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20 YEARS

S P Apparels Ltd.

Quick Small/Midcap Funda Momentum Picks

Medium to High risk

Key points:

- These picks are based on fundamentals and issued when momentum is seen in them. These stocks may not have enough liquidity and depth and may go from circuit to circuit (either up or down). In the interest of timeliness, detailed financial projections are not prepared.
- Small allocation of investible surplus may be put in such stocks and spread your surplus among several such stocks.
- Once the risk appetite in the market reduces, such stocks could face the pressure of selling irrespective of fundamentals or valuations.
- Entry and exit into these stocks have to be carefully timed.
- These stocks have inherent value in them and their expected rate of growth could be faster than their peers. Their current valuations may not reflect these and hence considering the current market conditions, a buy report has been issued.
- It is possible that the street may take time to recognize these or there may be adverse developments in the interim. Hence proper exit strategies have to be worked out in advance (that may include stoploss or trailing stoploss).

2-August-2021

RETAIL RESEARCH

S.P. Apparels Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Red flag level*	Time Horizon
Apparels	323.2	Buy in Rs 322-326 band and add on dips to Rs 288-292 band	365	402.5	262	1- 2 quarters

*Investor may sell 60-65% of their holding on first target being achieved and later keep a stop loss of first target for balance holding, in case the second target takes time to be achieved. Investor may also maintain Rs.262 as red flag level below which investment position needs to be reviewed, including the possibility to exit

HDFC Scrip Code	SPALTD
BSE Code	540048
NSE Code	SPAL
Bloomberg	SPAL IN
CMP Jul 30, 2021	323.2
Equity Capital (Rs cr)	25.7
Face Value (Rs)	10.0
Equity Share O/S (cr)	2.6
Market Cap (Rs cr)	833.5
Book Value (Rs)	217.3
Avg. 52 Wk Volumes	100,000
52 Week High	353.3
52 Week Low	61.5

Share holding Pattern % (Jun, 2021)	
Promoters	61.7
Institutions	14.8
Non Institutions	23.5
Total	100.0

Retail Research Risk Rating:

		RED*

*** Refer at the end for explanation on Risk Ratings**

Fundamental Research Analyst
Atul Karwa
atul.karwa@hdfcsec.com

Our Take:

SPAL, with an established market position in the infantwear segment and strong relationship with large customers in the UK market is one of the key beneficiaries of the recent extension of duty drawback schemes. Over the last few years it has increased its backward integration which has resulted in improvement in margins. The opening up of economies post the Covid lockdowns would drive higher sales for the company. UK retail sales, one of the key export markets, have witnessed strong growth in recent months. SPAL has the capability to increase its utilisation by increasing the number of shifts thereby further improving margins. Recent ban by the US of imports from Xinjiang, which is one of the key export markets could benefit Indian companies. The company has an outstanding order book of Rs 325cr and it continues to win repeat orders from existing customers.

Financial Summary (Consolidated)

Particulars (Rs cr)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY18	FY19	FY20	FY21P
Total Operating Income	191.6	168.4	*13.8*	209.5	*-8.6*	662.4	826.4	809.0	652.3
EBITDA	24.7	17.8	*38.8*	38.6	*-36.1*	105.8	133.8	83.1	104.3
Depreciation	7.6	8.3	*-9.2*	8.5	*-10.9*	22.4	21.6	29.9	32.3
Other Income	0.4	1.2	*-62.9*	0.2	*87.0*	16.4	3.4	23.7	1.4
Interest Cost	2.4	5.4	*-56.6*	3.8	*-37.3*	28.7	6.2	22.8	14.3
Tax	6.2	1.4	*335.9*	7.0	*-11.2*	23.4	36.1	-2.5	16.0
APAT	10.6	3.0	*249.2*	19.6	*-46.1*	48.6	73.3	47.3	43.5
Diluted EPS (Rs)	4.1	1.2	*249.2*	7.6	*-46.1*	19.3	28.5	18.4	16.9
RoE-%						13.0	17.4	9.8	8.4
P/E (x)						16.7	11.3	17.6	19.1
EV/EBITDA						9.2	7.3	12.0	9.3

(Source: Company, HDFC sec)

RETAIL RESEARCH

Valuations & Recommendation:

SPAL has the benefit of low base of FY21 and even Q1FY22 did not shape up well due to Covid-2. While FY22 could be better than FY21, FY23 could be the best year in recent times. Restoration of export scheme benefits will lead to higher margins. We believe investors could buy the stock in Rs 322-326 band and add on dips to Rs 288-292 band for base case fair value of Rs 365 and bull case fair value of Rs 402.5 over the next 1-2 quarters.

Triggers

Leader in childrenwear

SPAL is a leading manufacturer and exporter of infant and children wear, featuring among the large organised exporters in the category. The company predominantly caters to the high margin value-added infantwear segment and exports to the leading global retailers, with which it has established relationships. SPAL's operations are integrated across the textile value chain from spinning to garmenting and further value additions including dying, printing and embroidery. In the UK, Retailers' consolidation of supply base is still happening aggressively, and that is one of the reasons that will support SPAL's growth going forward.

Extension of duty drawback scheme would add to margins

The government recently gave approval for the continuation of Rebate of State and Central Taxes and Levies (RoSCTL) with the same rates as notified by the Ministry of Textiles for exports of apparel/garments and made-ups. The scheme has been extended till Mar-24. There was uncertainty about the subsidies till this extension was announced. Duty drawbacks received under the scheme would add to the margins of the company. For Q4FY21, SPAL had not accounted for this benefit and in the Q1FY22 results this would be accounted for boosting the income of Rs.12 cr for the Q4FY21.

Lifting of lockdowns to improve export volumes

Lifting of Covid related lockdowns in many of the European nations is likely to drive higher export volumes. The management expects export volumes for FY22 to be close to FY20 levels, which is ~37% higher than FY21 volumes.

Strong growth in UK retail sales

Despite the pandemic related disruptions, UK retail sales under SPUK segment increased by 52% YoY in FY21 to Rs 77cr. The company is in talks with three potential customers and expects their orders from Oct'21 onwards.

Capacity expansion in spinning to enhance margins

The company is expanding its spinning capacity by 3,600 spindles. SPAL currently sources 70% of its yarn requirement internally which would increase to ~75-80% after the expansion. This has the potential to enhance its margins. The management is confident of maintaining 18% EBITDA margins without the duty drawbacks.

Apart from the above, capital expenditure to be incurred in the near to medium term is likely to be limited, given the adequate unutilised capacities and the company's plans of utilising the existing capacities through additional shift over the medium term than adding new machines.

US ban of Chinese imports could benefit Indian companies

The US Senate recently passed legislation, the Uyghur Forced Labour Prevention Act, to ban the import of products from China's Xinjiang region. The Xinjiang Uyghur Autonomous Region (XUAR) produces about 20 percent of the world's cotton. Indian companies could benefit from the ban as US companies would look at other countries like India, Bangladesh, Vietnam, etc. to import garments for their consumption.

Concerns

Labour intensive operations

The products manufactured by the company are labour intensive and it has to constantly hire new people to expand its operations. It faces the problem of finding skilled labour whenever it wants to add capacity.

Increase in raw material costs

Prices of Cotton, which is the key raw material for the company have increased in recent times due to disruption of cotton crops. This could negatively impact company's profitability.

Foreign exchange fluctuations

SPAL derives more than 80% of its revenues from export of garments. Sharp fluctuation in forex rates could impact its margins. This risk is mitigated by back-to-back hedging arrangement undertaken by SPAL, with more than 80% of the receivables hedged in stages upon order confirmation.

Competition from other emerging market companies

Companies from other emerging markets like Bangladesh, Vietnam, etc. compete for the same orders, which could reduce order flows to SPAL.

Client concentration

The top 3 customers account for ~80% of the revenues. Loss of any of these customers could severely hamper its revenues and profitability. The risk is mitigated to an extent by the established relationship enjoyed with its clientele, and the recent addition of new customers.

Recurrence in Covid waves

In case a third wave of Covid happens, it could face operational issues like the social distancing norms and lack of adequate labour during that period, limiting the capacity utilisation levels. In the second wave, SAPL had to shut down the retail outlets from May 06, 2021. Its factories in Tamilnadu were running at 50% capacity utilization wef May 10, 2021 and curtailed operations even further wef May 17, 2021. Normal operations resumed wef June 28, 2021. This could impact its Q1FY22 results.

Retail operations continue to bleed at the EBITDA level.

Crocodile brand retail outlets are 43 in number (COCO and FOFO). Sales from these outlets has fallen from Rs.81.8 cr in FY19 to Rs.39.5 cr in FY21, partly due to Covid related issues.

S.P. Apparels Ltd.

Company Background:

Promoted originally as a partnership firm by Mr P Sundararajan in 1989, S.P. Apparels Ltd (SPAL) is an integrated readymade garment manufacturer of 100% cotton garments, primarily for the children's wear export market. Its manufacturing facilities are located in Tamil Nadu. The company has 23 manufacturing units in and around Avinashi, District Tirupur (knitting, processing, garmenting, printing and embroidery facilities), and in Salem (spinning facility). The company exports to renowned brands/marketers in the EU and US, lending stability to operations. It entered the domestic retail market in FY07 by acquiring a 70% equity stake in Crocodile Products Pvt. Ltd.

Peer Comparison

(FY21)	CMP (Rs)	Mcap (Rs cr)	Revenues (Rs cr)	EBITDAM (%)	PATM (%)	EPS (Rs)	BVPS (rs)	P/E (x)	P/BV (x)	RoNW (%)
Gokaldas Exports	197.9	850.7	1210.7	8.4	2.2	6.2	67.5	32.1	2.9	9.1
K P R Mill Ltd	1883.0	12956.9	3427.1	24.2	15.0	74.9	341.5	25.1	5.5	21.9
S P Apparels	323.2	830.3	652.3	16.0	6.7	16.9	217.3	19.1	1.5	8.4

Financial tables

Income Statement

(Rs cr)	FY17	FY18	FY19	FY20	FY21P
Net Revenues	**636**	**662**	**826**	**809**	**652**
Growth (%)	***19.3***	***4.2***	***24.8***	***-2.1***	***-19.4***
Operating Expenses	528	557	693	726	548
EBITDA	**107**	**106**	**134**	**83**	**104**
Growth (%)	***56.8***	***-1.4***	***26.5***	***-37.9***	***25.5***
EBITDA Margin (%)	***16.9***	***16.0***	***16.2***	***10.3***	***16.0***
Depreciation	21	22	22	30	32
Other Income	21	16	3	24	1
EBIT	**108**	**100**	**116**	**77**	**73**
Interest expenses	13	29	6	23	14
PBT	**94**	**71**	**109**	**44**	**59**
Tax	33	23	36	-3	16
Adj. PAT	**61**	**48**	**73**	**47**	**43**
Growth (%)	***228.6***	***-21.5***	***50.9***	***-35.5***	***-8.0***
EPS	24.6	19.3	28.5	18.4	16.9

Balance Sheet

As at March (Rs cr)	FY17	FY18	FY19	FY20	FY21P
SOURCE OF FUNDS					
Share Capital	25	25	26	26	26
Reserves	365	372	458	498	533
Shareholders' Funds	**390**	**397**	**484**	**523**	**558**
Minority Interest	-7	-6	-6	-6	-6
Total Debt	155	218	201	217	183
Net Deferred Taxes	40	34	35	20	30
Total Sources of Funds	**578**	**642**	**713**	**754**	**765**
APPLICATION OF FUNDS					
Net Block & Goodwill	297	307	317	444	444
CWIP	0	6	54	0	10
Investments	58	31	0	0	0
Other Non-Curr. Assets	17	13	30	20	22
Total Non Current Assets	**372**	**357**	**401**	**464**	**476**
Inventories	102	187	248	228	241
Debtors	134	166	128	94	117
Cash & Equivalents	35	46	58	46	41
Other Current Assets	39	54	51	60	35
Total Current Assets	**311**	**452**	**486**	**429**	**434**
Creditors	80	101	109	85	91
Other Current Liab & Provisions	26	72	64	54	54
Total Current Liabilities	**105**	**173**	**173**	**138**	**145**
Net Current Assets	206	279	312	290	289
Total Application of Funds	**578**	**637**	**713**	**754**	**765**

S.P. Apparels Ltd.

Cash Flow Statement

(Rs cr)	FY17	FY18	FY19	FY20	FY21P
Reported PBT	94	71	109	54	59
Non-operating & EO items	-5	19	-28	8	-4
Interest Expenses	11	13	6	18	10
Depreciation	21	22	22	30	32
Working Capital Change	-76	-104	-12	-15	-3
Tax Paid	-18	-23	-14	-13	-14
OPERATING CASH FLOW (a)	**26**	**-1**	**82**	**83**	**81**
Capex	-37	-39	-86	-51	-44
Free Cash Flow	-11	-40	-3	32	37
Investments	-58	27	31	0	0
Non-operating income	-21	-4	-6	12	23
INVESTING CASH FLOW (b)	**-116**	**-15**	**-60**	**-39**	**-21**
Debt Issuance / (Repaid)	-89	41	-3	-27	-32
Interest Expenses	-15	-18	-13	-18	-10
FCFE	-194	7	6	-1	18
Share Capital Issuance	200	0	1	0	0
Dividend	-4	-4	-1	0	0
FINANCING CASH FLOW (c)	**92**	**19**	**-17**	**-45**	**-42**
NET CASH FLOW (a+b+c)	**2**	**3**	**5**	**-1**	**18**

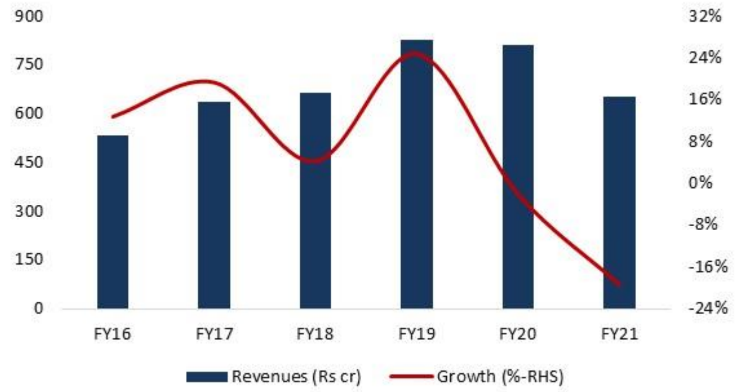
Key Ratios

	FY17	FY18	FY19	FY20	FY21P
Profitability (%)					
EBITDA (%)	16.9	16.0	16.2	10.3	16.0
EBIT (%)	16.9	15.1	14.0	9.5	11.3
APAT (%)	9.7	7.3	8.9	5.8	6.7
RoE (%)	25.6	13.0	17.4	9.8	8.4
RoCE (%)	23.7	17.2	17.8	10.8	9.9
Solvency Ratio					
Net Debt/EBITDA (x)	1.1	1.6	1.1	2.1	1.4
Net D/E (x)	0.3	0.4	0.3	0.3	0.3
PER SHARE DATA (Rs)					
EPS	24.6	19.3	28.5	18.4	16.9
CEPS	32.8	28.2	36.9	30.1	29.5
BV	155.0	157.8	188.3	203.6	217.3
Dividend	0.5	0.5	0	0	2.3
Turnover Ratios (days)					
Inventory	62	83	65	50	59
Debtor	66	80	96	107	131
Creditors	56	50	47	44	49
VALUATION (x)					
P/E	13.1	16.7	11.3	17.6	19.1
P/BV	2.1	2.0	1.7	1.6	1.5
EV/EBITDA	8.3	9.2	7.3	12.0	9.3
EV / Revenues	1.4	1.5	1.2	1.2	1.5
Dividend Yield (%)	0.2	0.2	0.0	0.0	0.7
Dividend Payout	2.0	2.6	0.0	0.0	13.3

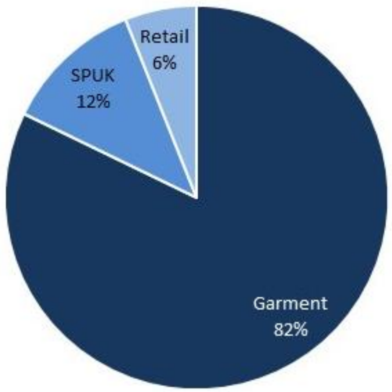
S.P. Apparels Ltd.

Story in charts

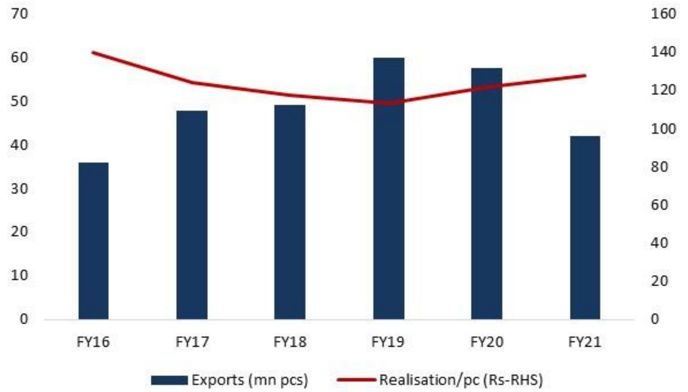
Revenue growth trend



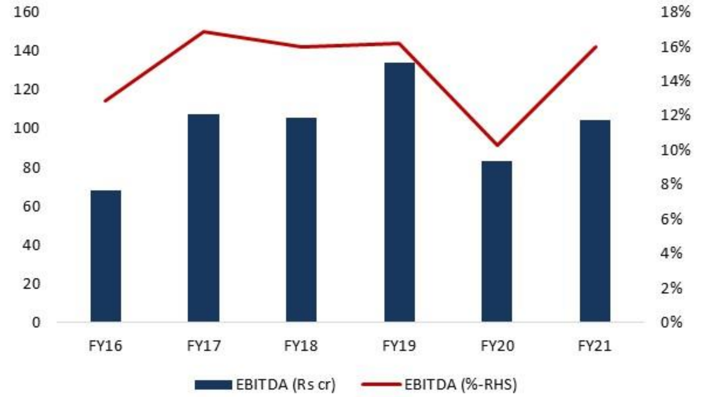
Revenue breakup (FY21)



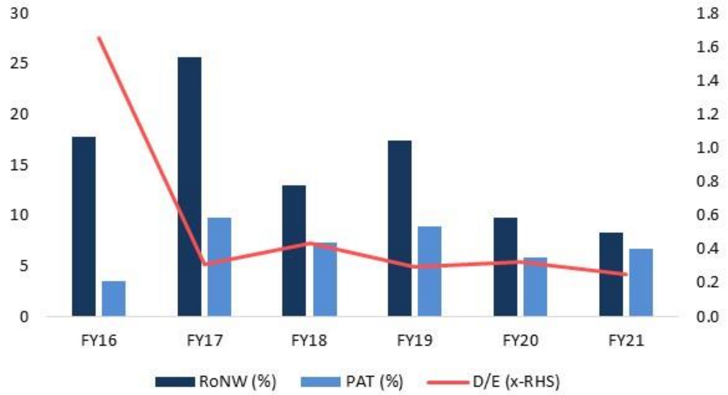
Export trend



EBITDA trend

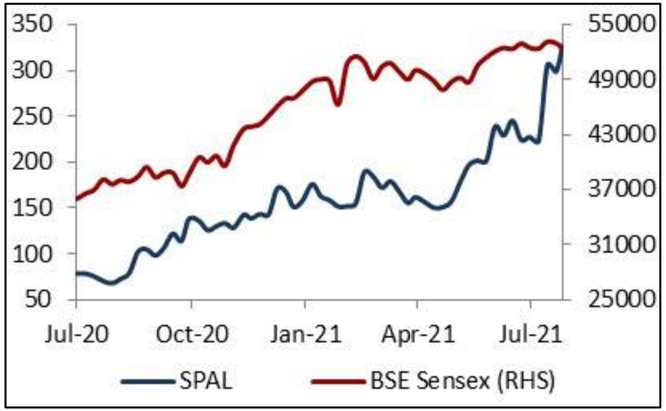


RoNW, PAT, D/E trend



RETAIL RESEARCH

Price Chart



HDFCSec Retail Research Rating description

Green rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Blue Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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