Company In-Depth

30 April 2007 | 9 pages

Alok Industries (ALOK.BO)

Buy: Strong 4QFY07, but Pressures Building

Rating change ☐
Target price change ☑
Estimate change ☑

- Operating performance in line — Revenues and EBITDA grew 41% and 51% respectively on the back of a rapid 119% growth in exports. Earnings growth of 127% was significantly higher due to extraordinary income (forex gain of Rs.296.8m); excluding which growth was still strong at 41%.
- Healthy EBITDA expansion — Margins expanded 150bps benefiting from higher operating leverage on newly commissioned capacities and better margins in texturizing yarn and garment businesses. We see some pressure going forward, on exports (35% of FY07 revenues) given the sharp rupee appreciation.
- More expansions planned — With Phase I and II expansions operational, Phase III on backward integration, to go on-stream by Mar'08 – management plans a Phase IV of Rs.11.8bn for adding capacities in spinning, processing, knits and garments by Mar'09. This will be funded through TUF debt (Rs.9.5bn) and internal accruals – this is concerning and could further depress ROCE's.
- Reducing earnings, to factor external pressures — Building in pressures from the sharp appreciation in rupee on exports (particularly bed linen) and rising interest costs given the high leverage, we reduce our earnings estimates by 12% for FY08-09; despite this, growth still looks strong at 24% CAGR for FY07E-10E.
- Maintain Buy/Medium Risk (1M), lowering target to Rs.76 — Earnings growth momentum strong, higher operating leverage benefits expected, valuations look attractive at 6.3x FY08E; Maintain Buy (1M) with lower target price of Rs.76 based on 8x FY08E P/E, on par with sector as we roll forward to Mar'08.

Buy/Medium Risk	1M
Price (30 Apr 07)	Rs61.85
Target price	Rs76.00
from Rs100.00	
Expected share price return	22.9%
Expected dividend yield	2.4%
Expected total return	25.3%
Market Cap	Rs10,538M
	US$258M

Price Performance (RIC: ALOK.BO, BB: ALOK IN)

See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. Statistical Abstract

Year To 31-Mar	FD EPS (Rs.)	EPS Gr. (%)	P/E (x)	ROE (%)
2006	5.1	-12%	11.8	14%
2007	7.3	73%	8.2	19%
2008E	9.5	29%	6.3	18%
2009E	11.8	25%	5.1	19%
2010E	13.9	18%	4.3	20%

Source: Company, CIR estimates

Figure 2. 4Q Earnings Summary (Rs.Mn, %)

	4QFY06	4QFY07	YoY
Net Sales	4,077.4	5,740.8	41%
EBITDA	875.9	1,320.6	51%
EBITDA Margin	21.5%	23.0%	150bps
Interest	172.6	268.5	56%
Other Income	15.0	353.4	nm
Depreciation	215.7	354.2	64%
PBT	502.6	1,051.3	109%
PAT	346.9	786.8	127%

Source: Company Reports

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	12.1	7.0	6.5	5.2	4.4
EV/EBITDA adjusted (x)	7.9	7.6	6.6	5.7	5.2
P/BV (x)	1.5	1.3	1.1	0.9	0.8
Dividend yield (%)	2.4	3.2	3.2	4.9	6.5
Per Share Data (Rs)					
EPS adjusted	5.10	8.80	9.47	11.79	13.90
EPS reported	5.10	8.80	9.47	11.79	13.90
BVPS	40.56	49.45	56.92	65.71	75.28
DPS	1.50	2.00	2.00	3.00	4.00
Profit & Loss (RsM)					
Net sales	14,207	18,290	23,986	28,089	33,202
Operating expenses	-12,054	-15,327	-20,139	-23,383	-27,617
EBIT	**2,154**	**2,962**	**3,848**	**4,707**	**5,586**
Net interest expense	-668	-893	-1,250	-1,400	-1,650
Non-operating/exceptionals	54	69	95	95	96
Pre-tax profit	**1,540**	**2,138**	**2,693**	**3,402**	**4,032**
Tax	-448	-682	-808	-1,055	-1,250
Extraord./Min.Int./Pref.div.	-76	297	0	0	0
Reported net income	**1,016**	**1,753**	**1,885**	**2,347**	**2,782**
Adjusted earnings	1,016	1,753	1,885	2,347	2,782
Adjusted EBITDA	2,958	4,168	5,494	6,466	7,662
Growth Rates (%)					
Sales	15.6	28.7	31.1	17.1	18.2
EBIT adjusted	19.1	37.6	29.9	22.3	18.7
EBITDA adjusted	24.1	40.9	31.8	17.7	18.5
EPS adjusted	-12.0	72.5	7.5	24.5	17.9
Cash Flow (RsM)					
Operating cash flow	**2,090**	**-993**	**5,313**	**2,545**	**2,637**
Depreciation/amortization	805	1,205	1,646	1,759	2,076
Net working capital	193	-3,951	1,782	-1,561	-2,221
Investing cash flow	**-11,062**	**-8,364**	**-4,512**	**-2,634**	**-8,600**
Capital expenditure	-10,743	-7,956	-5,250	-2,000	-8,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**9,043**	**9,091**	**5,347**	**3,603**	**-1,799**
Borrowings	8,256	9,661	5,744	4,200	-1,000
Dividends paid	-299	-398	-398	-597	-800
Change in cash	**71**	**-265**	**6,148**	**3,514**	**-7,762**
Balance Sheet (RsM)					
Total assets	**33,178**	**44,305**	**53,663**	**60,820**	**63,107**
Cash & cash equivalent	5,370	5,981	11,500	14,978	7,217
Accounts receivable	3,545	5,305	5,670	6,341	7,819
Net fixed assets	18,742	25,493	29,097	29,338	35,762
Total liabilities	**24,423**	**34,459**	**42,330**	**47,737**	**48,040**
Accounts payable	1,541	1,750	3,514	4,541	5,619
Total Debt	21,445	31,106	36,850	41,050	40,050
Shareholders' funds	**8,755**	**9,846**	**11,333**	**13,083**	**15,066**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	20.8	22.8	22.9	23.0	23.1
ROE adjusted	14.5	19.6	17.8	19.2	19.8
ROIC adjusted	8.2	7.3	8.1	9.2	9.6
Net debt to equity	183.6	255.2	223.7	199.3	217.9
Total debt to capital	71.0	76.0	76.5	75.8	72.7

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Key Points

Strong Operating performance in 4QFY07

Alok reported strong 4QFY07 in-line with our expectations. Sales grew 41% with EBITDA growth being stronger at 51%. Exports grew rapidly at 119% driven by strong growth across all business segments – particularly texturized yarn and apparel fabric, bed-linen exports picked up but were lower than expected.

EBITDA margins expanded 150bps YoY benefiting from higher operating leverage, improved product mix and some backward integration benefit in weaving. Higher overheads and staff cost due to the ongoing expansions capped the margin expansion. Despite higher depreciation and interest (continued expansion), earnings grew a robust 127% - due to one-time forex gain on repayment of forex debt; excluding which growth was still strong at 41%.

Figure 3. Earnings Summary (Rupees In Millions, Percent)

	4QFY06	4QFY07	YoY	FY06	FY07	YoY
Net Sales	4,077.4	5,740.8	41%	14,207.1	18,289.7	29%
EBITDA	875.9	1,320.6	51%	2,958.3	4,167.7	41%
EBITDA Margin	21.5%	23.0%	150bps	20.1%	22.2%	210bps
Interest	172.6	268.5	56%	667.8	893.4	34%
Other Income	15.0	56.6	277%	54.1	69.3	28%
Depreciation	215.7	354.2	64%	804.8	1,205.4	50%
PBT	502.6	754.5	50%	1,539.8	2,138.2	39%
PAT	346.9	490.0	41%	1,091.9	1,456.0	33%
Extraordinary	-	296.8		-	296.8	
PAT after Extraordinary	346.9	786.8	127%	1,091.9	1,752.8	61%

Source: Company Reports

More expansions planned

The company has further embarked on a Phase IV of expansion entailing Rs.11.8bn – primarily for adding capacities in spinning, processing of apparel fabric, knit weaving and processing, garments and made-ups. As per management this will be funded through a mix of debt (Rs.9.5bn) and internal accruals and would be operational by Mar'09. While this will build on overall scale, it is aggressive in our view. Given that company is still to realize the full benefits of its newly commissioned capacities and we believe this will continue to hinder improvement in ROCE's.

Figure 4. Existing and Planned apacity

Segment	Existing	Phase III	Phase IV	Total
Texturizing Yarn (TPA)	85,000			85,000
POY Plant	54,000			54,000
Weaving				
Fabric (mn mtrs)				
Apparel Fabric	57.5	25.0		82.5
Home Textiles	45.2	24.8		70.0
Knit (TPA)	16,800		50,400	67,200
Yarn (Ring Frame) TPA (MT)	5,250	15,000	9,750	30,000
Processing				
Apparel Fabric (mn mtrs)	82.5		22.5	105.0
H.Textiles Fabric (mn mtrs.)	60.0	22.5		82.5
Knit Fabric (TPA)	16,800		50,400	67,200
Yarn Dyeing (TPA)	3,000			3,000
Bed Linen (mn sets)	6.0	4.0	3.8	13.8
Garments (mn pcs)	8.0	7.0	7.0	22.0
Terry Towels (TPA)	6,700			6,700
Open Ended Yarn (TPA)	2,000			2,000

Source: Company Reports and Citigroup Investment Research

Lowering our earnings estimates

We are lowering our earnings estimates by 12% over FY08 and FY09, to account for building pressures from the sharp appreciation in rupee on exports (particularly bed linen – 20% of revenues) and rising interest costs given the high leverage (debt/equity of 3.2x in FY07E). Lowering of estimates was triggered by 9% lower than expected earnings (excluding extra-ordinaries) in FY07 due to 1) lower revenues in bed-linen following appreciating rupee and 2) lower other income. With the company's forward cover on exports until July'07; we expect pressure on realizations for some repeat orders in bed-linen. Factoring this, we have reduced our revenue and EBITDA estimates by 2% and 4% respectively for FY08E and FY09E. While large part (55%) of the company's debt is under low cost Technology Upgradation Fund scheme, given the high leverage of 3.2x FY07E, we expect interest cost to increase going forward. Factoring this, we have reduced our earnings estimates by 12% for FY08 and FY09. However, building for this and our expectation of higher operating leverage as more of expansion gets operational– we forecast an earnings growth of 18.5% for FY2010E. Factoring which, we still expect strong earnings CAGR of 24% over FY07-2010E.

Figure 5. Earnings revision summary

Year to	FY07			FY08E			FY09E		
31-Mar	Actual	Estimates	% Chg	New	Old	% Chg	New	Old	% Chg
Revenue	18,290	19,083	-4.2	23,986	24,553	-2.3	28,089	28,804	-2.5
EBITDA	4,168	4,389	-5.0	5,494	5,762	-4.6	6,466	6,848	-5.6
Net Profit	1,456	1,603	-9.2	1,885	2,147	-12.2	2,347	2,666	-12.0
FD EPS	7.3	8.05	-9.2	9.5	10.8	-12.2	11.8	13.4	-12.0

Source: Citigroup Investment Research estimates

Alok Industries

Company description

Alok has the largest textile processing capacity (142.5m meters) in India. Its manufacturing facilities, superior quality, wide product range in apparel fabrics (43% of FY07 revenues) and home textiles (20% of FY07 revenues) have made it a preferred vendor for global retailers such as Wal-Mart, JC Penny, GAP and garment exporters in India. It spans the textile value chain, with completely integrated facilities for yarn texturizing (27% of revenues), weaving, knitting, processing, made-ups and garments. Exports make up 35% of its revenues; but with the phasing out of quotas, the company's ramp-up in home textiles and its thrust on exports, we expect the share of exports to increase to 34% in FY08. It is controlled and managed by the Jiwrajka family, with the major shareholders owning a 29% stake.

Investment thesis

We maintain a Buy/Medium Risk (1M) rating on Alok with a target price of Rs.76 based on 8x FY08E P/E, on par with the sector. Our thesis is premised on the strong growth opportunity in home textiles and Alok's major expansions in weaving-processing capacities of bed linen and apparel fabric now operational. We see this providing the company with significant operating leveraging and earnings CAGR of 27% over FY07-09E.

Key growth drivers are 1) More expansions going on-stream over next two years; 2) thrust on diversifying to a richer product mix; 3) growing order book for exports; and 4) benefits of backward integration. While external pressures are mounting with appreciating rupee and rising interest costs, building for which we still forecast healthy growth potential. Its presence across a significant part of the textile value chain and close ties with global retailers should help exploit the outsourcing opportunities in the sector and improve margins. However we expect the company's aggressive expansion and newly announced Phase IV expansion will hinder improvement of ROCE's.

Valuation

We are lowering our target price from Rs.100 to Rs.76. Our revised target price is based on 8x FY08E P/E, still on par with Citigroup's textile sector (consisting of eight other stocks – Arvind Mills, Raymond, Gokaldas Exports, Welspun India, Mahavir Spinning, JCT, Abhishek Industries and S Kumar Nationwide), which we now value at 8x FY08E P/E (12.5x FY07E P/E earlier), as we have rolled over our base assumption from Sep'07 to Mar'08. The stock is trading at the lower end of its historical P/E band of 6-12x over the past two years – we see this trend breaking out going forward and expect valuations to catch up with our textile universe. Better earnings growth on the back of recently commissioned capacities, richer product mix and management's assurance of no further equity dilutions – are the key reasons we expect this. Because P/E captures the earnings growth potential of a company, we consider it as our primary valuation method.

Risks

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 6% in the sector still remain. The Medium risk is in line with our quantitative risk rating system, which tracks 260-day volatility of the shares.

The main company specific risks that could impede that stock from reaching our target price 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 3.2x 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 Rs41 will reduce price realizations of exports, which contributed 35% of FY07 revenues but which are expected to increase sharply as new capacity goes on stream;
- Any over-priced acquisition of spinning/garmenting facilities in its bid to backward integrate its home textiles business.

Appendix A-1

Analyst Certification

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IMPORTANT DISCLOSURES

Alok Industries (ALOK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 21 2005)

#	Date	Rating	Target Price	Closing Price
1:	20 Oct 05	2H	80.00	65.90
2:	1 Feb 06	2H	*88.00	72.10
3:	6 Apr 06	*1M	*100.00	NA

*Indicates change.

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