Nandan Denims

28 November 2014

Road-show Update

Reuters: NANE.BO; Bloomberg: NAND IN

Nandan Denims (NDL) is the second-largest textile company in India and is part of Chiripal Group, a leading business conglomerate. The company commenced its operations in 1994 with textile trading and forayed into textile manufacturing in 2004. The company which is located in Gujarat – textile hub of India - is the largest exporter of denim fabric cottons etc. The company manufactures denim, cotton fabrics and khaki cloth. It also has fully integrated facilities for manufacturing a range of products viz. woven fabrics, circular knitted fabrics, polar fleece fabrics, cotton hosiery, denim, etc. We did a road-show with Mr. Deepak Chiripal, director, and Mr. Govind Sharda, president of NDL recently to know the company's business plans and prospects. Key highlights are as follows:

- NDL has one of the largest denim fabric manufacturing capacities in the world and will be second-largest in India with denim capacity of 110mn metres per annum or mmpa (post expansion) after Arvind, which has a capacity of 130mmpa. Aarvee Denim is the third-largest with a capacity of 85mmpa in India followed by Sudarshan Jeans with a capacity of 70mmpa followed by Etco Denim and Jindal Worldwide with a capacity of 50mmpa each.
- NDL was set up with a focus on the domestic market with products launched being priced in the mid-segment, unlike Arvind whose sole purpose is to cater to export markets.
- Currently, ~90% of the company's sales come from domestic market and the rest from export markets.
- With the rise in challenges for Chinese manufacturers like increased employee costs, rise in power costs, unfavorable cotton policy (higher MSP or minimum sales price on domestic cotton leading to a fall in production), environmental concerns etc, Chinese manufacturers have slowed down denim production. On the other hand, NDL plans to increase its exports from 10% currently to ~30% in the next three years so as to fill the vacuum created by Chinese players.
- NDL has chalked out capacity expansion in denim fabric, spinning and shirting segments. The total capex requirement stands at Rs6,120mn, which will be funded with a D/E ratio of 2.4:1.
- **Phase I expansion:** a) Expansion of denim fabric capacity will help the company to increase its domestic market share as well as diversify its operations on a global scale through a rising share of exports, b) Addition of new shirting capacity to further diversify its operations, and c) Capex incurred stands at Rs2,069mn.
- **Phase II expansion:** a) Expansion of spinning capacity to support the increased denim fabric capacity of 110mmpa, b) Backward integration through spinning capacity expansion will help the company to improve operating flexibility and margins, and c) Incremental capex to be incurred stands at Rs4,051mn.
- NDL plans to backward integrate by expanding its spinning capacity from 64tpd (tonne per day) to 124tpd in FY15E-FY16E. This backward integration will result in savings of Rs5/kg to the company or ~10%-15% savings compared to purchase of yarn from the market, leading to higher operating margin and improved return ratios.
- NDL is going for all-round aggressive expansion of its existing facilities so as to avail the benefits laid out by Gujarat government. These benefits include: Gujarat textile policy**:** 5% (7% - spinning facility) interest subsidy and power subsidy @ Rs1/unit for five years, value added tax or VAT/entry tax reimbursement for eight years and 100% stamp duty reimbursement.
- TUFS (Central government textile policy): 5% interest subsidy and capital subsidy of 10% for processing capacity and 15% for looms for period of seven years. NDL is entitled to a 5% interest subsidy and a 15% capital subsidy for period of seven years.
- As per rules framed under the Gujarat government textile policy, NDL is entitled for VAT refund only on the machinery excluding land and other costs. Thus, out of Rs6,120mn, NDL will enjoy the benefit of VAT refund of Rs4500mn.

NOT RATED

Sector: Textile

CMP: Rs46

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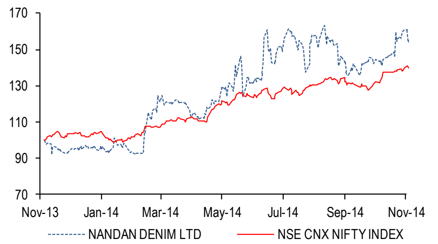
Key Data

Current Shares O/S (mn)	45.5
Mkt Cap (Rsbn/US$mn)	2.1/33.9
52 Wk H / L (Rs)	52/23
Daily Vol. (3M NSE Avg.)	273,593

One-Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Nandan Denim	5.9	23.0	55.3
Nifty Index	5.8	15.9	39.4

Source: Bloomberg

Exhibit 1: Financials

Y/E March (Rsmn) cons.	FY10	FY11	FY12	FY13	FY14
Revenue	3,758	5,074	5,738	7,031	8,938
YoY (%)	*18.2*	*35.0*	*13.1*	*22.5*	*27.1*
EBITDA	576	679	826	1,069	1,327
EBITDA (%)	*15.3*	*13.4*	*14.4*	*15.2*	*14.8*
Reported PAT	116	174	188	311	393
FDEPS (Rs)	2.5	3.8	4.1	6.8	8.6
YoY (%)	*NA*	*49.7*	*8.3*	*65.3*	*26.6*
RoE (%)	*9.5*	*12.7*	*12.3*	*18.1*	*19.7*
RoCE (%)	*5.7*	*7.4*	*9.0*	*12.2*	*10.8*
RoIC (%)	*5.5*	*7.2*	*8.8*	*11.9*	*10.4*
P/E (x)	18.1	12.1	11.2	6.7	5.3
P/B (x)	1.6	1.4	1.3	1.1	1.0
EV/EBITDA (x)	8.2	6.3	5.4	5.2	4.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Capacity expansion plan

Capacity	FY13	F14 – Phase I		FY15E-FY16E – Phase II	
	Year -end	Addition	Year-end	Addition	Year-end
Spinning (tpd)					
Open-end spinning	38	6	44	40	84
Ring spinning	16	4	20	20	40
Fabric (mmpa)					
Denim	71	39	110*	-	110*
Shirting	-	10	10	-	10

*Note: *Ongoing expansion*

Source: Company, Nirmal Bang Institutional Equities Research

- NDL plans to backward integrate by expanding its spinning capacity from 64tpd to 124tpd in FY15E-FY16E once the denim capacity increases from 71mmpa to 110mmpa. With the backward integration in place, the average cost of raw materials stands at Rs150/kg compared to Rs170/kg when outsourced from the open market. This backward integration will result in savings of ~10%-15% compared to purchase of yarn from the market, resulting in higher operating margin and improved return ratios.
- The company is expected to post a revenue of Rs5,000mn from a capex of Rs6,120mn. To manufacture one metre of fabric, 0.5-0.6kg of yarn is required. Therefore, the additional capacity of ~30mmpa will result in savings of Rs32mn at the operating level. These additional savings will increase operating margin of the added capacity in the range of 23%-24%. Operating margin in FY14 stood at 15%. Thus, the blended operating margin is expected to be 18%-19%. The management has not included any benefit of VAT refund on the same. With the interest subsidy, PAT will also witness an exorbitant jump from 4%-5% to 7%-8% from FY17E onwards.
- As per management, the upfront expansion capex of Rs6,120mn is at financing cost of only 1% - 3% (post State and Central government interest subsidies). Of this Rs6,120mn, the company has already spent Rs2,500mn and the balance will be spent by March 2016.
- Break-up of total cost, which stands at 85% of the total revenue: Raw-material costs: 70%, Manpower costs: 5%, Power costs: 5%, Selling overheads: 5%.
- As per management guidance, NDL is targeting revenue of Rs13.5bn in FY17E against Rs8.9bn in FY14, a CAGR of 14.9%. With all the benefits in place, EBITDA margin is expected to improve from 15.0% in FY14 to 19.7% in FY17E and PAT margin from 4.4% in FY14 to 7.6% in FY17E. With the completion of capacity expansion, the management expects return ratios to improve - RoE/RoCE of 19.7%/10.8%, respectively, in FY14 to 30.7%/17.3%, respectively, after the completion of phase II expansion, i.e. by FY17E.
- As per the management, NDL is increasing its focus on value-added products. The contribution of value-added products stands at 10%, which is expected to increase to ~30% in the next three years. As per the management, this will improve average realisation, which currently stands at Rs120/metre.

- In the next three years, the product mix will stand at 1/3rd (exports), 1/3rd (value addition) and 1/3rd (mass products).
- NDL has four-seven distributors per city.
- Working capital cycle stands at three months.
- Cotton inventory ranges from one month to four months, depending on the availability of cotton. As per the management, coarse counts in cotton are required to manufacture denim which is available throughout the year.
- Finished goods inventory is of 15 days.
- NDL has debt of Rs4,300mn, of which Rs1,100mn comprises long-term debt and the rest is working capital. The company expects peak debt in the range of Rs6,300mn-Rs6,500mn by FY17E.
- The company aligns its production to demand every month.
- Global denim capacity stands at 180.0bn metres. Out of this, China has 18.0bn capacity and India has 1.2bn capacity. India exports 300mn metres of denim.
- According to the management, Indian consumers are ready to pay a premium for good quality products, which was not the case three years ago. With high disposable income and rising demand from Tier II and Tier III cities, Indian market has become more fashion-oriented now.

Financials (standalone)

Exhibit 3: Income statement

Y/E March (Rsmn)	FY10	FY11	FY12	FY13	FY14
Net sales	3,758	5,074	5,738	7,031	8,938
Growth (%)	*18.2*	*35.0*	*13.1*	*22.5*	*27.1*
Raw material costs	2,590	3,042	3,512	4,258	4,655
Staff costs	130	147	192	254	310
Power & fuel costs	-	734	579	620	1,594
Other costs	463	473	630	829	1,052
Total expenditure	3,182	4,395	4,913	5,962	7,611
EBITDA	576	679	826	1,069	1,327
Growth (%)	-	*17.9*	*21.6*	*29.5*	*24.1*
EBITDA margin (%)	*15.3*	*13.4*	*14.4*	*15.2*	*14.8*
Other income	2	3	5	15	40
Extra-ordinary income	-	-	43	-	-
Interest costs	169	168	278	318	320
Gross profit	409	513	596	767	1,046
Growth (%)	-	*25.4*	*16.1*	*28.8*	*36.5*
Depreciation	226	254	333	409	497
Profit before tax	-	-	-	-	-
Growth (%)	*183*	*259*	*263*	*358*	*549*
Tax	-	41.6	1.4	36.0	53.5
Effective tax rate (%)	*67*	*86*	*75*	*47*	*156*
Net profit	36.7	33.1	28.6	13.2	28.4
Growth (%)	*116*	*174*	*188*	*311*	*393*
Extra-ordinary items	-	49.7	8.3	65.3	26.6
Adjusted PAT	116	174	188	311	393
Growth (%)	-	*49.7*	*8.3*	*65.3*	*26.6*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Balance sheet

Y/E March (Rsmn)	FY10	FY11	FY12	FY13	FY14
Equity	455	455	455	455	455
Reserves	825	999	1,134	1,380	1,710
Net worth	1,281	1,454	1,589	1,836	2,165
Short-term loans	2,525	784	673	1,004	1,078
Long-term loans	193	1,523	1,869	2,651	2,807
Total loans	2,718	2,307	2,542	3,655	3,885
Deferred tax liability	159	188	203	175	216
Liabilities	**4,158**	**3,949**	**4,334**	**5,666**	**6,266**
Gross block	2,718	3,668	4,346	5,152	6,704
Depreciation	750	1,004	1,332	1,740	2,181
Net block	1,968	2,664	3,014	3,412	4,523
Capital work-in-progress	660	146	47	541	-
Long-term Investments	34	34	3	4	42
Inventories	680	1,213	984	1,198	1,385
Debtors	1,283	550	695	912	1,214
Cash	48	69	155	199	261
Other current assets	230	261	362	509	492
Total current assets	2,242	2,094	2,196	2,818	3,352
Creditors	687	457	345	458	576
Other current liabilities	58	531	581	651	1,075
Total current liabilities	745	989	926	1,109	1,651
Net current assets	1,497	1,105	1,270	1,710	1,701
Total assets	**4,158**	**3,949**	**4,334**	**5,666**	**6,266**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Cash flow

Y/E March (Rsmn)	FY10	FY11	FY12	FY13	FY14
EBIT	350	425	493	660	830
Inc./(dec.) in working capital	21	413	(79)	(395)	70
Cash flow from operations	**371**	**838**	**414**	**265**	**900**
Other income	2	3	5	15	40
Depreciation	226	254	333	409	497
Deferred liabilities	5	29	15	(28)	41
Interest paid (-)	(169)	(168)	(278)	(318)	(320)
Tax paid (-)	(67)	(86)	(75)	(47)	(156)
Dividend paid (-)	-	-	(53)	(64)	(64)
Net cash from operations	**368**	**868**	**403**	**233**	**937**
Capital expenditure (-)	(382)	(436)	(583)	(1,302)	(1,068)
Net cash after capex	**(14)**	**432**	**(180)**	**(1,068)**	**(131)**
Inc./(dec.) in short-term borrowing	155	(1,741)	(111)	331	74
Inc./(dec.) in long-term borrowing	(118)	1,330	346	782	156
Inc./(dec.) in total borrowings	37	(411)	235	1,113	231
(Inc.)/dec. in investments	(0)	-	31	(1)	(38)
Equity issue/(buyback)	-	-	-	-	-
Cash from financial activities	**37**	**(411)**	**266**	**1,112**	**193**
Others	(0)	(0)	0	(0)	(0)
Opening cash	26	48	69	155	199
Closing cash	48	69	155	199	261
Change in cash	22	21	86	44	61

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

Y/E March	FY10	FY11	FY12	FY13	FY14
Per share (Rs)					
EPS	2.5	3.8	4.1	6.8	8.6
Book value	28	32	35	40	48
Valuation (x)					
P/E	18.1	12.1	11.2	6.7	5.3
P/sales	0.6	0.4	0.4	0.3	0.2
P/BV	1.6	1.4	1.3	1.1	1.0
EV/EBITDA	8.2	6.3	5.4	5.2	4.3
EV/sales	1.3	0.8	0.8	0.8	0.6
Return ratios (%)					
RoIC	10.9	7.2	8.8	11.9	10.4
RoCE	11.1	7.4	9.0	12.2	10.8
RoE	18.1	12.7	12.3	18.1	19.7
Margins (%)					
EBITDA margin	15.3	13.4	14.4	15.2	14.8
PBIT margin	9.3	8.4	8.6	9.4	9.3
PBT margin	4.9	5.1	4.6	5.1	6.1
PAT margin	3.1	3.4	3.3	4.4	4.4
Turnover ratios					
Asset turnover ratio (x)	0.9	1.3	1.3	1.2	1.4
Avg. inventory period (days)	95	144	101	101	107
Avg. collection period (days)	123	39	44	47	49
Avg. payment period (days)	96	54	35	39	45
Solvency ratios (x)					
Debt-equity	2.1	1.6	1.6	2.0	1.8
Debt/EBITDA	2.1	2.5	1.8	2.1	2.6
Interest coverage	2.1	2.5	1.8	2.1	2.6
Growth (%)					
Sales	18.2	35.0	13.1	22.5	27.1
EBITDA	(81.9)	17.9	21.6	29.5	24.1
PAT	(96.4)	49.7	8.3	65.3	26.6

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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