

Initiating Coverage Vardhman Textiles Ltd.

31-March-2021



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Textile	Rs. 1253	Buy on dips in the Rs 1130 and add more at Rs.1045	Rs. 1245	Rs. 1350	2 quarters

HDFC Scrip Code	VARTEXEQNR
BSE Code	502986
NSE Code	VTL
Bloomberg	VTEX IN
CMP March 31, 2021	1253
Equity Capital (Rs.cr)	56
Face Value (Re)	10
Equity Share O/S (cr)	5.7
Market Cap (Rs.crs)	7200
Book Value (Rs)	1070
Avg. 52 Wk Volumes	45,500
52 Week High	1290
52 Week Low	593

Share holding Pattern % (Dec, 2020)	
Promoters	62.83
Institutions	26.87
Non Institutions	10.3
Total	100.0

Fundamental Research Analyst

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Our Take:

Vardhman Textiles (VTL), is India's largest fully integrated textile company. Over last 5 decades, it has transformed itself from a mid-sized 6000 spindles company to a textile power house with dominant presence across yarn and fabric segment. Its current capacity in spinning stood at 11.26lk spindles while in weaving and processing its stood at 220/175 Mn MPA respectively. Despite the commoditized, highly capital and labor intensive nature of textile industry, VTL is amongst very few textile companies has been able to consistently and successfully operate with low leverage (Net D/E down from 1.2x in FY12 to 0.1x in FY20) in spite of continuous capacity expansion (FY12-20 total capex ~Rs. 4500Cr). In order to insulate itself from volatile yarn business the company has been constantly scaling-up its presence in high margin woven cotton fabric segment. It has increased its processing capacity from 110 Mn MTPA in FY15 to 175Mn MTPA as on FY20.

We believe, VTL with its strong market positioning and robust balance sheet is well placed to capture the consolidation theme in the Indian textile industry. Also with the largest domestic spindlage, it is in a sweet spot to benefit from the increasing spreads between yarn and cotton prices.

Valuations & Recommendation:

We are positive on the future earnings growth trajectory of VTL. We expect its revenue and PAT to record a growth of 4% and 17% CAGR over FY20-23E. Its superior market positioning, prudent expansion strategy along with ability to consistently generate strong cash flows with constant debt reduction provides comfort.

The stock is currently trading at valuation of 6x FY23E EV/EBITDA. We feel the base case fair value of the stock is Rs 1245 (6x FY23E EV/EBITDA) and bull case fair value is Rs 1350 (6.8x FY23E EV/EBITDA). Investors can buy on dips at the price of Rs 1130 (5.6x FY23E EV/EBITDA) and add more on dips to Rs.1045 (5.2x FY23E EV/EBITDA).

Financial Summary

Particulars (Rs cr)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
Total Operating Income	1750.1	1825.2	-4.1	1625.2	7.7	6,877.9	6,735.0	5,926.5	6,693.2	7,591.4
EBITDA	276.7	211.8	30.6	144.6	91.4	1,193.8	937.4	693.4	1,037.4	1,366.5
Depreciation	91.6	86.5	5.9	91.4	0.2	254.0	333.2	384.2	406.6	429.0
Other Income	66.3	73.9	-10.2	59.0	12.5	238.7	186.6	213.4	241.0	273.3
Interest Cost	23.3	29.4	-21.0	27.9	-16.7	119.7	135.3	106.0	96.0	86.0
Tax	53.3	-31.7	-268.3	22.7	134.9	318.2	64.5	104.1	193.9	281.2
PAT	170.5	199.2	-14.4	60.2	183.2	740.6	591.0	312.4	581.8	843.5
Diluted EPS (Rs)	29.7	34.6	-14.4	10.5	183.2	127.1	100.4	52.9	100.6	146.9
RoE						12%	9%	5%	9%	12%
P/E (x)						11	14	24	12	9
EV/EBITDA						8	10	13	8	6

Source: Company, HDFC sec

Q3FY21 Result Review

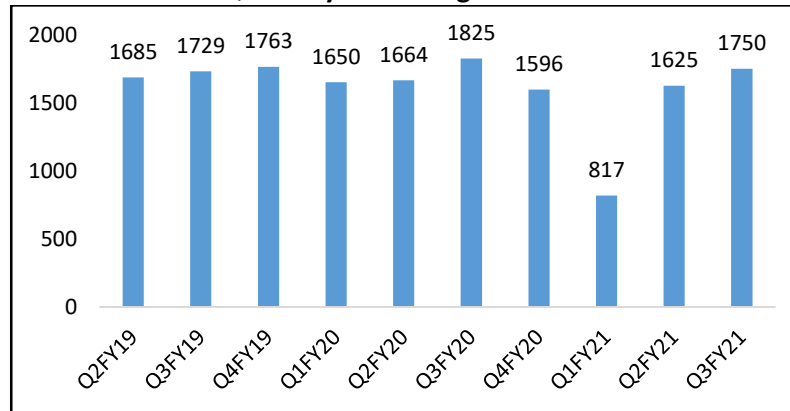
- Despite the Covid-19 pandemic, VTL had reported steady performance in Q3FY21 revenues stood at Rs 1750Cr which declined by 4% on YoY basis but grew 7.7% sequentially. Total yarn volume for the quarter grew by 3% YoY to 61,168MT while grey and processed fabric volumes declined by 8.6% and 19.2% respectively on the YoY basis. On the sequential comparison there has been a sharp recovery in grey and processed fabric volumes which grew by 42% and 40% respectively.
- EBITDA margins for the quarter stood 15.8% (+420/690 bps YoY/QoQ). Strong uptick in margins was on the back of Gross margin improvement of 340 bps YoY to 48.3% and lower power cost down 120 bps YoY to 9.9%.
- Consequently, PBT grew 31% YoY to Rs. 219Cr. However, PAT fell 13% to Rs. 175Cr owing to deferred tax adjustment in the base quarter.

Recent Triggers

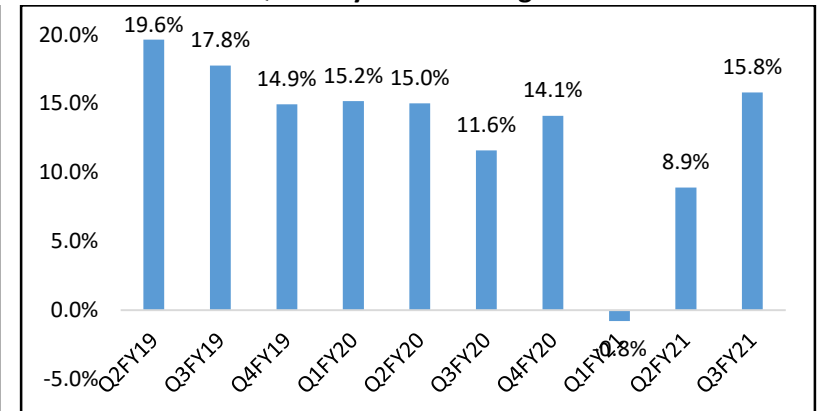
Strong pent-up demand both from domestic and international markets post lockdown resulting in favorable spreads

Covid-19 induced lockdown had severely impacted the entire textile value chain in Q1FY21, however with easing of restrictions the pent-up demand started rising. The inventory pipeline was broken down which resulted in aggressive refilling resulting in better realizations. The home textile exports were the first one to witness robust demand of super fine high 60's/80's count yarn which was mainly on the back of full capacity utilization of Indian bed sheet companies. Also higher demand of high counts resulted in shortage of medium count yarn resulting in higher delta in the spinning segment. Also a large part of small spinning mills weren't in a position to restart their business due to inadequate financing and infrastructure challenges which further benefited larger well-capitalized organized players like VTL. On the fabric side, as per the management the utilization levels has been gradually improving and in the December '20 quarter it clocked utilizations of ~80-85% of the total processing capacity which is likely to further improve in Q4.

Quarterly Revenue growth Trend



Quarterly EBITDA Margin Trend

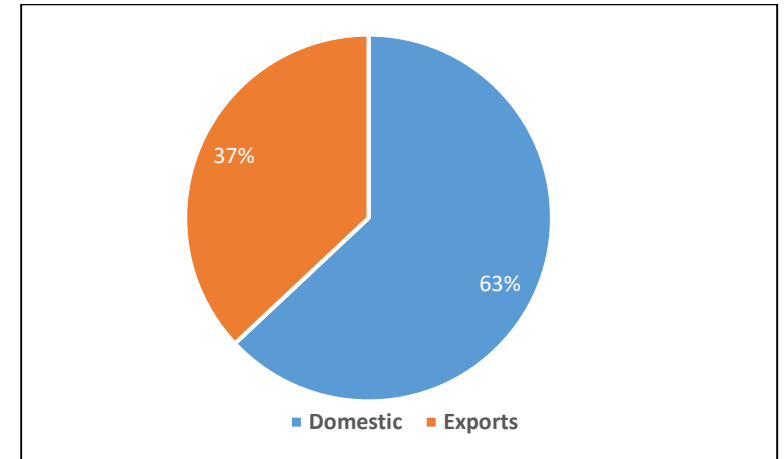
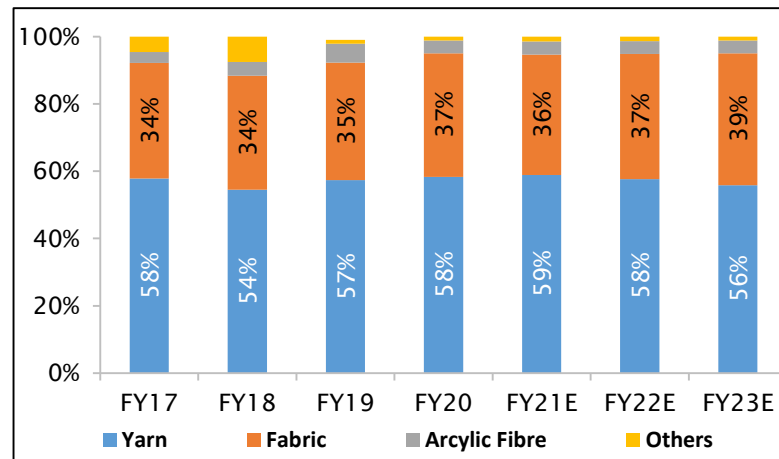


(Source: Company, HDFC sec)

Long Term Triggers

Presence across the value chain with major alliances with global players

VTL is a fully integrated textile player, is present across the entire spectrum of textile value chain ranging from yarns, threads, fibre to fabrics and garments. VTL's core business – Yarn and Fabric contributed 58% and 37% to FY20 product sales. It offers the widest range of specialised greige and dyed yarns in cotton, polyester, acrylic and varieties of blends. It also offers value-added products like organic cotton, melange, lycra, ultra yarns (contamination controlled), gassed mercerized, super fine yarns and fancy yarns for hand knitting. It is one of the largest exporters of cotton yarn to the most quality conscious markets of the EU, USA and the Far East. The company's yarn business caters equally to the domestic, international and captive fabric consumption. Yarn segment has been witnessing over capacity leading to restricted margins and low returns.



This diverse product portfolio has enabled the company to de-risk its business model and be less prone to the cyclicity of a particular business segment. The company has been continuously moving up the value chain which is likely to help increase sales volumes and aid margin expansion.

Over last 5 years, with an aim to expand its product basket, VTL has been constantly focusing on the fabric segment which offers value added products. It has doubled its fabric processing capacity from 110 Mn MTPA in FY15 to 220Mn MTPA as on FY20 resulting in fabric contributing ~37% of overall revenues v/s 34% in FY17. In this segment it caters to leading global and domestic brands like UNIQLO, M&S, H&M, Kohl's, Walmart, Allen Solly, Tommy Hilfiger, Arrow, Raymond etc. Its fabric is mainly used in Tops, bottoms, outer wear for men and women for both casual and formal wear.

Prudent expansion strategy with strong track record of execution

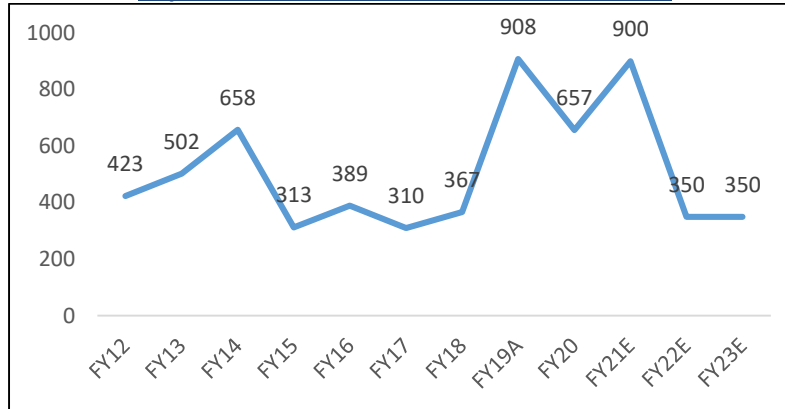
VTL in last decade has invested more than Rs. 5000Cr behind augmenting and modernizing its capacities. The company's track record of timely execution has been un-paralleled in Indian textile industry which is clearly evident from VTL's strong balance sheet. It has been consistently expanding its spinning capacity in a calibrated and gradual manner. Its spinning capacity has gradually grown from a 6k spindles to current 11.2lk spindles in FY20 thereby making it India's largest spinning capacity. The company has technical tie-ups with world leaders from Japan and Korea. In the yarn segment almost 35% of its production is exported. It is one of the largest exporters from India and accounts for ~5% of the total cotton yarn exported. Going forward, VTL plans to add close to about 100,000 spindles equivalent both in the vortex and the spinning capacity and the new capacity is likely to be operational in next 12 months.

Taking a further step towards forward integration, the company entered the fabric business in 1992 and started manufacturing greige (unprocessed) fabric. It further graduated to manufacture processed fabric in 1999. Vardhman currently operates with a capacity of ~1700 looms and 175 million metres of processed fabric.

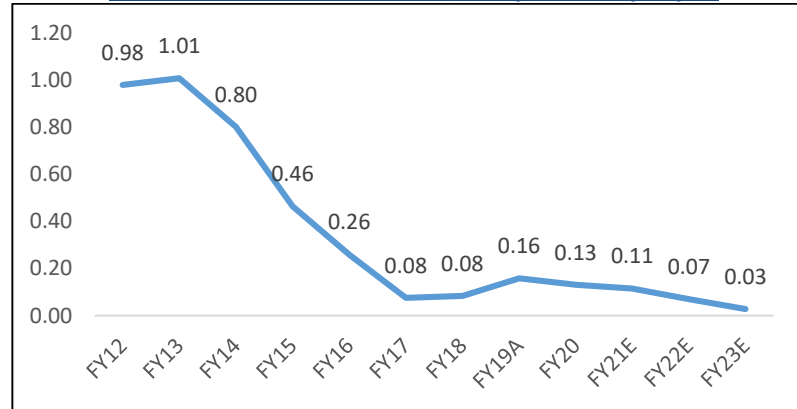
Consistent Debt reduction and strong cash flows despite higher capex

VTL has created a niche for itself in the entire textile and apparel industry in India with its constant endeavor to expand with a strict discipline on leverage. Within the comparable fully integrated textile companies, VTL has strongest and most resilient balance sheet which has enabled the company to absorb the prevailing pandemic related slowdown challenges and the company is well placed to tackle any unforeseen shocks. Going forward, once the economy revives with the green shoots already visible, we expect companies of the likes of VTL with undisputed leadership, strong track record and robust balance sheet to be in sweet spot.

Capex trend of over Rs 4500Cr over FY12-20



Consistent Net D/E reduction despite heavy capex



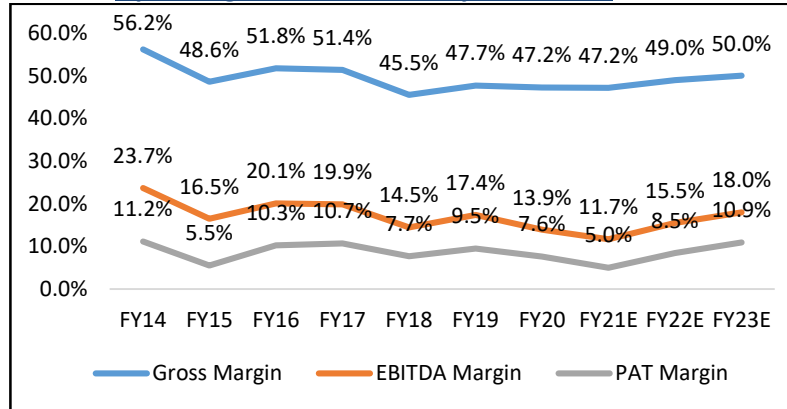
(Source: Company, HDFC sec)

VTL has incurred a capital expenditure of ~Rs. 4500 crore over FY12-20. Over the same period, it has registered revenue and PAT CAGR of 5% and 18% respectively. Currently as on Q3FY21 the company is operating at 95%/85% utilization levels in grey and processed fabric while in yarn segment the utilizations have reached optimal levels. Going forward, we expect the utilizations across segments to be at optimal levels for FY22 which is likely to generate strong free cash flows for the year. Also once stability prevails, the company is likely to further announce its next leg of expansion outlay in the fabric segment.

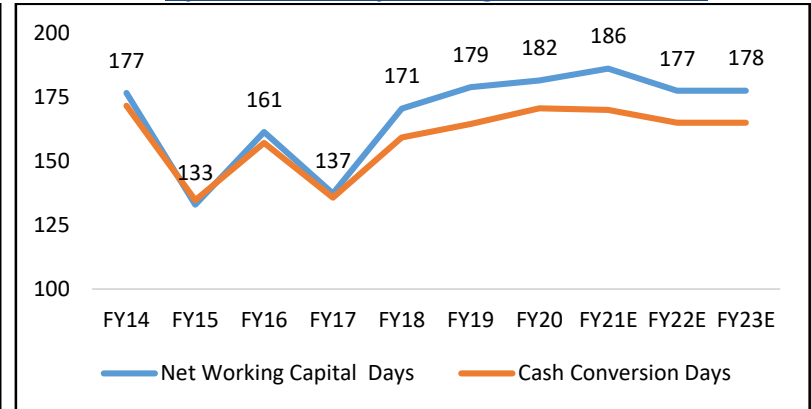
Key Financial Summary

- VTL in a commoditised volatile textile business has delivered a Revenue CAGR of 7% over FY10-20 which is mainly aided by volume growth on the back of consistent focus on aggressive expansion particularly in the fabric segment. Along with this, it has been constantly enriching its product portfolio by scaling-up its high margin value-add segment. Going forward, we are expecting VTL to report a revenue CAGR of 4% over FY20-23E.
- Its EBITDA and PAT grew by CAGR 13% and 17% respectively over FY10-20. Going forward, we expect its operational performance to improve which will be driven by favorable spreads and higher demand from exports leading to EBITDA and PAT growth of CAGR 13% and 17% respectively over FY20-23E.
- Textile and Apparels is a highly competitive and working capital intensive business. At Net D/E level, it has improved to 0.1x as on FY20 from 0.8x in FY14. Constant debt reduction is mainly driven by consistently high sweating of assets leading to cumulative OCF of Rs. 5963Cr over FY14-20. Despite continued investments behind incremental capacity expansion (Rs. 3600Cr FY14-20), VTL has generated a FCF of ~Rs 2300Cr over FY14-20.

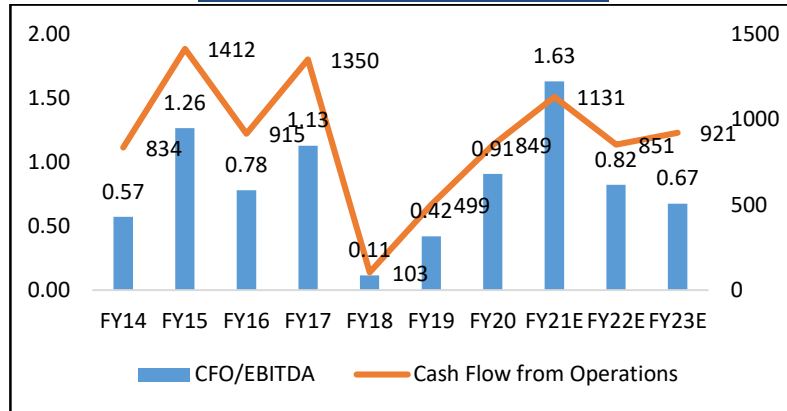
Operating Performance likely to stabilize



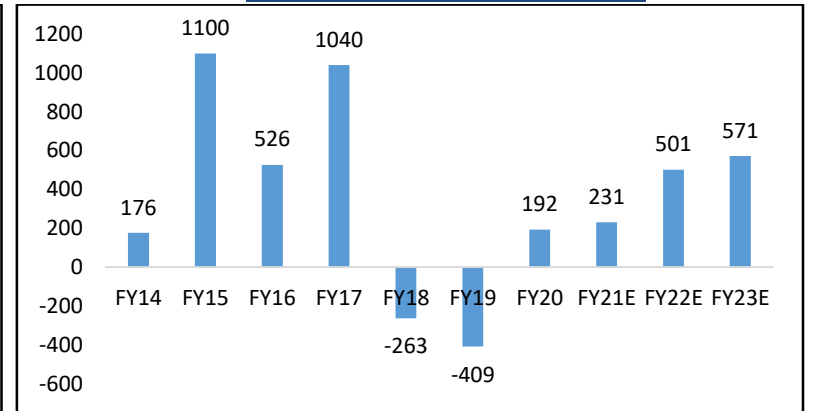
Optimal inventory stocking in Cotton Season



Strong operating cash Flow trend



Free Cash Flow generation Trend



(Source: Company, HDFC sec)

What could go wrong?

- **High input cost pressure**

Cotton prices have been volatile over the past few years. VTL business of the company is exposed to the risks of this volatility. The company procures cotton during mainly in the beginning of the cotton season. The inventory managed by the company is to the extent ~140 days. The extreme volatility in cotton prices would result in lower EBITDA.

- **Change in Government Policy**

Currently exports contribute ~1/3rd of VTL revenues. Indian textile exports are highly dependent on government incentives and subsidies like MEIS, DDT, RODTEP (Rebate of state and central levies and taxes) etc. Any adverse policy change by the government can impact the competitiveness of Indian textile exports.

- **Unfavorable cotton-cotton yarn spreads**

In a normal market condition, VTL's yarn has been positioned as a branded product in a highly commoditized domestic yarn industry. It thereby commands a 10-15% premium over industry realizations. In case of any prolonged demand crunch there can be contraction of cotton-cotton yarn spreads across market which can eventually result in narrowing down the VTL premium realizations on par with other market players.

- **Slowdown in global and domestic economy**

Any slowdown in the global economies will adversely impact VTL revenues. Domestic textile players, including Vardhman, are bullish on the domestic consumption led demand. A slowdown in domestic off-take can also adversely affect the company and lead to underutilization thereby impacting its cash flows.

Company Profile:

Vardhman Textiles Ltd (VTL) is a leading textile manufacturing company having presence across a wide spectrum – from manufacturing yarns to fabrics. VTL is a leading manufacturer and exporter of cotton yarn in India. The company has expanded its product portfolio (forayed into fabric & threads) and has entered into strategic alliances with leading global textile players helping the company gain access to latest technology. This has been in synergy with VTL's business and has helped it to introduce innovative and value-added products in the market,

which are expected to drive business momentum. VTL has 17 manufacturing facilities in India while its exports are spread across more than 55 countries across the globe.

Peer Comparison

	Mcap	Revenue			EBITDA Margin			PAT			ROE			Net D/E		
		FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
VTL	7210	6248	6878	6735	14.5%	17.4%	13.9%	482	653	514	10%	12%	9%	0.1	0.2	0.1
Arvind Ltd	1723	6,794	7,142	7,369	10.0%	10.0%	10.0%	309	226	96	8%	8%	4%	0.9	1.0	0.9
KPR Mills	7291	3,025	3,384	3,353	19.0%	18.0%	19.0%	290	335	377	18%	19%	20%	0.4	0.4	0.3
	EPS Growth		P/E			EV/EBITDA										
	FY20A-23E		FY21E	FY22E	FY23E	FY21E	FY22E	FY23E								
VTL	17.1%		24	12	9	13	8									
Arvind	45.3%		NA	8	5	8	5									
KPR Mills	14.6%		20	16	14	8	7									

(Source: Company, HDFC sec, Bloomberg Consensus, HDFC sec)

Vardhman Textiles Ltd.

Financials

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Net Revenues	6877.9	6735.0	5926.5	6693.2	7591.4
Growth (%)	10%	-2%	-12%	13%	13%
Operating Expenses	5684.2	5797.7	5233.1	5655.8	6225.0
EBITDA	1193.8	937.4	693.4	1037.4	1366.5
Growth (%)	32%	-21%	-26%	50%	32%
EBITDA Margin (%)	17.4	13.9	11.7	15.5	18.0
Depreciation	254.0	333.2	384.2	406.6	429.0
EBIT	939.7	604.1	309.2	630.9	937.5
Other Income	238.7	186.6	213.4	241.0	273.3
Interest expenses	119.7	135.3	106.0	96.0	86.0
PBT	1058.7	655.5	416.5	775.8	1124.7
Tax	318.2	64.5	104.1	193.9	281.2
RPAT	740.6	591.0	312.4	581.8	843.5
APAT	740.6	591.0	312.4	581.8	843.5
Growth (%)	35%	-21%	-42%	90%	46%
EPS	127.1	100.4	52.9	100.6	146.9

Balance Sheet

As at March	FY19	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	56.5	56.5	56.5	56.5	56.5
Reserves	5533.9	5991.4	6233.8	6717.4	7462.7
Shareholders' Funds	5590.4	6047.9	6290.3	6773.9	7519.2
Long Term Debt	2277.7	2220.9	2120.9	1920.9	1720.9
Net Deferred Taxes	323.3	243.5	248.4	253.3	258.4
Other Liabilities	37.5	39.7	41.7	43.8	46.0
Minority Interest	114.1	120.6	123.1	125.5	128.0
Total Source of Funds	8343	8673	8824	9117	9672
APPLICATION OF FUNDS					
Net Block & Goodwill	3201.1	3628.4	4144.2	4087.7	4008.7
CWIP	273.7	141.6	141.6	141.6	141.6
Other Non-Current Assets	107.1	128.4	118.5	133.9	151.8
Total Non-Current Assets	3581.9	3898.5	4404.4	4363.2	4302.1
Current Investments	1345.7	1144.9	1167.8	1226.2	1287.5
Inventories	2612.4	2683.4	2354.4	2567.3	2911.8
Trade Receivables	803.1	821.0	730.7	825.2	935.9
Cash & Equivalents	43.9	279.9	230.7	273.0	389.5
Other Current Assets	631.4	528.2	503.8	535.5	608.3
Total Current Assets	5436.5	5457.4	4987.2	5427.1	6133.0
Short-Term Borrowings				0.0	0.0
Trade Payables	316.0	357.0	324.7	366.8	416.0
Other Current Liab & Prov	359.3	326.2	242.6	306.7	347.2
Total Current Liabilities	675.3	683.2	567.3	673.5	763.1
Net Current Assets	4761.2	4774.2	4419.9	4753.6	5369.9
Total Application of Funds	8343	8673	8824	9117	9672

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	1,058.7	655.5	416.5	775.8	1,124.7
Non-operating & EO items	-155.0	-120.8	0.0	0.0	0.0
Interest Expenses	97.6	96.6	106.0	96.0	86.0
Depreciation	254.0	333.2	384.2	406.6	429.0
Working Capital Change	-499.1	-1.7	327.9	-233.0	-437.5
Tax Paid	-257.3	-113.3	-104.1	-193.9	-281.2
OPERATING CASH FLOW (a)	499.0	849.4	1,130.5	851.5	921.1
Capex	-908.2	-657.0	-900.0	-350.0	-350.0
Free Cash Flow	-409.2	192.4	230.5	501.5	571.1
Investments	577.2	289.5	-22.9	-58.4	-61.3
Non-operating income	53.5	-12.5	11.5	-14.2	-16.9
INVESTING CASH FLOW (b)	-277.5	-380.0	-911.4	-422.6	-428.2
Debt Issuance / (Repaid)	-43.5	-57.0	-100.0	-200.0	-200.0
Interest Expenses	-110.3	-121.1	-106.0	-96.0	-86.0
FCFE	-563.0	14.3	24.5	205.4	285.0
Share Capital Issuance	4.8	3.4	3.4	3.4	3.4
Others	-102.4	-58.6	-65.7	-93.9	-93.8
FINANCING CASH FLOW (c)	-251.4	-233.3	-268.4	-386.5	-376.4
NET CASH FLOW (a+b+c)	-29.9	236.1	-49.3	42.3	116.5

Key Ratios

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	17.4%	13.9%	11.7%	15.5%	18.0%
EBIT Margin	13.7%	9.0%	5.2%	9.4%	12.3%
APAT Margin	9.5%	7.6%	5.0%	8.5%	10.9%
RoE	12%	9%	5%	9%	12%
RoCE	12%	7%	4%	7%	10%
Solvency Ratio					
Net Debt/EBITDA (x)	0.7	0.8	1.0	0.4	0.0
Net D/E	0.2	0.1	0.1	0.1	0.0
PER SHARE DATA					
EPS	127.1	100.4	52.9	100.6	146.9
CEPS	161	150	121	172	223
Dividend	17.5	0.0	10.0	15.0	15.0
BVPS	990.0	1070.0	1112.9	1198.5	1330.4
Turnover Ratios (days)					
Debtor days	43	45	45	45	45
Inventory days	139	145	145	140	140
Creditors days	17	19	20	20	20
VALUATION					
P/E	11	14	24	12	9
P/BV	1.3	1.2	1.1	1	0.9
EV/EBITDA	8	10	13	8	6
EV / Revenues	1.4	1.3	1.5	1.3	1.1
Dividend Yield (%)	1.4	0.0	0.8	1.2	1.2
Dividend Payout	13.8	0.0	18.9	14.9	10.2

Source: Company, HDFC sec



One Year Stock Price Chart



Source: Company, HDFC sec

Disclosure

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