Welspun India Ltd

Mixed Q3; full-fledged recovery still some time away

Consumer Discretionary	Sharekhan code: WELSPUNIND
Reco/View: Hold ↔	CMP: Rs. 67
	Price Target: Rs. 75 ↓

↑ 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 Dec 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. 6,620 cr
52-week high/low:	Rs. 146 / 62
NSE volume: (No of shares)	11.3 lakh
BSE code:	514162
NSE code:	WELSPUNIND
Free float: (No of shares)	29.3 cr

Shareholding (%)

Promoters	70.4
FII	6.5
DII	6.1
Others	17.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-10.9	-11.3	-10.5	-57.1
Relative to Sensex	-2.2	-2.7	2.4	4.0

Sharekhan Research, Bloomberg

Summary

- Welspun India (WIL) registered a mixed bag show in Q3FY2023 with revenues declining by 23% (affected by lower export demand) while gross margins improved by 481 bps y-o-y to 48.8% led by decline in the cotton prices (OPM improved by 434 bps q-o-q to 10.4%).
- Core home textile business is impacted by higher inventories with global retailers due to lesser offtake in the inflationary environment. The same is expected to come back on track by Q2FY2024.
- Domestic consumer business (to grow at CAGR of 30-35%) and emerging businesses such as advance materials and flooring are expected to scale-up fast in the coming years. EBIDTA margins will sequentially improve, while on a y-o-y basis might remain lower due to muted sales volumes.
- Stock is currently trading at 13.1x/9.0x its FY2024E/25E earnings. In view of near term pressure on the core home textile exports business, we retain a Hold rating with a revised PT of Rs. 75.

Welspun India Limited (WIL) delivered mixed performance with revenues declining by ~23% y-o-y impacted by slowdown in the export markets while gross margins improved by 481 bps y-o-y to 48.8% on back of decline in the cotton prices. EBIDTA margins were down by 243 bps y-o-y to 10.4%, while it improved by 434 bps on a sequential basis due to fall in the cotton prices and decline in the international freight cost. The operating profit grew by 37% y-o-y to Rs. 194 crore. This along with higher interest cost led to 67% y-o-y decline in the reported PAT to Rs. 43.8 crore. Capacity utilisation for the quarter came in lower on a y-o-y basis at 72% for bath linen, 47% for bed linen, and 51% for rugs and carpets. For 9MFY2023, revenue declined by 16.6% y-o-y to Rs. 5,939.9 crore, while adjusted PAT was down by 87% y-o-y at Rs. 73.5 crore (EBITDA margin declined from 16.4% in 9MFY2022 to 8.0% in 9MFY2023). The company did capex of Rs. 239.1 crore in 9MFY2023 (will do capex of Rs. 20-25 crore in in Q4FY2023).

Key positives

- Domestic consumer business registered Rs. 150 crore revenues in Q3 (highest ever in any quarter); Year to date business revenues grew by 39% to Rs. 428 crore.
- Branded business crossed $100 million in revenues in Q3; branded business contribution has gone-up to 22% in 9MFY2023 from 15% in FY2022.
- EBIDTA improved by 434 bps q-o-q to 10.4% led by decline in the cotton prices and freight cost.
- Net Debt reduced to Rs. 1,909.2 crore from Rs. 2,542.0 crore in Q3FY2022.

Key negatives

- The home textile business declined by 22% y-o-y due to weak demand in export markets.
- Flooring business revenues was down by 12% y-o-y to Rs. 168.4 crore.
- Interest expenses were up by 78% y-o-y to Rs. 37 crore due to increase in the cost of debt.

Management Commentary

- The company's core business is impacted due to challenging global macro-economic environment and high consumer inflation leading to demand slowdown across markets. Due to lower demand, company's capacity utilisation for Q3FY2023 is lower y-o-y in all the segments at 72%/47%/51% for bath linen/bed linen/rugs and carpets from 88%/99%/70% in Q3FY2022.
- The company expects global demand to recover by Q2FY2024 as inventory with retailers is expected to liquidate (replenishment demand is ~80% of the total demand) in the coming months with inflation expected to cool-off. In the long run, with the likely free trade agreement with UK, the company expects higher opportunities in the UK and EU market. India is considered as one of the stable source of supply by some of the international retailers and expect higher demand from some of the key markets in the coming years.
- Domestic consumer business is expected to scale-up fast and expected to grow at CAGR of 30-35% and is likely to reach Rs. 1,700 crore by FY2026. Other emerging businesses such as advance material and flooring business are expected to grow faster in the coming years.
- The company has signed licensing agreement with Disney, Marvel and Lucas valid across whole UK & EU region which will create additional revenue streams for the company across different segments.
- With cotton and freight costs reducing, the company expects the EBIDTA margins to improve sequentially in the coming quarters. The margin expansion will be higher once emerging and branded business attain certain scale in the coming years.

Revision in estimates – We have broadly maintained our earnings estimates for FY2023, FY2024 and FY2025 as Q3 operating performance was better than our expectation.

Our Call

View: Retain Hold with a revised PT of Rs. 75: WIL's near-term performance is affected by weak demand in the international markets and higher inventory piled with global retailers. The export demand will take another to quarters to revive, while domestic consumer business and branded business will continue its strong run on a low base. WIL is creating strong growth drivers (domestic consumer business, global branded business, flooring business and advance material business) to achieve consistent growth in the long run. The stock has corrected from its high and is trading at 13.1x/9.0x its FY2024E/25E earnings. In view of near term stress on the core home textile export business, we maintain our Hold recommendation on the stock with a revised price target of Rs. 75.

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	7,708	9,278	10,899
OPM (%)	18.4	14.6	8.8	13.7	14.7
Adjusted PAT	551	607	109	505	735
% Y-o-Y growth	11.8	10.2	-82.0	-	45.5
Adjusted EPS (Rs.)	5.5	6.0	1.1	5.0	7.3
P/E (x)	12.2	10.9	60.9	13.1	9.0
P/B (x)	1.8	1.7	1.7	1.5	1.3
EV/EBIDTA (x)	6.8	6.6	13.0	7.0	5.4
RoNW (%)	16.6	15.9	2.7	12.1	15.6
RoCE (%)	14.4	13.7	3.9	11.1	14.3

Source: Company; Sharekhan estimates

Weak Q3 – Revenue down by 23% y-o-y; EBITDA margin declined by 243 bps y-o-y

Revenues declined by 23% y-o-y to Rs. 1,869.2 crore due to soft demand conditions in the international market. Home textile business revenue declined by 22% y-o-y while flooring business revenue declined by 12% y-o-y. Gross margins improved by 481 bps y-o-y to 48.8% while EBITDA margin dropped by 243 bps to 10.4% from 12.8% in Q3FY2022 impacted lower margins in the flooring business and lower sales volume in the home textile business. Operating profit declined by 37.3% y-o-y to Rs. 194.7 crore. In line with decline in operating profit coupled with higher interest costs, reported PAT was lower by 66.6% y-o-y to Rs. 43.8 crore. Net debt on books reduced to Rs. 1,909 crore as on December 31, 2022, versus Rs. 2,533.2 crore as on March 31, 2022. In 9MFY2023, the company spent Rs. 239.1 crore towards capex.

Weak Q3 for textile business

Revenue of the home textile business declined by 21.9% y-o-y to Rs. 1,758 crore in Q3FY2023. Capacity utilisation for bath linen/bed linen/rugs and carpets stood at 72%/47%/51% in Q3FY2023 as against 88%/99%/70% in Q3FY2022 and 60%/51%/58% in Q2FY2023. EBITDA margins for the segment declined to 11.7% in Q3FY2023 from 13.9% in Q3FY2022.

Flooring business underperformed in Q3

The flooring business revenue declined by 11.8% y-o-y to Rs. 168 crore in Q3FY2023. Capacity utilisation for the flooring business stood at 30% in Q3FY2023 versus 38% in Q3FY2022 and 31% in Q2FY2023. The flooring business reported EBITDA margins of 1.8% in Q3FY2023 against 5.4% in Q3FY2022.

Double-digit growth in the advanced textile business

The advanced textile business registered revenue of Rs. 76 crore in Q3FY2023 against Rs. 63 crore in Q3FY2022, registering 20.8% y-o-y growth.

Key Conference call takeaways

- **Core business recovery expected in latter part of H1FY2024 or in H2FY2024 –** The company's core business is impacted due to challenging global macro-economic environment and high consumer inflation leading to demand slowdown across markets. Due to lower demand, company's capacity utilisation for Q3FY2023 is lower y-o-y in all the segments at 72%/47%/51% for bath linen/bed linen/rugs and carpets from 88%/99%/70% in Q3FY2022. The management indicated that the offtake in bath linen is better than the bed linen as ticket size is lesser. Welspun has also lost market share to China & Pakistan during the quarter. The company expects recovery in the global demand by Q2FY2024 as the inventory with the retailers is expected to liquidate (replenishment demand is ~80% of the total demand) in the coming months with inflation expected to cool-off. In the long run, the likely free trade agreement with UK, the company expects higher opportunities in the UK and EU market. India is considered as one of the stable source of supply by some of the international retailers and expect higher demand from some of the key markets in the coming years.
- **Emerging business gaining momentum –** Out of the emerging businesses, retail, advanced textile and flooring businesses recorded y-o-y growth of 19% in 9MFY2023, contributing 19% of total sales in 9MFY23. With the scale up in these businesses, the company expects the profitability to also improve in the coming quarters.

- **Domestic consumer business on strong growth trajectory –** Domestic consumer business achieved its highest quarterly sales in Q3FY2023 through its two major brands of Welspun and Spaces. Welspun has an addressable market size of Rs. 48,000 crore across sheets, towels, rugs & carpets, while the addressable market for Spaces is at Rs. 2,000-3,000 crore across the same categories. Welspun is the most distributed brand in the country and the company targets to expand its reach to 50,000 stores by FY26 from over 10,600 stores currently. The share of domestic consumer business to Welspun's revenue has more than doubled from 3.1% in FY2021 to ~8% in Q3FY2023. The management has indicated that the company targets revenue to reach Rs. 1,700 core by FY2026, registering a 30-35% CAGR in next 2-3 years.

- **Flooring business performance stands out across markets –** In India, flooring business witnessed good demand for hard flooring from institutional and hospitality players and the company expects this momentum to continue in the quarters ahead. The company has also witnessed good demand in the Middle East and South East Asia during the quarter. However, the demand was muted in US & UK due to slower housing demand in these regions. The management expects demand in US & UK to improve in a couple of quarters with improvement in the housing demand.

- **Licensing agreement with Disney a good opportunity –** The company has signed licensing agreement with Disney, Marvel and Lucas valid across whole UK & EU region which will create additional revenue streams for the company across different segments. The licensing agreement opens more doors for Welspun in terms of retailers and also widen the company's target audience (enter the market for kids, infants and youngsters through fast fashion products such as Disney towels, bedsheets, etc).

- **Margins to improve sequentially –** As stated by the management, cotton & container prices have started to correct recently. The average cotton prices in Q3FY2023 stood at Rs. 69,000 per candy, down from Rs. 83,000 per candy in Q2FY2023. The current price of cotton is lower at Rs. 62,000 per candy and the management expects the prices to correct further with new cotton crop. Average freight cost for the quarter stood at $5,300 per tonne, down from USD 9,000 per tonne in Q2FY2023, while the current rate is even lower at $3,500 per tonne.

- **Debt reduction continued in Q3FY2023 -** Net debt stood at Rs. 1,909 crore as on December 31, 2022, vs. Rs. 2,542 crore as on December 31, 2021, a y-o-y reduction of Rs. 633 crore. Net debt excluding the flooring business stood at Rs. 1,013 crore as on December 31, 2022, versus Rs. 1,774 crore as on December 31, 2021, a y-o-y reduction of Rs. 762 crore. As indicated by the management, the company repaid term load of Rs. 46 crore in Q3FY2023. The average cost of debt for Q3FY2023 stands higher at 5.5% due to overall increase in the interest rates.

- **Capex spends on track –** The company spend Rs. 239 crore in 9MFY23. For full year FY2023, the management has indicated that it would be spending ~Rs. 250-260 crore while for FY2024, the company is expected to spend ~Rs. 200 crore on capacity addition in the power plant and another Rs. 150 crore as maintenance capex, taking the total capex spends at Rs. 350 crore.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	y-o-y (%)	Q2FY23	q-o-q (%)
Total Revenue	**1,869.2**	**2,418.2**	**-22.7**	**2,113.5**	**-11.6**
Raw material cost	956.6	1,353.9	-29.3	1,234.8	-22.5
Employee cost	199.5	220.4	-9.5	201.4	-1.0
Other expenses	518.4	533.2	-2.8	548.7	-5.5
Total operating cost	1,674.4	2,107.4	-20.5	1,984.9	-15.6
Operating profit	**194.7**	**310.7**	**-37.3**	**128.5**	**51.5**
Other income	34.9	19.8	76.7	23.1	50.9
Interest & other financial cost	36.9	20.8	77.5	28.4	30.1
Depreciation	114.2	106.7	7.0	109.5	4.2
Profit Before Tax	**78.5**	**203.0**	**-61.3**	**13.7**	**-**
Tax	34.7	36.0	-3.6	5.5	-
Adjusted PAT	43.8	167.0	-73.7	8.3	-
Extra-ordinary items	0.0	-35.9	-	0.0	-
Reported PAT	43.8	131.1	-66.6	8.3	-
Adjusted EPS (Rs.)	**0.4**	**1.7**	**-73.8**	**0.1**	**-**
			bps		bps
GPM (%)	48.8	44.0	481	41.6	725
OPM (%)	10.4	12.8	-243	6.1	434
NPM (%)	2.3	6.9	-456	0.4	195
Tax rate (%)	44.2	17.7	-	39.9	432
Tax rate (%)	39.9	28.8	-	41.3	-145

Source: Company, Sharekhan Research

Business-wise revenue Rs cr

Segments	Q3FY23	Q3FY22	y-o-y %	Q2FY23	q-o-q %
Home Textile - B2B	1,068	1,581	-32.4	1,315	-18.7
Home Textile – branded	236	262	-9.8	199	18.9
Home Textile - e-commerce	99	104	-5.4	102	-3.7
Total - Home Textile	**1,403**	**1,948**	**-28.0**	**1,616**	**-13.2**
Advance Textile	**76**	**63**	**20.8**	**98**	**-21.9**
Flooring - B2B	115	156	-26.2	113	1.4
Flooring – branded	40	22	84.8	30	34.6
Total - Flooring	**155**	**177**	**-12.6**	**143**	**8.3**

Source: Company, Sharekhan Research

Business-wise operations

Particulars	Units	Capacity	Q3FY23 (Prodn.)	Utilisation (%)	Q3FY22 (prodn.)	Utilisation (%)	Q2FY23 (prodn.)	Utilisation (%)
Home Textile								
Bath Linen	MT	90,000	16,279	72	18,387	88	13,538	60
Bed Linen	Mn mtrs	108	12.6	47	22.3	99	13.9	51
Rugs & Carpets	Mn sq mtrs	12.0	1.5	51	2.1	70	1.7	58
Advance Textile								
Spunlace	MT	27,729	2,564	37	1,576	80	2,438	35
Needle Punch	MT	3,026	283	37	326	53	316	42
Wet wipes	Mn packs	100	6.0	24	5.0	34	6.0	24
Flooring	Mn sq mtrs	18.0	1.4	30	1.7	38	1.4	31

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.

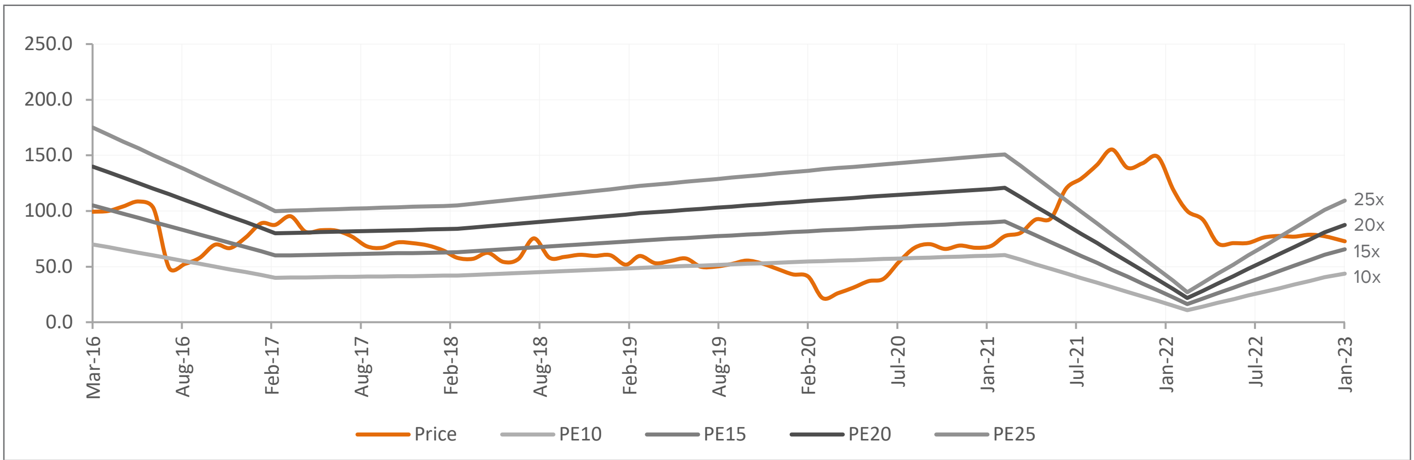
■ Company Outlook – Multiple headwinds to impact near term performance

Q3 performance was mixed, as subdued demand environment impacted revenue growth, while margins improved sequentially due to decline in the cotton prices and freight cost. The near-term performance is expected to be weak due to inflationary pressure impacting demand in the key exports market. 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 reducing freight cost.

■ Valuation – Retain to Hold with a revised PT of Rs. 75

WIL's near-term performance is affected by weak demand in the international markets and higher inventory piled with global retailers. The export demand will take another to quarters to revive, while domestic consumer business and branded business will continue its strong run on a low base. WIL is creating strong growth drivers (domestic consumer business, global branded business, flooring business and advance material business) to achieve consistent growth in the long run. The stock has corrected from its high and is trading at 13.1x/9.0x its FY2024E/25E earnings. In view of near term stress on the core home textile export business, we maintain our Hold recommendation on the stock with a revised price target of Rs. 75.

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	21.0	21.8	17.7	15.1	13.9	11.2	31.0	24.3	26.1
Himatsingka Seide	4.9	-	10.7	6.5	19.7	7.4	8.7	0.5	6.6
Weslpun India	10.9	60.9	13.1	6.6	13.0	7.0	13.7	3.9	11.1

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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.74
2	Infinity Holdings	1.28
3	Bhanshali Akash	1.07
4	Vanguard Group Inc	1.02
5	L & T Mutual Fund Trustee India	1.00
6	Dimensional Fund Advisors LP	0.77
7	Aditya Birla Sun Life AMC	0.48
8	Blackrock Inc	0.42
9	Norges Bank	0.37
10	Nippon Life India AMC	0.26

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

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by BNP PARIBAS

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