Company In-Depth

15 June 2007 | 8 pages

Raymond Ltd. (RYMD.BO)

Buy: Reducing Target Price but Valuations Attractive

Rating change ☐
Target price change ☑
Estimate change ☑

- **Reducing target to Rs.365, Maintain BUY** — We reduce our estimates to model for 1) unexpected losses in JVs, particularly denim and woolen-fabric JV and 2) initial pressures from new store additions. With core business valuation at 2-yr lows of 9.1x EV/EBITDA; we maintain our Buy rating with reduced target price of Rs365 on 10.3x FY08E EV/EBITDA (vs. PE used earlier), at premium to sector.
- **Denim JV dragging down earnings** — Raymond's 50:50 JV with UCO reported an unexpected loss of ~Rs.600m in FY07 – triggered by low utilization and high overheads for US and EU plants in 4QFY07, while domestic faired better. Raymond is taking initiatives to improve utilization, but this is unlikely to reduce losses materially in the medium-term; We expect this to hit overall earnings.
- **New store additions to impact near-term margins** — Raymond's has aggressive plans to add ~110 new stores in FY08E – this will increase total to ~540 stores. While this will drive revenues by 18% CAGR over FY07-09E, high set-up cost and brand promotions will impact near-term margins of apparel business.
- **Core worsted fabrics, the silver lining** — With steady demand, enriching product mix and higher operating leverage from increased capacities at Vapi (6m mtrs), we expect worsted fabric revenues to drive growth at 10% CAGR over FY07-10E.
- **Conclusion** — While denim JV losses have dampened sentiments, stock's 14% fall last month largely discounts this. With earnings CAGR of 16% over FY07-10E, healthy cash reserves of ~Rs5bn (Rs.80 per share) and potential to unlock real estate assets; we see upside.

Buy/Low Risk	1L
Price (15 Jun 07)	Rs308.30
Target price	Rs365.00
from Rs570.00	
Expected share price return	18.4%
Expected dividend yield	1.6%
Expected total return	20.0%
Market Cap	Rs18,924M
	US$466M

Price Performance (RIC: RYMD.BO, BB: RW IN)

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

Figure 1. Consolidated Statistical Abstract

Year to 31-Mar	Net Profit (Rs Mils)	FD EPS* (Rs)	EPS Growth (%)	P/E (x)	EV/EBITDA (x)	P/BV (x)	ROE (%)
2006	1,361	23.0	22.4	13.4	8.7	1.5	10.7
2007E	1,400	16.5	(28.4)	18.7	10.0	1.4	10.1
2008E	1,141	18.6	12.6	16.6	9.1	1.3	7.8
2009E	1,459	23.8	27.9	13.0	7.3	1.2	9.3
2010E	1,859	30.3	27.4	10.2	5.9	1.1	10.8

Source: Citigroup Investment Research estimates, * Excludes Extraordinary Items

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	13.9	13.5	16.6	13.0	10.2
EV/EBITDA adjusted (x)	8.4	9.7	9.3	7.8	6.3
P/BV (x)	1.5	1.4	1.3	1.2	1.1
Dividend yield (%)	1.6	1.6	1.6	1.9	1.9
Per Share Data (Rs)					
EPS adjusted	22.17	22.82	18.58	23.77	30.29
EPS reported	22.17	22.82	18.58	23.77	30.29
BVPS	207.52	225.33	238.92	256.69	281.00
DPS	5.00	5.00	5.00	6.00	6.00
Profit & Loss (RsM)					
Net sales	17,106	20,407	22,559	24,976	27,165
Operating expenses	-15,518	-19,127	-21,072	-22,986	-24,583
EBIT	**1,588**	**1,280**	**1,487**	**1,990**	**2,582**
Net interest expense	-390	-502	-552	-510	-525
Non-operating/exceptionals	826	783	819	765	803
Pre-tax profit	**2,024**	**1,561**	**1,755**	**2,245**	**2,861**
Tax	-610	-547	-614	-786	-1,001
Extraord./Min.Int./Pref.div.	-54	387	0	0	0
Reported net income	**1,361**	**1,400**	**1,141**	**1,459**	**1,859**
Adjusted earnings	1,361	1,400	1,141	1,459	1,859
Adjusted EBITDA	2,463	2,537	2,870	3,414	4,050
Growth Rates (%)					
Sales	18.8	19.3	10.5	10.7	8.8
EBIT adjusted	82.4	-19.4	16.2	33.8	29.8
EBITDA adjusted	56.1	3.0	13.1	18.9	18.6
EPS adjusted	50.2	2.9	-18.5	27.9	27.4
Cash Flow (RsM)					
Operating cash flow	**1,961**	**1,083**	**1,208**	**3,022**	**2,646**
Depreciation/amortization	875	1,257	1,383	1,425	1,467
Net working capital	-274	-1,574	-1,315	138	-681
Investing cash flow	**-4,707**	**-4,318**	**-548**	**-1,311**	**-1,846**
Capital expenditure	-5,120	-4,680	-1,617	-1,183	-1,434
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**2,852**	**3,462**	**-933**	**-1,743**	**-243**
Borrowings	3,002	3,689	-652	-1,400	100
Dividends paid	-307	-307	-307	-368	-368
Change in cash	**107**	**227**	**-273**	**-32**	**557**
Balance Sheet (RsM)					
Total assets	**27,191**	**31,301**	**31,774**	**30,966**	**31,972**
Cash & cash equivalent	576	715	443	216	693
Accounts receivable	3,022	3,469	3,948	3,996	3,803
Net fixed assets	11,196	14,618	14,852	14,611	14,578
Total liabilities	**14,230**	**17,176**	**16,775**	**14,926**	**14,465**
Accounts payable	2,296	2,323	2,560	2,156	1,849
Total Debt	9,413	13,102	12,450	11,050	11,150
Shareholders' funds	**12,961**	**14,125**	**14,999**	**16,041**	**17,508**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.4	12.4	12.7	13.7	14.9
ROE adjusted	11.1	10.5	8.0	9.6	11.3
ROIC adjusted	6.7	3.8	3.8	5.2	6.8
Net debt to equity	68.2	87.7	80.1	67.5	59.7
Total debt to capital	42.1	48.1	45.4	40.8	38.9

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Key Points

Denim JV to impact overall earnings

The company's denim 50:50 JV, Raymond UCO Denim, posted a loss of Rs.598.8m for FY07. The loss was due to low utilization and high overheads at the company's plants in the U.S. and Europe (Belgium), which was exacerbated by some large customers failing to pick up ordered goods and structural overcapacity and difficult market conditions in Europe in 4QFY07. In the Indian operations of the denim JV, profits in the fabric unit were more than offset by losses in the garmenting unit (on account of under utilization of capacity), resulting in a net loss of Rs.80m.

Difficult for Raymond to materially recover losses suffered in the denim JV in the medium-term

The company intends to improve operating efficiency of the JV going forward and plans to ramp up utilization at the relatively low cost Romania plant, which became fully operational in 4QFY07. Other corrective measures include adding new customers in the U.S. market and securing orders for a newly launched collection that is expected to contribute revenues in 2HFY08. That said we believe it will be difficult for the company to recover losses suffered in the denim JV in the medium term and expect this business to impact overall earnings.

New stores to drive revenues, but affect near-term margins

New stores additions and brand launches are positives, but higher set-up costs and promotion expenses will impact near-term margins

Raymond's retail focus is intact with aggressive plans to add 55 branded apparel stores (Colorplus, Park Avenue, Zapp) and 55 Raymond stores in FY08E. This will take the company's total store network from ~430 in FY07 (of which it owns ~100 stores) to ~540 stores in FY08E. Besides, the company also launched two new brands Notting Hill (targeting popular price segment) and Zapp (targeting kids-wear) in FY07. In addition, the company recently entered into a JV with Italian apparel brand Grotto SpA through which it intends to open 60 stores retailing the 'GAS' brand in the next three years.

Branded apparel revenues to grow at 18% CAGR, but expect lower earnings CAGR of 16% over FY07-09E

Raymond's efforts to ramp up retail network and launch new brands are positive. We expect this to drive branded apparel revenues by 18% CAGR over FY07-09E. However, initial high set-up costs for new stores and brand promotion expenses will impact near-term branded apparel margins and hence forecast lower earnings CAGR of 16% over FY07-10E for this business.

Core worsted fabric business – doing well

With 3m mtr worsted fabric additional capacity recently commissioned at the new Vapi plant, all the planned expansion of 6m mtrs in worsted fabric is now operational. With steady demand, enriching product mix and higher operating leverage from increased capacities at Vapi (6m mtrs); we expect highly profitable worsted fabric revenues to grow at 10% CAGR over FY07-10E

Reducing estimates and target price

We are reducing our earnings estimate by 45%-52% respectively over FY08-FY09 to account for 1) unexpected losses from Denim JV, 2) slow ramp-up of its shirting and woolen fabric JVs which are expected to longer than expected to become earnings accretive and 3) earnings pressures in branded apparels due to initial set-up costs associated with launch of new stores.

We had expected 1) Denim business to contribute EBITDA margins of 12-14%, 2) Branded apparel to generate EBITDA of 14-15% over FY07-FY09; and 3) JVs in shirting and woolen fabric to report nominal losses in FY07 and break-even in FY08E. Now, we expect lower EBITDA of 4-8%, primarily due to JVs overseas operations, lower margins of 9-10% for branded apparel business and turnaround of other fabric JVs to be pushed backed to FY09E. Factoring this we, have reduced our consolidated EBTIDA margins to 12.4-13.7% for FY07-09E vs. our earlier estimated 16.5-19.5%.

We still expect earnings CAGR of 16% over FY07-FY10E

Factoring in our new assumptions, we still expect earnings CAGR of 20% over FY07-FY09E. Further with growth in branded apparels and losses from denim JV to reduce going forward, we forecast earnings growth of 25% in FY2010E – which translates to earnings CAGR of 16% over FY07-10E.

With near-term earnings subdued due to Denim JV losses, we believe EV/EBITDA is more appropriate valuation method than the P/E approach used earlier. Factoring this, our change in earnings, we cut our target price to Rs365 (from Rs570 earlier) based on 10.3x EV/EBITDA forFY08E at 40% premium to sector valuation of 7.3x recognizing Raymond's strong brand portfolio and growing branded apparel sales (contributing ~45% of FY07 Revenues).

Figure 2. Earnings Revision (Rupees in Millions, Percent)

Year to	FY07			FY08E			FY09E		
31-Mar	New	Old	% Chg	New	Old	% Chg	New	Old	% Chg
Revenue	20,407	19,862	2.7	22,559	22,921	-1.6	24,976	25,012	-0.1
EBITDA	2,537	3,281	-22.7	2,870	4,148	-30.8	3,414	4,888	-30.2
Net Profit	1,400	1,847	-24.2	1,141	2,396	-52.4	1,459	2,823	-48.3
EPS	16.5	30.09	-45.1	18.6	39.0	-52.4	23.8	46.0	-48.3

Source: Citigroup Investment Research estimates

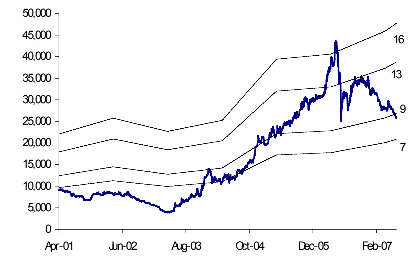
Company description

Raymond is among the top three worsted fabric players in the world, with capacity of 31m meters per annum. In India it is a leader with 60% market share, strong brand equity and a distribution network of 430 retail outlets. It also has a presence in denim and branded apparel garments, which it is looking to ramp-up. In files & tools, a non core engineering business, it is one of the largest producers with a 30% share, and dominates the domestic market with a 70% share. Its thrust on garmenting is a step toward vertically integrating its business model, leveraging off its fabric capacity. It is the flagship company of the Singhania Group, which owns a 35% stake in the company.

Investment thesis

We rate Raymond Buy/Low Risk (1L) with a target price of Rs365 based on 10.3x FY08E EV/EBITDA. With near-term earnings likely to be depressed until the JVs and new retail stores become accretive, we believe EV/EBITDA is a suitable valuation metric. Our target multiple of 10.3x EV/EBITDA, is at 40% premium to sector valuation of 7.3x recognizing Raymond's strong brand portfolio and growing branded apparel sales (contributing ~45% of FY07 revenues). With most new expansions now operational, highly profitable worsted fabric business doing well and strong brand-portfolio and retail network, we believe Raymond offers growth potential. With Raymond's core business valuation at 2-yr lows of 9.1x EV/EBITDA for FY08E, earnings CAGR of 16% over FY07-10E, strong brand portfolio with healthy cash reserves of ~Rs5bn (approximately Rs.80/share), we see upside. Potential to unlock real estate assets (140acres in Thane) remains an additional trigger.

Figure 3. 1-yr forward Raymond EV/EBITDA chart

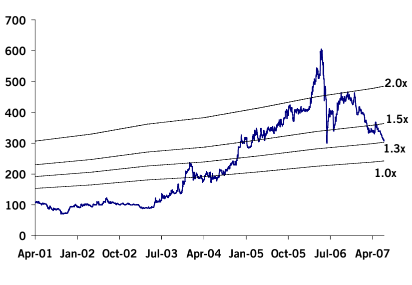


Source: Citigroup Investment Research

Valuation

Our target price of Rs365 is based on 10.3x FY08E EV/EBITDA. We believe EV/EBITDA is a suitable valuation tool since net profit will be depressed in the near-term until its JVs and new retail stores become accretive. Our target multiple places the stock at a 40% premium to our India textile universe valuations of 7.3x EV/EBITDA building for 1) strong brand portfolio (Raymond, Park Avenue, Parx and Colorplus) – contributing ~45% of FY07 Revenues, 2) wide retail store network of ~430 stores and 2) Raymond's leadership in worsted fabric business. We believe a premium of 40% to the sector multiple is fair value. Further the stock trades at 9.1x EV/EBITDA for FY08E and 1.3x P/BV both towards the lower end of its 2-years EV/EBITDA band of 9-14x and lower than its P/BV band of 1.5-2.0x. The current valuations are attractive, in our view.

Figure 4. 1-yr forward Raymond P/BV



Source: Citigroup Investment Research

Risks

We rate Raymond Low Risk based on our quantitative risk rating system that measures the stock volatility over a 260-day period. The main company-specific risks are: 1) slower than anticipated turnaround in the denim and other loss making JVs, 2) lower than anticipated margins in the branded apparel business, 3) High priced acquisitions to dilute cash reserves and adversely impact ROCE's. Acquisitions in non-core business would hinder re-rating; 4) Sharp increase in cotton prices by 10-12% from current levels of Rs52/kg and any decline in denim price realization would impact profitability of the denim business (13% of FY07 consolidated revenues), with cotton costs constituting (43% of denim revenues).If any of these risk factors plays out, Raymond's share price will likely have difficulty attaining our target price.

Appendix A-1

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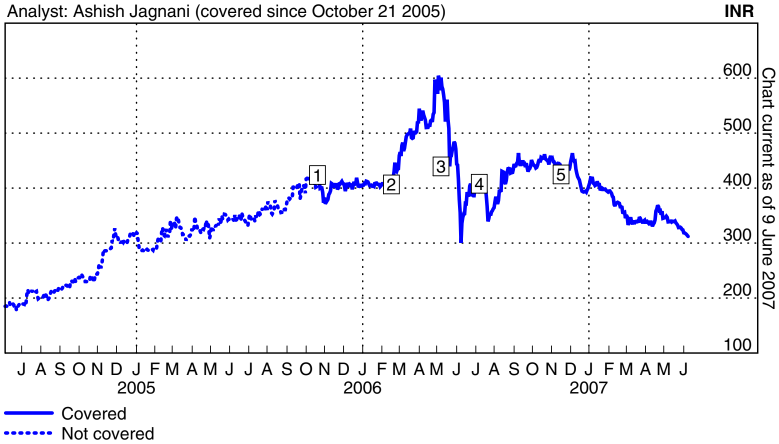
Raymond Ltd. (RYMD.BO)

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	1L	500.00	412.40
2:	16 Feb 06	1L	*540.00	416.05
3:	8 May 06	*2L	*625.00	601.00
4:	7 Jul 06	*1L	625.00	403.25
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*Indicates change.

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