Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

KPR Mill Limited

Integrated model; Garmenting division to drive growth ahead

Consumer Discretionary	Sharekhan code: KPRMILL	Company Update

Summary

- We maintain our Buy recommendation on KPR Mill with a revised PT of Rs. 1,420. Integrated business model, deleveraged balance sheet, and strong growth prospects in the garmenting business make it a good pick in the textile space with decent valuation of 12x its FY2023E EPS.
- Reduction in replacement cycle to 15-20 days from 20-25 days earlier will give boost to garment demand; the garmenting division's revenue is expected to post a CAGR of 21% over FY2020-FY2023 with new capacity.
- New sugar facility (Sugar – 10,000 TCD and ethanol 230 kilo litre per day) will contribute additional revenue of Rs. 500-600crore in FY2023E; sugar division's margins are expected to be at 25%.
- Balance sheet remains strong with Rs. 350 crore of cash on books and debt:equity ratio standing at 0.3x as of December 2020. The company expects return ratios to significantly improve once new capacities reach optimum utilisation.

KPR Mills' (KPR) integrated business model makes it one of the better plays in the domestic textile sector, as significant jump in cotton prices will not have any substantial impact on the profitability of the business. About 15%-20% of the company's yarn manufactured is used for captive consumption (to manufacture fabric) and rest of the yarn is sold in the domestic market. Yarn revenue stood flat in Q3. However, the shortage of yarn in the domestic and international markets and higher realisation will definitely help KPR to post better sales from the yarn segment in the coming quarters. Higher export orders have boosted the garment division, which grew by around 20% in Q3. In export markets, the replacement cycle for garments has reduced to 15-20days from 20-25days earlier due to improving hygiene habits of people. This led to strong demand for garments in international markets. Realisations also improved because of better demand, which currently stands at Rs. 150 per piece, which was around Rs. 130 per piece in FY2020. Current order book stands at Rs. 700crore. We believe with operations of new capacity (42million pieces) in place by H2FY2022, revenue of the garmenting divisionis expected to reach ~Rs. 2,300crore by FY2023 (post a 21% CAGR over FY2020-FY2023). With better realisation and higher volumes, margins of the garmenting division will improve substantially in the coming years (stood at 33% in Q3FY2021). On the other hand, the sugar division is expected to contribute around Rs. 500 crore-600crore by FY2023 with new sugar facility of 10,000 tonne crushed per day (TCD) and ethanol capacity of 230 KLPD (to be operational in the next 10-12 months). Margins of the division are expected to reach around 25% by the next two to three yearswith ethanol and power mix likely to improve to 60% of the sugar division's revenue. Thus, overall, the company is targeting revenue of Rs. 5,000crore by FY2023 (we expect revenue of Rs. 4,850crore by FY2023) through increased capacities of garmenting and sugar divisions. Consolidated OPM, which stood close to 19% in FY2020, will improve to 23% by FY2023 with higher margins in the garmenting division and improving margins in the sugar division. KPR has one of the strongest balance sheets with debt:equity lowest at 0.3x because of stable working capital management. Cash on balance sheet stood at Rs. 350crore as of December 2020. With improvement in overall profitability, return ratios are expected to improve significantly with RoE and RoCE standing at 24.6% and 29.3%, respectively.

Our Call

View: Retained Buy with a revised PT of Rs. 1,420: We have increased our earnings estimates for FY2022 and FY2023 to factor in higher sales from the garmenting and sugar divisions along with better-than-expected OPM. An increase in garmenting capacity, improving sales of high-value products in yarn/fabrics division, and improving growth prospects in exports markets backed by strong government reform would help the textile business achieve strong double-digit growth in the next 2-3 years. Overall, we expect KPR's earnings to post a CAGR of 24% over FY2020-FY2023. Further, the company is likely to create value for shareholders by demerging its sugar division into a separate entity once it attains a certain scale. The stock is currently trading at 11.7x its FY2023E EPS and 7.4x its FY2023E EV/EBIDTA. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,420 (valuing the stock at 14x its FY2023E EPS).

Key Risks

Any decline in export revenue due to lower demand from international clients or significant increase in raw-material prices would act as a key risk to our earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	3,384	3,353	3,231	3,951	4,847
OPM (%)	18.1	18.6	21.2	21.9	23.1
Adjusted PAT	335	377	393	527	715
% Y-o-Y growth	15.3	12.5	4.4	34.1	35.7
Adjusted EPS (Rs.)	48.7	54.7	57.1	76.6	103.9
P/E (x)	25.6	21.6	21.4	15.9	11.7
P/B (x)	4.8	4.4	3.7	3.1	2.6
EV/EBIDTA (x)	15.3	14.0	12.8	9.9	7.4
RoNW (%)	19.9	20.6	19.3	21.8	24.6
RoCE (%)	21.1	19.7	20.7	24.7	29.3

Source: Company; Sharekhan estimates

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,183**	
Price Target: **Rs. 1,420**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

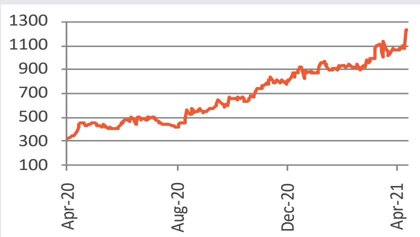
Company details

Market cap:	Rs. 8,140 cr
52-week high/low:	Rs. 1,298 / 395
NSE volume: (No of shares)	0.7 lakh
BSE code:	532889
NSE code:	KPRMILL
Free float: (No of shares)	1.7 cr

Shareholding (%)

Promoters	74.7
FII	2.2
DII	15.8
Others	7.2

Price chart



Price performance

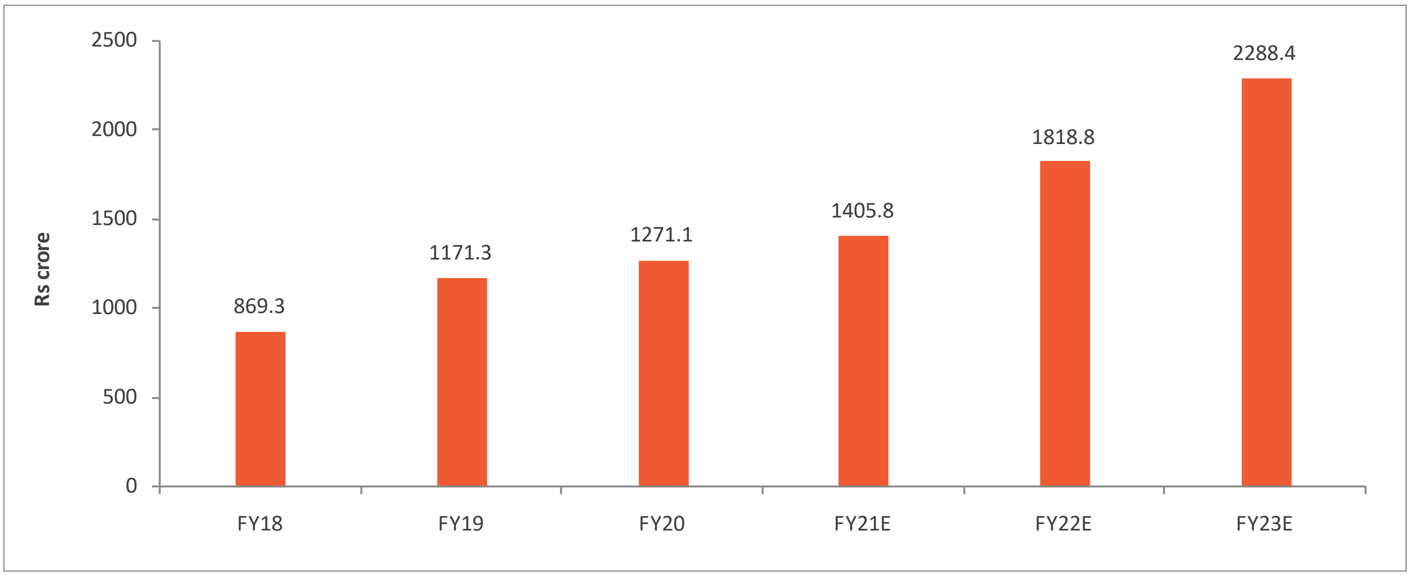
(%)	1m	3m	6m	12m
Absolute	8.5	32.8	85.6	156.8
Relative to Sensex	11.6	32.2	63.4	97.2

Sharekhan Research, Bloomberg

Garmenting division's revenue to report a 21% over FY2020-FY2023

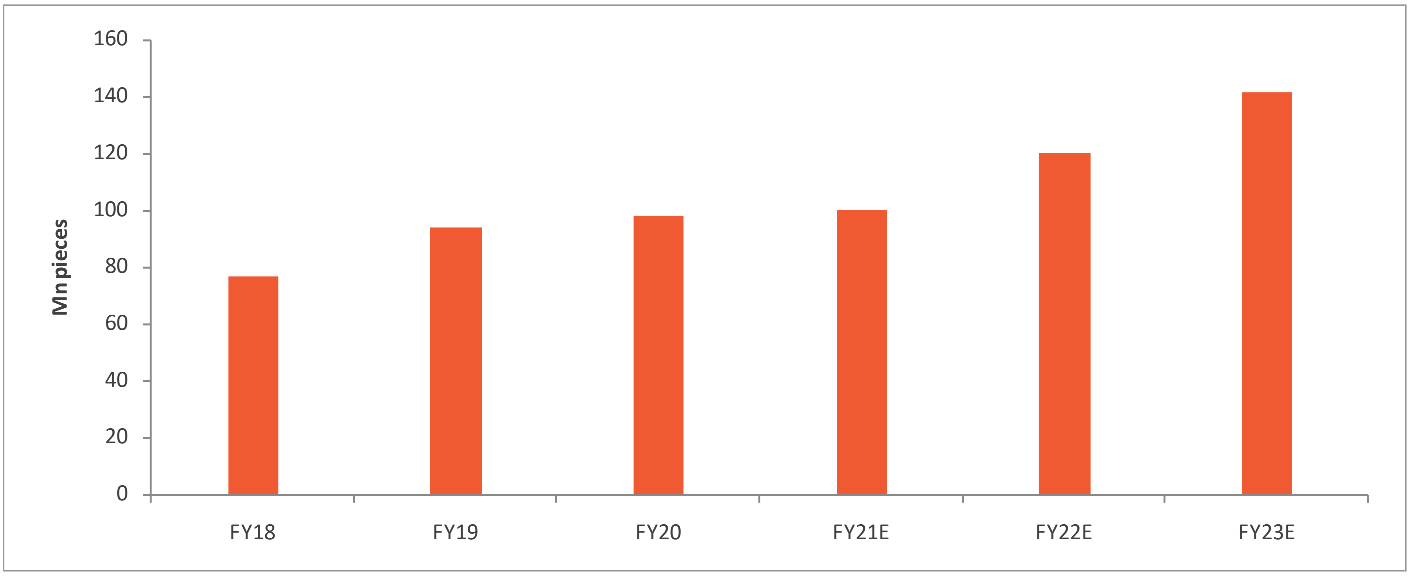
With higher demand from the international market, KPR expects strong growth momentum in the garmenting division to sustain in the coming quarters. The company is not only getting orders from existing customers but also receivingorders from new customers. This is mainly because of reduction in the replacement cycle to 15-20 days from 20-25 days earlier. International customers are replacing the garments faster due to improvement in hygiene factors in the current pandemic environment.The garmenting division has orders of Rs. 700 crore spread over the next two quarters. Further, the company is sensing a big opportunity from shift of the customer base from China to India. This will happen when most manufacturers further expand their respective manufacturing facilitiesto cater to the shift in demand. The new garmenting facility of 42 million pieces is expected to come onstream in the midst of FY2022. We expect capacity utilisation in the first year of operations to be 30%-40% and expect it improve to 80% by FY2023. Overall, we expect KPR's garmenting division's revenue to post a 21% CAGR over FY2020-FY2023 to Rs. 2,300crore in FY2023. Operating profit margin (OPM) of the division will also improve substantially with the division attaining certain scale and efficiencies in the coming years.

Revenue trend of the garmenting division



Source: Company; Sharekhan Research

Garment sales likely to reach 140million pieces

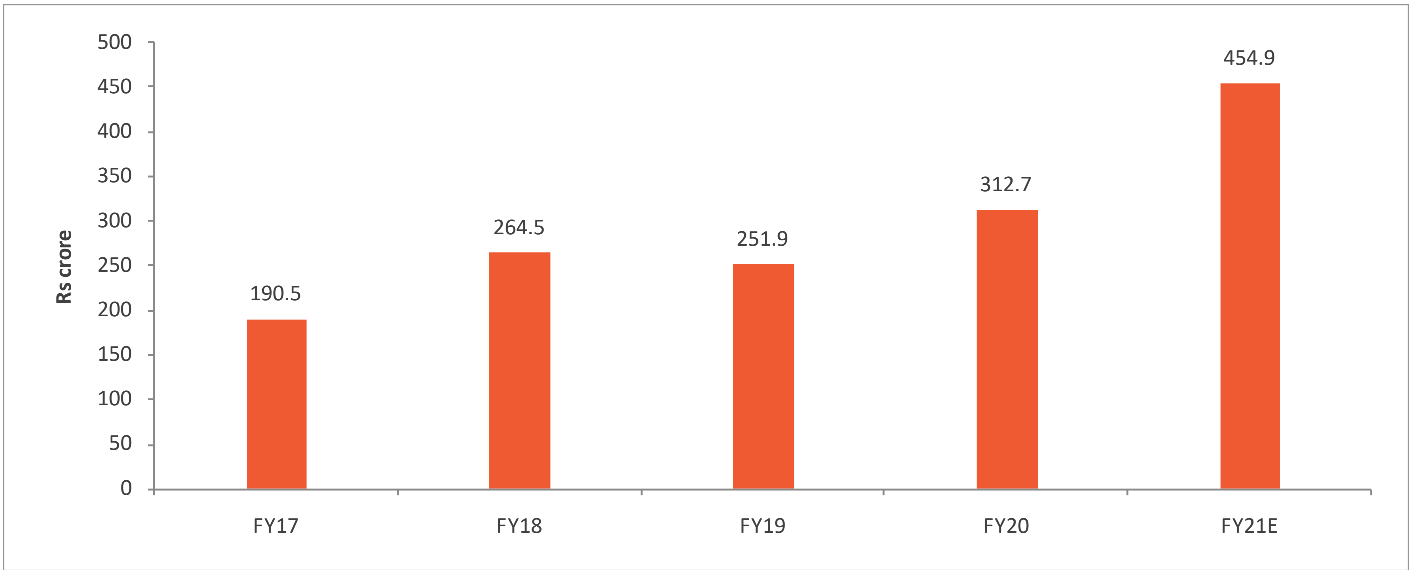


Source: Company; Sharekhan Research

Sugar division to post revenue of Rs. 600crore by FY2023; Margins to improve to 25%

KPR has decided to establish a new sugar mill with sugar capacity of 10,000 tonne of cane per day (TCD), power capacity of 47.50 megawatt (MW), and ethanol capacity of 230 kilo litre per day (KLPD), close to its existing facility. The companywill be doing capex of Rs. 500crore for the new capacity. The company proposes to convert 30% of sugarcane crushed into ethanol during the season and during the off-season. Further,KPRplans to expand its ethanol capacity to 300KLPD and convert 50% of sugarcane crushed into ethanol. The company is targeting revenue mix of 60:40 from ethanol andpower division and sugar division. Overall, with expanded capacity, the company is looking to post revenue of Rs. 1,000crore over the next three to four years. With better revenue mix, margins of the division will also improve in the coming years. The company is targeting this division to achieve OPM of around 25% in the coming years.

Trend in sugar revenue



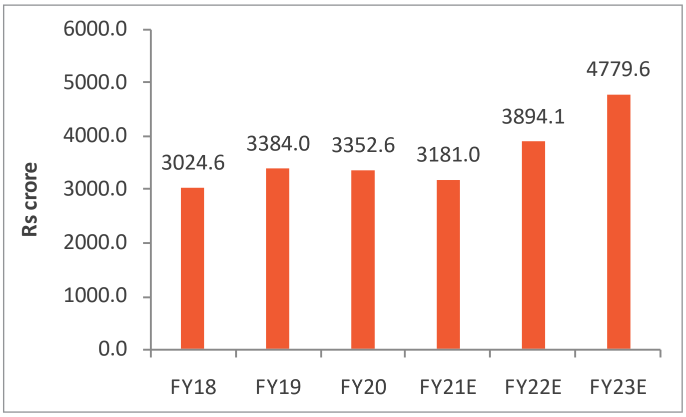
Source: Company; Sharekhan Research

OPM to reach 23% in FY2023; Return ratios to improve significantly

KPR's integrated business model, improving sales of high-value products in the yarn/fabrics division, increasing contribution from the garmenting division, and improving mix of the sugar division will help consolidated OPM to reach 23% in FY2023 from 18.6% in FY2020. Cumulative free cash flow (FCF) between FY2017-FY2020 stood at Rs. 720crore. Cash flows are expected to improve further in the coming quarters with improvement in profitability and stable working capital management. Capex in the garmenting division and sugar division will largely be taken care by internal accruals. Thus, we do not expect debt on books to increase from the current levels and debt:equity ratio is likely to remain lower at 0.3x-0.5x. Further, with improvement profitability, return ratios are expected to consistently improve in the coming years. We expect RoE and RoCE to improve to 24.6% and 29.3%, respectively, in FY2023 from 20.6 and 19.7% in FY2020.

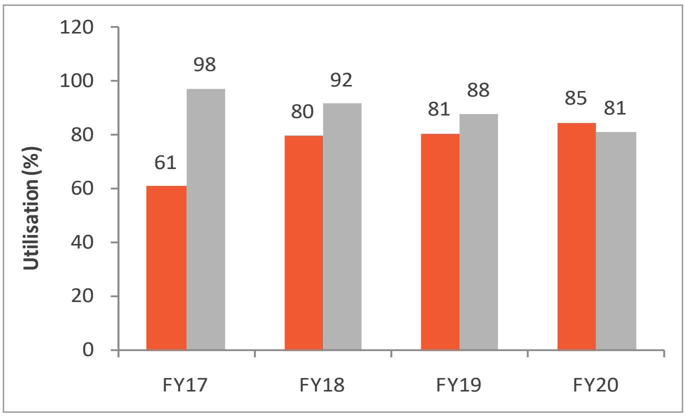
Financials in charts

Revenue Trend



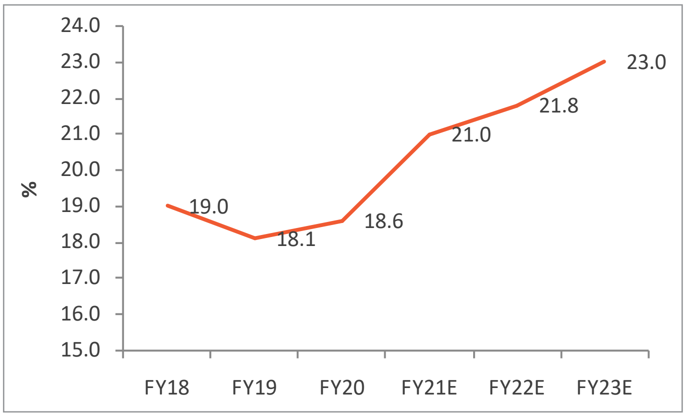
Source: Company, Sharekhan Research

Capacity utilisation for the garmenting and fabric division



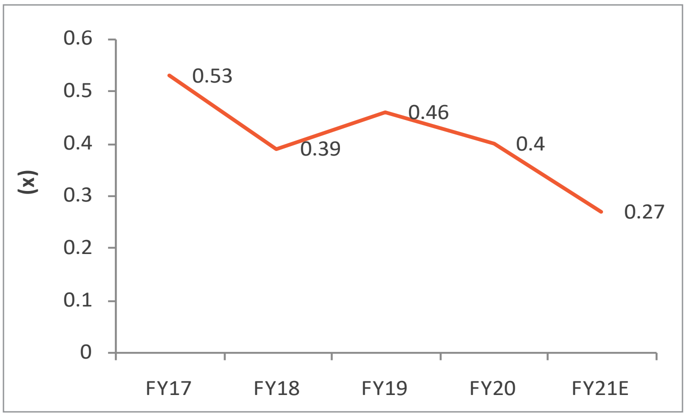
Source: Company, Sharekhan Research

OPM to reach 23% by FY2023



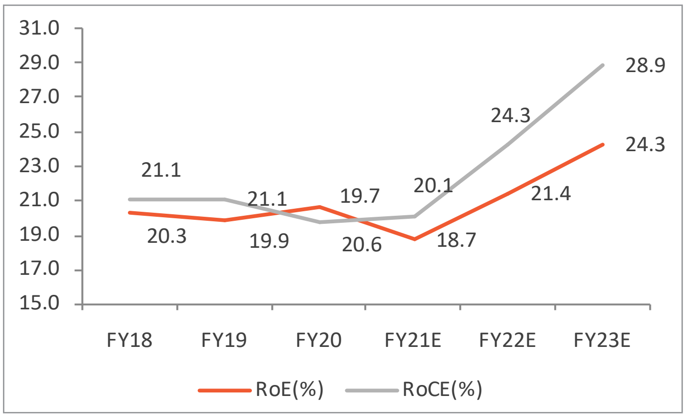
Source: Company, Sharekhan Research

Consistent improvement in debt:equity ratio



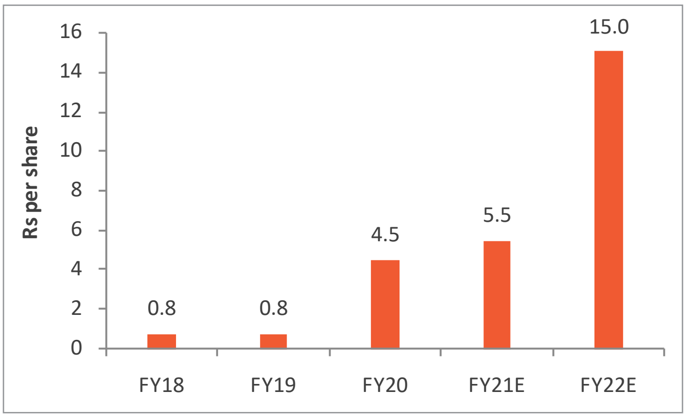
Source: Company, Sharekhan Research

Return ratios to improve substantially



Source: Company, Sharekhan Research

Dividend pay to improve ahead



Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Long-term growth prospects improving

The Indian textiles sector's H1FY2021 performance was affected by lesser exports and lower domestic sales during the lockdown. Demand for textile products improved from August and remained good till October, largely on account of better demand from markets such as the US and Europe. Readymade garment exports were higher by 10%-14% in September-October. Most textile companies registered good orders from countries such as US and UK due to pent-up demand for apparel and home textile as retailers were building up the stock prior to the festive season. However, the recent spike in COVID-19 cases (especially Europe) acts as a risk to near-term demand. However, long-term growth prospects of the Indian textile industry are intact. The augmentation of capacity with value-added products, key export markets focusing on shifting to India for long-term supply, and government's support policies provide scope for textile companies to post robust growth in the long run.

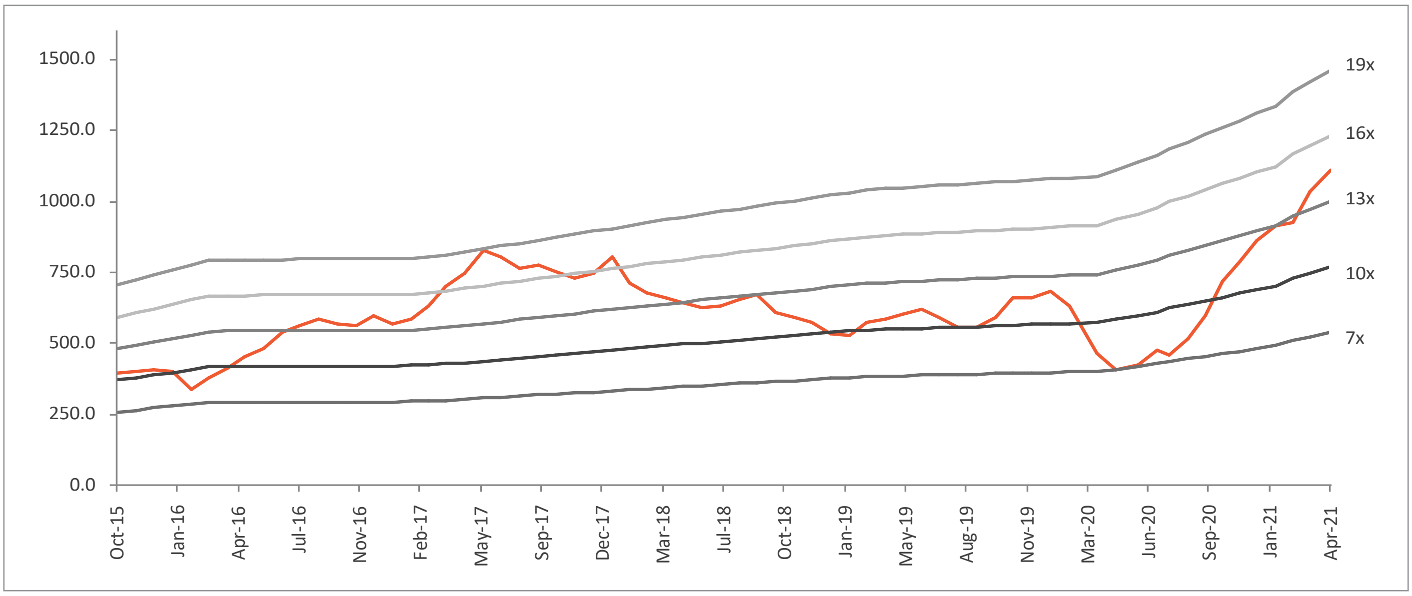
Company outlook - New garment capacity to drive growth in the long run

KPR posted strong performance in Q3FY2021 with revenue growing by ~21% (led by 19% growth in the textile business and 67% growth in the sugar business), while OPM expanded by 917 bps to 27% mainly on account of improved mix and better efficiencies. With improving retail demand in exports markets, we expect revenue growth momentum to sustain with the garmenting facility expected to operate in optimal utilisation. Thus, we expect the company to end FY2021 with marginal drop in revenue and OPM to stand at 21%. The company will be scaling up the garmenting facility by 42 million pieces per annum. With scale up in garment capacity and increased utilisation, we expect revenue of the garment business to post a21% CAGR over FY2020-FY2023. This along with higher contribution from value-added yarn products and improving margins in the sugar division will help consolidated margins to stand at 23% in FY2023.

Valuation - Retained Buy with a revised PT of Rs. 1,420

We have increased our earnings estimates for FY2022 and FY2023 to factor in higher sales from the garmenting and sugar divisions along with better-than-expected OPM. An increase in garmenting capacity, improving sales of high-value products in the yarn/fabrics division, and better growth prospects in exports markets backed by strong government reforms would help the textile business achieve strong double-digit growth in the next 2-3 years. Overall, we expect KPR's earnings to post a 24% CAGR over FY2020-FY2023. Further, the company is likely to create value for shareholders by demerging its sugar division into a separate entity once it attains a certain scale. The stock is currently trading at 11.7x its FY2023E EPS and 7.4x its FY2023E EV/EBIDTA. We maintain our Buy recommendation on the stock with a revised PT of Rs. 1,420 (valuing the stock at 14x its FY2023E EPS).

One year forward P/E band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Arvind	-	11.5	8.2	7.0	4.7	4.1	3.1	5.8	6.9
KPR Mill	21.4	15.9	11.7	12.8	9.9	7.4	20.1	24.3	28.9

Source: Company, Sharekhan estimates

About company

KPR is one of the largest vertically integrated textile manufacturing companies in India present across the value chain from fibre-to-fashion. KPR has 12 technology-oriented manufacturing units with a capacity to produce 1,00,000 MT of yarn per annum,40,000 MT of fabrics per annum, and 115 million readymade knitted apparel per annum, including a 10-million knitted garment capacity in Ethiopia. KPR has recently got into the retail segment – FASO, a 100% organic innerwear, sportswear, and athleisure brand. The company also has a sugar business with production capacity of 5,000 TCD and has recently started an operational ethanol facility of 130KLPD. Around 65% of the total revenue comes from the domestic market, whereas 35% is exported to over 60 countries, including Europe, Australia, and the US.

Investment theme

KPR is one of India's largest vertically integrated textile players havinga steady financial record and a sturdy balance sheet. The strength of its integrated model helps the company to achieve consistent OPMs that are much better than some of the exporting peers. A shift in base from China to India, addition of more international clients, transforming itself from a volatile yarn business to a profitable garment business, scale-up in the retail business, and scale-up in garmenting revenue through increased capacity utilisation from newly commissioned Ethiopia facility are some of the medium to long-term growth drivers for KPR.

Key Risks

- Any decline in export revenue due to lower demand from international clients or a significant increase in raw-material prices would act as a key risk to our earnings estimates.
- Any volatility in key raw material prices such as cotton prices can affect the profitability of the company.

Additional Data

Key management personnel

KPD Singamani	Managing Director
KP Ramasamy	Chairman
P Nataraj	CEO & MD
PL Murugappan	CFO
P Kandaswamy	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	L&T Mutual Fund Trustee Ltd.	6.3
2	Franklin Resources	3.2
3	DSP Investment Management	2.3
4	Aditya Birla Sunlife Asset Management	3.0
5	Nippon Life India Asset Management	1.3
6	L&T Investment Management	1.1
7	IDFC Mutual Fund	0.7
8	Dimensional Fund Advisors	0.5
9	Canara Robecco Asset Management	0.3
10	Tata Asset Management	0.1

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;