Stock Update

Vardhman Textiles Ltd.

February 21, 2022

RETAILRESEARCH

Vardhman Textiles Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Textile	Rs 2592	Buy in Rs 2580-2620 band and add on dips to Rs 2230-2270 band	Rs 2770	Rs 3030	2 quarters

HDFC Scrip Code	VARTEX
BSE Code	502986
NSE Code	VTL
Bloomberg	VTEX IN
CMP Feb 18, 2022	2591.6
Equity Capital (Rs cr)	57.8
Face Value (Rs)	10.0
Equity Share O/S (cr)	5.8
Market Cap (Rs cr)	14950
Book Value (Rs)	1143.6
Avg. 52 Wk Volumes	150,500
52 Week High (Rs)	2880.0
52 Week Low (Rs)	1034.8

Share holding Pattern % (Dec, 2021)	
Promoters	63.2
Institutions	25.1
Non Institutions	11.7
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Vardhman Textiles (VTL), is India's largest fully integrated textile company. It is well placed to benefit from the strong demand uptick for cotton yarn post the ban imposed by the US on China's Xinjiang region. Importing companies in the west are also looking to diversify away from China, which is beneficial for textile companies in India. The long-term demand outlook remains positive as global retailers seek additional sourcing partners to diversify their supply chains. The ban has also resulted in strong demand for fabrics, which resulted in 100% utilisation of fabric capacity for VTL in Q3FY22. The demand for cotton yarn and fabrics is likely to remain strong for the coming few quarters as producing countries enhance their capacities to meet the disruption caused by the ban.

The company has announced capex plans of ~Rs 3,000cr over the next three years to expand its yarn capacity, funded through a mix of debt and equity. It might also consider expanding its fabric capacity if the demand continues to remain strong.

On March 31, 2021, we had initiated coverage on the stock (Link) with a recommendation to 'Buy on dips at 1130 and add more at 1045' for base case fair value of Rs 1245 and bull case fair value of Rs 1350. The stock had achieved our base case target on April 27 and bull case target on May 11, 2021.

Financial Summary

Particulars (Rs cr)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	FY21	FY22E	FY23E	FY24E
Operating Income	2603	1750	48.7	2385	9.1	6,139.9	9099	9922	10698
EBITDA	619	277	123.8	676	-8.4	813.8	2156	2163	2236
APAT	432	171	153.1	482	-10.5	422.5	1478	1474	1508
Diluted EPS (Rs)	75.6	29.7	155.0	85.0	-11.0	72.5	259.2	258.4	264.4
RoE (%)						6.5%	20.5%	17.1%	15.1%
P/E (x)						35.8	10.0	10.0	9.8
EV/EBITDA (x)						20.3	7.4	7.1	6.6

(Source: Company, HDFC sec)

Valuation & Recommendation:

We are positive on the future earnings growth trajectory of VTL. We expect Revenue/EBITDA/PAT growth of 20/40/53% over FY21-FY24 driven by strong demand and increased capacities gradually coming on stream. EBITDA margins are likely to compress from the current unsustainable levels but would remain at the upper end of the 18-22% guidance given by the management. We believe investors could buy the stock in Rs 2580-2620 band and add on dips to Rs 2230-2270 band (8.5x Dec-23E EPS) for base case fair value of Rs 2770 (10.5x Dec-23E EPS) and bull case fair value of Rs 3030 (11.5x Dec-23E EPS) over the next 2 quarters.

Q3FY22 Result update

VTL reported strong performance in Q3FY22 with revenues increasing by 49% YoY to an all-time high level of Rs 2,603cr driven by higher yarn and fabric realisation and improved capacity utilisation. Fabrics division, which has been a laggard in the last few quarters, reported 100% utilisation for the first time. Yarn sales volume declined by 5/5% QoQ/YoY to 58,232 MT while grey fabrics sales volume rose 5.4/7.7% QoQ/YoY, and processed fabrics sales volume increased 23.3/41.8% QoQ/YoY. Gross margin improved 400bps YoY to 52.4% due to higher cotton-yarn spread but compressed 350bps sequentially due to low-cost inventory benefit in Q2FY22.

EBITDA more than doubled YoY to Rs 619cr and EBITDA margin expanded 898bps to 23.8% due to operating leverage. PAT increased 151% YoY to Rs 429cr driven by higher EBITDA, other income and lower interest cost. The management expects EBITDA to remain at the upper end of 18-22% range. PAT increased by 153% to Rs 431cr driven by higher other income and lower interest cost.

The company's board of directors have approved a 1:5 stock split from face value of Rs 10 per share to Rs 2 per share, subject to the approval of the shareholders.

Key Triggers

Capex plans to expand yarn capacity

VTL has one of the largest spinning capacities in India and is among the largest domestic yarn producers, with a significant presence in the export market. It has an ongoing capex plan of adding 1 lakh spindles at an estimated cost of Rs 700cr (likely to be commissioned by Q2FY23). In Q2FY22, it announced a brownfield expansion to add 1.65 lakh spindles to its capacity at a cost of ~Rs 1,400cr. It plans to further enhance its capacity by adding 40 Vortex machines which will give ~70,000 equivalent spindles. Currently the capacity of the company stands at ~12 lakh spindles. In fabrics, the management is contemplating some debottlenecking capex. Overall, the company has chalked out capex plans of ~Rs 3,000cr over the next three years, which would be funded equally through internal accruals and debt. The expansion plans in spinning suggest the view of the management about sustainability of the revival in the prospects of the spinning industry over the medium term.

US ban driving higher yarn exports

In December 2021, the U.S. President signed into law a legislation that bans imports from China's Xinjiang region over concerns about forced labour. As Xinjiang constitutes ~20% of the global cotton market, this led to a supply crunch in yarn and the supply readjustment on account of this ban has led to more demand for Indian Cotton and Cotton yarn. Countries like Bangladesh, Vietnam, Cambodia have now become net importer of yarn, leading to shortage of Yarn in the global market. Indian cotton exports have skyrocketed in the past eight months as a result. Even earlier in FY21, yarn exports had begun to rise and accounted for 49% of the segment’s revenue as compared to 35% in the previous two years.

Increased utilisation in fabrics

VTL is also among the top three woven fabric manufacturers in India, with grey and processed fabric capacity of ~1,550 looms and ~170 million meter per annum (mmpa), respectively. Demand for fabrics has increased significantly and it was the first time in Q3FY22 that the company witnessed 100% capacity utilisation. The management expects further improvement in the fabric business to be price-led, as prices remain low.

Cotton-Yarn spread likely to remain elevated in the near term

Cotton prices have increased sharply in past few months. Domestic cotton prices increased to Rs 68,000/candy at the end of Q3FY22 from Rs 52,000/candy at the start of the quarter. In the month of Jan’22 cotton prices have remained in an uptrend rising to ~Rs 74,000/candy. Yarn prices have also increased in tandem with increase in cotton prices and the spread between cotton and cotton yarn has expanded by ~20% YoY to $1.2 from $1 in Q3FY21. Due to the high cotton prices the company has adopted a cautious strategy for inventory procurement and is purchasing cotton based on monthly requirements.

Strong growth in demand from domestic and exports markets alongwith reduction in domestic cotton availability is likely to maintain spreads at elevated levels for some more time.

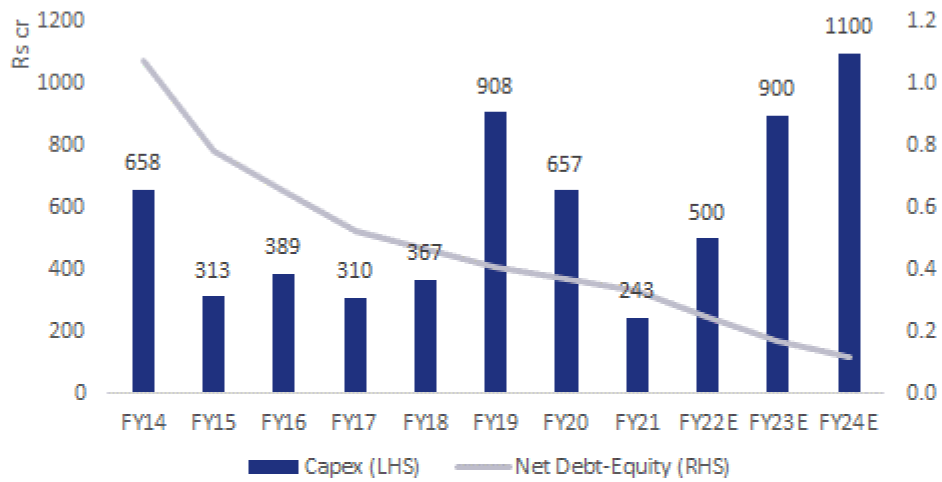
Increased cotton prices passed on

VTL has been able to pass on most of the increase in cotton prices to its customers thereby protecting its margins. This indicates that the company has strong pricing power and negotiation capabilities.

Leverage under control despite regular capacity additions

VTL has been incurring capital expenditure to expand its capacities on a regular basis. Despite huge capex of Rs ~Rs 2500cr incurred over the last five years the company has managed to bring its net debt-equity ratio from 0.7x in FY16 to 0.3x in FY21. It indicates that the company has strong cash flows and ability to meet a large part of its requirement through internal accruals.

Improving net debt-equity ratio despite huge capex



(Source: Company, HDFC sec)

Risks & Concerns

Easing of ban by US on China Xinjiang region

The sharp increase in demand for yarn is mainly on account of the ban imposed by US on China's Xinjiang region which account for ~20% of the trade. Any easing of ban could result in lower demand and margin compression.

Change in Government Policy

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 affect the competitiveness of Indian textile exports. Also adverse regulations and unfavourable change in the duty structure in its key export markets will directly impact the earnings of VTL.

High input cost pressure

Cotton prices have been volatile over the past few years. The business of the company is exposed to the risks of this volatility. The company procures cotton mainly during the beginning of the cotton season. However, due to the high cotton prices, the management is treading cautiously in building cotton inventory. The extreme volatility in cotton prices would result in lower EBITDA.

Sharp increase in cotton price (Rs/bale)

(Source: MCX, HDFC sec)

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 15-20%% 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 or reversal in demand uptick in textiles

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.

Foreign exchange fluctuations

VTL derives more ~1/3rd of its revenues from exports. Sharp fluctuation in forex rates could impact its margins.

Company Background:

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. VTL has 17 manufacturing facilities in India while its exports are spread across more than 60 countries across the globe. VTL enjoys leadership in Yarn manufacturing with ~1.13mn spindles/664MT per day capacity. The company also manufactures Acrylic Yarn, Grey Fabric (220mn meters p.a. capacity) and Processed Fabrics (175mn meters p.a. capacity). Its wholly owned subsidiary, Vardhman Nisshinbo Garments Co Ltd has garmenting capacity of ~5000 shirts per day.

Peer Comparison

(Rs cr)	Mcap	Sales			EBITDA Margin (%)			PAT			RoE (%)			P/E (x)			P/B (x)		
		FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Arvind	7925	7967	8680	12176	13.6	15.1	16.0	254	340	435	9.3	11.8	13.6	13.0	9.4	7.2	1.2	1.0	0.9
K P R Mill Ltd	22289	4674	5440	6013	24.2	23.9	24.3	793	897	991	27.7	25.2	23.1	28.4	25.3	22.5	7.4	5.9	4.7
VTL	14950	9099	9922	10698	23.7	21.8	20.9	1478	1474	1508	20.5	17.1	15.1	10.0	10.0	9.8	1.9	1.6	1.4

(Source: HDFC sec, Bloomberg)

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Financials

Income Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	**6735**	**6140**	**9099**	**9922**	**10698**
Growth (%)	-2%	-9%	48%	9%	8%
Operating Expenses	5798	5326	6942	7759	8462
EBITDA	**937**	**814**	**2156**	**2163**	**2236**
Growth (%)	**-21%**	**-13%**	**165%**	**0%**	**3%**
EBITDA Margin (%)	**13.9**	**13.3**	**23.7**	**21.8**	**20.9**
Depreciation	333	364	382	433	496
EBIT	**604**	**450**	**1775**	**1730**	**1740**
Other Income	187	222	299	320	342
Interest expenses	135	113	102	84	71
PBT	**655**	**559**	**1971**	**1965**	**2011**
Tax	65	136	493	491	503
RPAT	**591**	**422**	**1478**	**1474**	**1508**
APAT	**591**	**422**	**1478**	**1474**	**1508**
Growth (%)	-21%	-29%	258%	0%	2%
EPS	100.4	72.5	259.2	258.4	264.4

Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	57	57	57	57	57
Reserves	5991	6412	7793	9169	10580
Shareholders' Funds	**6048**	**6468**	**7849**	**9226**	**10636**
Total Debt	2221	2132	1932	1532	1232
Net Deferred Taxes	243	257	262	267	273
Other Liabilities	40	38	39	41	44
Minority Interest	121	133	146	158	171
Total Source of Funds	**8673**	**9028**	**10229**	**11225**	**12356**
APPLICATION OF FUNDS					
Net Block & Goodwill	3628	3539	3657	4124	4728
CWIP	142	78	78	78	78
Other Non-Current Assets	128	241	182	198	214
Total Non Current Assets	**3898**	**3858**	**3917**	**4400**	**5020**
Current Investments	1145	1075	1128	1185	1244
Inventories	2683	2801	3615	3806	3957
Trade Receivables	821	1039	1246	1278	1319
Cash & Equivalents	280	212	548	798	1074
Other Current Assets	528	648	728	795	857
Total Current Assets	**5457**	**5774**	**7265**	**7861**	**8450**
Short-Term Borrowings			0	0	0
Trade Payables	357	318	499	544	586
Other Current Liab & Provisions	326	280	455	492	526
Total Current Liabilities	**683**	**598**	**953**	**1035**	**1113**
Net Current Assets	4774	5176	6312	6826	7337
Total Application of Funds	**8673**	**9034**	**10229**	**11225**	**12356**

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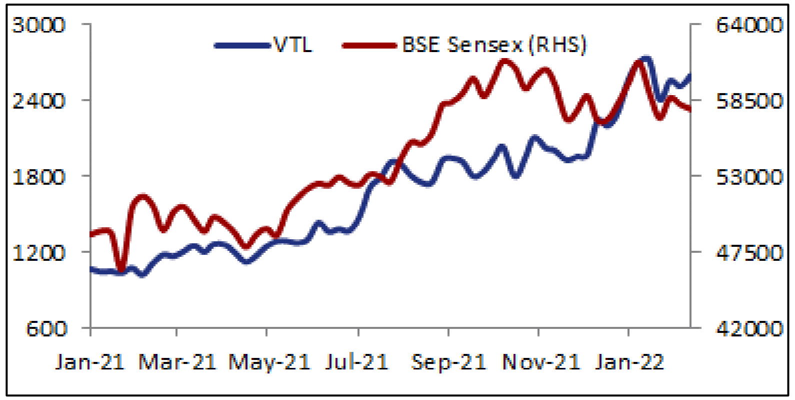
Vardhman Textiles Ltd.

Cash Flow Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
PBT	655	559	1,971	1,965	2,011
Non-operating & EO items	-121	-390	10	15	16
Interest Expenses	97	65	102	84	71
Depreciation	333	364	382	433	496
Working Capital Change	-2	-383	-746	-206	-177
Tax Paid	-113	-46	-493	-491	-503
OPERATING CASH FLOW (a)	**849**	**168**	**1,226**	**1,801**	**1,914**
Capex	-657	-243	-500	-900	-1,100
Free Cash Flow	192	-75	726	901	814
Investments	290	149	-54	-56	-59
Non-operating income	-13	-22	60	-15	-14
INVESTING CASH FLOW (b)	**-380**	**-116**	**-494**	**-972**	**-1,174**
Debt Issuance / (Repaid)	-57	-89	-200	-400	-300
Interest Expenses	-121	-94	-102	-84	-71
FCFE	14	-258	424	417	443
Share Capital Issuance	3	9	0	0	0
Dividend	-59	54	-94	-94	-94
FINANCING CASH FLOW (c)	**-233**	**-121**	**-397**	**-578**	**-465**
NET CASH FLOW (a+b+c)	**236**	**-68**	**336**	**251**	**275**

Price chart



Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	13.9%	13.3%	23.7%	21.8%	20.9%
EBIT Margin	9.0%	7.3%	19.5%	17.4%	16.3%
APAT Margin	8.6%	6.7%	16.1%	14.7%	14.0%
RoE	10%	7%	20%	17%	15%
RoCE	7%	5%	18%	16%	15%
Solvency Ratio					
Net Debt/EBITDA (x)	0.8	1.0	0.1	-0.2	-0.5
Net D/E	0.1	0.1	0.0	0.0	-0.1
PER SHARE DATA					
EPS	100.4	72.5	259.2	258.4	264.4
CEPS	30.0	27.4	65.3	67.0	70.4
Dividend	0.0	10.0	15.0	15.0	15.0
BVPS	1070.0	1144.6	1387.8	1631.2	1880.5
Turnover Ratios (days)					
Debtor days	44.5	61.7	50.0	47.0	45.0
Inventory days	145	167	145	140	135
Creditors days	19	19	20	20	20
VALUATION					
P/E	25.4	35.8	10.0	10.0	9.8
P/BV	2.4	2.3	1.9	1.6	1.4
EV/EBITDA	17.7	20.3	7.4	7.1	6.6
EV / Revenues	2.5	2.7	1.8	1.5	1.4
Dividend Yield (%)	0.0	0.4	0.6	0.6	0.6
Dividend Payout	0.0	13.8	5.8	5.8	5.7

(Source: Company, HDFC sec)

HDFC Sec 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.

Yellow 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.

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