Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Welspun India Ltd

Weak Q2; Near-term headwinds persist

Consumer Discretionary	Sharekhan code: WELSPUNIND
Reco/View: Hold ↔	CMP: Rs. 77
	Price Target: Rs. 90 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 14.36

Updated Oct 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

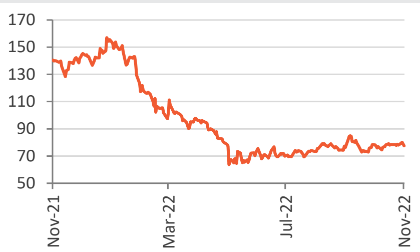
Company details

Market cap:	Rs. 7,648 cr
52-week high/low:	Rs. 160 / 62
NSE volume: (No of shares)	18.5 lakh
BSE code:	514162
NSE code:	WELSPUNIND
Free float: (No of shares)	29.3 cr

Shareholding (%)

Promoters	70.4
FII	7.0
DII	5.6
Others	17.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.1	2.5	21.5	-44.9
Relative to Sensex	-6.3	-0.4	8.7	-45.9

Sharekhan Research, Bloomberg

Summary

- Q2FY2023 was yet another weak quarter for Welspun India Limited (WIL), as revenue fell by 15% y-o-y to Rs. 21,153.5 crore, while EBIDTA margin plunged to 6.1% (vs. 16.5% in Q2FY2022), resulting in a 96% y-o-y decline in PAT to Rs. 8.3 crore.
- Demand is expected to remain muted owing to multiple headwinds such as higher consumer inflation, European energy crisis, and reduced share of discretionary spends. However, margins are likely to remain stable in the near term with softening raw-material and freight costs.
- Medium to long-term growth drivers include scaling up of D2C, domestic branded and e-commerce businesses, and consistent growth in the flooring business.
- We retain Hold with a revised PT of Rs. 90 (valuing at October 2024 earnings). The stock trades at 71x/16x its FY2023E/FY2024E earnings.

Welspun India Limited (WIL) delivered another weak quarter in Q2FY2023 with revenue declining by 15% y-o-y as weak market sentiments impacted demand in the international market. Revenue of the home textile business declined by 15.3% y-o-y, while revenue of the flooring business stood flat at Rs. 159.6 crore. Capacity utilisation for the quarter came in significantly lower on a y-o-y basis at 60% for bath linen, 51% for bed linen, and 58% for rugs and carpets. Gross margin contracted sharply by 473 bps y-o-y to 41.6%, while EBITDA margin fell to 6.1% from 16.5% in Q2FY2022, primarily impacted by the surge in raw-material prices, adverse currency movement, and lower operating leverage. Operating profit declined by 69% y-o-y. In line with the decline in operating profit and higher incidence of tax, reported PAT fell by 96% y-o-y to Rs. 8.3 crore. For H1FY2023, revenue declined by 13.4% y-o-y to Rs. 4,070.7 crore, while adjusted PAT was down by 93% y-o-y at Rs. 29.6 crore and EBITDA margin declined from 18.2% in H1FY2022 to 6.9%. In H1FY2023, the company spent Rs. 194.3 crore towards capex and reduced net debt by Rs. 535 crore.

Key positives

- Domestic retail business registered 31% y-o-y and 16% q-o-q growth.
- Emerging business recorded y-o-y growth of 17% in H1, contributing 33% to total revenue.
- Despite a challenging environment, net debt reduced by Rs. 535 crore in H1FY2023.

Key negatives

- The home textile business declined by 15.3% y-o-y due to weak sentiments across markets.
- Gross margin contracted by 473 bps y-o-y, while EBITDA margin fell to 6.1% from 16.5% in Q2FY2023.
- Capacity utilisation was lower on a y-o-y basis at 60% for bath linen, 51% for bed linen, and 58% for rugs and carpets.

Management Commentary

- Demand is expected to remain muted in the near term, impacted by weak global macro environment, higher consumer inflation, and energy crisis. As per the management, the festive and holiday season is expected to be subdued as inventory has not been cleared up since last year by many retailers. Management also believes that people are focusing on travelling over the purchase of textile products and other discretionary items, leading to reduction in demand.
- Raw-material prices have seen a slowdown and are declining from their peak. Freight costs were up for the fourth time consecutively but are softening currently. Energy crisis in Europe remain an issue. Overall raw-material costs have softened, especially cotton, and the domestic cotton yield is up 7% this year, which will ease demand and bring down commodity prices.
- The company continued its focus on improving its distribution network and brand building. Welspun plans to aggressively open more outlets in Tier 1,2,3,4 cities in India to achieve the goal of 'Har Ghar Welspun'.

Revision in estimates – We have reduced our earnings estimates for FY2023 and FY2024 to factor in the below-par performance in Q2FY2023 and near-term headwinds. We have introduced FY2025 earnings estimates in this note.

Our Call

View: Retain Hold with a revised PT of Rs. 90: Q2FY2023 was another dull quarter with double-digit decline in revenue, while EBIDTA margin came in substantially lower on a y-o-y basis. However, in the long run, market share gains in the home-textile market in the US, higher demand from retail clients of Europe/UK coupled with strong growth in the B2C business will drive WIL's core home-textile business. Emerging business (including flooring) will add substantially to revenue and profitability over the next two to three years. The stock is currently trading at 71.2x/16.1x its FY2023E/FY2024E earnings. Near-term headwinds and expected underperformance in the near term will keep a toll on valuations. We retain Hold with a revised price target (PT) of Rs. 90 (valuing at October 2024 earnings).

Key Risks

Any sustained slowdown in key markets, including the US and Europe, or increased input prices/logistics cost would act as key risks to our earnings estimates in the near term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenue	7,340	9,311	6,861	8,420	10,102
OPM (%)	18.4	14.6	9.2	13.8	14.9
Adjusted PAT	551	607	107	475	706
% Y-o-Y growth	11.8	10.2	-82.3	-	48.7
Adjusted EPS (Rs.)	5.5	6.0	1.1	4.7	7.0
P/E (x)	14.1	12.6	71.2	16.1	10.8
P/B (x)	2.1	1.9	1.9	1.8	1.5
EV/EBIDTA (x)	7.6	7.4	15.2	8.4	6.4
RoNW (%)	16.6	15.9	2.7	11.4	15.1
RoCE (%)	14.4	13.7	3.3	10.0	13.4

Source: Company; Sharekhan estimates

Weak Q2 performance affected by lower sales and dip in margins

WIL's revenue declined by 15% y-o-y to Rs. 2,113.5 crore, impacted by weak demand for home textile products in the US market. Revenue of the home textile business declined by 15.3% y-o-y to Rs. 2,011.4 crore, while revenue of the flooring business stood flat at Rs. 159.6 crore. Gross margin was down by 473 bps y-o-y to 41.6%, while EBITDA margin fell to 6.1% from 16.5% in Q2FY2022, impacted primarily by the surge in raw-material prices, adverse currency movement, and lower operating leverage. Operating profit declined by 69% y-o-y to Rs. 128.5 crore. In line with the decline in operating profit and higher incidence of tax, reported PAT was down by 96% y-o-y to Rs. 8.3 crore. Net debt on books reduced to Rs. 1,998 crore as on September 30, 2022, vs. Rs. 2,533.2 crore as on March 31, 2022. For H1FY2023, revenue declined by 13.4% y-o-y to Rs. 4,070.7 crore, while adjusted PAT fell by 93% y-o-y to Rs. 29.6 crore. EBITDA margin declined from 18.2% in H1FY2022 to 6.9% in H1FY2023. In H1FY2023, the company spent Rs. 194.3 crore towards capex.

Textile business continued to underperform

Revenue of the home textile business declined by 15.3% y-o-y to Rs. 2,011.4 crore in Q2FY2023. Capacity utilisation for bath linen/bed linen/rugs and carpets stood at 60%/51%/58% in Q2FY2023 as against 95%/100%/99% in Q2FY2022 and 54%/52%/60% in Q1FY2023. EBITDA margin for the segment declined to 6.3% in Q2FY2023 from 17.4% in Q2FY2022. Capacity expansion at Vapi and Anjar was operationalised in H1FY2023.

Flat quarter for the flooring business

Revenue of the flooring business stood flat y-o-y at Rs. 159.6 crore in Q2FY2023. Capacity utilisation for the flooring business stood at 31% in Q2FY2023, slightly up from 30% in Q2FY2022 and down from 37% in Q1FY2023. The flooring business reported EBITDA margin of 26.3% in Q2FY2023 against 2.8% in Q2FY2022, aided by operating efficiencies. The flooring business witnessed good demand build-up in India within commercial as well as institutional segments, with its domestic market sales having crossed the double-digit mark in Q2.

Strong growth in the advanced textile business

The advanced textile business registered revenue of Rs. 97.5 crore during Q2FY2023 against Rs. 67.4 crore in Q2FY2022, registering 44.7% y-o-y growth.

Key conference call highlights:

- **Demand expected to remain muted:** The global business (USA, UK, and Europe) continued to see muted demand due to weak global macro environment. Interest rate hikes in the US also affected the company's performance. In UK and Europe, energy crisis and inflation at 8-9% is expected to put pressure on consumer discretionary goods, which in turn would reduce demand. As per management, the festive and holiday season is expected to be subdued as inventory has not been cleared up since last year by many retailers. Management believes people are focusing on travelling over the purchase of textile products and other discretionary items.
- **Raw-material issue improving:** Raw-material prices have seen a slowdown and are declining from their peak. Cotton, which had touched highs in the previous quarters, has softened from Rs. 80,000 per candy to Rs. 40,000 per candy in H1. Freight costs were up for the fourth time consecutively but are softening currently. Energy crisis in Europe remains an issue. Overall, raw-material costs have softened, especially cotton and the domestic cotton yield is up 7% this year, which will ease the demand and bring down commodity prices.
- **Focus on distribution and marketing:** The company successfully operates 10,000+ outlets in the country, which is almost double from last year. The company will aggressively open more outlets in Tier 1,2,3,4 cities in India to achieve the goal of 'Har Ghar Welspun'. 15% of the overall business of Welspun will come from the domestic business. The company has brought on board Akshay Kumar as the brand ambassador of the company and to help the company to achieve its goal. Management has guided that Welspun will continue to invest in the growth market and expand its leadership. The company's marketing spends reflect the same being 10.5% of domestic revenues during Q2.
- **India business margin to improve:** The company's margins were affected by the global macro-economic environment. The company's domestic (India) EBITDA was positive, and the company believes the domestic business can generate historical margins in the coming quarters compared with the global business.
- **Debt reduction continued:** Net debt stood at Rs. 1,998 crore as on September 30, 2022, vs. Rs. 2,533.2 crore as on September 30, 2021, a y-o-y reduction of Rs. 535.2 crore. Net debt excluding the flooring business stood at Rs. 1,099.4 crore as on September 30, 2022, vs. Rs. 1,769.9 crore as on September 30, 2021, a y-o-y reduction of Rs. 670.5 crore.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Total Revenue	**2,113.5**	**2,487.6**	**-15.0**	**1,957.3**	**8.0**
Raw-material cost	1,234.8	1,335.8	-7.6	1,145.6	7.8
Employee cost	201.4	235.9	-14.6	193.3	4.2
Other expenses	548.7	505.9	8.4	466.5	17.6
Total operating cost	1,984.9	2,077.7	-4.5	1,805.4	9.9
Operating profit	**128.5**	**410.0**	**-68.7**	**151.8**	**-15.3**
Other income	23.1	13.8	68.1	21.7	6.4
Interest and other financial cost	28.4	35.3	-19.5	32.3	-12.1
Depreciation	109.5	105.2	4.1	104.9	4.4
Profit Before Tax	**13.7**	**283.3**	**-95.2**	**36.3**	**-62.2**
Tax	5.5	81.7	-93.3	15.0	-63.5
Adjusted PAT before MI	8.3	201.6	-95.9	21.3	-61.2
Minority Interest (MI)/ Profit from associates	0.0	-0.1	-100.0	0.1	-100.0
Adjusted PAT after MI	8.3	201.5	-95.9	21.4	-61.3
Reported PAT	**8.3**	**201.5**	**-95.9**	**21.4**	**-61.3**
Adjusted EPS (Rs.)	0.1	2.0	-95.9	0.2	-61.2
			Bps		bps
GPM (%)	41.6	46.3	-473	41.5	11
OPM (%)	6.1	16.5	-1040	7.8	-168
NPM (%)	0.4	8.1	-771	1.1	-70
Tax rate (%)	39.9	28.8	-	41.3	-145

Source: Company, Sharekhan Research

Business-wise revenue Rs cr

Segments	Q2FY23	Q2FY22	y-o-y %	Q1FY23	q-o-q %
Home Textile - B2B	1,315	1,686	-22.0	1,097	19.9
Home Textile - Branded	199	196	1.5	316	-37.0
Home Textile - E-commerce	102	146	-29.7	84	22.2
Total - Home Textile	**1,616**	**2,027**	**-20.3**	**1,496**	**8.0**
Advance Textile	**98**	**67**	**44.7**	**90**	**8.6**
Flooring - B2B	113	131	-13.6	135	-16.3
Flooring - Branded	30	15	102.7	22	36.1
Total - Flooring	**143**	**146**	**-1.9**	**157**	**-9.0**

Source: Company, Sharekhan Research

Business-wise operations

Particulars	Units	Capacity	Q2FY23 (Prodn.)	Utilisation (%)	Q2FY22 (prodn.)	Utilisation (%)	Q1FY23 (Prodn.)	Utilisation (%)
Home Textile								
Bath Linen	MT	90,000	13,538	60	19,769	95	11,632	54
Bed Linen	Mn mtrs	108	13.9	51	23.9	100	14	52
Rugs and Carpets	Mn sq mtrs	12.0	1.7	58	2.7	99	1.8	60
Advance Textile								
Spunlace	MT	27,729	2,438	35	1,706	82	2,386	34
Needle Punch	MT	3,026	316	42	343	54	246	32
Wet wipes	Mn packs	100	6.0	24	4.9	33	5.0	20
Flooring	**Mn sq mtrs**	**18**	**1.4**	**31**	**1.4**	**30**	**1.5**	**37**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Near-term outlook weak; Medium-long term prospects remain strong

The near-term outlook of the home textile industry is weak because of multiple headwinds such as high input prices, sustaining logistics issues, increased consumer inflation, and geopolitical tensions due to Russia-Ukraine issue. Thus, companies in this space are expected to deliver weak performance for the next two-three quarters. However, in the medium-long term, the Indian home textile sector is expected to gain market share, aided by increased demand due to higher focus on home hygiene post the pandemic environment, China +1 factor, and India entering trade tie-ups with key countries. Top players such as WIL and HSL have expanded their capacities for bed linen/terry towel, sensing to fulfil strong demand coming in from key markets because of higher spends on hygiene products and customers looking at India as an alternate supply base.

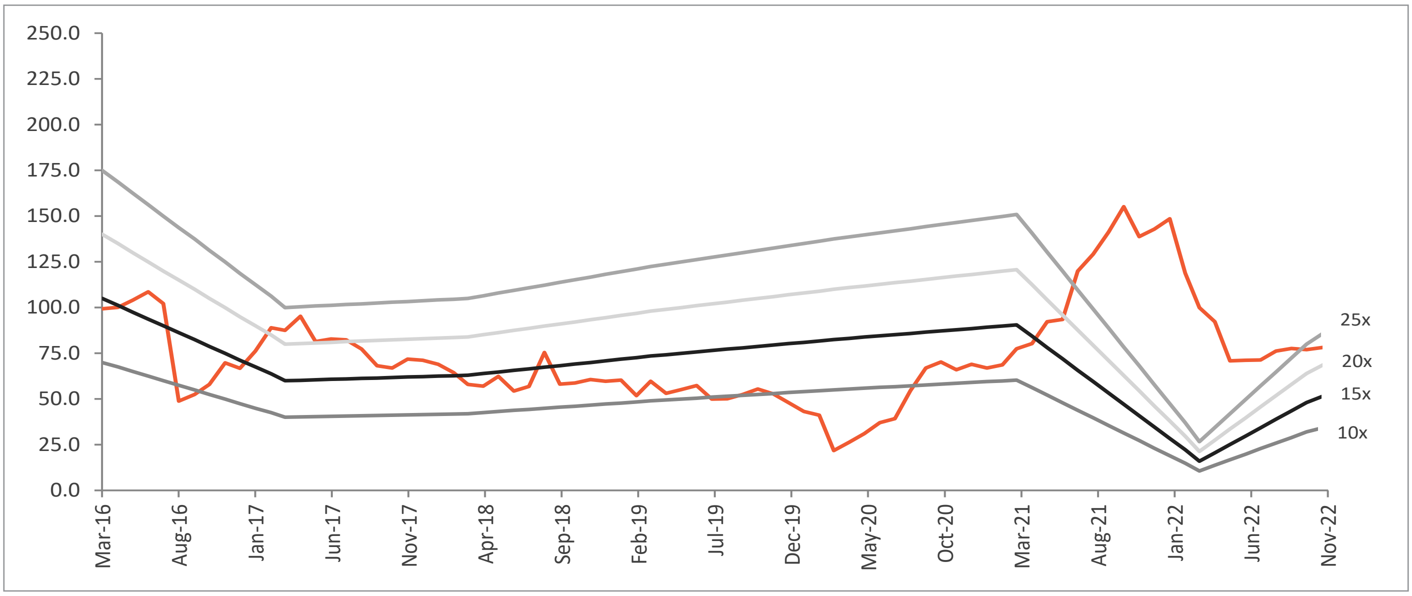
■ Company outlook - Multiple headwinds to impact near term performance

WIL's Q2FY2023 performance was weak, as subdued demand environment impacted revenue growth, while margins were affected by lower operating leverage. The near-term sentiment is expected to be weak due to logistical challenges, unseen levels of increased commodity prices, and Ukraine-Russia conflict. However, in the medium-long term, the company expects to maintain strong revenue growth, driven by sustained good demand for home textile products in the US market and scale up in the advance textile, flooring, and branded businesses. Margins are expected to stablise in the near term with softening of cotton and yarn prices coupled with reducing freight cost.

■ Valuation - Retain to Hold with a revised PT of Rs. 90

Q2FY2023 was another dull quarter with double-digit decline in revenue, while EBIDTA margin came in substantially lower on a y-o-y basis. However, in the long run, market share gains in the home-textile market in the US, higher demand from retail clients of Europe/UK coupled with strong growth in the B2C business will drive WIL's core home-textile business. Emerging business (including flooring) will add substantially to revenue and profitability over the next two to three years. The stock is currently trading at 71.2x/16.1x its FY2023E/FY2024E earnings. Near-term headwinds and expected underperformance in the near term will keep a toll on valuations. We retain Hold with a revised price target (PT) of Rs. 90 (valuing at October 2024 earnings).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
KPR Mill	22.1	19.7	16.7	15.9	12.9	10.8	31.0	27.7	28.0
Himatsingka Seide	6.9	5.1	2.8	7.0	5.7	4.0	8.7	10.2	14.5
Welspun India	12.6	71.2	16.1	7.4	15.2	8.4	13.7	3.3	10.0

Source: Company; Sharekhan Research

About company

WIL, a Welspun Group company, started its activities in 1985 as Welspun Winilon Silk Mills Private Limited, a synthetic yarn business, which went on to become Welspun Polyesters (India) Limited and, finally, Welspun India Limited emerged in 1995. The company offers a variety of products such as towels in different sizes and qualities, bed sheets using state-of-the-art technology, and the best quality of Egyptian cotton. WIL is Asia's largest and is among the top four terry towel producers in the world (number one player in the US). The company's business is spread across continents and has a distribution network in 50+ countries, such as US, UK, Canada, Australia, Italy, Sweden, and France. About 95% of the total products are exported.

Investment theme

WIL is one of the leading players in the global textile market with capacities of 85,400 metric tonne (MT) and 90 million metres of terry towels and bed linen, respectively, largely catering to export markets. The company will benefit from recovery in the US, where it has a market share of 19% and 13% in the terry towel and bed sheets segments, respectively. New ventures such as flooring business and advanced textile revenue would add on to revenue in the near to medium term. This along with benign cotton prices and enhanced revenue mix would aid in improving profitability consistently in the near to medium term. Better cash flows would aid the company to reduce debt on books over FY2022-FY2024.

Key Risks

- **Decline in revenue of key exporting markets:** Any decline in the revenue of key exporting markets such as US and Europe due to change in the trade policy, slowdown in the macro environment, or increased competition from other international players would be key risks to our earnings estimates.
- **Unfavourable currency movement:** About 95% of WIL's revenue comes from export markets such as US and Europe. Hence, any adverse currency movement would act as a key risk to revenue growth.
- **Increased cotton prices:** Any significant increase in global cotton prices (including Egypt) would act as a key risk to profitability.

Additional Data

Key management personnel

Balkrishan Goenka	Chairman
Rajesh Mandawewala	Executive Director and MD
Dipali Goenka	CEO-MD
Sanjay Gupta	Chief Financial Officer
Shashikant Thorat	Company Secretary and Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.66
2	Infinity Holdings	1.28
3	Bhanshali Akash	1.07
4	Vanguard Group Inc..	1.04
5	L & T Mutual Fund Trustee India	1.00
6	Dimensional Fund Advisors LP	0.76
7	Aditya Birla Sun Life AMC	0.48
8	Blackrock Inc.	0.40
9	Norges Bank	0.37
10	State Street Corp.	0.20

Source: Bloomberg

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

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