



Vardhman Textiles

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,411	VTEX IN
	REUTERS CODE
S&P CNX: 4,250	MHSP.BO

30 May 2007

Buy

Previous Recommendation: Buy

Rs200

Equity Shares (m)	64.1
52-Week Range (Rs)	380/181
1,6,12 Rel.Per. (%)	0/-29/-79
M.Cap (Rs. b)	12.8
M.Cap (US\$ b)	0.3

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
3/07A	20,876	1,717	26.8	-12.5	7.5	1.2	16.6	9.3	1.3	7.9
3/08E	23,759	1,429	22.3	-16.8	9.0	1.0	12.2	7.8	1.6	9.2
3/09E	29,817	1,792	28.0	25.4	7.1	0.9	13.7	8.0	1.4	7.6

- 4QFY07 results came in below our expectation. During 4QFY07 EBITDA stood at Rs768m (v/s our estimate of Rs909m). EBITDA margin declined 267bp YoY to 14.2% (v/s est. of 16.5%), as a result of poor performance from the fabric and yarn division.
- During the quarter EBIT margins declined across all its key segments — fabric, yarn and steel. EBIT margins dropped 356bp YoY in the yarn division to 10.9%, while EBIT margins in the fabric division dropped 565bp YoY to 2.5%. The sewing thread division was able to buck the trend and record 358bp YoY jump in EBIT margins to 11.1%.
- We expect yarn margins to continue to face margin pressure in the near term due to weak cotton prices and increased capacities in the domestic market.
- Appreciation of rupee v/s the US\$ by more than 9%, over the last two-three month is likely to negatively impact the company in the near term. Although actual exports of the company is only around Rs4b, indirect exports or sales to garment exporters constitute almost 60% of its business. Hence, the company expects margin pressure across verticals, going forward.
- We expect interest cost to increase significantly, going forward. Nearly 60% of the company's debt is in TUF loans, a majority of which have floating interest rates. As a result, the effective cost of TUF loans has increased from 3.5% to around 5-5.5%, substantially increasing the interest cost.
- As a result of multiple margin pressures and higher interest cost, we are lowering our FY08 and FY09 net profit estimates by 32.3% and 29.1% respectively to Rs1.4b and Rs1.8b. The stock trades at PER of 9x FY08E EPS of Rs22.3 and 7.1x FY09E EPS of Rs28. Maintain **Buy**.

Y/E MARCH	FY06				FY07				FY06		FY07	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Sales	4,221	4,596	5,127	4,948	4,755	5,283	5,438	5,400	18,892	20,876		
Change (%)	2.0	-3.9	6.0	3.9	12.7	15.0	6.1	9.1	2.1	10.5		
Total Expenditure	3,438	3,743	4,169	4,112	133	4,366	4,470	4,632	15,462	17,388		
EBITDA	783	853	958	836	836	917	968	768	3,430	3,488		
Change (%)	16.0	19.2	30.7	9.5	6.8	7.5	1.0	-8.2	18.9	1.7		
As % of Sales	18.5	18.6	18.7	16.9	17.6	17.4	17.8	14.2	18.2	16.7		
Depreciation	251	251	267	244	286	301	290	317	1,013	1,194		
Interest	112	98	91	93	110	99	87	81	395	377		
Other Income	12	27	56	120	62	37	77	129	214	340		
Extra-ordinary Income	0	0	0	270	0	35	0	1	270	35		
PBT	431	531	656	888	501	590	668	500	2,506	2,292		
Tax	142	132	143	127	126	132	152	131	543	541		
Effective Tax Rate (%)	32.8	24.8	21.7	14.3	25.2	22.4	22.8	26.2	21.7	23.6		
Reported PAT	290	399	513	762	375	458	516	369	1,963	1,752		
Adj. PAT	290	399	513	492	375	423	516	369	1,693	1,717		
Change (%)	62.0	62.5	64.2	4.2	29.4	5.9	0.5	-24.9	62.6	1.4		

E: MOST Estimates

Segmental result analysis

During 4QFY07, Vardhman reported margin declines across all its key segments — fabric, yarn and steel. EBIT margins dropped 356bp YoY in the yarn division to 10.9%, while EBIT margins in the fabric division dropped 565bp YoY to 2.5%. The sewing thread division was able to buck the trend and record a 358bp YoY jump in EBIT margins to 11.1%.

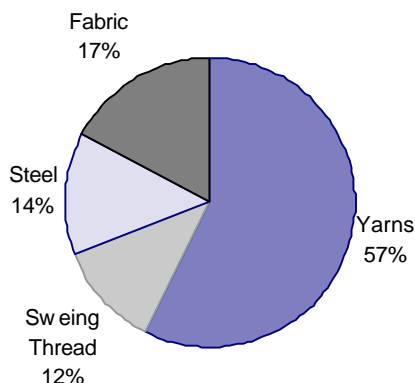
SUMMARY OF SEGMENTAL REVENUES (RS M)

SEGMENT REVENUES	4QFY06	4QFY07	% CH.
Yarns	3,305	3,563	7.8
Sweing Thread	830	735	-11.4
Steel	699	852	21.9
Fabric	975	1,076	10.3
Less: Inter Segment Revenue	861	826	-4.1
Total	4,948	5,400	9.1
EBIT			
Yarns	479	390	-18.6
Sweing Thread	63	82	30.7
Steel	122	126	3.6
Fabric	79	26	-66.6
Total	743	625	-15.9
EBIT margins (%)			
Yarns	14.5	10.9	-24.5
Sweing Thread	7.5	11.1	47.5
Steel	17.5	14.8	-15.0
Fabric	8.1	2.5	-69.8
Total	15.0	11.6	-23.0

Source: Company/ Motilal Oswal Securities

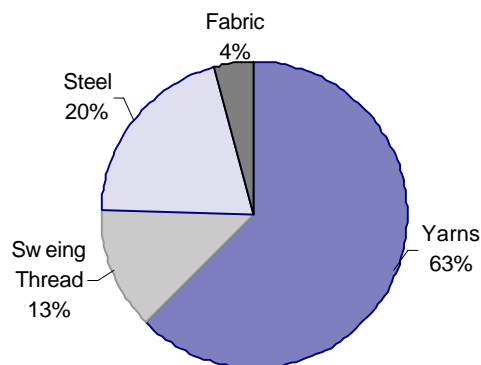
The table above depicts the revenue and EBIT composition for 4QFY07. The company’s poor performance in the fabric division is the key concern.

REVENUE BREAK-UP 4QFY07



Source: Company/Motilal Oswal Securities

EBIT BREAK-UP 4QFY07

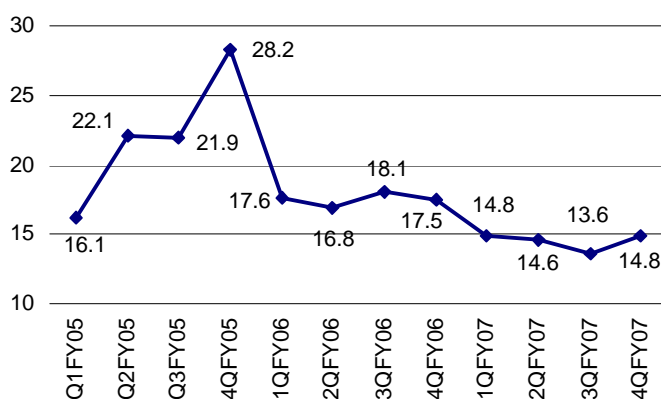


Source: Company/ Motilal Oswal Securities

Steel EBIT margins have stabilized

Vardhman’s steel business has been witnessing stable EBIT margins on a QoQ basis at around 14-15%. However, on a YoY basis, steel EBIT margins dropped 262bp to 14.8%. We expect Vardhman’s steel business to continue to record stable performance in FY08, on the back of robust outlook with respect to its auto ancillary business.

QOQ EBIT MOVEMENT (%)



Source: Company/ Motilal Oswal Securities

Capex schedule

Vardhman is embarking on a significant capacity expansion program with capex outlay of close to Rs20b. Post expansion, its processed fabric capacity would increase by around 168% and spindle capacity, by around 55%. In line with its expansion plans, the company has already acquired land in Madhya Pradesh. It intends to increase fabric

weaving and processing capacity from 42m meters in FY07 to 102m meters by FY08 and opt for a corresponding increase in spindle capacity by 234,000 spindles by FY08. This will significantly improve the company's growth prospects going forward and should positively impact margins.

SUMMARY OF CAPEX SCHEDULE

PARTICULARS	FY07E	FY08E
In No's.		
Badi	198,200	198,200
Other existing plants	307,300	307,300
Greenfield at MP	90,000	234,000
Total	595,500	739,500
Fabric		
Greige Fabric (Looms in No's.)		
Badi	490	490
Greenfield at MP	120	400
Total	610	890
Processed Fabric (Mn meters)		
Badi	42	42
Greenfield at MP		60
Total	42	102

Source: Company/ Motilal Oswal Securities

Lowering estimates

The appreciation of rupee v/s the US\$ by more than 9%, over the last 2-3 months is likely to negatively impact the company in the forthcoming quarters. Although actual exports of the company are merely at around Rs4b, indirect exports or sales to garment exporters constitute nearly 60% of its revenues. Hence, the company expects margin pressure across verticals going forward.

We expect the interest cost for the company to increase significantly, going forward. Almost 60% of the company's debt is in TUF loans, a majority of which have floating interest rates. As a result, the effective cost of TUF loans has increased from 3.5% to around 5-5.5%, substantially increasing the interest cost. As a result of near term margin pressure in the form of lower yarn prices, poor fabric performance and higher interest cost, we are lowering our net profit estimates for FY08 by 32.3% to Rs1.4b and for FY09 by 29.1% to Rs1.8b respectively. The revised diluted EPS for FY08 stands at Rs22.3 and for FY09, at Rs28.

REVISED ESTIMATES (RS M)

PAT	OLD	NEW	CHG %
FY08	2,110	1,429	-32.3
FY09	2,526	1,792	-29.1

Source: Motilal Oswal Securities

Valuation and view

As a result of multiple margin pressures and higher interest costs, we are lowering our net profit estimates for FY08 by 32.3% to Rs1.4b and for FY09 by 29.1% to Rs1.8b respectively. Although the near term outlook on the stock remains negative as a result of multiple margin pressure, we remain bullish on the stock over the medium to long term, due to strong growth opportunity in the upstream textile sector. The stock is trading at undemanding valuations of 9x PER on FY08E EPS of Rs22.3 and of 7.1x PER on FY09E EPS of Rs28. Maintain **Buy**.

Vardhman Textiles: an investment profile

Company description

Vardhman Textiles is the flagship of one of the most respected textile groups in India. It has large spindlage capacity and is the second largest sewing thread player in India. The company stands to gain substantially from the strong increase in demand from the domestic downstream sector and the robust export market. In our opinion, Vardhman is all set to emerge as one of the most cost competitive textile companies globally by virtue of its large scale capacities, world class facilities and diversified product mix.

Key investment arguments

- ✍ De-risked business model.
- ✍ Superior management quality.
- ✍ Poised to reap benefits of expansion.

Key investment risks

- ✍ Commodity nature of its business.
- ✍ Steel contribution to decline.
- ✍ New capacities to go on stream only from mid-FY08.

Recent developments

- ✍ Is eligible for tax breaks under Section 80IC for the incremental capex at Baddi.
- ✍ Has plans to hive off its sewing thread business to a JV.

Valuation and view

- ✍ Is expanding weaving and processing capacity.
- ✍ We are lowering our FY08 and FY09 net profit estimates by 32.3% and 29.1% respectively to Rs1.4b and Rs1.8b.
- ✍ The stock is trading at undemanding valuation of 9x PER on FY08E EPS of Rs22.3 and of 7.1x PER on FY09E EPS of Rs28.
- ✍ We rate the stock a **Buy** with a price target of Rs236.

Sector view

- ✍ Exports from China are likely to be severely constrained due to safeguard measures introduced by the US and the EU.
- ✍ Indian exports to the US and EU were muted in FY07 and recording flat growth rates.
- ✍ Global buyers are focusing on building vendor partners who have high product development skills.
- ✍ The concern of industry overcapacity causing waves of deflation in prices is overblown.

COMPARATIVE VALUATIONS

		VARDHMAN	ARVIND	ALOK
P/E (x)	FY08E	9.0	28.5	6.5
	FY09E	7.1	11.1	5.8
P/BV (x)	FY08E	1.1	0.6	1.8
	FY09E	0.9	0.5	1.8
EV/Sales (x)	FY08E	1.6	1.2	7.9
	FY09E	1.4	1.1	7.8
EV/EBITDA (x)	FY08E	9.3	9.1	2.9
	FY09E	7.6	7.6	2.5

SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	62.2	62.2	62.2
Domestic Inst	18.2	17.9	12.4
Foreign	3.1	3.5	6.4
Others	16.5	16.4	19.0

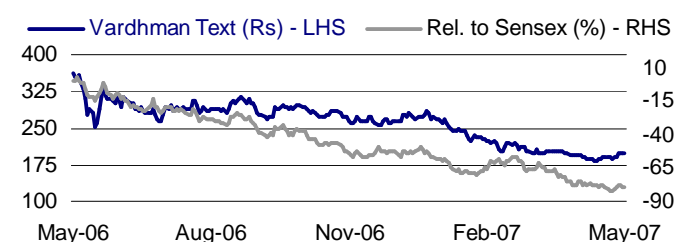
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	22.3	36.6	-39.0
FY09	28.0	46.6	-39.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
200	236	17.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT				
(Rs Million)				
Y/E MARCH	2006	2007E	2008E	2009E
Net Sales	18,892	20,876	23,759	29,817
Change (%)	2.1	10.5	13.8	25.5
Total Expenditure	15,461	17,388	20,820	25,352
EBITDA	3,430	3,488	4,177	5,458
Change (%)	18.9	1.7	19.7	30.7
% of Net Sales	18.2	16.7	17.6	18.3
Depreciation	1,013	1,194	1,559	2,066
EBIT	2,417	2,294	2,618	3,392
Interest & Finance Charges	395	377	988	1,303
Other Income	214	340	300	300
Non-recurring Items/ Inc.	270	0	0	0
PBT	2,506	2,257	1,931	2,389
Tax	543	541	502	597
Effective Rate (%)	21.7	24.0	26.0	25.0
Reported PAT	1,964	1,717	1,429	1,792
Change (%)	62.6	-2.6	-16.8	25.4
Adjusted PAT	1,694	1,717	1,429	1,792

BALANCE SHEET				
(Rs Million)				
Y/E MARCH	2006	2007E	2008E	2009E
Equity Capital	578	641	641	641
Share Capital	578	641	641	641
Reserves	9,039	10,463	11,673	13,173
Net Worth	9,617	11,104	12,314	13,814
Loans	11,022	15,464	26,464	29,464
Deferred Tax Liability	922	1,030	1,130	1,250
Capital Employed	21,560	27,597	39,907	44,527
Gross Fixed Assets	17,599	25,599	38,099	42,599
Less: Depreciation	8,188	9,382	10,941	13,006
Net Fixed Assets	9,411	16,217	27,158	29,592
Capital WIP	965	965	965	965
Investments	684	684	684	684
Curr. Assets	12,458	11,744	13,192	15,665
Inventory	5,690	5,875	6,864	8,358
Sundry Debtors	2,220	2,354	2,611	3,277
Cash & Bank Balances	2,715	858	662	823
Loans & Advances & Other C	1,832	2,656	3,055	3,207
Current Liab. & Prov.	1,957	2,012	2,091	2,378
Sundry Creditors	1,636	537	630	783
Other Liabilities	1,148	1,183	1,242	1,304
Provisions	321	292	219	292
Net Current Assets	10,501	9,732	11,100	13,286
Application of Funds	21,560	27,597	39,907	44,527

E: M OSt Estimates

RATIOS				
Y/E MARCH	2006	2007E	2008E	2009E
Basic (Rs)				
EPS	30.7	26.8	22.3	28.0
Cash EPS	46.9	45.4	46.6	60.2
Book Value per Share	166.5	173.4	192.3	215.7
DPS	4.5	4.0	3.0	4.0
Payout (Incl. Div. Tax) %	15.1	17.0	15.3	16.3
Valuation (x)				
P/E	6.5	7.5	9.0	7.1
Cash P/E	4.3	4.4	4.3	3.3
EV/EBITDA	6.2	7.9	9.2	7.6
EV/Sales	1.1	1.3	1.6	1.4
Price to Book Value	12	12	10	0.9
Dividend Yield (%)	2.3	2.0	1.5	2.0
Profitability Ratios (%)				
RoE	22.3	16.6	12.2	13.7
RoCE	12.7	9.3	7.8	8.0
Turnover Ratios				
Debtors (Days)	43	41	40	40
Inventory (Days)	134	123	120	120
Creditors (Days)	23	20	20	20
Working Capital (Days)	203	170	171	163
Asset Turnover (x)	0.9	0.8	0.6	0.7
Fixed Asset Turnover (x)	1.1	0.8	0.6	0.7
Leverage Ratio				
Debt/Equity (x)	1.15	1.39	2.15	2.13

CASH FLOW STATEMENT				
(Rs Million)				
Y/E MARCH	2006	2007E	2008E	2009E
PBT before E.O. Items	2,506	2,257	1,931	2,389
Add : Depreciation	1,013	1,194	1,559	2,066
Less : Direct taxes paid	581	433	402	478
Inc/Dec in WC	670	1,025	1,565	2,025
CF from operations	2,269	1,994	1,523	1,953
Minority Int. & Share of Asso	0	0	0	0
CF from Oper. incl. EO I	2,269	1,994	1,523	1,953
(Inc)/Dec in FA	-4,680	-8,000	-12,500	-4,500
(Pur)/Sale of Investments	-273	0	0	0
CF from investments	-4,953	-8,000	-12,500	-4,500
Inc/Dec in Networth	1,942	0	0	0
Inc/Dec in Debt	3,526	4,442	11,000	3,000
Less: Dividend Paid	296	292	219	292
CF from Fin. Activity	5,172	4,149	10,781	2,708
Inc/Dec of Cash	2,488	-1,857	-196	160
Add: Beginning Balance	227	2,715	858	662
Closing Balance	2,715	859	662	822



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Vardhman Textiles

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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 |
| 4. Investment Banking relationship with company covered | No |

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