Vardhman Textiles (VARTEX)

CMP: ₹ 340 Target: ₹ 355 (4%) Target Period: 12 months **HOLD**

November 2, 2022

Cotton price parity critical for margin improvement…

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 ~0.2x in FY24E

Q2FY23 Results: Vardhman Textiles reported a soft performance in a challenging business scenario with revenue declining on a QoQ basis and EBITDA margin at 14.5%, which is lower than long term average range of 18-22%.

- Sales increased 4% YoY to ₹ 2470 crore (QoQ decline of 12%)
- Gross margin (on a high base) declined 1250 bps YoY to 43.4% (QoQ decline of 292 bps). EBITDA margin declined 1390 bps YoY to 14.5% (QoQ decline of 420 bps). Consequently, PAT de-grew 57% YoY to ₹ 205 crore (QoQ increase of 38%)

What should investors do? After registering strong margins of 25%+ in 9MFY22, margins declined significantly from Q4FY22 owing to elevated domestic cotton prices and weak spreads. Arrival of new cotton crop should ease domestic cotton prices and gradually make Indian spinners competitive vs. global peers

- We maintain **HOLD** recommendation on the stock

Target Price and Valuation: We value VTL at ₹ 355 i.e. 8x FY24E earnings.

Key triggers for future price performance:

- The key factor for enhanced competitiveness and improvement in profitability will be price parity of Indian cotton prices with global cotton price. Currently, the premium of Indian cotton prices over international cotton prices has reduced from US$0.2 per pound to ~ US$0.1 per pound (historical average US$0.05 per pound)
- While the domestic spinning industry was operating at 50% utilisation level, VTL continued to outperform with nearly 90% capacity utilisation. Yarn demand from global buyers is lukewarm and is leading to low capacity utilisation for yarn manufacturers as most buyers are adopting a wait and watch approach since there is expectation of decline in cotton prices
- We model revenue and earnings CAGR of 5% and -10%, respectively, in FY22-24E owing to softer demand and expected decline 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 ratio

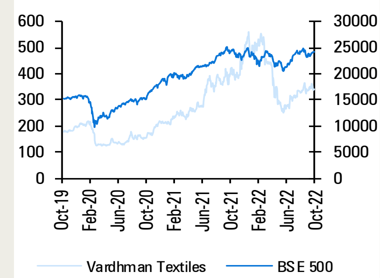
Particulars

Particulars	
Market Capitalisation (₹ Crore)	9,662.8
Debt (FY21) (₹ Crore)	1,983.0
Cash (FY21) (₹ Crore)	126.0
EV (₹ Crore)	11,519.8
52 week H/L	576 / 246
Equity Capital (₹ Crore)	56.8
Face Value (₹)	2

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	63.2	63.2	62.9	62.9	63.8
FII	4.9	6.3	8.3	7.5	7.0
DII	20.7	18.8	16.9	16.6	16.7
Others	11.2	11.7	12.0	13.0	12.5

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 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	9,758.5	10,585.3	4.9%
EBITDA	1,194.1	937.3	813.8	-6.2%	2,273.9	1,605.5	2,026.5	-5.6%
Adjusted PAT	731.1	577.5	414.4	0.7%	1,546.9	983.3	1,261.1	-9.7%
P/E (x)	13.1	16.6	23.2		6.2	9.8	7.7	
EV/EBITDA (x)	9.7	12.1	13.8		5.1	6.9	5.6	
RoCE (%)	12.9	7.7	5.5		21.2	11.8	13.8	
RoE (%)	13.1	9.5	6.4		20.1	11.2	12.8	

Source: Company, ICICI Direct Research

Key takeaways of Q2FY23 conference call

- Q2FY23 was a subdued quarter for VTL owing to low demand scenario prevailing in domestic and export markets. Over the last few quarters, Indian spinners have been at a disadvantage with Indian cotton cost being significantly higher than global cotton prices, which has made it difficult for Indian yarn players to compete in international markets. The current spreads are trending at US$0.7 per kg vs. US$0.5 in the previous quarter
- Multiple factors led to Indian cotton prices being higher than global cotton prices. Indian cotton production was lower than estimated owing to damage to crops due to pests and unseasonal rains in some cotton producing regions. Also, the cotton quality was not good, which affected the realisations of cotton spinners. Further Indian spinners could not import lower cost cotton due to supply chain and other issues. From VTL's perspective, the company has shut ~10% of its yarn capacity owing to low demand and further shifted 10-12% of production to other material like viscose, etc. Overall, yarn capacity utilisation for VTL was at ~ 85-90%, while for fabric VTL's utilisation level for grey fabric was 80-85% and processed fabric capacity utilisation was more than 90%. Demand for fabrics was more stable compared to yarn demand
- On the expansion front, the 1 lakh spindles, which were expected to be operational from October 2022 has been delayed. In October 2022, 35000 spindles (vortex) have become operational and rest 65000 spindles are expected to be operational from December 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 demand is expected to gradually pick up as the inventory held by global retailers reduces. The management expects improved order flow from clients who were sitting on earlier inventory and have been able to gradually liquidate the same. Also, India's competitiveness compared to global peers is improving and expected to be on par with global competitors after the arrival of new cotton at lower prices and in tandem with global cotton prices. The company expects better demand from the US region while demand from Europe could continue to be soft. On the domestic front, the company expects demand to pick up as inventory in pipeline has reduced
- Over the longer term the management remain positive on the prospects of the industry owing to the China+1 strategy of global retailers, which should be beneficial for Indian textile players
- 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 Q3FY23 could witness revaluation of inventory at new cotton prices, which could result in mark to market losses for the cotton based product industry. Historically, the company has been able to manage the risk of inventory loss. VTL expects normalcy to return from Q4FY23 with Indian cotton prices aligning with global prices. The company expects next year's cotton crop to be higher than the current year, which would lead to softening of domestic cotton prices
- On the cotton stocking policy, the management indicated that it is monitoring the situation and will decide on the same based on its judgement on the future cotton price trend

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**	**9,758.5**	**10,585.3**
Growth (%)	-8.8	56.7	1.4	8.5
Raw Material Expenses	3,260.5	4,560.7	5,371.8	5,510.2
Employee Expenses	590.1	729.1	712.4	783.3
Mfg, Admin & selling Exps	1,475.5	2,058.7	2,068.8	2,265.2
Total Operating Expenditure	5,326.0	7,348.4	8,153.0	8,558.8
EBITDA	**813.8**	**2,273.9**	**1,605.5**	**2,026.5**
Growth (%)	-13.2	179.4	-29.4	26.2
Depreciation	363.8	367.5	401.5	440.1
Interest	113.3	99.7	107.3	134.0
Other Income	201.6	224.5	165.9	179.9
Exceptional income	0.0	0.0	0.0	0.0
PBT	538.3	2,031.2	1,262.6	1,632.4
Total Tax	132.0	519.7	318.2	411.4
PAT	406.3	1,511.5	944.4	1,221.0
Minority Interest / Others	12.6	4.3	2.8	3.7
PAT (after minority interest	**414.4**	**1,546.9**	**983.3**	**1,261.1**
Growth (%)	-28.3	273.3	-36.4	28.3
EPS (₹)	**14.7**	**54.4**	**34.6**	**44.4**

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement ₹ crore

(Year-end March)	FY21P	FY22E	FY23E	FY24E
PAT	414.4	1,546.9	983.3	1,261.1
Add: Depreciation	363.8	367.5	401.5	440.1
(Inc)/dec in Current Assets	-452.7	-628.8	-388.7	-694.5
Inc/(dec) in CL and Provisions	-20.8	-10.3	41.6	-14.7
Others	0.0	0.0	0.0	0.0
CF from operating activities	**304.7**	**1,275.4**	**1,037.7**	**992.0**
(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	-32.9	421.1
Others	34.7	-319.6	111.8	-185.4
CF from financing activities	**-120.1**	**-184.5**	**79.0**	**235.8**
Net Cash flow	-68.4	-85.5	425.2	158.5
Opening Cash	279.9	211.5	126.0	551.2
Closing Cash	**211.5**	**126.0**	**551.2**	**709.7**

Source: Company, ICICI Direct Research

Exhibit 3: Balance Sheet ₹ crore

(Year-end March)	FY21P	FY22E	FY23E	FY24E
Liabilities				
Equity Capital	56.6	56.8	56.8	56.8
Reserve and Surplus	6,417.3	7,646.9	8,735.9	9,807.9
Total Shareholders funds	6,473.9	7,703.8	8,792.8	9,864.7
Total Debt	1,848.2	1,983.0	1,950.2	2,371.3
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	140.4	140.4
Total Liabilities	**8,733.0**	**10,095.4**	**11,157.7**	**12,654.5**
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	3,208.3	3,770.1
Debtors	1,038.6	1,321.2	1,336.8	1,450.0
Loans and Advances	2.7	2.1	3.9	4.2
Other Current Assets	647.0	907.6	952.9	972.0
Cash	211.5	126.0	551.2	709.7
Total Current Assets	4,695.9	5,239.2	6,053.1	6,906.0
Creditors	874.3	864.4	908.9	889.4
Provisions	19.7	19.3	16.4	21.2
Total Current Liabilities	894.0	883.7	925.3	910.6
Net Current Assets	3,801.9	4,355.5	5,127.7	5,995.4
Others Assets	239.5	317.0	301.1	286.1
Application of Funds	**8,733.0**	**10,095.4**	**11,157.7**	**12,654.5**

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios

(Year-end March)	FY21P	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	14.7	54.4	34.6	44.4
Cash EPS	27.5	67.4	48.7	59.9
BV	228.9	271.1	309.4	347.1
DPS	0.0	8.2	5.2	6.7
Cash Per Share	7.5	4.4	19.4	25.0
Operating Ratios				
EBITDA Margin (%)	13.3	23.6	16.5	19.1
PBT Margin (%)	8.8	21.1	12.9	15.4
PAT Margin (%)	6.6	15.7	9.7	11.5
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	11.2	12.8
RoCE	5.5	21.2	11.8	13.8
RoIC	6.5	25.0	14.6	17.2
Valuation Ratios (x)				
P/E	23.2	6.2	9.8	7.7
EV / EBITDA	13.8	5.1	6.9	5.6
EV / Net Sales	1.8	1.2	1.1	1.1
Market Cap / Sales	1.6	1.0	1.0	0.9
Price to Book Value	1.5	1.3	1.1	1.0
Solvency Ratios				
Debt/EBITDA	2.3	0.9	1.2	1.2
Debt / Equity	0.3	0.3	0.2	0.2
Current Ratio	5.4	6.1	6.7	7.8
Quick Ratio	2.2	2.7	3.1	3.5

Source: Company, ICICI Direct Research

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