

# Vardhman Textiles Ltd

## Subdued exports, inventory loss hit margins; Recovery at all fronts started

Vardhman Textile Limited (VTL) came out with another subdued set of numbers, with way below estimated profitability for Q3FY23 in a very challenging business environment. In recent months, cotton prices have been correcting and domestic demand is good. There are still issues at exports demand recovery due to the geopolitical situation in Europe, inflation, and slowdown in the US market. However, recovery at exports front already started happening with smaller orders pouring in post inventory correction by some clients and exports to China has also begun. We believe that Q3FY23 is the bottom of recent quarterly performance, and the company will report far better numbers in coming quarters as currently VTL is hitting around the full utilization at spinning front. The company has deferred its capacity expansion decision making for a few more months and looking for a more opportune time to start the process when there is a higher confidence on profitability. We are positive on prospects of Indian textiles and maintain BUY rating on the stock with a reduced target price of Rs410 per share (9.5x FY25e EPS).

### Subdued performance in a challenging environment

- During the quarter, the company posted a de-growth of 3.5% YoY, but 4.6% QoQ growth at Yarn production volume front. Grey fabric production was ~1% up QoQ, but down by 9.9% YoY. Processed fabric production was up 0.5% QoQ, but down 13.9% YoY.
- The company reported ~4.0% QoQ/8.9% YoY sales decline. On account of lower scale of operation and inventory loss, margin was subdued at 7.5%.

### Textile demand should be on track, exports recovery in sight

- The industry has been facing tough times due to a slowdown in demand in the international market and price difference between domestic and international cotton prices.
- India cotton prices have corrected a lot and now stabilised at lower levels. Now Indian spinners are able to export to China market where pent-up demand is also expected.

### Outlook and Valuation

- The management highlighted the possibility of better utilization with better cotton situation and recovery in demand in coming months.
- Though the new capacity addition is on hold for few months, but the management is all set to increase the capacity in coming years. Despite reaching full utilization at spinning front, they feel the current situation is not favourable and it is better to wait for few more months.
- As higher inventory loss situation is behind and cotton prices are stabilizing at lower levels, we can expect better margins. Considering the tough situation, we have trimmed down our estimates.
- We assign **9.5x PE multiple to FY25e earnings** and arrive at a **target price Rs410 per share, offering 42% upside from current levels**. Hence, we maintain **BUY** rating on the stock.

Y/E Mar (Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY22	QoQ (%)	Q3FY22e	Var. (%)
Revenues	23,705	26,032	-8.9	24,696	-4.0	24,435	-3.0
Gross profit margin (%)	37.0	52.4	(1,537) bps	43.4	(635) bps	-	-
Employee expense	1,893	1,899	-0.3	1,918	-1.3	-	-
Other expense	5,098	5,546	-8.1	5,215	-2.2	-	-
EBITDA	1,785	6,194	-71.2	3,579	-50.1	3,530	-49.4
EBITDA Margin (%)	7.5	23.8	(1,626) bps	14.5	(696) bps	14.4	(691) bps
Depreciation	986	924	6.8	988	-0.2	-	-
Interest	206	215	-4.1	249	-17.1	-	-
Other Income	665	636	4.4	304	118.6	-	-
Exceptional items	-	-	NA	-	NA	-	-
PBT	1,258	5,692	-77.9	2,647	-52.5	-	-
Tax	306	1,470	-79.2	681	-55.0	-	-
Effective Tax Rate (%)	24.4	25.8	(146.9) bps	25.7	(137) bps	-	-
PAT	951	4,222	-77.5	1,966	-51.6	-	-
Share of Associate / JV	103	93	10.4	103	-0.2	-	-
Minority Interest	30	29	3.4	20	50.2	-	-
Consolidated PAT	1,024	4,286	-76.1	2,049	-50.0	1,672	-38.7

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	4.8
FY22	96,223	56.7	22,739	23.6	15,469	273.3	53.6	5.7	17.1	7.1	4.7
FY23e	103,045	7.1	13,648	13.2	8,563	-44.6	29.6	18.5	8.6	9.7	6.1
FY24e	100,905	-2.1	17,201	17.0	11,121	29.9	38.5	9.2	10.2	7.5	5.5
FY25e	110,167	9.2	19,179	17.4	12,460	12.0	43.1	10.7	10.5	6.7	5.1

Source: Company, SMIFS research estimates



Rating: **Buy** Upside/(Downside): **42%**

Current Price: **228** Target Price: **410**

### | Earlier recommendation

Previous Rating:	Buy
Previous Target Price:	457

### | Market data

Bloomberg:	VTEX:IN
52-week H/L (Rs):	565/246
Mcap (Rs bn/USD bn):	83.1/1.01
Shares outstanding (mn):	289.1
Free float:	36.1%
Daily vol. (3M Avg):	0.25 Mn
Face Value (Rs):	2

Source: Bloomberg, SMIFS research

### | Shareholding pattern (%)

	Dec-22	Sep-22	Jun-22	Mar-22
Promoter	63.9	63.8	62.9	62.9
FII	7.0	7.0	7.5	8.3
DII	16.9	16.7	16.6	16.9
Public/others	12.2	12.5	13.0	11.9

Source: BSE

### | Promoters pledging (%)

Promoters pledged shares	0.0	0.0	0.0	0.0
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Source: BSE

### | Price performance (%) \*

	1M	3M	12M	36M
NIFTY 50	-3	-1	3	45
NIFTY 500	-4	-2	1	49
VTL	-12	-15	-40	39

\* As on 27<sup>th</sup> Jan 2023; Source: AceEquity, SMIFS research

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## Q3FY23 – Key takeaways from the management call

### Export market overview

- General slowdown in demand was seen in the previous quarter because of oil and gas prices, geopolitical situation, inflation, and interest costs.
- Most retail brands were having their inventories piled up which were getting cleared up instead of new buying.
- After inventory correction, many brands have started putting orders and this has led to some recovery in demand.
- Export to China has also started and some pent-up demand is expected from there.
- The FTA signed with Australia will be giving a level playing field to Indian textile companies. To that extent, it is positive, but as such that is not a big market for us.

### Cotton price, procurement, and availability

- Cotton prices have been coming down lately, but were higher in most part of Q3FY23.
- The overall crop size is good in new current season, but the cotton arrival was very low so far. It was around 110 lakh bales out of the total expectation of 330 lakh bales for the entire season and as compared to 175 lakh bales at this time last year.
- This situation is not because of non-availability of cotton, but more of better price expectation from farmers.
- Farmers hoarded most of the cotton in anticipation of getting better prices as seen in the last year. This is the first time in the history that farmers are hoarding. Last time, International cotton prices were around 125 cent per pound and currently it is 85-87 cent per pound. So, some rationalization is required on the part of farmers.
- The company is having one month of inventory and looking at the situation will not go for six months of inventory building up at higher prices.
- Due to higher cotton prices, exports are low and hence, cotton should be available at the later stage as well.

### Fabric

- Inventory correction at retail levels continue and expected to normalize in 3-4 months.
- This quarter has been a better demand than the previous quarter because of marriage season.

### Margin

- Devaluation of stocks, exports issue, global pressure, very high price of cotton led to lower margins.
- Q4FY23 situation is better in terms of demand and cotton prices, but there are smaller orders and hence difficult to take a call on the overall margin of Q4.

### Utilization

- The global spinning utilization was 70% and Indian cotton spinning utilization was much lower, about 50%.
- Now it has reached to 80-85% utilization. From Vardhman perspective, it is already hitting 100% utilization, but profitability is still lower.

### Capacity expansion

- The management has not committed any capex despite 100% utilization as this situation has come after long time recently and still profitability is low.
- They are looking for stabilization for better confidence. With commercialization of new 65,000 spindles, the capacity will reach towards around 12 lakhs spindles.
- In FY23, the capex would be around Rs6.5 Bn including normal capex and in FY24, it would be around Rs2 Bn as normal capex for maintenance.

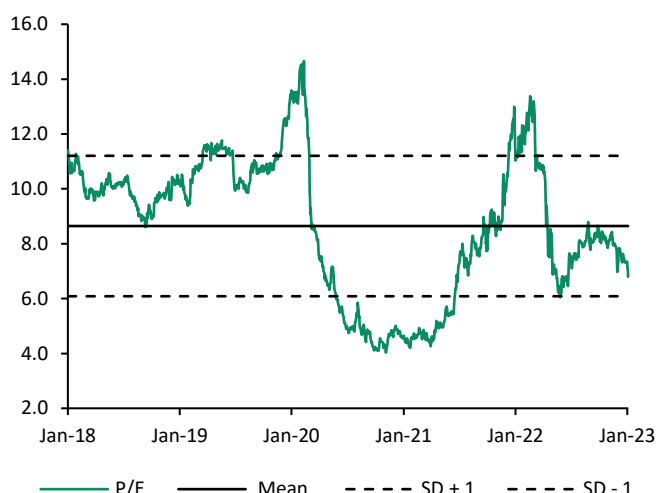
### Other highlights

- The debt level is Rs15 Bn whereas cash equivalents are around Rs24 Bn. Cash levels are higher as cotton inventory is yet to be done.
- Overall Q4FY23 prospects are far better than Q3FY23.

## Outlook and Valuations

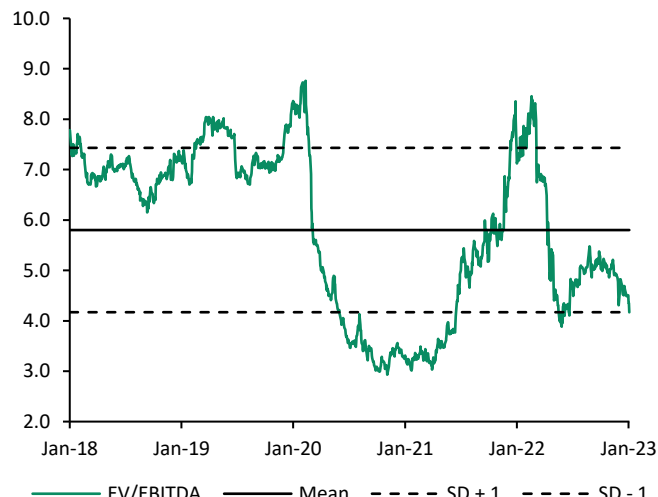
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- As higher inventory loss situation is behind and cotton prices are stabilizing, we can expect better margins. Considering the tough situation, we have trimmed down our estimates.
- We assign **9.5x PE multiple to FY25E earnings** and arrive at a **target price Rs410 per share, offering 42% upside from current levels**. Hence, we maintain **BUY** rating on the stock.
- Slower recovery at exports front and continued higher cotton prices as compared to international prices are risks to our call.

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



Source: AceEquity, SMIFS research

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



Source: AceEquity, SMIFS research

## Change in Estimates

Rs mn	New Estimates			Old Estimates			Change		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e
Revenue	103,045	100,905	110,167	106,532	107,364	116,553	-3.3%	-6.0%	-5.5%
Gross Profit	43,755	48,383	52,713	49,483	51,480	56,469	-11.6%	-6.0%	-6.7%
Gross Margin (%)	42.5	47.9	47.8	46.4	47.9	48.4	(399) bps	(0) bps	(60) bps
EBITDA	13,648	17,201	19,179	19,375	20,298	22,934	-29.6%	-15.3%	-16.4%
EBITDA Margin (%)	13.2	17.0	17.4	18.2	18.9	19.7	(494) bps	(186) bps	(227) bps
PAT	8,563	11,121	12,460	11,501	11,999	13,771	-25.5%	-7.3%	-9.5%
EPS (Rs)	30	39	43	41	43	49	-27.5%	-9.6%	-11.6%

Source: Company, SMIFS Research estimates

## Quarterly financials, operating metrics & key performance indicators

**Fig 3: Quarterly Financials**

Y/E March (Rs mn)	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY22	Q2FY23	Q3FY23
<b>Net Sales</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>	<b>23,705</b>
Raw Materials	10,990	8,709	10,526	12,393	13,979	15,098	13,984	14,928
Employee Costs	1,736	1,673	1,815	1,899	1,904	1,904	1,918	1,893
Other Expenditure	2,803	4,099	4,746	5,546	6,196	5,861	5,215	5,098
<b>EBITDA</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>	<b>1,785</b>
Other Income	474	450	675	636	484	200	304	665
Depreciation	919	913	917	924	922	931	988	986
<b>EBIT</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>	<b>1,464</b>
Interest	284	257	235	215	290	263	249	206
Exceptional items	0	0	0	0	0	0	0	0
<b>PBT</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>	<b>1,258</b>
Tax	822	990	1,561	1,470	1,175	1,053	681	306
<i>Tax rate (%)</i>	25.6	24.3	24.8	25.8	27.6	24.7	25.7	24.4
<b>PAT</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>	<b>951</b>
Share of Associate / JV	111	92	96	93	116	117	103	103
Minority interest	67	22	7	29	-15	34	20	30
<b>Adjusted PAT</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>1,024</b>
<b>YoY Growth (%)</b>								
Revenue	22.0	135.7	46.8	48.7	39.0	45.9	3.5	-8.9
EBITDA	75.1	NA	367.7	123.8	26.7	9.8	-47.1	-71.2
Adj PAT	67.1	NA	699.6	151.3	32.3	4.6	-57.4	-76.1
<b>QoQ Growth (%)</b>								
Revenue	11.3	-1.0	23.8	9.1	4.0	3.9	-12.2	-4.0
EBITDA	42.4	21.5	41.3	-8.4	-19.4	5.3	-31.9	-50.1
Adj PAT	42.8	29.3	53.0	-11.0	-24.8	2.2	-37.7	-50.0
<b>Margins (%)</b>								
RMC/revenue (%)	56.4	45.2	44.1	47.6	51.6	53.7	56.6	63.0
Gross margin (%)	43.6	54.8	55.9	52.4	48.4	46.3	43.4	37.0
Employee cost/revenue (%)	8.9	8.7	7.6	7.3	7.0	6.8	7.8	8.0
Other expenses/revenue (%)	14.4	21.3	19.9	21.3	22.9	20.8	21.1	21.5
EBITDA margin (%)	20.2	24.8	28.4	23.8	18.4	18.7	14.5	7.5
Adj PAT margin (%)	12.5	16.3	20.2	16.5	11.9	11.7	8.3	4.3

Source: Company, SMIFS research

**Fig 4: Key Assumptions**

Operating Details	FY19	FY20	FY21	FY22	FY23e	FY24e	FY25e
<b>Production Data</b>							
Yarn (in Metric Ton)	204,729	212,946	211,334	238,638	240,609	255,341	272,530
Grey Fabric (in Lakh Mtr)	1,883	2,067	1,554	1,934	2,031	2,150	2,288
Processed Fabric (in Lakh Mtr)	1,310	1,410	1,002	1,517	1,435	1,533	1,616
<b>Sales Volume Data (including internal transfer)</b>							
Yarn (in Metric Ton)	208,807	215,449	214,374	233,584	243,015	257,895	275,255
Grey Fabric (in Lakh Mtr)	1,900	2,064	1,589	1,974	2,051	2,171	2,310
Processed Fabric (in Lakh Mtr)	1,320	1,380	1,008	1,520	1,435	1,533	1,616
<b>Sales (Rs mn)</b>							
Yarn	39,802	39,240	40,096	60,824	64,308	62,168	68,423
Total Fabric	24,313	24,745	18,124	30,238	31,622	31,930	34,509
Others	4,665	3,365	3,179	5,161	7,115	6,807	7,235
<b>Total Sales</b>	<b>68,779</b>	<b>67,350</b>	<b>61,399</b>	<b>96,223</b>	<b>103,045</b>	<b>100,905</b>	<b>110,167</b>
<i>YoY Growth (%)</i>	10.1	-2.1	-8.8	56.7	7.1	-2.1	9.2

Source: Company, SMIFS research estimates

## 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>103,045</b>	<b>100,905</b>	<b>110,167</b>
Raw Materials	32,605	45,607	59,290	52,523	57,453
% of sales	53.1	47.4	57.5	52.1	52.2
Personnel	5,901	7,291	7,874	8,504	9,269
% of sales	9.6	7.6	7.6	8.4	8.4
Other Expenses	14,755	20,587	22,234	22,678	24,266
% of sales	24.0	21.4	21.6	22.5	22.0
<b>EBITDA</b>	<b>8,138</b>	<b>22,739</b>	<b>13,648</b>	<b>17,201</b>	<b>19,179</b>
Other Income	2,016	2,245	1,958	2,321	2,534
Depreciation & Amortization	3,638	3,675	3,653	3,733	4,320
<b>EBIT</b>	<b>6,516</b>	<b>21,309</b>	<b>11,953</b>	<b>15,789</b>	<b>17,392</b>
Finance cost	1,133	997	1,042	1,339	1,185
<b>Core PBT</b>	<b>3,367</b>	<b>18,067</b>	<b>8,953</b>	<b>12,129</b>	<b>13,673</b>
Exceptional items	0	0	0	0	0
<b>PBT</b>	<b>5,383</b>	<b>20,312</b>	<b>10,911</b>	<b>14,450</b>	<b>16,207</b>
Tax-Total	1,320	5,197	2,673	3,670	4,117
Tax Rate (%) - Total	24.5	25.6	24.5	25.4	25.4
<b>PAT</b>	<b>4,063</b>	<b>15,115</b>	<b>8,238</b>	<b>10,780</b>	<b>12,090</b>
Share of Associates	206	397	412	454	496
Minority Interest	126	43	86	112	126
<b>Adjusted PAT</b>	<b>4,144</b>	<b>15,469</b>	<b>8,563</b>	<b>11,121</b>	<b>12,460</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	7.1	-2.1	9.2
EBITDA	-13.2	179.4	-40.0	26.0	11.5
Adjusted PAT	-28.3	273.3	-44.6	29.9	12.0
<b>Margin Ratio (%)</b>					
Gross Profit	46.9	52.6	42.5	47.9	47.8
EBITDA Margin	13.3	23.6	13.2	17.0	17.4
EBIT Margin	10.6	22.1	11.6	15.6	15.8
Core PBT margins	5.5	18.8	8.7	12.0	12.4
Adjusted PAT Margin	6.7	16.1	8.3	11.0	11.3
<b>Return Ratios</b>					
ROE	9.0	5.7	18.5	9.2	10.7
ROCE	5.7	17.1	8.6	10.2	10.5
<b>Turnover Ratios (days)</b>					
Gross Block Turnover (x)	1.2	1.7	1.7	1.6	1.6
Adj OCF / Adj PAT (%)	16.6	88.2	73.7	133.2	76.5
Inventory	307	227	200	210	210
Debtors	55	45	52	52	52
Creditors	37	28	32	32	32
Cash Conversion Cycle	325	244	220	230	230
<b>Solvency ratio (x)</b>					
Debt-equity	0.3	0.3	0.2	0.2	0.2
Net Debt-Equity	0.1	0.0	0.0	-0.1	-0.1
Gross Debt/EBITDA	2.6	0.9	1.6	1.3	0.9
Current ratio	3.7	3.0	3.5	4.1	4.4
Interest coverage ratio	5.8	21.4	11.5	11.8	14.7
<b>Dividend</b>					
DPS (Rs.)	3.5	6.8	4.4	5.8	6.5
Dividend Yield (%)	2.1	1.8	1.5	2.0	2.2
Dividend Payout (%)	24.4	12.7	15.0	15.0	15.0
<b>Per share (Rs.)</b>					
Basic EPS (reported)	14.7	54.6	29.6	38.5	43.1
Adjusted EPS	14.3	53.6	29.6	38.5	43.1
CEPS	26.9	66.3	42.3	51.4	58.1
BV	228.5	271.5	307.0	338.4	380.9
<b>Valuation</b>					
Adj P/E	11.7	7.1	9.7	7.5	6.7
P/BV	0.7	1.4	0.9	0.9	0.8
EV/EBITDA	4.8	4.7	6.1	5.5	5.1
EV/Sales	0.6	1.1	0.8	0.9	0.9
Adj Mcap/Core PBT	11.0	5.2	6.8	4.1	3.8
Adj Mcap/Adj OCF	53.7	6.9	9.7	3.3	5.4

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	88,112	97,171	109,467
<b>Shareholders' Funds</b>	<b>66,015</b>	<b>78,413</b>	<b>88,680</b>	<b>97,740</b>	<b>110,035</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	2,968	2,985	3,047
<b>Total Liabilities</b>	<b>90,287</b>	<b>101,114</b>	<b>113,480</b>	<b>122,557</b>	<b>129,913</b>
<b>Application of funds</b>					
Gross Block	53,621	56,814	63,312	65,810	74,808
Net Block	35,266	34,916	37,762	36,529	41,209
Capital WIP	780	2,412	2,202	2,617	2,977
<b>Investments</b>	<b>10,745</b>	<b>16,911</b>	<b>16,178</b>	<b>16,851</b>	<b>18,398</b>
<b>Other non current assets</b>	<b>2,435</b>	<b>3,206</b>	<b>3,643</b>	<b>3,568</b>	<b>3,893</b>
Inventories	27,961	28,823	32,488	30,219	33,055
Sundry Debtors	10,386	13,212	14,680	14,376	15,695
Cash & Bank Balances	2,115	1,217	7,550	18,924	14,789
Other current Assets	6,482	9,095	8,790	8,607	9,838
<b>Total Current Assets</b>	<b>46,944</b>	<b>52,347</b>	<b>63,508</b>	<b>72,126</b>	<b>73,377</b>
<b>Sundry Creditors</b>	<b>2,993</b>	<b>3,956</b>	<b>5,198</b>	<b>4,605</b>	<b>5,037</b>
Other Current Liabilities	2,889	4,722	4,616	4,529	4,903
<b>Total Current Liabilities</b>	<b>5,882</b>	<b>8,677</b>	<b>9,814</b>	<b>9,134</b>	<b>9,940</b>
<b>Net Current Assets</b>	<b>41,062</b>	<b>43,670</b>	<b>53,694</b>	<b>62,992</b>	<b>63,437</b>
<b>Total Assets</b>	<b>90,287</b>	<b>101,114</b>	<b>113,480</b>	<b>122,557</b>	<b>129,913</b>

Source: Company, SMIFS research estimates

Cash Flow					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Operating profit before WC changes	8,724	23,837	14,060	17,655	19,674
Net chg in working capital	(6,584)	(4,219)	(4,030)	2,169	(4,844)
Income tax Paid	(463)	(5,173)	(2,673)	(3,670)	(4,117)
<b>Cash flow from operating activities (a)</b>	<b>1,677</b>	<b>14,446</b>	<b>7,357</b>	<b>16,154</b>	<b>10,714</b>
Adj. OCF	687	13,639	6,315	14,815	9,528
Capital expenditure	-2,430	-5,191	-6,500	-2,500	-9,000
Adj FCF	-1,743	8,448	-185	12,315	528
<b>Cash flow from investing activities (b)</b>	<b>-1,159</b>	<b>-8,992</b>	<b>-3,770</b>	<b>-1,252</b>	<b>-8,438</b>
Debt	-885	-1,491	2,000	0	-5,000
Dividend	-3	-3,492	-1,285	-1,668	-1,869
Interest & lease	-944	-860	-1,042	-1,339	-1,185
<b>Cash flow from financing activities (c)</b>	<b>-1,740</b>	<b>-5,714</b>	<b>2,576</b>	<b>-3,513</b>	<b>-6,476</b>
<b>Net chg in cash (a+b+c)</b>	<b>-1,222</b>	<b>-260</b>	<b>6,163</b>	<b>11,389</b>	<b>-4,200</b>

Source: Company, SMIFS research estimates

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