

## Gokaldas Exports

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,853	GOKL IN
	REUTERS CODE
S&P CNX: 3,215	GOKL. BO

29 May 2006

Buy

Previous Recommendation: Buy

Rs605

Equity Shares (m)	17.2
52-Week Range (Rs)	809/469
1,6,12 Rel.Per. (%)	-10/-19/-69
M.Cap (Rs. b)	10.4
M.Cap (US\$ b)	0.2

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
3/06A	8,706	617	35.9	27.0	17.1	2.9	23.4	19.2	1.2	11.2
3/07E	10,583	770	44.8	24.7	13.5	2.5	20.0	19.3	1.0	9.5
3/08E	12,719	918	53.4	19.2	11.3	2.1	20.0	20.4	0.8	8.0

- ☞ Gokaldas Exports posted revenues of Rs2.4b for 4QFY06, up 12.2% QoQ. Being the first year of listing, comparable numbers for 4QFY05 are unavailable. The company recorded PAT of Rs150m for the quarter, which is in line with our estimate.
- ☞ EBITDA margins for the quarter stood at 11.5%, up 57bp QoQ. EBITDA margins for the full year FY06 stood at 10.9%, up 280bp. Key factors resulting in the sharp improvement in margins were absence of quota cost, better product mix and improved utilization.
- ☞ Deferred tax provisioning of Rs33m during 4QFY06 led to a sharp increase in tax/PBT to 26% in 4QFY06. For FY06, PAT increased by a robust 53% despite 40% increase in depreciation.
- ☞ We expect the company to register revenue CAGR of 21% and profit CAGR of 22% over FY06-08. The stock trades at 13.5x FY07E and 11.3x FY08E earnings. **Buy** with a price target of Rs802, an upside of 32.6%.

### QUARTERLY PERFORMANCE

Y/E MARCH	FY06				FY05	FY06
	1Q	2Q	3Q	4Q		
<b>Sales</b>	<b>1,790</b>	<b>2,471</b>	<b>2,193</b>	<b>2,391</b>	<b>7,240</b>	<b>8,845</b>
Change (%)	na	na	na	na	35.1	22.2
<b>EBITDA</b>	<b>179</b>	<b>265</b>	<b>240</b>	<b>276</b>	<b>583</b>	<b>960</b>
Change (%)	na	na	na	na	11.1	64.6
As % of Sales	10.0	10.7	11.0	11.5	8.1	10.9
Depreciation	34	42	50	54	129	181
Interest	33	38	37	35	119	143
Other Income	8	5	12	17	105	43
<b>PBT</b>	<b>120</b>	<b>190</b>	<b>166</b>	<b>204</b>	<b>439</b>	<b>679</b>
Tax	4	5	8	54	41	71
Effective Tax Rate (%)	2.9	2.6	5.1	26.3	9.4	10.4
Reputed PAT	116	185	157	150	398	609
<b>Adj. PAT</b>	<b>116</b>	<b>185</b>	<b>157</b>	<b>150</b>	<b>398</b>	<b>609</b>
Change (%)	na	na	na	na	6.6	53.0

E: MOST Estimates

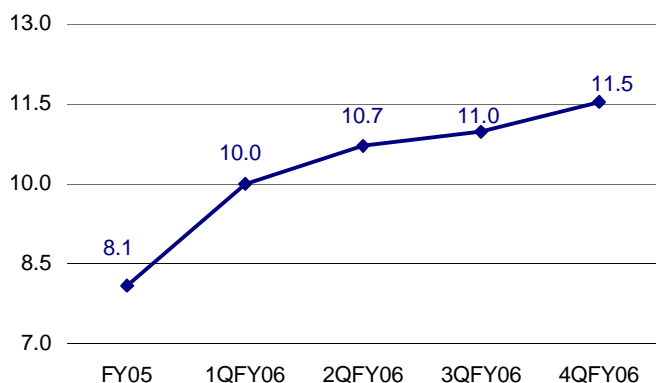
### Buoyant topline growth

Gokaldas recorded a robust 22% increase in revenues for FY06 to Rs8.8b. We expect Gokaldas to register revenue CAGR of 20% over FY06-08, driven by increased capacities and better utilization levels. Almost 80% of the company's revenues are derived from outerwear and bottoms. Both these items have remained the key to revenue generation for the company. The outerwear segment includes sportswear and winterwear, while bottoms include casual pants, chinos, linen trousers, denim jeans, etc.

### Robust EBITDA margin expansion

EBITDA margins in 4QFY06 stood at 11.5%, up 57bp on a QoQ basis. EBITDA margins for FY06 at 10.9% were up a robust 280bp. Key factors leading to the sharp improvement in margins are absence of quota cost, better product mix and improved utilization levels.

EBITDA MARGINS STEADILY EXPANDING (%)



Source: Company/ Motilal Oswal Securities

### PAT growth constrained by higher depreciation

During FY06, PAT increased by a robust 53% despite 40% increase in depreciation. Total capex in FY06 was Rs860m v/s Rs390m in FY05. As a result of increased capex, deferred tax provisioning stood at Rs33m in 4QFY06, increasing tax/PBT to 26%.

### Supply side constraints to benefit India

The Chinese Ministry of Commerce (Mofcom) has estimated that almost 20% of China's export quotas to the US and EU could remain unutilized in FY06 owing to Mofcom's distribution policy. In accordance with the current system, Beijing distributes 70% of the total annual EU and US quotas to those enterprises with sound export history. The remaining 30% of the quotas are awarded on the basis of two rounds of bidding. However, smaller firms found it difficult to bid for the quotas in the 30% category as they were expensive.

The above stated supply constraints are in addition to the quota constraints that are already imposed by the US and EU on China until CY08. China's existing trade agreements with the US and EU limit its textile exports over the next three years to 8%-12% per annum. In our opinion, these circumstances would significantly benefit India, and Gokaldas in particular, due to its leadership position in the Indian garment industry.

### 'Preferred vendor' for some of the world's largest brands

Gokaldas Exports is one of the largest and most respected garment manufacturers in India. It has been accorded 'Preferred Vendor' status by some of the world's best-known brands – Nike, GAP, Old Navy, Tom Tailor and Lebek International. With quotas now abolished, international trade in apparel is expected to increase significantly. Most studies indicate that India and China will be the biggest beneficiaries. We believe that Gokaldas Exports is well placed to capture this huge opportunity.

### Global sourcing capabilities; integrated facilities

The company has the capability to source raw materials globally. Since the quantities sourced are large, it has developed an efficient supply chain, which allows it to reduce input costs and enhance competitiveness. It can also

reduce its lead time, when required, by sourcing from suppliers that are capable of meeting its delivery schedules.

### **Pricing pressure to reduce**

The management has indicated that, going forward, they are looking at low pricing pressure and a stable industry-pricing environment. The imposition of embargos against China by the USA and EU is forcing large retailers to reduce dependence on China.

### **Valuation and view**

Gokaldas Exports is one of the best proxies to play the quota-outsourcing story in the Indian textiles space. It is one of

the largest and most respected garment manufacturers in India. We anticipate sharp improvements in productivity levels, aided by longer runs, implementation of modern scientific shop floor management techniques and increased mechanization.

The management has indicated a strong order book for FY07. It has also hinted at a stable pricing environment, with the possibility of price increases for some of its key categories in FY07. We expect the company to register revenue CAGR of 21% and profit CAGR of 22% over FY06-FY08. The stock trades at 13.5x FY07E and 11.3x FY08E earnings. **Buy** with a price target of Rs802, an upside of 32.6%.

## Gokaldas Exports: an investment profile

### Company description

Gokaldas Exports is one of the best proxies for the quota-outsourcing story in the Indian textiles sector. It is one of the largest and most respected garment manufacturers in India. It has global-scale capacities and established relationships with major international retailers and buyers, which, we believe, it can leverage to its advantage in the post-quota era.

### Key investment arguments

- ✍ Preferred vendor for some of the world's largest brands.
- ✍ Global sourcing capabilities and integrated facilities.
- ✍ Superior design capabilities.
- ✍ Specialization in outerwear enables it to earn higher margins.
- ✍ High non-quota country sales.

### Key investment risks

- ✍ High dependence on GAP.
- ✍ Margins under pressure.
- ✍ Differential tariffs to be a crucial issue.
- ✍ Constricting labor laws.

### Recent developments

- ✍ Has expanded capacity to 296 lines.
- ✍ Plans to set up three factories in FY07 and change its product mix to cover all categories.
- ✍ Likely to benefit substantially from safeguard measures against China by USA and EU.

### Valuation and view

- ✍ Expected to register revenue and PAT CAGR of 21% and 22%, over FY06-FY08.
- ✍ The stock trades at 13.5x FY07E and 11.3x FY08E earnings. **Buy** with a price target of Rs802, an upside of 32.6%.

### Sector view

- ✍ Exports from China are likely to be severely constrained due to safeguard measures imposed by the US and EU.
- ✍ India registered robust export growth rates to the US and EU in the post-quota era.
- ✍ Global buyers are focusing on building vendor partners that have high product development skills.
- ✍ Concern of industry overcapacity causing waves of deflation in prices is overblown.

#### COMPARATIVE VALUATIONS

		GOKALDAS	WELSPUN	ARVIND
P/E (x)	FY07E	13.5	13.2	14.2
	FY08E	11.3	10.8	12.4
P/BV (x)	FY07E	2.5	1.3	1.0
	FY08E	2.1	1.2	1.0
EV/Sales (x)	FY07E	1.0	1.8	1.8
	FY08E	0.8	1.5	1.6
EV/EBITDA (x)	FY07E	9.5	8.4	7.8
	FY08E	8.0	6.9	8.0

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05
Promoters	76.9	76.9
Domestic Institutions	7.4	6.6
FII's/FDIs	6.0	5.1
Others	9.7	11.4

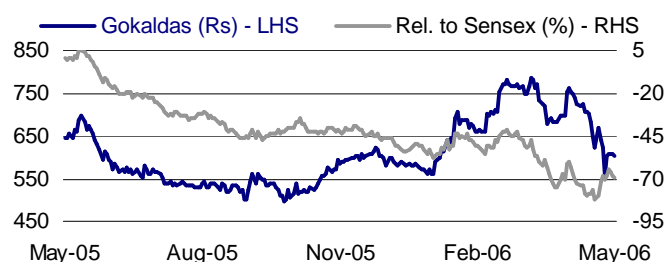
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	44.8	45.5	-1.6
FY08	53.4	51.3	4.2

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
605	802	32.6	Buy

#### STOCK PERFORMANCE



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Net Sales</b>	<b>5,361</b>	<b>7,240</b>	<b>8,845</b>	<b>10,583</b>	<b>12,719</b>	
Change (%)	14.5	35.1	22.2	19.6	20.2	
<b>Total Expenditure</b>	<b>4,918</b>	<b>6,657</b>	<b>7,885</b>	<b>9,544</b>	<b>11,511</b>	
<b>EBITDA</b>	<b>525</b>	<b>583</b>	<b>960</b>	<b>1,124</b>	<b>1,316</b>	
Change (%)	17.3	11.1	64.6	17.1	17.1	
% of Net Sales	9.8	8.1	10.9	10.6	10.4	
Depreciation	107	129	181	193	207	
<b>EBIT</b>	<b>418</b>	<b>454</b>	<b>779</b>	<b>930</b>	<b>1,110</b>	
Interest & Finance Charges	76	119	143	148	165	
Other Income	34	105	43	75	75	
<b>PBT</b>	<b>376</b>	<b>439</b>	<b>679</b>	<b>857</b>	<b>1,020</b>	
Tax	3	41	71	87	102	
Effective Rate (%)	0.7	9.4	10.4	10.2	10.0	
<b>Reported PAT</b>	<b>373</b>	<b>398</b>	<b>609</b>	<b>770</b>	<b>918</b>	
Change (%)	7.8	6.6	53.0	26.5	19.2	
<b>Adjusted PAT</b>	<b>373</b>	<b>398</b>	<b>609</b>	<b>770</b>	<b>918</b>	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Equity Capital	136	141	172	172	172	
Share Capital	136	141	172	172	172	
Reserves	1,281	1,525	3,361	4,013	4,814	
<b>Net Worth</b>	<b>1,417</b>	<b>1,666</b>	<b>3,533</b>	<b>4,185</b>	<b>4,985</b>	
Loans	1,241	1,906	956	856	706	
Deferred Tax Liability	43	35	42	64	89	
<b>Capital Employed</b>	<b>2,700</b>	<b>3,606</b>	<b>4,530</b>	<b>5,104</b>	<b>5,780</b>	
Gross Fixed Assets	1,196	1,448	1,948	2,198	2,348	
Less: Depreciation	364	410	582	775	982	
<b>Net Fixed Assets</b>	<b>832</b>	<b>1,038</b>	<b>1,366</b>	<b>1,423</b>	<b>1,366</b>	
Capital WIP	0	29	0	0	0	
Investments	1	1	1	0	0	
<b>Curr. Assets</b>	<b>2,333</b>	<b>3,135</b>	<b>3,899</b>	<b>4,663</b>	<b>5,587</b>	
Inventory	1,466	1,870	2,135	2,745	3,311	
Sundry Debtors	248	590	596	725	871	
Cash & Bank Balances	308	225	626	542	624	
Loans & Advances & Other	312	451	542	651	781	
<b>Current Liab. &amp; Prov.</b>	<b>467</b>	<b>598</b>	<b>736</b>	<b>981</b>	<b>1,173</b>	
Sundry Creditors	467	598	736	981	1,173	
<b>Net Current Assets</b>	<b>1,867</b>	<b>2,537</b>	<b>3,163</b>	<b>3,682</b>	<b>4,414</b>	
<b>Application of Funds</b>	<b>2,700</b>	<b>3,606</b>	<b>4,530</b>	<b>5,104</b>	<b>5,780</b>	

E: Most Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>27.5</b>	<b>28.3</b>	<b>35.4</b>	<b>44.8</b>	<b>53.4</b>	
Cash EPS	35.4	37.5	46.0	56.1	65.4	
Book Value per Share	104.4	118.4	205.6	243.6	290.1	
DPS	0.0	0.0	4.0	5.0	6.0	
Payout (Incl. Div. Tax) %	0.0	0.0	12.7	15.3	12.8	
<b>Valuation (x)</b>						
P/E		21.4	17.1	13.5	11.3	
Cash P/E		16.1	13.2	10.8	9.2	
EV/EBITDA		20.7	11.2	9.5	8.0	
EV/Sales		1.7	1.2	1.0	0.8	
Price to Book Value		5.1	2.9	2.5	2.1	
Dividend Yield (%)		0.0	0.7	0.8	1.0	
<b>Profitability Ratios (%)</b>						
RoE	22.8	25.8	23.4	20.0	20.0	
RoCE	17.0	14.4	19.2	19.3	20.4	
<b>Turnover Ratios</b>						
Debtors (Days)	17	30	25	25	25	
Inventory (Days)	109	103	100	105	105	
Creditors (Days)	52	23	25	30	30	
Working Capital (Days)	127	128	131	127	127	
Asset Turnover (x)	2.0	2.0	2.0	2.1	2.2	
Fixed Asset Turnover (x)	4.5	5.0	4.5	4.8	5.4	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.9	1.1	0.3	0.2	0.1	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>PBT before E.O. Items</b>	<b>376</b>	<b>439</b>	<b>679</b>	<b>857</b>	<b>1,020</b>	
Add : Depreciation	107	129	181	193	207	
Interest	76	119	143	148	165	
Less : Direct taxes paid	3	41	71	87	102	
(Inc)/Dec in WC	-445	-753	-225	-603	-650	
<b>CF from Operations</b>	<b>2</b>	<b>-307</b>	<b>527</b>	<b>308</b>	<b>424</b>	
<b>CF from Oper. Incl. EO</b>	<b>2</b>	<b>-307</b>	<b>527</b>	<b>308</b>	<b>424</b>	
(Inc)/dec in FA	-291	-222	-529	-250	-150	
<b>CF from Investments</b>	<b>-291</b>	<b>-281</b>	<b>-471</b>	<b>-250</b>	<b>-150</b>	
(Inc)/Dec in Shares	29	0	-1,328	0	0	
(Inc)/Dec in Debt	-125	-665	950	100	150	
Less : Interest Paid	76	119	143	148	165	
Dividend Paid	0	32	78	118	118	
<b>CF from Fin. Activity</b>	<b>130</b>	<b>506</b>	<b>345</b>	<b>-142</b>	<b>-193</b>	
<b>Inc/Dec of Cash</b>	<b>-159</b>	<b>-83</b>	<b>401</b>	<b>-84</b>	<b>81</b>	
Add: Beginning Balance	467	308	225	626	542	
<b>Closing Balance</b>	<b>308</b>	<b>225</b>	<b>626</b>	<b>542</b>	<b>623</b>	



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**Gokaldas Exports**

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|--|----|
| 1. Analyst ownership of the stock            | No |
| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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