



Margins expected to bounce back in FY24...

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

Q3FY23 Results: Vardhman Textiles reported a disappointing performance with decline in revenues and multi-year low EBITDA margin at 7.5%, which is significantly lower than long term average range of 18-22%.

- Sales declined 9% YoY to ₹ 2371 crore (QoQ decline of 4%)
- Gross margin (on a high base) fell 1537 bps YoY to 37% (QoQ decline of 635 bps). EBITDA margin fell 1630 bps YoY to 7.5% (QoQ decline of 700 bps). Hence, PAT de-grew 76% YoY to ₹ 102 crore (QoQ increase of 50%)

What should investors do? Elevated domestic cotton prices and weak spreads had negatively impacted the performance of VTL over the last few quarters. We believe the worst is over for the company and expect a gradual improvement in profitability. We expect a decline in cotton prices, improvement in export order flow driven by China+1 strategy of global retailers and government initiatives like FTAs with trading partner countries to aid in providing sustainable growth opportunity for large Indian textile player like VTL.

- We change our rating on the stock from HOLD to **BUY** as we believe that the negatives are already priced in

Target Price and Valuation: We value VTL at ₹ 345 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
- Stress witnessed by competing countries like Pakistan owing to varied internal factors can be beneficial for Indian cotton spinners, which can lead to increased order flow from global clients
- While the domestic spinning industry was operating at 70%+ utilisation level in Q3FY23, VTL continued to outperform with 90%+ capacity utilisation. Yarn demand has improved with China starting imports of cotton yarn from India post opening up after Covid induced lockdowns in China
- We expect revenue CAGR of 6% (FY22-24E) and margins to improve towards lower band of normal long term range of 18-22% in FY24

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

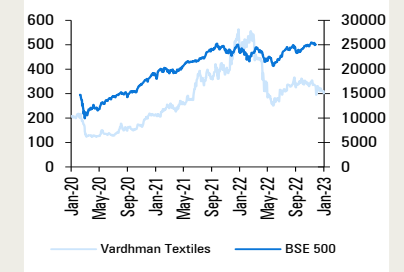
Stock data

| Particular | Amount |
|---------------------------------|-----------|
| Market Capitalisation (₹ Crore) | 8,469.2 |
| Debt (FY22) (₹ Crore) | 1,983.0 |
| Cash (FY21) (₹ Crore) | 121.7 |
| EV (₹ Crore) | 10,330.5 |
| 52 week H/L | 564 / 246 |
| Equity Capital (₹ Crore) | 56.8 |
| Face Value (₹) | 2 |

Shareholding pattern

| | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 |
|----------|--------|--------|--------|--------|--------|
| Promoter | 63.2 | 62.9 | 62.9 | 63.8 | 63.9 |
| FII | 6.3 | 8.3 | 7.5 | 7.0 | 7.1 |
| DII | 18.8 | 16.9 | 16.6 | 16.7 | 16.9 |
| Others | 11.7 | 12.0 | 13.0 | 12.5 | 12.2 |

Price Chart



Recent event & key risks

- VTL current yarn utilisation trending at 100%
- **Key Risk:** (i) Elevated product pricing can lower demand (ii) Lower-than-expected margin

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Key Financial Summary

| Financials | FY19 | FY20 | FY21 | 5 year CAGR (FY16-21) | FY22 | FY23E | FY24E | 2 year CAGR (FY22-24E) |
|---------------|---------|---------|---------|-----------------------|---------|----------|----------|------------------------|
| Net Sales | 6,878.3 | 6,735.0 | 6,139.9 | -2.0% | 9,622.3 | 10,122.4 | 10,677.9 | 5.3% |
| EBITDA | 1,194.1 | 937.3 | 813.8 | -6.2% | 2,273.9 | 1,321.2 | 1,960.0 | -7.2% |
| Adjusted PAT | 731.1 | 577.5 | 414.4 | 0.7% | 1,546.9 | 849.9 | 1,231.1 | -10.8% |
| P/E (x) | 11.5 | 14.6 | 20.3 | | 5.5 | 10.0 | 6.9 | |
| EV/EBITDA (x) | 8.7 | 10.8 | 12.4 | | 4.5 | 7.7 | 5.3 | |
| RoCE (%) | 12.9 | 7.7 | 5.5 | | 21.2 | 10.0 | 13.6 | |
| RoE (%) | 13.1 | 9.5 | 6.4 | | 20.1 | 9.8 | 12.7 | |

Key takeaways of Q3FY23 conference call

- Q3FY23 witnessed an improvement in utilisation levels of Indian cotton spinners to 70% from 50% level in Q2FY23. 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 management indicated that cotton yarn demand has improved from mid-December onwards as China has resumed buying cotton yarn from India after resumption of business activities post Covid induced lockdowns. Further stress witnessed by competing countries like Pakistan is expected to aid in improvement in cotton yarn buying from India
- Multiple factors led to Indian cotton prices being higher than global cotton prices. Indian cotton arrivals have been lower than expected. Total 1,10,000 bales of cotton have reached the market compared to 1,75,000 bales at the same time last year. The short supply of cotton is owing to expectation of better price, going ahead. From VTL's perspective, the company had shifted 10-12% of production to other material like viscose, etc, but has now reduced the other materials share to 3-4% only. Its cotton yarn utilisation is close to normal. Overall, yarn capacity utilisation for VTL was at was 90%+ for the quarter and has been running at 100% utilisation for the last one and a half months
- 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) became operational and rest 65000 spindles are expected to be operational from March 2023. 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. Some global retailers have started placing orders in small lots signifying a reduction of inventories with them. 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 is expected to be on par with global competitors after the arrival of new cotton at lower prices and in tandem with global cotton prices
- 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
- From a cotton sourcing perspective, the company highlighted that key considerations are quality of cotton and pricing. Normally, the company prefers purchasing good quality cotton in early season cotton arrivals. However, currently the company is buying cotton on a monthly basis and will continue to do the same till the price of cotton declines to comfortable levels. The company currently has minimum cotton stock and is not resorting to hedging of cotton
- From a profitability perspective, fabric business is currently able to generate better margins than the cotton yarn business
- On the capex front, the management indicated a capex of ₹ 600-650 crore for FY23E and ₹ 300 crore for FY24E

Financial Summary

| Exhibit 1: Profit and loss statement | | ₹ crore | | | |
|--------------------------------------|----------------|----------------|-----------------|-----------------|--|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Total operating Income | 6,139.9 | 9,622.3 | 10,122.4 | 10,677.9 | |
| Growth (%) | -8.8 | 56.7 | 5.2 | 5.5 | |
| Raw Material Expenses | 3,260.5 | 4,560.7 | 5,916.3 | 5,642.6 | |
| Employee Expenses | 590.1 | 729.1 | 738.9 | 790.2 | |
| Mfg, Admin & selling Exps | 1,475.5 | 2,058.7 | 2,146.0 | 2,285.1 | |
| Total Operating Expenditure | 5,326.0 | 7,348.4 | 8,801.2 | 8,717.8 | |
| EBITDA | 813.8 | 2,273.9 | 1,321.2 | 1,960.0 | |
| Growth (%) | -13.2 | 179.4 | -41.9 | 48.3 | |
| Depreciation | 363.8 | 367.5 | 302.9 | 431.9 | |
| Interest | 113.3 | 99.7 | 106.7 | 117.4 | |
| Other Income | 201.6 | 224.5 | 172.1 | 181.5 | |
| Exceptional income | 0.0 | 0.0 | 0.0 | 0.0 | |
| PBT | 538.3 | 2,031.2 | 1,083.8 | 1,592.2 | |
| Total Tax | 132.0 | 519.7 | 273.1 | 401.2 | |
| PAT | 406.3 | 1,511.5 | 810.6 | 1,191.0 | |
| Minority Interest / Others | 12.6 | 4.3 | 2.4 | 3.6 | |
| PAT (after minority interest) | 414.4 | 1,546.9 | 849.9 | 1,231.1 | |
| Growth (%) | -28.3 | 273.3 | -45.1 | 44.9 | |
| EPS (₹) | 14.7 | 54.4 | 29.9 | 43.3 | |

Source: Company, ICICI Direct Research

| Exhibit 2: Cash flow statement | | ₹ crore | | | |
|-------------------------------------|---------------|-----------------|-----------------|---------------|--|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| PAT | 414.4 | 1,546.9 | 849.9 | 1,231.1 | |
| Add: Depreciation | 363.8 | 367.5 | 302.9 | 431.9 | |
| (Inc)/dec in Current Assets | -452.7 | -633.1 | 0.6 | -832.6 | |
| Inc/(dec) in CL and Provisions | -20.8 | -10.3 | 91.5 | -51.7 | |
| Others | 0.0 | 0.0 | 0.0 | 0.0 | |
| CF from operating activities | 304.7 | 1,271.1 | 1,244.9 | 778.7 | |
| (Inc)/dec in Investments | 70.4 | -616.5 | -422.8 | -380.5 | |
| (Inc)/dec in Fixed Assets | -274.5 | -319.1 | -650.0 | -300.0 | |
| (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 | -1,165.7 | -795.4 | |
| Issue/(Buy back) of Equity | 0.0 | 0.3 | 0.0 | 0.0 | |
| Inc/(dec) in loan funds | -154.8 | 134.8 | -43.7 | 139.4 | |
| Others | 34.7 | -319.6 | 131.4 | -180.9 | |
| CF from financing activities | -120.1 | -184.5 | 87.7 | -41.4 | |
| Net Cash flow | -68.4 | -89.8 | 166.9 | -58.2 | |
| Opening Cash | 279.9 | 211.5 | 121.7 | 288.6 | |
| Closing Cash | 211.5 | 121.7 | 288.6 | 230.4 | |

Source: Company, ICICI Direct Research

| Exhibit 3: Balance Sheet | | ₹ crore | | | |
|-----------------------------|----------------|-----------------|-----------------|-----------------|--|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Liabilities | | | | | |
| Equity Capital | 56.6 | 56.8 | 56.8 | 56.8 | |
| Reserve and Surplus | 6,417.3 | 7,646.9 | 8,622.5 | 9,669.0 | |
| Total Shareholders funds | 6,473.9 | 7,703.8 | 8,679.4 | 9,725.8 | |
| Total Debt | 1,848.2 | 1,983.0 | 1,939.3 | 2,078.7 | |
| 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 | 140.0 | 140.0 | |
| Total Liabilities | 8,733.0 | 10,095.4 | 11,033.0 | 12,222.7 | |
| Assets | | | | | |
| Gross Block | 8,332.6 | 8,651.8 | 9,301.8 | 9,601.8 | |
| Less: Accu Depreciation | 4,793.6 | 5,161.1 | 5,464.0 | 5,895.9 | |
| Net Block | 3,539.1 | 3,490.7 | 3,837.8 | 3,705.8 | |
| Capital WIP | 78.0 | 241.2 | 350.0 | 480.0 | |
| Total Fixed Assets | 3,617.0 | 3,731.9 | 4,187.8 | 4,185.8 | |
| Investments | 1,074.5 | 1,691.1 | 2,113.8 | 2,494.3 | |
| Inventory | 2,796.1 | 2,882.3 | 2,773.3 | 3,510.5 | |
| Debtors | 1,038.6 | 1,321.2 | 1,386.6 | 1,462.7 | |
| Loans and Advances | 2.7 | 6.4 | 4.0 | 4.3 | |
| Other Current Assets | 647.0 | 907.6 | 952.9 | 972.0 | |
| Cash | 211.5 | 121.7 | 288.6 | 230.4 | |
| Total Current Assets | 4,695.9 | 5,239.2 | 5,405.5 | 6,179.9 | |
| Creditors | 874.3 | 864.4 | 961.1 | 902.8 | |
| Provisions | 19.7 | 19.3 | 14.1 | 20.7 | |
| Total Current Liabilities | 894.0 | 883.7 | 975.2 | 923.5 | |
| Net Current Assets | 3,801.9 | 4,355.5 | 4,430.2 | 5,256.5 | |
| Others Assets | 239.5 | 317.0 | 301.1 | 286.1 | |
| Application of Funds | 8,733.0 | 10,095.4 | 11,033.0 | 12,222.7 | |

Source: Company, ICICI Direct Research

| Exhibit 4: Key ratios | | | | | |
|-----------------------------|-------|-------|-------|-------|--|
| (Year-end March) | FY21 | FY22 | FY23E | FY24E | |
| Per share data (₹) | | | | | |
| EPS | 14.7 | 54.4 | 29.9 | 43.3 | |
| Cash EPS | 27.5 | 67.4 | 40.6 | 58.5 | |
| BV | 228.9 | 271.1 | 305.4 | 342.2 | |
| DPS | 0.0 | 8.2 | 4.5 | 6.5 | |
| Cash Per Share | 7.5 | 4.3 | 10.2 | 8.1 | |
| Operating Ratios | | | | | |
| EBITDA Margin (%) | 13.3 | 23.6 | 13.1 | 18.4 | |
| PBT Margin (%) | 8.8 | 21.1 | 10.7 | 14.9 | |
| PAT Margin (%) | 6.6 | 15.7 | 8.0 | 11.2 | |
| Inventory days | 166.2 | 109.3 | 100.0 | 120.0 | |
| 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 | 9.8 | 12.7 | |
| RoCE | 5.5 | 21.2 | 10.0 | 13.6 | |
| RoIC | 6.5 | 25.0 | 12.9 | 17.8 | |
| Valuation Ratios (x) | | | | | |
| P/E | 20.3 | 5.5 | 10.0 | 6.9 | |
| EV / EBITDA | 12.4 | 4.5 | 7.7 | 5.3 | |
| EV / Net Sales | 1.6 | 1.1 | 1.0 | 1.0 | |
| Market Cap / Sales | 1.4 | 0.9 | 0.8 | 0.8 | |
| Price to Book Value | 1.3 | 1.1 | 1.0 | 0.9 | |
| Solvency Ratios | | | | | |
| Debt/EBITDA | 2.3 | 0.9 | 1.5 | 1.1 | |
| Debt / Equity | 0.3 | 0.3 | 0.2 | 0.2 | |
| Current Ratio | 5.4 | 6.1 | 5.6 | 6.8 | |
| Quick Ratio | 2.2 | 2.7 | 2.7 | 3.0 | |

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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