Shri Lakshmi Cotsyn

BSE code:	526049

CMP: Rs 104 | **Target: Rs 210** | **BUY**

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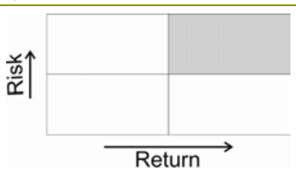
Company data

Particulars	
Market cap (Rs bn / US$ mn)	1.5/37.5
Outstanding equity shares (mn)	14.8
52-week high/low (Rs)	141/73
2-month average daily volume	46,319

Financial snapshot (Y/E June)

Particulars	FY07E	FY08E	FY09E
Sales (Rs mn)	6,443.8	8,650.0	10,700.0
Growth (%)	79.0	34.2	23.7
Adj net profit (Rs mn)	408.4	600.0	840.0
Growth (%)	157.8	46.9	40.0
FDEPS (Rs)	27.6	30.0	42.0
Growth (%)	138.6	8.7	40.0
P/E (x)	3.8	3.5	2.5
RoE (%)	26.7	25.1	24.6

Risk-return profile



Shareholding pattern

(%)	Mar-07	Jun-07
Promoters	35.7	32.7
FIIs	5.2	5.2
Banks & FIs	-	3.0
Public	59.1	59.1

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Shri Lakshmi	104	(14.2)	(1.6)	(1.0)
Sensex	15,465	2.2	6.4	24.6

Company website	www.shrilakshmi.com

Seamless growth

Innovate product range and new forays point to a sustained strong performance

Investment rationale

- One of the largest textile players in Northern India with a turnover of Rs 6.4bn during FY07, which we estimate will cross Rs 10bn by FY09 supported by a Rs 6.6bn capex project.
- Specialises in technical and safety textiles like fusible interlining, PU coated nylon, fire retardant fabric and bullet proof jackets. Recent forays into terry towels, home furnishing, denim, bottom-weight fabric and garments are expected to contribute a bulk of future growth.
- Cost-efficient manufacturer with highly automated production processes and machinery sourced from reputed international suppliers. Operational savings from an in-house textile auxiliary chemical plant, captive power and backward & forward integration to expand margins.
- Strong network of dealers with established brands for suiting and fusible interlining; intends to utilise this network and brand equity to retail bed sheets and terry towels in the domestic market.
- Proven performance record with consistently strong revenue and PAT growth over the past decade (33% and 32% CAGR over FY99-FY09).
- JV with UK-based Armet Armored Vehicles for the assembly of armoured vehicles leverages on existing business synergies and will serve as a key long-term impetus to growth.

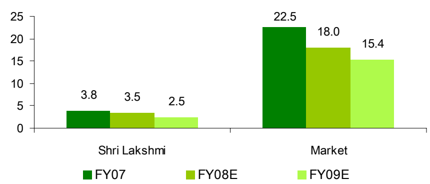
Key concerns

- Industry-wide slowdown in exports due to rupee appreciation.
- Sectoral anomalies like high fragmentation and unfriendly labour laws act as a deterrent to foreign investors.

Valuation

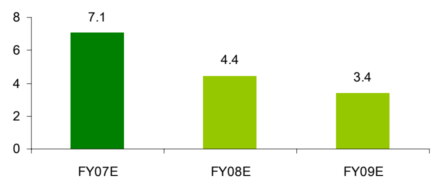
- Currently trades at low P/E multiples of 3.5x and 2.5x on FY08E and FY09E respectively and at 4.4x FY08E EV/EBIDTA. We recommend a Buy with a target of Rs 210 based on a P/E of 7x on FY08E.

P/E multiple (x)



Source: Religare Research

EV/EBITDA multiple (x)



Source: Religare Research

Company profile

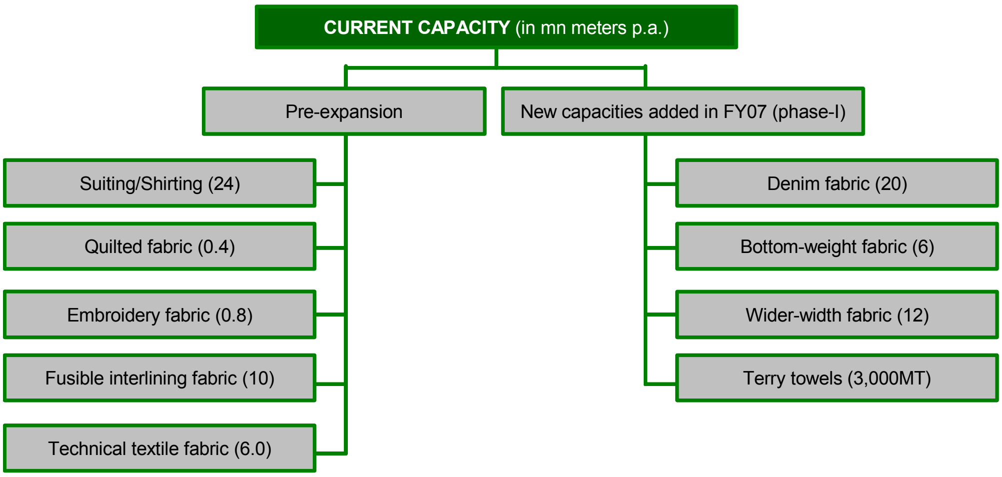
Diversified textile player with a dominant position in North India

Incorporated in August 1998 Shri Lakshmi Cotsyn (SLC, previously Galaxy Indo-Fab) manufactures and processes a wide range of fabrics and is one of the largest textile players in Northern India. The company was set up to process 100% cotton and blended fabrics, with an installed capacity of 6mn meters per annum, which has risen to 30mn meters today. SLC has also diversified into fusible interlining (fabric used in shirt collars, cuffs, etc), embroidery, quilting, and defence- and army-related textile products such as camouflage-fabric uniforms and bullet proof jackets.

New product forays in FY07

In FY07, the company forayed into the manufacture of denim, terry towel, home furnishing and bottom-weight fabric. It further intends to enter the garmenting segment in January 2008. SLC has three manufacturing units, two in Uttar Pradesh (Aung and Malwan) and one in Haryana (Sonepat). The Malwan unit was set up in FY07 to support the new range of textile products, while a fourth plant is currently being established at Roorkee in Uttaranchal for garmenting.

Current capacity



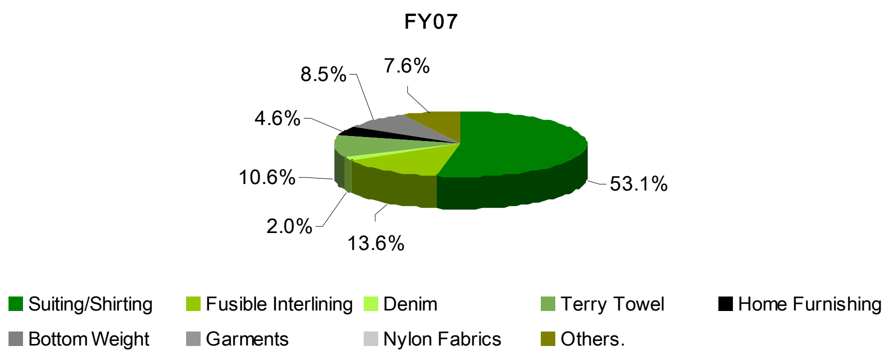
Source: Company, Religare Research

Suiting and shirting contributed 53% of sales in FY07

Revenue share of suiting and shirting has dipped from 73% in FY06 as new products kicked in

During FY07, the suiting and shirting division contributed 53.1% of sales, while fusible interlining accounted for 13.6%, terry towels 10.6% and bottom-weight fabric 8.5%. The balance came from home furnishing, denim, embroidery and other products.

Segmental revenue contribution

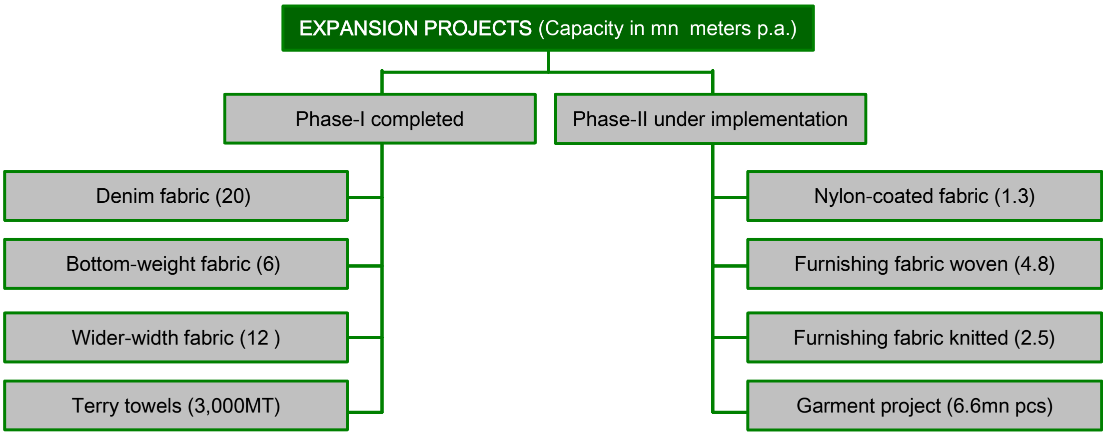


Source: Company, Religare Research

Expansion programme

The company has embarked on a large expansion programme entailing a capex of Rs 6.6bn over FY06-FY09. The first phase has been completed during FY07 at a cost of Rs 2.7bn, while the second phase will conclude by December 2007 for Rs 2.1bn. The third and final stage is scheduled for completion by June 2008 at Rs 1.8bn.

Expansion programme



Source: Company, Religare Research

Phase I: Phase I entailed the set up of the company's third unit at Malwan, UP for the manufacturing into home furnishing, denim and bottom-weight fabric as well as terry towels and yarn dyeing. The capex of Rs 2.7bn has been funded through a term loan of Rs 1.9bn, internal accruals of Rs 170mn and the issue of shares and warrants to promoters and others for Rs 620mn.

Since the expansion project was completed during FY07, the full impact will be reflected in revenues for FY08. On an annualised basis, the expansion is likely to contribute Rs 4.6bn a year and the company expects at least 70% capacity utilisation in the first year of operations.

Only domestic player with integrated facilities for nylon-coated fabric, post-phase II

Phase II: During phase II, which is currently underway and scheduled for completion by December,07 SLC will integrate forward by setting up a new garment facility at Roorkee at a cost of Rs 670mn. It will also expand its capacities at Malwan further, besides introducing a production line for nylon-coated fabric. This will make SLC the only player in India to have integrated facilities for manufacturing nylon-coated fabric.

This phase of expansion is expected to contribute annualised revenues of Rs 3.5bn at 100% capacity utilisation. The company plans to raise funds through a term loan of Rs 1.3bn and an FCCB/GDR/private equity issue of Rs 800mn. This may dilute equity by 25-30%.

Phase III: SLC currently operates its terry towel plant at full capacity and has booked orders which will utilise production capacity for the next six months. Considering the buoyant demand from international retailers and the company's plans to market its own brands, SLC will expand its terry towel manufacturing capacity from 3,000MT to 10,500MT at an investment of Rs 1.3bn.

The company also plans to set up a captive power plant for Rs 300mn. This apart, it has entered into a joint venture with Armet Armoured Vehicles for diversifying into the manufacture of armoured vehicles, which will require an investment of Rs 250mn for a 49% stake. The company has not yet finalised plans to raise funds for this phase.

Industry outlook

Textiles is one of the largest industries in India, employing more than 35mn people. The industry has various segments comprising man-made fibre, spinning, weaving, knitting, processing (dyeing and printing) and garmenting.

Exports currently undergoing a lean phase

India's textile industry has witnessed only a modest growth in exports in FY07 due to the sharp rupee appreciation. The country's textile and apparel exports grew at just 7.7% in FY07 after clocking a sharp 24% rise during FY06 in the post-quota regime. However, sales to the two key markets of the US and EU showed satisfactory growth of 9% and 15% respectively.

Export woes are rupee-related; India is still seen as a higher quality, low cost sourcing base

India remains a preferred supplier to large global players

Despite the slowdown in exports, India is still perceived as having huge potential as it has superior design and processing capabilities, a large base of skilled cheap labour, multi-fibre raw materials and a growing domestic market. Although China and other Asian countries are putting up competition on the volume front, India's low-cost advantage coupled with better quality perception makes it the supplier of choice for large global players. We expect the industry prospects to improve once the rupee rate stabilises.

Government thrust bolsters sector prospects

Further, the government is placing a stronger emphasis on growth in the sector, with the announcement of favourable policies such as the TUF (textile upgradation fund) subsidy scheme for textile-oriented capex. A total of Rs 580bn was provided under TUF in the last three years while another Rs 250bn is expected during this fiscal. The government aims to attract investments of Rs 1,400bn into the sector over the eleventh plan period (2007-12).

Investment rationale

SLC's fusible interlining product commands more than 20% of the Rs 4bn domestic market

Holds a dominant position in Northern India

SLC is one of the largest textile players in Northern India with a turnover of Rs 6.4bn in FY07, which we estimate will cross Rs 10bn by FY09. The company has been able to withstand stiff competition from larger players to penetrate both domestic and global markets. Its fusible interlining product controls more than 20% of the domestic market share and commands a premium even over textile giant Bombay Dyeing.

Extensive product portfolio

Product range

SLC

Regular textiles
- Suiting / Shirting
- Embroidery
- Quilt fabric
- Denim
- Terry towels
- Home furnishing bed linen

Technical textiles
- Ballistic body armour
- Bulletproof jackets/ helmets
- Tents
- Sleeping bags
- Mosquito nets

Safety textiles
- PU/PVC coated fabric
- Nylon coated fabric
- Fire retardant fabric
- Waterproof fabric
- Camouflage printed fabric
- Breathable fabric
- NBC fabric
- Dope dyed fabric

Source: Company, Religare Research

Apart from regular textile products like terry towels, home furnishing, denim and bottom-weight fabric, SLC also manufactures specialised technical and safety textile products catering to varied end-users. SLC's safety products include fire retardant, waterproof fabric and its technical range comprises fusible interlining, PU coated nylon, bullet proof jackets and helmets, and high-altitude fabric, which are supplied to industrial and institutional buyers including the defence sector. SLC is an approved supplier to multiple government defense establishments including the Indian army, navy and air force, central paramilitary and state police forces as well as several ordinance factories. This, along with its registrations with several regulatory agencies (see table), ensures acceptance of its technical products.

SLC's defense product approvals

Approved supplier to	Registered with
Indian Army, Navy, Air Force	Directorate General of Supplies & Disposal
Ordnance Factories	Director General of Quality Assurance
All Central Paramilitary Forces	Ministry of Defence (Navy)
State Police Forces	Defence Material Stores R&D Establishment
Indian Railways	ADRDE
	Federation of Indian Export Organisation
	RDSO (Indian Railway)
	Indian Postal Department

Source: Company

High operational leverage has aided margin expansion

Margins improving due to highly automated processes, and backward & forward integration

SLC is steadfastly pursuing newer technologies and expanding its backward and forward linkages in the textile manufacturing process. This approach has enabled the company to become a cost-efficient manufacturer in several product categories. SLC has put in place highly automated production processes with machinery sourced from reputed international suppliers. The company has an in-house textile auxiliary chemical plant with a capacity of 1,200MT. It has also put up a 5MW captive power plant to ensure lower cost and uninterrupted supply.

Further, the company's manpower cost as a percentage to sales is only about 2%, which is much lower than the industry average of over 4%. It also enjoys the advantage of scale of operations for its various products, and with backward and forward integration, margins have risen sharply from 7.3% in FY06 to 13.7% in FY07.

Expansion of branded retail line

Intends to introduce bed-sheets and terry towels in the high-margin retail market

SLC has a wide network of dealers across India and has established brands like *Star Track* for suiting and fusible interlining, and *Alisha* for embroidery laces. It has opened offices abroad and also formed a subsidiary in the UAE. SLC intends to utilise this network and brand to introduce bed-sheets and terry towels in the domestic market. With branding and retailing of end products manufactured using in-house raw material, it hopes to improve margins substantially. Spinning, weaving and processing have matured as high capital, low labour intensive segments, while garmenting has evolved as a low capital, high labour intensive segment.

Consistent growth in revenue and PAT

SLC has consistently performed well over the years, clocking a CAGR of 45.1% in sales, 72.4% in EBITDA and 87.6% in net profit over FY04-FY07. A look at the company's financials over the past ten years also reveals a similarly strong growth trend with a sales, EBITDA and PAT CAGR of 32.5%, 35.2% and 31.7% respectively. A large product mix paired with robust production and marketing infrastructure has fuelled the steady ramp-up in performance. Over the past decade, SLC has never reported any losses and the EPS has never moved below Rs 4.5.

JV with Armet Armored Vehicles to unlock value in the long term

SLC currently supplies safety equipment like ballistic body armour and bullet-proof jackets and helmets to the defence sector. The company has now entered into a joint venture with UK-based Armet Armored Vehicles (AAVL) for the assembly of armoured vehicles. SLC will hold a 49% equity stake in the JV company 'Armet Armored Vehicles & Shri Lakshmi', while AAVL will hold the balance 51%.

JV with AAVL to assemble 300 vehicles a year starting FY09

This venture will require an investment of Rs 500mn from both JV partners to produce 300 vehicles a year, and is likely to commence production by FY09. The company will also manufacture armour plates, panels, helmets, ballistic body amour and similar safety and security-related equipment for the domestic and foreign markets.

About Armet Armored Vehicles (AAVL)

AAVL, a part of the UK-based Armet Industries Group, has been in the business of constructing armoured vehicles since the late 1970s. The company started with security vehicles for banking and for police forces, and since then has grown into one of the world's largest armoured vehicle manufacturers. AAVL exports 99% of its production and currently supplies armoured vehicles to the US, Russia, Middle East and the Persian Gulf. These are widely used by heads of state, government agencies, police forces, army and riots control authorities, bankers and government officials.

AAVL also manufactures Thikamineplate, the world's finest protection against explosive devices for the civilian automotive market. Apart from highly advanced ballistic and blast protection technology, the company has an in-house ballistic testing lab and firing ranges which enable it to test new developments and innovations.

Armoured vehicle assembled by AAVL

Source: Company

JV leverages on existing business synergies and holds large market potential in India and overseas

Since SLC already has business synergies with the defence and paramilitary forces for its safety products, this JV serves as a forward integration in that direction. AAVL has chosen SLC as a JV partner considering the latter's ability to deliver on both on quality and reliability. We believe the company's JV with AAVL holds large market potential, both in India and in neighbouring countries. In India, SLC's approved supplier status to various government defense establishments will also expedite acceptance of the JV's security products. We thus expect the new foray to add significant value to the company's financials over a period of time, especially considering the high margins in this business segment.

Key concerns

Heavy capex coupled with a rising rupee is denting profit growth

Textile industry is out of favour with investors

Due to large-scale expansion underway within the industry, the resultant spike in interest and depreciation costs coupled with an appreciating rupee is putting pressure on the margins of textile players. Though revenue and profits are expanding, the earning multiples are not improving as profit growth is not keeping pace with sales.

Host of sector-related constraints restrict global investments

A high degree of fragmentation with dominance by the small-scale sector, heavy power costs, rising interest rates, rupee appreciation, unfriendly labour laws and logistical disadvantages in terms of shipping pose serious threats to the growth of the textile sector. Consequently, it has failed to attract significant foreign direct investments (FDI). Recently, however, the US-based Blackstone Group announced the acquisition of 51% in Gokaldas Exports, which may induce others to follow suit.

Financial review

Quarterly and yearly results

Y/E June (Rs mn)	Q4FY07	Q4FY06	% Chg	FY07E	FY06	% Chg
Net sales	2,247.8	945.1	137.8	6,443.8	3,600.3	79.0
EBIDTA	369.6	60.7	508.9	879.8	264.0	233.3
Depreciation	51.3	8.4	510.7	127.3	27.3	366.3
EBIT	318.3	52.3	508.6	752.5	236.7	217.9
Interest	149.8	22.6	562.8	295.9	98.6	200.1
Other income	0.7	11.3	(93.8)	41.1	39.1	5.1
PBT	169.2	41.0	312.7	497.7	177.2	180.9
Tax	27.8	6.5	327.7	89.3	18.8	375.0
PAT	141.4	34.5	309.9	408.4	158.4	157.8
EPS (Rs)	9.8	2.5	289.9	28.4	11.6	145.3
Margins (%)						
EBIDTA	16.4	6.4	-	13.7	7.3	-
EBIT	14.2	5.5	-	11.7	6.6	-
PBT	7.5	4.3	-	7.7	4.9	-
PAT	6.3	3.7	-	6.3	4.4	-

Source: Company, Religare Research

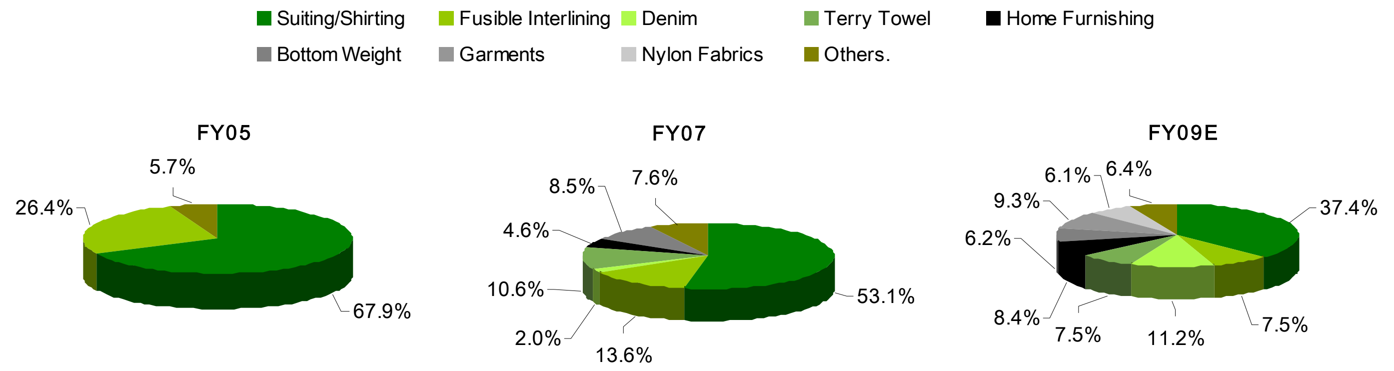
Sales recorded a 79% growth in FY07 as the phase-I expansion projects came onstream

Changing product mix fuels sharp revenue growth in FY07

SLC reported net sales of Rs 2.8bn for FY05 which rose 28% to Rs 3.6bn in FY06 and further by 79% to Rs 6.4bn for FY07. The sharp rise in FY07 is on account of the phase-I expansion coming on stream. With the introduction of new products, the revenue share of the suiting/shirting division declined from 73.2% in FY06 to 53.1%, while that of fusible interlining dipped to 13.6% from 23.1% earlier. The new products brought in the balance revenues with terry towels contributing 10.6%, bottom-weight fabric 8.5%, home furnishing 4.6% and denim 2%.

Once the entire expansion project is complete, we expect a bulk of the revenues to come from these new products (along with the garment division). Consequently, we estimate that the share of the suiting/shirting division will decline further to 37% by FY09, while fusible interlining is projected to dip to 7.5%.

Segmental revenue



Source: Company, Religare Research

Operating profit expands 233%

Operational efficiencies have led to a strong 233% increase in EBITDA

Stronger operational efficiencies led to a faster pace of growth in operating profits at 233% to Rs 880mn. This was achieved despite a substantial 200% rise in interest cost and a 366% increase in depreciation.

Improving EBIDTA margins

SLC has steadily improved its margins via better capacity utilisation (suiting/shirting and fusible interlining achieved over 100% utilisation) and new product introductions. The EBIDTA margin increased 640bps YoY to 13.7% for FY07 from 7.3% in the previous year. EBIT margins have improved to 11.7% from 6.6% and PAT margins have gone up from 4.4% to 6.3% in the same period.

PAT up 159%

The company's net profit rose 157.8% to Rs 408mn during the fiscal. This translates into an EPS of Rs 27.6 for FY07 on equity of Rs 148mn (includes preferential allotment of shares and warrants to promoters and strategic investors at Rs 129/share during FY06 to fund the expansion programme).

Valuation

Initiate coverage with a target of Rs 210; Buy

Valuations appear highly under-priced; we initiate coverage with a P/E-based target of Rs 210

At the current price of Rs 104 the stock is trading at 3.5x on FY08E EPS of Rs 30x, 2.5x on FY09E EPS of Rs 42 and 4.4x FY08E EV/EBIDTA. With a healthy book value of Rs 152/share, the P/BV is 0.7x. In our view, these valuations are significantly low for a company with a decade-long track record of consistent growth, expected sales growth to over Rs 10bn and a market capitalisation of Rs 1.5bn.

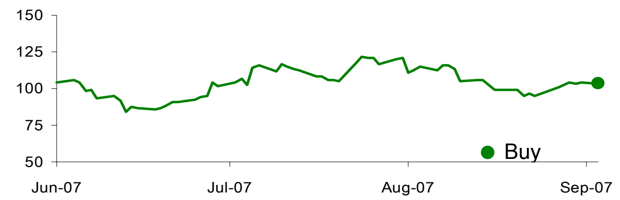
SLC has been successfully creating multiple drivers of growth by matching proven internal capabilities with emerging marketing opportunities. We believe the stock merits a P/E multiple of 7x on FY08E, which gives us a one-year target price of Rs 210. This signifies an upward potential of 102% from the current price. We initiate coverage with a Buy.

Recommendation history

Date	Event	Reco price	Tgt price	Reco
05-Sep-07	Initiating Coverage	104	210	Buy

Source: Religare Research

Stock performance



Source: Religare Research

Financials

Profit and Loss statement

Y/E June (Rs mn)	FY06	FY07E	FY08E	FY09E
Revenues	3,600.3	6,443.8	8,650.0	10,700.0
Growth (%)	27.5	79.0	34.2	23.7
EBITDA	264.0	879.8	1,410.0	1,840.0
Growth (%)	27.5	233.3	60.3	30.5
Depreciation	27.3	127.3	250.0	280.0
EBIT	236.6	752.5	1,160.0	1,560.0
Growth (%)	28.9	218.0	54.2	34.5
Interest	98.5	295.9	300.0	330.0
Other income	39.1	41.1	50.0	50.0
EBT	177.2	497.7	910.0	1,280.0
Growth (%)	56.8	180.9	82.8	40.7
Tax	18.8	89.3	310.0	440.0
Effective tax rate	10.6	17.9	34.1	34.4
Adj net income	158.4	408.4	600.0	840.0
Growth (%)	54.1	157.8	46.9	40.0
Shares outstanding (mn)	13.7	14.8	20.0	20.0
FDEPS (Rs)	11.6	27.6	30.0	42.0
DPS (Rs)	0.0	3.0	4.0	5.0
CEPS (Rs)	14.5	40.1	48.3	60.3

Source: Company, Religare Research

Balance sheet

Y/E June (Rs mn)	FY06	FY07E	FY08E	FY09E
Cash and cash eq	16.7	10.0	19.0	30.0
Accounts receivable	686.1	1,400.0	1,850.0	2,300.0
Inventories	636.7	1,100.0	1,730.0	2,230.0
Others current assets	98.8	239.5	139.5	139.5
Current assets	1,438.3	2,749.5	3,738.5	4,699.5
LT investments	4.6	4.6	154.6	154.6
Net fixed assets	347.4	3,689.6	4,639.6	4,659.6
CWIP	1,959.7	400.0	200.0	200.0
Total assets	3,750.0	6,843.7	8,732.7	9,713.7
Payables	146.2	300.0	500.0	650.0
Others	5.8	50.1	94.1	117.1
Current liabilities	152.0	350.1	594.1	767.1
LT debt	2,266.6	4,676.0	4,900.0	4,900.0
Other liabilities	18.2	75.7	190.7	275.7
Equity capital	208.6	148.0	200.0	200.0
Reserves	1,104.6	1,593.9	2,847.9	3,570.9
Net Worth	1,313.2	1,741.9	3,047.9	3,770.9
Total liabilities	3,750.0	6,843.7	8,732.7	9,713.7
BVPS (Rs)	95.9	117.7	152.4	188.5

Source: Company, Religare Research

Cash flow statement

Y/E June (Rs mn)	FY06	FY07E	FY08E	FY09E
Net income	158.4	408.4	600.0	840.0
Depreciation	27.3	127.3	250.0	280.0
Other adjustments	13.0	57.5	115.0	85.0
Changes in WC	(251.9)	(1,164.1)	(780.0)	(800.0)
Operating cash flow	(53.2)	(570.9)	185.0	405.0
Capital expenditure	(1,850.2)	(1,909.9)	(1,000.0)	(300.0)
Investments	(4.4)	0.0	(150.0)	0.0
Other investing inc/(exp)	-	-	-	-
Investing cash flow	(1,854.6)	(1,909.8)	(1,150.0)	(300.0)
Free cash flow	(1,907.9)	(2,480.7)	(965.0)	(105.0)
Issue of equity	548.9	70.3	800.0	0.0
Issue/repay debt	1,372.6	2,409.4	224.0	0.0
Dividends paid	0.0	(50.0)	(94.0)	(117.0)
Others	0.6	44.4	44.0	23.0
Financing cash flow	1,922.1	2,474.1	974.0	(94.0)
Beg. cash & cash eq	2.4	16.7	10.0	19.0
Chg in cash & cash eq	14.3	(6.6)	9.0	11.0
Closing cash & cash eq	16.7	10.0	19.0	30.0

Source: Company, Religare Research

Financial ratios

Y/E June	FY06	FY07E	FY08E	FY09E
EBITDA margin (%)	7.3	13.7	16.3	17.2
EBIT margin (%)	6.6	11.7	13.4	14.6
Net profit margin (%)	4.4	6.3	6.9	7.9
FDEPS growth (%)	12.6	138.6	8.7	40.0
Receivables (days)	70.0	79.0	78.0	78.0
Inventory (days)	65.0	62.0	73.0	76.0
Payables (days)	15.0	17.0	21.0	22.0
Current ratio (x)	9.5	7.9	6.3	6.1
Interest coverage (x)	2.4	2.5	3.9	4.7
Debt/equity ratio (x)	1.7	2.7	1.6	1.3
ROE (%)	16.5	26.7	25.1	24.6
ROCE (%)	9.3	14.9	15.9	18.3
ROAE (%)	7.3	13.6	17.7	20.9
EV/Sales (x)	1.7	1.0	0.7	0.6
EV/EBITDA (x)	23.5	7.1	4.4	3.4
P/E (x)	9.0	3.8	3.5	2.5
P/BV (x)	1.1	0.9	0.7	0.6
P/CEPS (x)	7.2	2.6	2.2	1.7

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< -5%	Absolute Returns
	BUY	SELL	
Mid-caps**	> 25%	< 10%	

**Market cap over US$ 1bn **Market cap less than US$ 1bn*

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