

CMP: ₹ 2500

Target: ₹ 3125 (25%)

Target Period: 12 months

January 25, 2022

BUY



Increasing capacity to benefit from strong demand...

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 reduce debt by ~₹ 152 crore in FY21 (D/E: 0.3x in FY21). We expect D/E ratio to stay at ~0.3x in FY24E

Q3FY22 Results: Vardhman Textiles reported a strong operational performance for Q3FY22 with all-time high revenues. EBITDA margin performance in Q3FY22 was strong amid enhanced demand in the yarn segment.

- Revenues increased 49% YoY to ₹ 2603 crore (QoQ growth of 9%)
- Gross margin improvement of 405 bps YoY to 52.4% (QoQ decline of 350 bps on an exceptionally high base owing to use of low cost inventory) and operating leverage led to EBITDA margin expansion of 800 bps YoY to 23.8%. EBITDA was higher by 124% YoY at ₹ 619 crore
- Consequently, PAT grew 145% YoY to ₹ 429 crore

What should investors do? Despite being in the cyclical textile business, VTL's stock price has appreciated at 18% CAGR in the last five years.

- We continue to remain structurally positive and maintain **BUY** rating

Target Price and Valuation: We value VTL at ₹ 3125 i.e. 11x FY24E earnings.

Key triggers for future price performance:

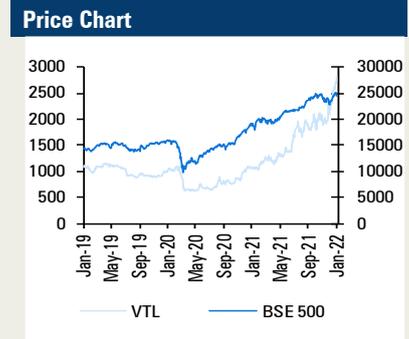
- Global retailers are looking at de-risking their supply chains and VTL is expected to be a beneficiary in the yarn and fabric segment
- Strong demand coupled with supply constraint owing to closure of ~5-6% of capacities due to impact of pandemic is expected to result in stronger spreads in the yarn business
- Owing to strong demand from customers the company is expanding its yarn spindle capacity by installing 1,65,000 spindles with capex of ₹1400 crore. Further, it is expanding capacity by 70000 spindles with capex of ₹ 600 crore
- We model revenue and earnings CAGR of 22% and 57%, respectively, in FY21-24E with RoCE of ~16% in FY24E

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
- BUY with a target price of ₹ 820

Particulars	
Particular	Amount
Market Capitalisation (₹ Crore)	14,172.5
Debt (FY21) (₹ Crore)	1,848.2
Cash (FY21) (₹ Crore)	211.5
EV (₹ Crore)	15,809.2
52 week H/L	2880 / 1011
Equity Capital (₹ Crore)	56.7
Face Value (₹)	10

Shareholding pattern					
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	62.8	63.3	63.2	63.2	63.2
FII	5.3	4.3	4.4	4.9	6.3
DII	22.1	21.6	21.3	20.7	18.8
Others	9.8	10.8	11.1	11.2	11.7



- ### Recent event & key risks
- Capacity expansion of 70000 spindles announced
 - Key Risk:** (i) Pandemic led restriction can lower sales, (ii) high RM cost can subdue margin

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Key Financial Summary

Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 year CAGR (FY21-24E)
Net Sales	6,878.3	6,735.0	6,139.9	-2.0%	9,260.6	10,209.1	11,279.2	22.5%
EBITDA	1,194.1	937.3	813.8	-6.2%	2,280.7	2,355.7	2,419.6	43.8%
Adjusted PAT	731.1	577.5	409.9	0.5%	1,516.6	1,549.5	1,589.2	57.1%
P/E (x)	19.3	24.5	34.5		9.3	9.1	8.9	
EV/EBITDA (x)	13.4	16.9	19.4		6.9	6.8	6.7	
RoCE (%)	12.9	7.7	5.5		21.1	18.1	15.8	
RoE (%)	13.1	9.5	6.3		19.1	16.8	15.0	

Key takeaways of conference Call

- The demand for yarn remained strong during the quarter with yarn realisation increasing significantly mainly owing to higher input cost, which the spinners passed on to their customers. Vardhman's yarn division operated at full capacity. Yarn demand from Bangladesh was strong and continued to be the biggest importer of cotton yarn from India
- The management indicated that fabric business which was a laggard in last few quarters also improved during the quarter. The fabric division for the first time operated at 100% utilisation. The margins in the fabric business were still below normal levels. The management expects the same to improve, going forward, from current low levels
- To cater to the strong demand, the company had earlier announced a capacity expansion of 1 lakh spindles. Further in October 2021, VTL announced capacity expansion plan to add 1.65 lakh spindles (capex of ₹ 1400 crore). In addition to the above, the company is now planning to add 70000 spindles (capex of ₹ 600 crore) to enhance the overall yarn capacity. The 1 lakh spindles are expected to be operational from October 2022. The other expansions projects are expected to be operational in phases by FY24
- The management indicated that it would fund the capex through 50% debt and rest through internal accruals
- The management expects the EBITDA margin to be at the upper end of 18-22% long term average EBITDA margin range
- On the cotton inventory front, the management is treading cautiously and has not purchased cotton requirement for the entire season as the current prevailing prices are very high. The company is monitoring the cotton price trend closely and currently buying cotton on a monthly requirement basis
- The management indicated that its export business was not impacted due to the third wave. However, the domestic business has seen a slowdown owing to local restriction on trade within India
- Power cost continues to remain high. The company has two thermal power plants. However, owing to increase in cost of coal, VTL has stopped one power plant and is operating the other at lower capacity. The company is meeting its power requirement through the national grid power, which makes economic sense in the current scenario
- Challenges in availability of containers for transportation continues with supply chain issues still persisting. The management expects the same to improve in the next few quarters
- The company's board of directors have approved the split/ sub-division of equity shares of the company from face value of ₹ 10 per share to ₹ 2 per share, subject to the approval of the shareholders

Financial Summary

Exhibit 1: Profit and loss statement		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Total operating Income	6,139.9	9,260.6	10,209.1	11,279.2	
Growth (%)	-8.8	50.8	10.2	10.5	
Raw Material Expenses	3,260.5	4,433.3	5,028.6	5,738.7	
Employee Expenses	590.1	731.6	816.7	902.3	
Mfg, Admin & selling Exps	1,475.5	1,815.1	2,008.1	2,218.6	
Total Operating Expenditure	5,326.0	6,979.9	7,853.5	8,859.6	
EBITDA	813.8	2,280.7	2,355.7	2,419.6	
Growth (%)	-13.2	180.2	3.3	2.7	
Depreciation	363.8	374.5	424.7	444.5	
Interest	113.3	99.2	105.1	124.2	
Other Income	201.6	240.8	265.4	293.3	
Exceptional income	0.0	0.0	0.0	0.0	
PBT	538.3	2,047.7	2,091.3	2,144.2	
Total Tax	136.4	516.0	527.0	540.3	
PAT	401.8	1,531.7	1,564.3	1,603.8	
Minority Interest / Others	12.6	36.8	37.5	38.5	
PAT (after minority interest)	409.9	1,516.6	1,549.5	1,589.2	
Growth (%)	-29.0	270.0	2.2	2.6	
EPS (₹)	72.5	267.5	273.3	280.3	

Source: Company, ICICI Direct Research

Exhibit 2: Cash flow statement		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
PAT	409.9	1,516.6	1,549.5	1,589.2	
Add: Depreciation	363.8	374.5	424.7	444.5	
(Inc)/dec in Current Assets	-452.7	-801.4	-562.3	-514.7	
Inc/(dec) in CL and Provisions	-20.8	40.8	-19.6	-213.5	
Others	0.0	0.0	0.0	0.0	
CF from operating activities	300.3	1,130.5	1,392.3	1,305.5	
(Inc)/dec in Investments	70.4	-107.5	-236.4	-283.7	
(Inc)/dec in Fixed Assets	-274.5	-700.0	-1,300.0	-800.0	
(Inc)/dec in CWIP	63.7	-222.0	-50.0	-130.0	
Others	-112.6	0.0	0.0	0.0	
CF from investing activities	-253.0	-1,029.5	-1,586.4	-1,213.7	
Issue/(Buy back) of Equity	0.0	0.1	0.0	0.0	
Inc/(dec) in loan funds	-154.8	-44.2	530.7	425.6	
Others	39.1	-24.1	-191.3	-234.3	
CF from financing activities	-115.7	-68.1	339.4	191.3	
Net Cash flow	-68.4	32.9	145.3	283.2	
Opening Cash	279.9	211.5	244.4	389.7	
Closing Cash	211.5	244.4	389.7	672.9	

Source: Company, ICICI Direct Research

Exhibit 3: Balance Sheet		₹ crore			
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Liabilities					
Equity Capital	56.6	56.7	56.7	56.7	
Reserve and Surplus	6,417.3	7,869.9	9,187.0	10,537.8	
Total Shareholders funds	6,473.9	7,926.6	9,243.7	10,594.5	
Total Debt	1,848.2	1,804.1	2,334.7	2,760.3	
Deferred Tax Liability	256.9	256.9	256.9	256.9	
Other LT Liabilities	20.8	23.9	27.5	31.6	
Minority Interest / Others	133.2	170.0	207.5	207.5	
Total Liabilities	8,733.0	10,181.5	12,070.3	13,850.9	
Assets					
Gross Block	8,332.6	9,032.6	10,332.6	11,132.6	
Less: Accu Depreciation	4,793.6	5,168.1	5,592.9	6,037.3	
Net Block	3,539.1	3,864.5	4,739.8	5,095.3	
Capital WIP	78.0	300.0	350.0	480.0	
Total Fixed Assets	3,617.0	4,164.5	5,089.8	5,575.3	
Investments	1,074.5	1,182.0	1,418.4	1,702.1	
Inventory	2,796.1	3,425.2	3,915.8	4,326.3	
Debtors	1,038.6	1,217.8	1,286.6	1,421.5	
Loans and Advances	2.7	27.8	30.6	0.0	
Other Current Assets	647.0	615.0	615.0	615.0	
Cash	211.5	244.4	389.7	672.9	
Total Current Assets	4,695.9	5,530.2	6,237.8	7,035.7	
Creditors	874.3	908.2	888.0	673.8	
Provisions	19.7	26.6	27.2	27.9	
Total Current Liabilities	894.0	934.8	915.1	701.6	
Net Current Assets	3,801.9	4,595.5	5,322.7	6,334.0	
Others Assets	239.5	239.5	239.5	239.5	
Application of Funds	8,733.0	10,181.5	12,070.3	13,850.9	

Source: Company, ICICI Direct Research

Exhibit 4: Key ratios					
(Year-end March)	FY21P	FY22E	FY23E	FY24E	
Per share data (₹)					
EPS	72.5	267.5	273.3	280.3	
Cash EPS	136.8	333.6	348.3	358.7	
BV	1,144.6	1,398.2	1,630.6	1,868.9	
DPS	0.0	40.1	41.0	42.1	
Cash Per Share	37.4	43.1	68.7	118.7	
Operating Ratios					
EBITDA Margin (%)	13.3	24.6	23.1	21.5	
PBT Margin (%)	8.8	22.1	20.5	19.0	
PAT Margin (%)	6.5	16.5	15.3	14.2	
Inventory days	166.2	135.0	140.0	140.0	
Debtor days	61.7	48.0	46.0	46.0	
Creditor days	33.5	35.0	35.0	35.0	
Return Ratios (%)					
RoE	6.3	19.1	16.8	15.0	
RoCE	5.5	21.1	18.1	15.8	
RoIC	6.5	23.8	20.5	18.8	
Valuation Ratios (x)					
P/E	34.5	9.3	9.1	8.9	
EV / EBITDA	19.4	6.9	6.8	6.7	
EV / Net Sales	2.6	1.7	1.6	1.4	
Market Cap / Sales	2.3	1.5	1.4	1.3	
Price to Book Value	2.2	1.8	1.5	1.3	
Solvency Ratios					
Debt/EBITDA	2.3	0.8	1.0	1.1	
Debt / Equity	0.3	0.2	0.3	0.3	
Current Ratio	5.4	6.1	7.0	10.4	
Quick Ratio	2.2	2.3	2.6	4.0	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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