (rupee depreciated by Rs1.33/US\$ in 1QFY07). As a result, reported PAT declined by almost 30% YoY to Rs76m v/s our estimate of Rs137m.

Status of capex plans

1QFY07 was the first quarter post completion of first phase of Welspun's capex plans at Anjar. With this the company has aggregate capacities of 24,000t p.a. of terry towel and bed linen capacity of 35m meters p.a. The capacity utilization levels for Welspun's terry towel division stood at 85%, while its sheets division reported revenues of Rs505m and operated at 40% utilization levels. Welspun is currently undertaking phase two of its expansion program, which entails enhancing capacities of its terry towels, bed sheets, spinning and a foray into decorative bedding. Management expects the entire phase-two expansion program to be fully functional from FY07 onward.

FUTURE CAPACITY EXPANSION PLANS

	CURRENT	ADDITIONS	POST EXPANSION
Terry Towels (Mt)	24,000	10,000	34,000
Bed-Linen			
Weaving (m meters)	8	30	38
Processing (m meters)	35	8	43
Spindles (No's)	25,000	25,000	50,000

Source: Company/ Motilal Oswal Securities

Acquires 85% stake in UK's leading towel brand 'Christy'

Welspun India has acquired an 85% stake in CHT Holdings Limited, the holding company of the UK's leading towel brand *Christy*, gaining access to the EU market, which is the second largest home textiles market after US. Consideration paid by Welspun for 85% stake is US\$25m (Rs1.1b), valuing *Christy* at an EV of US\$30m (Rs1.3b). The deal includes a call option on the part of Welspun management and a put option on the part of *Christy*'s management to buy/sell the remaining 15% stake at an agreed EBITDA multiple based on FY08-09 financials.

We view the acquisition as a significant positive for Welspun as it gains access to the EU market, which is the second largest home textiles market in the world, while also consolidating and fully integrating its business model across the textile chain from spinning to front end retailing/branding on a global scale.

Management has indicated that the acquisition price for *Christy*'s implies an EV/EBITDA of 5.5x FY06 (June ending). Welspun plans to finance the entire acquisition through a combination of debt and internal accruals. Though the management has not shared *Christy*'s financials, they have indicated that they expect *Christy* to achieve revenues of US\$71m in FY07 (Revenues in FY06 was US\$67m) and are targeting an EBITDA margin of 9-10%. *Christy* has a 17% market share of the towel market in EU and is positioned as an up-market brand.

It has a strong retail presence of its own and operates 98 concessions, principally with House of Fraser and Debenhams besides 22 stand-alone *Christy* branded retail stores. Outside of UK, the brand is available in leading retailers across the world such as Lane Crawford in Hong Kong, Karstadt in Germany and Bloomingdales in the USA.

Though we await further details to incorporate *Christy*'s financials with Welspun, our conservative back of the envelope working indicates that this acquisition could add around Rs2.7b in topline, Rs244m in EBITDA and Rs84m in bottom line to Welspun's financials in FY08.

FINANCIALS: FY08 (RS M)

	WELSPUN	CHRISTY	CONSOLIDATED
Revenues	9,911	2,716	12,627
EBITDA	2,156	244	2,400
% of sales	21.8	9.0	19.0
PAT	720	84	804
% of sales	7.3	3.1	6.4
EPS	9.4	1.1	10.5

Source: Motilal Oswal Securities

Foray into decorative bedding

Welspun is expanding into the decorative bedding segment. Management perceives high demand for decorative bedding in the US owing to closure of leading textile manufacturers. The decorative bedding segment comprises comforters, pillow shams, dust ruffles etc. and can be rolled out as a 'Bed in a Bag' concept. Further, since Welspun is already into the bed linen segment, foray into the decorative bed segment will provide horizontal extension in home textiles products.

Further inorganic initiatives to contribute to growth

Welspun is looking at inorganic growth opportunities in its textile business. Management has conveyed that they are in advanced stage of negotiation with certain retail/brand companies in the US/EU, which would allow them to vertically integrate from the yarn to the retail stage. We believe the company would acquire entities that would complement its existing service offerings and provide access to a wider target market. However, we have not factored this into our estimates.

Ranked highly by global retailers

With its strengths in product design, innovation and fabrication, and updated plant and machinery, Welspun is fast emerging as a preferred vendor partner to global buyers in the home textile space. Welspun has direct relationships with almost twelve of the top twenty global retailers. The company is well highly regarded by global buyers for its product development and innovation skills. Furthermore,

almost 85% of Welspun's sales to global retailers have moved to replenishment mode, which ensures better margins and provides business stability.

Home textiles: a big opportunity

Unlike garments, where production facilities have already migrated from developed to low-cost developing countries, shifting of production bases for home textiles is still to occur. Almost 40% of the global home textile capacity is still located in developed countries. Going forward, a majority of these production capacities would migrate to low-cost developing countries. An estimated 120,000-ton terry towel capacity in developed countries has been rendered unviable (West Stevens - 70,000 ton per year; Pillotex - 50,000 ton per year). We believe this represents a big opportunity for countries such as India that have intrinsic strengths in home textiles.

Lowering FY07 PAT estimates by 5%

We are lowering our FY07 PAT estimates by 5% from Rs586m to Rs560m, primarily on the back of increase in interest expense by 10% to Rs425m

Valuation and view

We expect Welspun's revenues and earnings to witness CAGR of 23% and 32% (FY06-FY08E), respectively. The company is well regarded by global buyers for its product development and innovation skills. Any strategic acquisition of a retail outlet or brand will be a further positive for the stock. Welspun trades at 9.8x FY07E and 7.6x FY08E earnings. We maintain **Neutral**.

Welspun India: an investment profile

Company description

Welspun is one of India's largest home textile companies and fifth largest terry towel player in the world. It is well positioned to exploit the potential substantial opportunities in the home textiles market post-quota tariff scenario, as global manufacturing capacities in the developed world are closing down. Thus, its capex is well timed. It has emerged as a large integrated home textiles player with wide product mix and global-sized capacity and is well regarded by global buyers for its product development and innovation skills.

Key investment arguments

- Welspun is fast emerging as a preferred vendor partner to global buyers in the home textile space.
- Several home textile facilities have shut down in the developed world and moved operations to low-cost developing countries.
- Welspun has timed its expansion to coincide with the potential vast opportunity arising post-quotas.

Key investment risks

- Realizations are likely to be under pressure due to increasing competition in the terry towel segment.

Recent developments

- In 1QFY07, Welspun acquired an 85% stake in CHT Holdings Limited for Rs1.1b, the holding company of the UK's leading towel brand *Christy*, gaining access to the EU market, which is the second largest home textiles market after US.
- During 1QFY07, Welspun had first full years operations post its Rs5.8b expansion project at Anjar, Gujarat, which has effectively increased its capacity for terry towels by 13,000 ton, bed sheeting by 35m meters and cotton spinning by 25,000 spindles.

Valuation and view

- We expect Welspun's revenues and earnings to witness 23% and 32% CAGR (FY06-FY08E), respectively.
- Welspun trades at 9.8x FY07E and 7.6x FY08E earnings. We maintain **Neutral**.

Sector view

- The Indian textile industry occupies a unique niche in the global market, nearly equaling China's strength.
- India would be one of the biggest beneficiaries of the culmination of the quota system, trailing China.

COMPARATIVE VALUATIONS

		WELSPUN	GOKALDAS	ARVIND
P/E (x)	FY07E	9.8	11.4	12.2
	FY08E	7.6	9.6	9.5
P/BV (x)	FY07E	0.9	2.1	0.8
	FY08E	0.8	1.8	0.7
EV/Sales (x)	FY07E	2.0	0.9	1.5
	FY08E	1.8	0.7	1.4
EV/EBITDA (x)	FY07E	9.1	7.9	7.0
	FY08E	8.4	6.6	7.1

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	34.0	34.0	34.0
Domestic Institutions	40.8	37.1	33.8
FII's/FDIs	19.1	21.4	23.4
Others	6.1	7.5	8.8

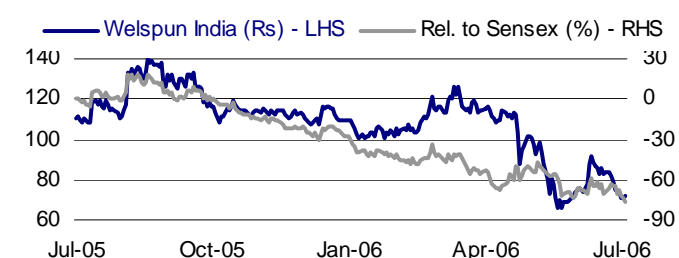
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	7.3	5.8	25.4
FY08	9.4	8.3	12.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
72	103	43.0	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E MARCH	2005	2006	2007E	2008E	
Net Sales	4,696	6,537	8,701	9,911	
Change (%)	36.3	39.2	33.1	13.9	
Total Expenses	3,855	5,309	6,839	7,755	
				2,156	
EBITDA	841	1,228	1,862	2,156	
Change (%)	80.9	46.1	51.6	15.8	
% of Net Sales	17.9	18.8	21.4	21.8	
Depreciation	269	486	683	812	
EBIT	811	742	1,179	1,344	
Interest & Finance Charges	278	343	425	355	
Other Income	84	234	90	95	
PBT	618	633	844	1,084	
Tax	223	217	284	364	
Effective Rate (%)	36.1	34.3	33.6	33.6	
Reported PAT	395	415	560	720	
Adjusted PAT	395	415	560	720	
Change (%)	33.9	5.3	34.8	28.4	

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2005	2006	2007E	2008E	
Equity Capital	565	768	768	768	
Share Capital	992	768	768	768	
Reserves	2,721	4,969	5,398	5,945	
Net Worth	3,713	5,737	6,166	6,713	
Loans	5,953	8,550	12,050	12,800	
Deferred Tax Liability	455	663	805	623	
Capital Employed	10,121	14,950	19,021	20,135	
Gross Fixed Assets	7,153	13,653	18,403	20,503	
Less: Depreciation	1,422	1,908	2,591	3,403	
Net Fixed Assets	5,731	11,745	15,812	17,100	
Capital WIP	2,582	0	0	0	
Investments	95	95	95	95	
Curr. Assets	3,211	3,934	4,327	4,387	
Inventory	1,334	1,235	1,593	1,806	
Sundry Debtors	337	627	834	950	
Cash & Bank Balances	813	1,017	528	190	
Loans & Advances & Other Current	728	1,055	1,372	1,441	
Current Liab. & Prov.	1,498	823	1,180	1,414	
Sundry Creditors	1,222	433	679	795	
Other Liabilities	182	255	332	365	
Provisions	93	135	169	254	
Net Current Assets	1,714	3,111	3,147	2,973	
Application of Funds	10,121	14,950	19,021	20,135	

E: M O S t Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	
Basic (Rs)					
EPS	5.1	5.4	7.3	9.4	
Cash EPS	17.9	17.2	19.9	24.7	
Book Value per Share	58.2	74.7	80.3	87.4	
DPS	0.0	0.0	1.5	2.0	
Payout (Incl. Div. Tax) %	0.0	0.0	23.4	24.0	
Valuation (x)					
P/E	13.9	13.2	9.8	7.6	
Cash P/E	4.0	4.2	3.6	2.9	
EV/EBITDA	13.2	10.6	9.1	8.4	
EV/Sales	2.4	2.0	2.0	1.8	
Price to Book Value	1.2	1.0	0.9	0.8	
Dividend Yield (%)	0.0	0.0	2.1	2.8	
Profitability Ratios (%)					
RoE	14.5	9.2	9.4	11.2	
RoCE	11.0	5.9	6.9	6.9	
Turnover Ratios					
Debtors (Days)	26	35	35	35	
Inventory (Days)	104	69	67	67	
Creditors (Days)	219	60	60	60	
Working Capital (Days)	133	174	132	109	
Asset Turnover (x)	0.5	0.4	0.5	0.5	
Fixed Asset Turnover (x)	0.7	0.5	0.5	0.5	
Leverage Ratio					
Debt/Equity (x)	1.6	1.5	2.0	1.9	

CASH FLOW STATEMENT		(Rs Million)			
Y/E MARCH	2005	2006	2007E	2008E	
PBT before EO Items	618	633	844	1,084	
Add: Depreciation	269	486	683	812	
Less: Direct Taxes Paid	50	9	142	182	
(Inc)/Dec in WC	726	-1,193	-525	-164	
CF from Operations	1,239	-317	770	1,455	
CF from Operations incl. EO	1,239	-317	770	1,455	
(Inc)/Dec in FA	-2,086	-9,082	-4,750	-2,100	
(Pur)/Sale of Investments	-327	0	0	0	
CF from Investments	-6,498	-3,918	-4,750	-2,100	
(Inc)/Dec in Networth	-1,242	-1,712	90	95	
(Inc)/Dec in Debt	-3,746	-2,596	-3,500	-750	
Less: Interest Paid	278	343	425	355	
Dividend Paid	0	0	131	173	
CF from Fin. Activity	5,589	4,439	3,491	307	
Inc/Dec of Cash	330	204	-489	-338	
Add: Beginning Balance	483	813	1,017	528	
Closing Balance	813	1,017	528	190	



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@motiloswal.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

	Welspun India
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.