

Low demand scenario to persist for next two quarters

About the stock: Vardhman Textiles (VTL) (earlier known as Mahavir Spinning) is part of the Vardhman Group, a large textile conglomerate with a presence across the textile value chain.

- Vardhman is among few textile companies that have been able to maintain a debt equity ratio below one despite continuous capacity addition
- Healthy cash flows have enabled VTL to maintain reasonable debt levels. We expect the D/E ratio to stay at ~0.3x in FY24E

Q4FY22 Results: Vardhman Textiles reported steady performance in a challenging business scenario with revenue increasing on a QoQ basis and EBITDA margin at 18.7% being maintained in long term average range 18-22%.

- Sales increased by 46% YoY to ₹ 2812 crore (QoQ growth of 4%).
- Gross margin declined 850 bps YoY to 46.3% (QoQ decline of 206 bps). EBITDA margin declined 616 bps YoY to 18.7% (QoQ increase of 25 bps).
- Consequently, PAT grew by 4% YoY to ₹ 329 crore (QoQ increase of 2%).

What should investors do? After registering strong margins of 25%+ in 9MFY22, the margins have started to decline significantly from Q4FY22. Low demand and high cotton prices are likely to dent margins of spinners further in the near term.

- We downgraded the stock from BUY to HOLD in our sector update released on 20th June 2022 and maintain **HOLD** recommendation on the stock

Target Price and Valuation: We value VTL at ₹ 300 i.e. 7x FY24E earnings.

Key triggers for future price performance:

- The key factor for improvement in profitability will be decline in Indian cotton prices which are trending higher than international cotton prices
- Yarn demand from global buyers is lukewarm and leading to low capacity utilisation for yarn manufacturers as most of the buyers are adopting a wait and watch approach since there is expectation of decline in cotton prices.
- We model revenue and earnings CAGR of 6% and -8%, respectively, in FY22-24E owing to deceleration of demand and expected erosion in margin profile from peak levels. Improvement in revenue and earnings trajectory would be the key aspect to assign a higher multiple to the stock

Alternate Stock Idea: Apart from VTL, in our textile coverage we also like KPR Mills.

- KPR Mills is among select vertically integrated textile players in India that has displayed consistent operating margins with strong return ratios
- it has consistently maintained average RoCE of ~20%

Key Financial Summary

Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	FY24E	2 year CAGR (FY22E-24E)
Net Sales	6,878.3	6,735.0	6,139.9	-2.0%	9,622.3	10,506.7	11,522.4	6.2%
EBITDA	1,194.1	937.3	813.8	-6.2%	2,273.9	1,453.9	1,984.1	-4.4%
Adjusted PAT	731.1	577.5	414.4	0.7%	1,546.9	877.3	1,220.1	-7.6%
P/E (x)	12.0	15.2	21.2		5.7	10.0	7.2	
EV/EBITDA (x)	9.0	11.2	12.8		4.7	7.3	5.5	
RoCE (%)	12.9	7.7	5.5		21.2	10.3	13.5	
RoE (%)	13.1	9.5	6.4		20.1	10.1	12.5	

Source: Company, ICICI Direct Research



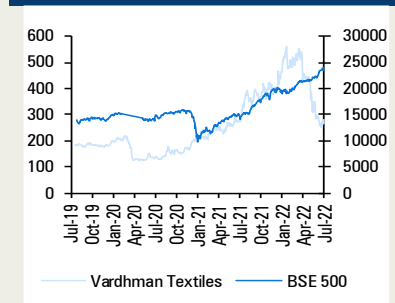
Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	8,813
Debt (FY22) (₹ Crore)	1,983
Cash (FY22) (₹ Crore)	121.7
EV (₹ Crore)	10,674.6
52 week H/L	576 / 246
Equity Capital (₹ Crore)	56.9
Face Value (₹)	2

Shareholding pattern

	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	63.2	63.2	63.2	62.9	62.9
FII	4.4	4.9	6.3	8.3	7.5
DII	21.3	20.7	18.8	16.9	16.6
Others	11.1	11.2	11.7	12.0	13.0

Price Chart



Recent event & key risks

- Indian cotton prices trending higher than global cotton prices
- Key Risk:** (i) Elevated product pricing can lower demand (ii) Higher-than-expected margin

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Key takeaways of Q1FY23 conference call

- Q1FY23 was a reasonable quarter for VTL as it had some low cost cotton available which enabled it to report a higher EBITDA margin in Q1FY23 compared to Q4FY22.
- Indian spinners are at a disadvantage with Indian cotton cost being significantly higher than global cotton prices which is making it difficult for Indian yarn players to compete in the international markets. From VTL's perspective the company has shut 8-10% of its yarn capacity owing to low demand. Over all the yarn capacity utilization for VTL stood at ~ 90%, while for Fabric VTL's utilization level stood at 80-85%.
- On the expansion front, 1 lakh spindles are expected to be operational from October 2022. The other expansion projects, which were announced in October 2021 (addition of more than 2 lakh spindles) were only at the planning stage. The company had not made much progress on the same. These expansion projects are expected to be deferred. The management will take a decision once the overall demand situation improves
- On the demand front, the management indicated that the demand was low as most of the customers were in wait and watch mode as they were expecting the cotton prices to correct further in the next few months. The management believes that the demand scenario will be subdued for 4-5 months.
- Yarn demand from Bangladesh has been good over the last two years, however in the last two months it has also slowed down. Bangladesh has expanded its garmenting capacity but has not made commensurate investments in expanding the yarn capacity and it imports yarn from India, China and other countries.
- The management also highlighted that it continued to service large clients to maintain long term relationships with these clients and they have not lost any large client.
- The management indicated that for Q2FY23 it expects the demand to remain subdued with decline in margins whereas Q3FY23 could witness revaluation of inventory at new cotton prices which could result in mark to market losses for the cotton based product industry. It expects normalcy to return from Q4FY23 with Indian cotton prices aligning with the global prices. The company expects that next year cotton crop will be higher than the current year which would lead to softening of domestic cotton prices.
- The company has a diversified client base with top 5 clients in yarn and fabric business contributing around 20% and 15% respectively.
- On the EBITDA margin front the management indicated that the margin could be lower than the lower end of its long term average range of 18-22% for next two quarters

Financial Summary

Exhibit 1: Profit and loss statement		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Total operating Income	6,139.9	9,622.3	10,506.7	11,522.4	
Growth (%)	-8.8	56.7	9.2	9.7	
Raw Material Expenses	3,260.5	4,560.7	6,058.4	6,254.4	
Employee Expenses	590.1	729.1	767.0	841.1	
Mfg, Admin & selling Exps	1,475.5	2,058.7	2,227.4	2,442.7	
Total Operating Expenditure	5,326.0	7,348.4	9,052.8	9,538.3	
EBITDA	813.8	2,273.9	1,453.9	1,984.1	
Growth (%)	-13.2	179.4	-36.1	36.5	
Depreciation	363.8	367.5	401.5	440.1	
Interest	113.3	99.7	110.6	139.4	
Other Income	201.6	224.5	178.6	172.8	
Exceptional income	0.0	0.0	0.0	0.0	
PBT	538.3	2,031.2	1,120.5	1,577.4	
Total Tax	132.0	519.7	282.4	397.5	
PAT	406.3	1,511.5	838.1	1,179.9	
Minority Interest / Others	12.6	4.3	2.5	3.5	
PAT (after minority interest)	414.4	1,546.9	877.3	1,220.1	
Growth (%)	-28.3	273.3	-43.3	39.1	
EPS (₹)	14.7	54.4	30.9	42.9	

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
PAT	414.4	1,546.9	877.3	1,220.1	
Add: Depreciation	363.8	367.5	401.5	440.1	
(Inc)/dec in Current Assets	-452.7	-633.1	-736.7	-808.2	
Inc/(dec) in CL and Provisions	-20.8	-10.3	105.6	-4.0	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	304.7	1,271.1	647.6	847.9	
(Inc)/dec in Investments	70.4	-616.5	101.5	-254.3	
(Inc)/dec in Fixed Assets	-274.5	-319.1	-700.0	-700.0	
(Inc)/dec in CWIP	63.7	-163.3	-108.8	-130.0	
Others	-112.6	-77.5	15.8	15.1	
CF from investing activities	-253.0	-1,176.3	-691.5	-1,069.3	
Issue/(Buy back) of Equity	0.0	0.3	0.0	0.0	
Inc/(dec) in loan funds	-154.8	134.8	27.0	436.2	
Others	34.7	-319.6	127.4	-179.2	
CF from financing activities	-120.1	-184.5	154.4	257.0	
Net Cash flow	-68.4	-89.8	110.6	35.7	
Opening Cash	279.9	211.5	121.7	232.3	
Closing Cash	211.5	121.7	232.3	268.0	

Source: Company, ICICI Direct Research

Exhibit 3: Balance Sheet		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Liabilities					
Equity Capital	56.6	56.8	56.9	56.9	
Reserve and Surplus	6,417.3	7,646.9	8,645.8	9,682.9	
Total Shareholders funds	6,473.9	7,703.8	8,702.7	9,739.7	
Total Debt	1,848.2	1,983.0	2,010.0	2,446.3	
Deferred Tax Liability	256.9	249.1	249.1	249.1	
Other LT Liabilities	20.8	22.0	25.3	29.1	
Minority Interest / Others	133.2	137.5	140.1	140.1	
Total Liabilities	8,733.0	10,095.4	11,127.1	12,604.2	
Assets					
Gross Block	8,332.6	8,651.8	9,351.8	10,051.8	
Less: Accu Depreciation	4,793.6	5,161.1	5,562.6	6,002.7	
Net Block	3,539.1	3,490.7	3,789.2	4,049.1	
Capital WIP	78.0	241.2	350.0	480.0	
Total Fixed Assets	3,617.0	3,731.9	4,139.2	4,529.1	
Investments	1,074.5	1,691.1	1,589.6	1,843.9	
Inventory	2,796.1	2,882.3	3,454.3	4,103.9	
Debtors	1,038.6	1,321.2	1,439.3	1,578.4	
Loans and Advances	2.7	3.0	4.2	4.6	
Other Current Assets	647.0	910.9	956.5	975.6	
Cash	211.5	121.7	232.3	268.0	
Total Current Assets	4,695.9	5,239.2	6,086.5	6,930.4	
Creditors	874.3	864.4	974.8	964.8	
Provisions	19.7	19.3	14.6	20.5	
Total Current Liabilities	894.0	883.7	989.3	985.3	
Net Current Assets	3,801.9	4,355.5	5,097.2	5,945.1	
Others Assets	239.5	317.0	301.1	286.1	
Application of Funds	8,733.0	10,095.4	11,127.1	12,604.2	

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios					
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Per share data (₹)					
EPS	14.7	54.4	30.9	42.9	
Cash EPS	27.5	67.4	45.0	58.4	
BV	228.9	271.1	306.1	342.6	
DPS	0.0	8.2	4.6	6.4	
Cash Per Share	7.5	4.3	8.2	9.4	
Operating Ratios					
EBITDA Margin (%)	13.3	23.6	13.8	17.2	
PBT Margin (%)	8.8	21.1	10.7	13.7	
PAT Margin (%)	6.6	15.7	8.0	10.2	
Inventory days	166.2	109.3	120.0	130.0	
Debtor days	61.7	50.1	50.0	50.0	
Creditor days	33.5	31.7	35.0	37.0	
Return Ratios (%)					
RoE	6.4	20.1	10.1	12.5	
RoCE	5.5	21.2	10.3	13.5	
RoIC	6.5	25.0	12.3	16.1	
Valuation Ratios (x)					
P/E	21.2	5.7	10.0	7.2	
EV / EBITDA	12.8	4.7	7.3	5.5	
EV / Net Sales	1.7	1.1	1.0	1.0	
Market Cap / Sales	1.4	0.9	0.8	0.8	
Price to Book Value	1.4	1.1	1.0	0.9	
Solvency Ratios					
Debt/EBITDA	2.3	0.9	1.4	1.2	
Debt / Equity	0.3	0.3	0.2	0.3	
Current Ratio	5.4	6.1	6.2	7.2	
Quick Ratio	2.2	2.7	2.7	2.9	

Source: Company, ICICI Direct Research

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Sell: <-15%



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