



# Vardhman Textiles Ltd

## RM pressure going away, performance to be better going forward

Vardhman Textile Limited (VTL) came out with a subdued set of numbers, but ahead of estimates for Q2FY23 in a very challenging business environment and rising input costs. In recent months, cotton prices have been correcting and domestic demand is good. There is still some doubt on exports demand recovery due to geo-political situation in Europe and slowdown in the US market. However, we believe that Q2FY23 is the bottom of recent quarterly performance, and the company will report far better numbers in coming quarter. The company has deferred its capacity expansion plan for few more months and looking for more opportune time to start the process. We are positive on prospects of Indian textiles and assign BUY rating on the stock of the company with a target price of Rs457 per share, 10x Sept'24e EPS.

### Ahead of estimates, but subdued performance in a challenging environment

- During the quarter, the company posted a de-growth of 11.6% YoY/8.6% QoQ at Yarn production volume front. Grey fabric production was ~1% up QoQ, but down by 12.7% YoY. Processed fabric production was up 3.0% YoY/5.6% QoQ.
- The company reported ~12.2% QoQ sales decline but ~3.5% growth on YoY basis.
- On account of lower scale of operation and higher input costs, margin contraction was ~420bps QoQ and finally it reported 37.7% QoQ/57.4% YoY PAT decline to Rs 2,049mn.

### Textile demand should be on track, capacity addition to propel medium term growth

- The industry is facing tough time due to slowdown in demand in the international market and price difference between domestic and international cotton prices.
- India cotton prices have corrected a lot and expected to correct further in coming months with the arrival of good quality of cotton in adequate quantity.
- Not much capacity is getting added in spinning industry and hence pricing comfort should be there in the future.

### Valuation and risks

- The management of the company highlighted the possibility of better utilization and recovery in demand situation in coming months.
- Though new capacity addition is on hold for few months, but the management is all set to increase the capacity in coming years. They feel the current situation and cost of capex are not favourable at this moment and hence, it is better to wait for few more months.
- Despite lower utilization and high input costs, margin profile was decent during the quarter and we expect it should tend towards 20% in coming years.
- We assign **10x PE multiple to Sept'24e earnings** and arrive at a **target price Rs457 per share, offering 36% upside from current levels.** Hence, we assign BUY rating on the stock.

Y/E Mar (Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1 FY22	QoQ (%)	Q3 FY22e	Var. (%)
Revenues	24,696	23,851	3.5	28,118	-12.2	21,850	13.0
Gross profit margin (%)	43.4	55.9	(1,249) bps	46.3	(293) bps	-	-
Employee expense	1,918	1,815	5.7	1,904	0.7	-	-
Other expense	5,215	4,746	9.9	5,861	-11.0	-	-
EBITDA	3,579	6,765	-47.1	5,256	-31.9	3,059	17.0
EBITDA Margin (%)	14.5	28.4	(1,387) bps	18.7	(420) bps	14.0	49.3 bps
Depreciation	988	917	7.8	931	6.0	-	-
Interest	249	235	5.7	263	-5.3	-	-
Other Income	304	675	-54.9	200	52.3	-	-
Exceptional items	-	-	NA	0	NA	-	-
PBT	2,647	6,287	-57.9	4,261	-37.9	-	-
Tax	681	1,561	-56.4	1,053	-35.3	-	-
Effective Tax Rate (%)	25.7	24.8	89.6 bps	24.7	102 bps	-	-
PAT	1,966	4,726	-58.4	3,209	-38.7	-	-
Share of Associate / JV	103	96	7.6	117	-11.8	-	-
Minority Interest	20	7	179.2	34	-41.4	-	-
Consolidated PAT	2,049	4,815	-57.4	3,291	-37.7	1,672	22.6

Source: Company, SMIFS research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	Adj. EPS	RoE (%)	RoCE (%)	Adj. P/E (x)	EV/EBITDA (x)
FY21	61,399	-8.8	8,138	13.3	4,144	-28.3	14.3	9.0	5.7	11.7	7.2
FY22	96,223	56.7	22,739	23.6	15,469	273.3	53.6	5.7	17.1	7.1	5.0
FY23E	1,06,532	10.7	19,375	18.2	11,807	-23.7	40.9	18.1	11.7	8.2	5.3
FY24E	1,07,364	0.8	20,298	18.9	12,304	4.2	42.6	12.1	10.9	7.9	4.8
FY25E	1,16,553	8.6	22,934	19.7	14,095	14.6	48.8	11.2	11.4	6.9	4.0

Source: Company, SMIFS research estimates

Rating: Buy Upside/(Downside): 36%

Current Price: 336 Target Price: 457

### Earlier recommendation

Previous Rating: NA

Previous Target Price: NA

### Market data

Bloomberg:	VARH:IN
52-week H/L (Rs):	576/246
Mcap (Rs bn/USD bn):	97.2/1.17
Shares outstanding (mn):	289.1
Free float:	37.0%
Daily vol. (3M Avg):	0.68 Mn
Face Value (Rs):	2
Group:	S&P BSE 500

Source: Bloomberg, SMIFS research

### Shareholding pattern (%)

	Sep-22	Jun-22	Mar-22	Dec-21
Promoter	64%	63%	63%	63%
FIIs	7%	8%	8%	6%
DIIIs	17%	17%	17%	19%
Public/others	13%	13%	12%	12%

### Promoter Pledging (%)

Pledging	0%	0%	0%	0%
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Source: BSE

### Price performance (%) \*

	1M	3M	12M	36M
S&P BSE 500	4.0%	5.3%	2.5%	59.8%
VTL	-0.3%	11.2%	-13.5%	86.2%

\* As on 31<sup>st</sup> Oct 2022; Source: AceEquity, SMIFS research

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## Q2FY23 – Key takeaways from the management call

### Spinning industry continues to face various challenges with good possibilities of recovery

- During Q2FY23, the spinning industry all over the world was facing challenges.
- India cotton crop got damaged last year and hence, the overall cotton crop was less. Availability of quality cotton was an issue and relief on custom duty for imports came late. Due to all this, cotton prices in India started increasing in higher degrees as compared to international market.
- These challenges impacted the Indian exports as they lost their competitiveness, and this resulted in lower capacity utilization in spinning capacity.
- VTL also stopped ~10% of the capacity and certain part of spindles were used to non-cotton products to cover the fixed costs.
- Currently, it is estimated that cotton consumption is not more than 50% as compared to normal consumption.
- However, at the onset of new crop arrival timing, cotton prices have started correcting and this is a good sign giving comfort on RM costs side.

### Vardhman's yarn capacity utilization

- The company face huge pressure on demand side on exports front. Industry players started diverting the supplies to domestic market.
- Hence domestic demand for the company also experienced pressure because the demand for yarn in the market was not high as per the supply.
- Vardhman stopped its spinning capacity by 10% to 12%.
- Around 8%-10% of capacity was diverted to alternate products as it was helping in reduction of losses.
- 40% to 50% of the stopped spindle capacity are expected to start running after few weeks.

### Fabric business faring better

- Woven fabric business has been performing good as compared to other textiles value chain due to surge in demand due to ease in movement of the people, opening of schools etc post covid-19.
- Vardhman, is operating its woven fabric division at around 90% utilization.

### Good quality cotton in adequate amount is on card

- India is likely to produce 34.4 million bales of cotton in the 2022-23 season that started on October 1, up 12% from a year ago whereas industry estimates are nearly 36.0 million bales.
- Cotton consumption is expected to be lower by around 8% during the next cycle and hence, cotton price is expected to correct further and parity with international cotton price can emerge giving some comfort of exports front.

### Demand Outlook

- The existing inventory in the system is vanishing in domestic market and this will lead to demand recovery in the market.
- With cotton price coming down, these would be more activities on the exports front.
- The capacity utilization in spinning is expected to improve and the worst period for spinning industry is at end.

### **Capacity expansion**

- The management continues to postpone its expansion plan for few more months in order to grab the best opportunity in the future.
- The company has already added 35,000 spindles which is fully operation. Another project of 65,000 spindles addition was delayed due to supply chain issue and non-availability of electronic and machinery but currently it is under commissioning, and it is expected to get in operation partly by November, 2022 and by 31<sup>st</sup> Dec, 2022 it is expected to be totally ready.
- After the commission of additional capacity of spindles, it will reach to 1.2mn spindles.

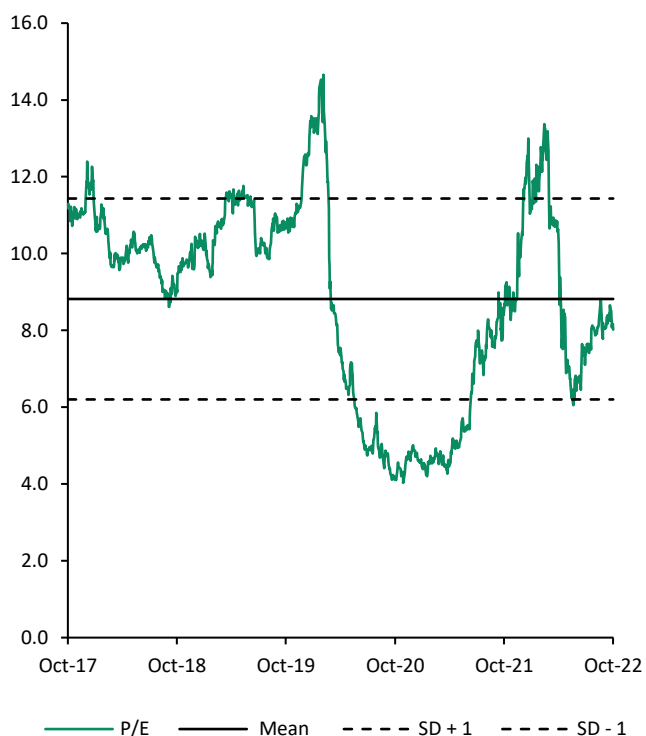
### **Cotton Inventory**

- The company highlighted that at the end of Sept month, there was cotton inventory of 1 and ½ month to run the plant till new cotton procurement starts.
- Most of the players in the Industry will have cotton inventory at price point of 85,000 to 90,000 per candy.

## Outlook and Valuations

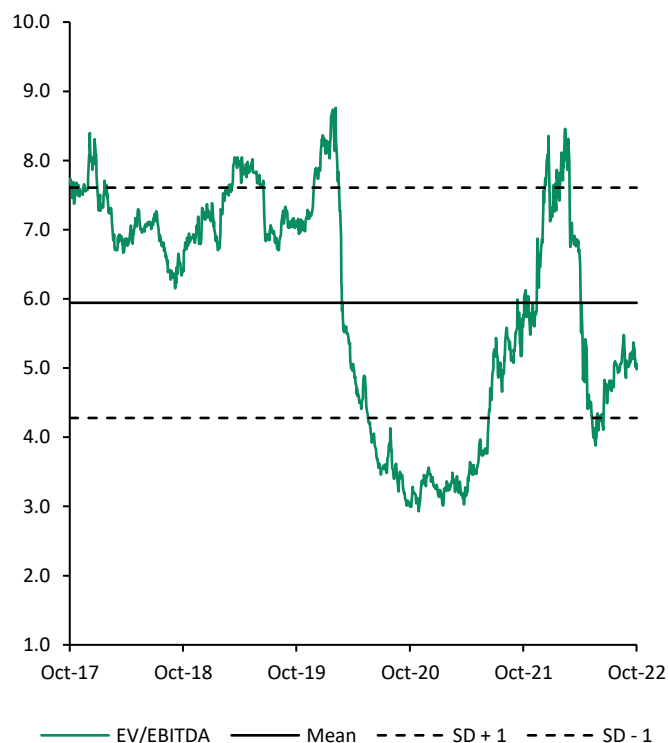
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**Fig 1: 1-year forward P/E**



Source: AceEquity, SMIFS research

**Fig 2: 1-year forward EV/EBITDA**



Source: AceEquity, SMIFS research

## Quarterly financials, operating metrics & key performance indicators

Y/E March (Rs mn)	Q3FY21	Q4FY22	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
<b>Net Sales</b>	<b>17,501</b>	<b>19,471</b>	<b>19,270</b>	<b>23,851</b>	<b>26,032</b>	<b>27,071</b>	<b>28,118</b>	<b>24,696</b>
Raw Materials	9,041	10,990	8,709	10,526	12,393	13,979	15,098	13,984
Employee Costs	1,521	1,736	1,673	1,815	1,899	1,904	1,904	1,918
Other Expenditure	4,172	2,803	4,099	4,746	5,546	6,196	5,861	5,215
<b>EBITDA</b>	<b>2,767</b>	<b>3,942</b>	<b>4,788</b>	<b>6,765</b>	<b>6,194</b>	<b>4,992</b>	<b>5,256</b>	<b>3,579</b>
Other Income	568	474	450	675	636	484	200	304
Depreciation	916	919	913	917	924	922	931	988
<b>EBIT</b>	<b>2,419</b>	<b>3,497</b>	<b>4,325</b>	<b>6,523</b>	<b>5,907</b>	<b>4,555</b>	<b>4,524</b>	<b>2,896</b>
Interest	233	284	257	235	215	290	263	249
Exceptional items	0	0	0	0	0	0	0	0
<b>PBT</b>	<b>2,186</b>	<b>3,213</b>	<b>4,067</b>	<b>6,287</b>	<b>5,692</b>	<b>4,265</b>	<b>4,261</b>	<b>2,647</b>
Tax	533	822	990	1,561	1,470	1,175	1,053	681
<i>Tax rate (%)</i>	<i>24.4</i>	<i>25.6</i>	<i>24.3</i>	<i>24.8</i>	<i>25.8</i>	<i>27.6</i>	<i>24.7</i>	<i>25.7</i>
<b>PAT</b>	<b>1,653</b>	<b>2,391</b>	<b>3,077</b>	<b>4,726</b>	<b>4,222</b>	<b>3,090</b>	<b>3,209</b>	<b>1,966</b>
Share of Associate / JV	96	111	92	96	93	116	117	103
Minority interest	43	67	22	7	29	-15	34	20
<b>Adjusted PAT</b>	<b>1,705</b>	<b>2,435</b>	<b>3,147</b>	<b>4,815</b>	<b>4,286</b>	<b>3,221</b>	<b>3,291</b>	<b>2,049</b>
<b>YoY Growth (%)</b>								
Revenue	-4.1	22.0	135.7	46.8	48.7	39.0	45.9	3.5
EBITDA	30.6	75.1	-28100.0	367.7	123.8	26.7	9.8	-47.1
Adj PAT	-14.4	67.1	-589.5	699.6	151.3	32.3	4.6	-57.4
<b>QoQ Growth (%)</b>								
Revenue	7.7	11.3	-1.0	23.8	9.1	4.0	3.9	-12.2
EBITDA	91.3	42.4	21.5	41.3	-8.4	-19.4	5.3	-31.9
Adj PAT	183.2	42.8	29.3	53.0	-11.0	-24.8	2.2	-37.7
<b>Margins (%)</b>								
RMC/revenue (%)	51.7	56.4	45.2	44.1	47.6	51.6	53.7	56.6
Gross margin (%)	48.3	43.6	54.8	55.9	52.4	48.4	46.3	43.4
Employee cost/revenue (%)	8.7	8.9	8.7	7.6	7.3	7.0	6.8	7.8
Other expenses/revenue (%)	23.8	14.4	21.3	19.9	21.3	22.9	20.8	21.1
EBITDA margin (%)	15.8	20.2	24.8	28.4	23.8	18.4	18.7	14.5
Adj PAT margin (%)	9.7	12.5	16.3	20.2	16.5	11.9	11.7	8.3

Source: Company, SMIFS research

## Key Assumptions:

Operating Details	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e
<b>Production Data</b>							
Yarn (in Metric Ton)	2,04,729	2,12,946	2,11,334	2,38,638	2,48,750	2,71,682	2,88,304
Grey Fabric (in Lakh Mtr)	1,883	2,067	1,554	1,934	2,100	2,287	2,420
Processed Fabric (in Lakh Mtr)	1,310	1,410	1,002	1,517	1,484	1,631	1,710
<b>Sales Volume Data (including internal transfer)</b>							
Yarn (in Metric Ton)	2,08,807	2,15,449	2,14,374	2,33,584	2,51,237	2,74,399	2,91,187
Grey Fabric (in Lakh Mtr)	1,900	2,064	1,589	1,974	2,121	2,310	2,444
Processed Fabric (in Lakh Mtr)	1,320	1,380	1,008	1,520	1,484	1,631	1,710
<b>Sales (Rs mn)</b>							
Yarn	39,802	39,240	40,096	60,824	66,484	66,146	72,382
Total Fabric	24,313	24,745	18,124	30,238	32,692	33,973	36,511
Others	4,665	3,365	3,179	5,161	7,355	7,244	7,661
<b>Total Sales</b>	<b>68,779</b>	<b>67,350</b>	<b>61,399</b>	<b>96,223</b>	<b>1,06,532</b>	<b>1,07,364</b>	<b>1,16,553</b>
<i>YoY Growth (%)</i>	<i>10.1</i>	<i>-2.1</i>	<i>-8.8</i>	<i>56.7</i>	<i>10.7</i>	<i>0.8</i>	<i>8.6</i>

## Financial Statements (Consolidated)

Income Statement					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
<b>Revenues</b>	<b>61,399</b>	<b>96,223</b>	<b>1,06,532</b>	<b>1,07,364</b>	<b>1,16,553</b>
Raw Materials	32,605	45,607	57,049	55,884	60,084
% of sales	53.1	47.4	53.6	52.1	51.6
Personnel	5,901	7,291	7,874	8,504	9,269
% of sales	9.6	7.6	7.4	7.9	8.0
Other Expenses	14,755	20,587	22,234	22,678	24,266
% of sales	24.0	21.4	20.9	21.1	20.8
<b>EBITDA</b>	<b>8,138</b>	<b>22,739</b>	<b>19,375</b>	<b>20,298</b>	<b>22,934</b>
Other Income	2,016	2,245	1,918	2,362	2,564
Depreciation & Amortization	3,638	3,675	4,454	5,091	5,694
<b>EBIT</b>	<b>6,516</b>	<b>21,309</b>	<b>16,839</b>	<b>17,569</b>	<b>19,804</b>
Finance cost	1,133	997	1,277	1,339	1,185
<b>Core PBT</b>	<b>3,367</b>	<b>18,067</b>	<b>13,644</b>	<b>13,868</b>	<b>16,055</b>
Exceptional items	0	0	0	0	0
<b>PBT</b>	<b>5,383</b>	<b>20,312</b>	<b>15,561</b>	<b>16,230</b>	<b>18,619</b>
Tax-Total	1,320	5,197	4,061	4,232	4,848
Tax Rate (%) - Total	24.5	25.6	26.1	26.1	26.0
<b>PAT</b>	<b>4,063</b>	<b>15,115</b>	<b>11,501</b>	<b>11,999</b>	<b>13,771</b>
Share of Associates	206	397	426	429	466
Minority Interest	126	43	119	124	142
<b>Adjusted PAT</b>	<b>4,144</b>	<b>15,469</b>	<b>11,807</b>	<b>12,304</b>	<b>14,095</b>

Source: Company, SMIFS research estimates

Key Ratios					
YE March	FY21	FY22	FY23e	FY24e	FY25e
<b>Growth Ratios (%)</b>					
Net Sales	-8.8	56.7	10.7	0.8	8.6
EBITDA	-13.2	179.4	-14.8	4.8	13.0
Adjusted PAT	-28.3	273.3	-23.7	4.2	14.6
<b>Margin Ratio (%)</b>					
Gross Profit	46.9	52.6	46.4	47.9	48.4
EBITDA Margin	13.3	23.6	18.2	18.9	19.7
EBIT Margin	10.6	22.1	15.8	16.4	17.0
Core PBT margins	5.5	18.8	12.8	12.9	13.8
Adjusted PAT Margin	6.7	16.1	11.1	11.5	12.1
<b>Return Ratios</b>					
ROE	9.0	5.7	18.1	12.1	11.2
ROCE	5.7	17.1	11.7	10.9	11.4
<b>Turnover Ratios (days)</b>					
Gross Block Turnover (x)	1.1	1.7	1.6	1.4	1.4
Adj OCF / Adj PAT (%)	16.6	88.2	41.1	118.6	83.8
Inventory	313	231	238	245	249
Debtors	62	50	52	52	52
Creditors	34	32	32	32	32
Cash Conversion Cycle	341	249	258	265	269
<b>Solvency ratio (x)</b>					
Debt-equity	0.3	0.3	0.2	0.2	0.1
Net Debt-Equity	0.1	0.0	0.1	0.0	0.0
Gross Debt/EBITDA	2.6	0.9	1.1	1.1	0.7
Current ratio	8.0	6.0	6.5	7.0	6.9
Interest coverage ratio	5.8	21.4	13.2	13.1	16.7
<b>Dividend</b>					
DPS (Rs.)	0.0	12.1	6.1	6.4	7.3
Dividend Yield (%)	0.0	3.6	1.8	1.9	2.2
Dividend Payout (%)	0.1	22.6	15.0	15.0	15.0
<b>Per share (Rs.)</b>					
Basic EPS (reported)	14.7	54.6	40.9	42.6	48.8
Adjusted EPS	14.3	53.6	40.9	42.6	48.8
CEPS	26.9	66.3	56.3	60.2	68.5
BV	228.5	271.5	318.8	355.5	402.8
<b>Valuation</b>					
Adj P/E	11.7	7.1	8.2	7.9	6.9
P/BV	0.7	1.4	1.1	0.9	0.8
EV/EBITDA	7.2	5.0	5.3	4.8	4.0
EV/Sales	0.9	1.2	1.0	0.9	0.8
EV/Core PBT	17.3	6.3	7.5	7.0	5.8

Source: Company, SMIFS research estimates

Balance Sheet					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
<b>Sources of funds</b>					
Capital	566	568	568	568	568
Reserves & Surplus	65,449	77,845	91,511	1,02,122	1,15,794
<b>Shareholders' Funds</b>	<b>66,015</b>	<b>78,413</b>	<b>92,079</b>	<b>1,02,690</b>	<b>1,16,362</b>
<b>Total Loan Funds</b>	<b>21,323</b>	<b>19,832</b>	<b>21,832</b>	<b>21,832</b>	<b>16,832</b>
Other liabilities	2,950	2,869	3,068	3,098	3,160
<b>Total Liabilities</b>	<b>90,287</b>	<b>1,01,114</b>	<b>1,16,979</b>	<b>1,27,620</b>	<b>1,36,354</b>
<b>Application of funds</b>					
Gross Block	53,621	56,814	66,812	76,310	85,308
Net Block	35,266	34,916	40,461	44,871	48,177
Capital WIP	780	2,412	2,325	3,037	3,397
<b>Investments</b>	<b>10,745</b>	<b>16,911</b>	<b>16,725</b>	<b>17,930</b>	<b>19,464</b>
<b>Other non current assets</b>	<b>2,435</b>	<b>3,206</b>	<b>3,766</b>	<b>3,795</b>	<b>4,117</b>
Inventories	27,961	28,823	37,199	37,511	40,989
Sundry Debtors	10,386	13,212	15,177	15,296	16,605
Cash & Bank Balances	2,115	1,217	1,997	5,713	3,626
Other current Assets	6,482	9,095	9,087	9,158	10,408
<b>Total Current Assets</b>	<b>46,944</b>	<b>52,347</b>	<b>63,460</b>	<b>67,678</b>	<b>71,628</b>
<b>Sundry Creditors</b>	<b>2,993</b>	<b>3,956</b>	<b>5,002</b>	<b>4,899</b>	<b>5,268</b>
Other Current Liabilities	2,889	4,722	4,757	4,790	5,161
<b>Total Current Liabilities</b>	<b>5,882</b>	<b>8,677</b>	<b>9,758</b>	<b>9,690</b>	<b>10,429</b>
<b>Net Current Assets</b>	<b>41,062</b>	<b>43,670</b>	<b>53,702</b>	<b>57,988</b>	<b>61,199</b>
<b>Total Assets</b>	<b>90,287</b>	<b>1,01,114</b>	<b>1,16,979</b>	<b>1,27,620</b>	<b>1,36,354</b>

Source: Company, SMIFS research estimates

Cash Flow					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
<b>Operating profit before WC changes</b>					
<b>Operating profit before WC changes</b>	<b>8,724</b>	<b>23,837</b>	<b>19,801</b>	<b>20,727</b>	<b>23,400</b>
Net chg in working capital	(6,584)	(4,219)	(9,613)	(570)	(5,558)
Income tax Paid	(463)	(5,173)	(4,061)	(4,232)	(4,848)
<b>Cash flow from operating activities (a)</b>	<b>1,677</b>	<b>14,446</b>	<b>6,127</b>	<b>15,926</b>	<b>12,994</b>
<b>Adj. OCF</b>	<b>687</b>	<b>13,639</b>	<b>4,850</b>	<b>14,587</b>	<b>11,809</b>
Capital expenditure	-2,430	-5,191	-10,000	-9,500	-9,000
Adj FCF	-1,743	8,448	-5,150	5,087	2,809
<b>Cash flow from investing activities (b)</b>	<b>-1,159</b>	<b>-8,992</b>	<b>-8,005</b>	<b>-9,060</b>	<b>-8,395</b>
Debt	-885	-1,491	2,000	0	-5,000
Dividend	-3	-3,492	-1,771	-1,846	-2,114
Interest & lease	-944	-860	-1,277	-1,339	-1,185
<b>Cash flow from financing activities (c)</b>	<b>-1,740</b>	<b>-5,714</b>	<b>2,462</b>	<b>-3,155</b>	<b>-6,751</b>
<b>Net chg in cash (a+b+c)</b>	<b>-1,222</b>	<b>-260</b>	<b>585</b>	<b>3,710</b>	<b>-2,151</b>

Source: Company, SMIFS research estimates

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