

Company Focus

20 December 2007 | 7 pages

Welspun India (WLSP.BO)

 Change in opinion
 Rating change
 Target price change

Discontinuing Coverage

- We are discontinuing coverage of Welspun's stock due to limited investor interest and reallocation of coverage resources.
- The firm's final recommendation for the security is Sell/Medium Risk (3M), and our increased target price is Rs79. We have downgraded from Hold/Medium Risk (2M) given negative expected total return, and in light of 1) ongoing volatility in earnings due to margin pressures and appreciating rupee; 2) slower-than-expected ramp-up of production at newly commissioned capex; and 3) unfavorable risk/reward given the stock's 70% run over the last 3 months; valuations rich at 12x FY09E P/E (a premium to sector).
- With Welspun's large exposure to the US (60% of exports) and intensifying competition from other Asian peers, we believe outlook is challenging. Further, with concerns on appreciating rupee and rising cotton prices building, we see these adversely affecting export (95% of revenues) realizations and core earnings. Its recent acquisition of 76% in bath-rug major Sorema-Tapates e Cortinasde Banho SA of Portugal, at an EV of Rs600m, ties-in with its strategy to enhance portfolio of brands; however, we believe benefits will be back-end.
- This is our final rating on Welspun India's stock; we will not be providing further updates to our research or ratings. Because facts and circumstances may change, the information and analysis contained in this or prior research may no longer be applicable or accurate in the future. Accordingly, you should not rely on this or previous research with respect to this company going forward.

Sell/Medium Risk	3M
<i>from Hold/Medium Risk</i>	
Price (20 Dec 07)	Rs101.85
Target price	Rs79.00
<i>from Rs68.00</i>	
Expected share price return	-22.4%
Expected dividend yield	0.0%
Expected total return	-22.4%
Market Cap	Rs7,444M
	US\$188M

Price Performance (RIC: WLSP.BO, BB: WLSI IN)



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	440	5.74	2.7	17.8	1.5	10.3	0.0
2007A	498	6.49	13.2	15.7	1.4	9.1	0.0
2008E	580	7.56	16.4	13.5	1.2	9.6	0.0
2009E	670	8.73	15.5	11.7	1.1	10.1	0.0
2010E	749	9.76	11.8	10.4	1.0	10.2	1.0

Source: Powered by dataCentral

Ashish Jagnani¹

 +91-22-6631-9861
 ashish.jagnani@citi.com

Karishma Solanki¹

karishma.solanki@citi.com

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

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	17.8	15.7	13.5	11.7	10.4
EV/EBITDA adjusted (x)	11.5	9.9	8.4	7.9	7.6
P/BV (x)	1.5	1.4	1.2	1.1	1.0
Dividend yield (%)	0.0	0.0	0.0	0.0	1.0
Per Share Data (Rs)					
EPS adjusted	5.74	6.49	7.56	8.73	9.76
EPS reported	4.97	6.49	7.56	8.73	9.76
BVPS	68.32	74.81	82.37	91.10	99.85
DPS	0.00	0.00	0.00	0.00	1.00
Profit & Loss (RsM)					
Net sales	6,537	9,736	11,796	13,416	14,906
Operating expenses	-5,833	-8,812	-10,518	-11,880	-13,283
EBIT	705	924	1,278	1,536	1,623
Net interest expense	-246	-478	-650	-665	-646
Non-operating/exceptionals	234	379	265	160	176
Pre-tax profit	692	825	893	1,031	1,153
Tax	-217	-304	-312	-361	-403
Extraord./Min.Int./Pref.div.	-93	-23	0	0	0
Reported net income	381	498	580	670	749
Adjusted earnings	440	498	580	670	749
Adjusted EBITDA	1,191	1,575	2,138	2,461	2,643
Growth Rates (%)					
Sales	37.2	48.9	21.2	13.7	11.1
EBIT adjusted	1.9	31.1	38.3	20.2	5.6
EBITDA adjusted	22.9	32.2	35.8	15.1	7.4
EPS adjusted	2.7	13.2	16.4	15.5	11.8
Cash Flow (RsM)					
Operating cash flow	-347	1,143	1,640	1,626	2,638
Depreciation/amortization	486	651	860	925	1,020
Net working capital	-1,466	-6	199	31	869
Investing cash flow	-3,639	-6,967	-1,896	-1,836	-2,458
Capital expenditure	-2,456	-3,544	-3,616	-2,602	-2,365
Acquisitions/disposals	-942	-2,802	1,809	691	0
Financing cash flow	3,997	5,177	238	175	-229
Borrowings	2,362	5,258	323	175	-152
Dividends paid	0	0	0	0	-77
Change in cash	11	-647	-18	-35	-48
Balance Sheet (RsM)					
Total assets	15,509	21,094	22,105	23,672	24,512
Cash & cash equivalent	810	163	145	110	61
Accounts receivable	417	633	708	805	894
Net fixed assets	10,256	13,150	15,906	17,583	18,929
Total liabilities	10,001	15,175	15,781	16,678	16,845
Accounts payable	747	1,224	1,449	1,753	2,085
Total Debt	8,395	13,006	13,311	13,450	13,250
Shareholders' funds	5,508	5,919	6,324	6,994	7,667
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	18.2	16.2	18.1	18.3	17.7
ROE adjusted	10.3	9.1	9.6	10.1	10.2
ROIC adjusted	4.4	4.3	5.6	6.0	5.9
Net debt to equity	137.7	217.0	208.2	190.7	172.0
Total debt to capital	60.4	68.7	67.8	65.8	63.3

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Welspun India

Company description

Welspun India is among Asia's largest terry towels manufacturers and the fourth largest in the world. A wide product range, fully integrated scaleable capacities and ability to offer value-added products make it a preferred supplier to global retailers in the EU and US. It already has a presence in retailing, having the license to market under Nautica, Umbra in the US and owns the Chirsty brand in UK and SPACES brand in India. The company's foray into bed-linen is a step to position itself as a single-point vendor in home textiles. Exports constitute 95% of revenues. Given the company's vertically integrated business model in home textiles, most expansion now operational, we expect Welspun to deliver high growth. It is a flagship company of the Welspun Group (34% holding).

Investment thesis

We are downgrading Welspun to Sell/Medium Risk (3M) from Hold/Medium Risk with a target price of Rs79 (vs. 68 earlier). This is factoring in a negative expected total return, and in light of 1) ongoing volatility in earnings due to margin pressures and appreciating rupee; 2) slower-than-expected ramp-up of production at newly commissioned capex; and 3) unfavorable risk/reward given the stock's 70% run over last 3 months, valuations rich at 13x FY08E P/E (a premium to sector).

With Welspun's initiatives to move up the value chain, focus on branded home textiles and backward/forward integration, we believe the company offers a strong business model for growth. Its strategy to expand to bed linen, decorative bed sets and entry into bath rugs post the acquisition of a 76% stake in Sorema, Portugal should enrich product mix. However, because of the adverse impact of the appreciating rupee given the high proportion of exports, rising cotton costs and high initial overheads in the bed-linen capacity, we expect earnings volatility to continue. Factoring this and with the stock already trading at 12x FY09E P/E, at a significant premium to our sector target of 8x, we believe upsides are priced in.

Valuation

Our revised target price of Rs79 (vs. Rs68 earlier) is based on 9x P/E for FY09E P/E as we roll forward from FY08E earlier. We still believe Welspun will trade at a 10% premium to our sector target valuations of 8x. The premium is a function of Welspun's leadership in terry towels exports with global capacities; focus on branded home textiles and vertically integrated business model, provides a proxy for playing the outsourcing theme in home textiles.

P/E is our primary valuation tool as we see it as best capturing the company's earnings growth potential. However, with earnings volatility to continue, post the stock's 70% move over the last 3 months, we consider valuations rich.

Risks

We rate Welspun Medium Risk, as opposed to the High Risk rating assigned by our quantitative risk-rating system. The key reasons we opt for a Medium Risk rating include: (1) Secular growth prospects in home textiles post quotas and shrinking capacities in the US; (2) Rapid growth on account of new capacity expansion; (3) Welspun's leadership position in India and its relationships with global brands; and (4) Peer stocks are rated Low or Medium Risk. The upside risks to our target price include: 1) Faster than expected breakeven of the bed-linen business; 2) Long-term sourcing tie-ups with global branded home textile retailers; and 3) significant depreciation in the rupee over and above Rs40 to the USD will positively affect the company's future earnings and our estimates.

Appendix A-1

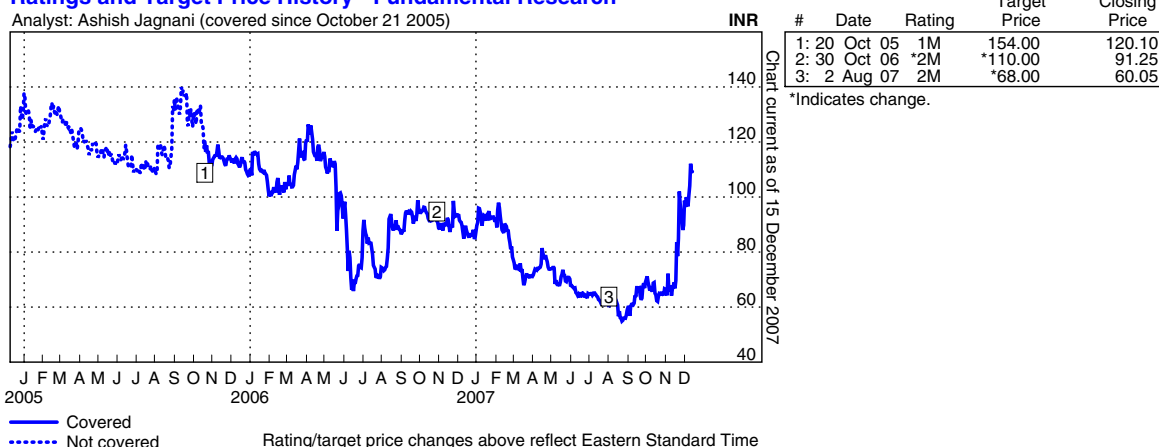
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Analyst: Ashish Jagnani (covered since October 21 2005)



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