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Mayur Uniquoters Ltd.

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Date: 27th April 2018

Long Term Recommendation: Mayur Uniquoters Ltd.

Growth story steered by capex and product mix change

CMP INR: 500
Rating: BUY
Target Price INR: 653
Upside: 31%

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Bloomberg:	MUNI:IN
52-week range (INR):	569.95 / 311.00
Share in issue (cr):	5
M cap (INR cr):	2,266
Avg. Daily Vol. BSE/NSE :('000):	59
Promoter Holding (%)	61.26

Mayur Uniquoters (MUL) is one of the largest manufacturers of artificial leather/PVC vinyl in India with ~37million meters (mm) annual capacity and ~8% domestic market share. During the past 5 years, MUL has reported a strong 20% profit CAGR despite 8% revenue CAGR supported by changing product mix towards higher realisation automotive OEM exports and cost efficiencies. Over the past 7 years, MUL has steadily established its credentials as a quality supplier to marquee automobile players in the US with the management now eyeing the European luxury car segment. Moreover, the company is foraying into Polyurethane (PU) leather by setting up a manufacturing unit in Gwalior which would entail a peak revenue potential of INR 500-600 cr. Together, the above mentioned initiatives are expected to drive revenue and net profit growth of 22%/25% CAGR respectively over FY18-20 while creating a strong base for robust growth post FY20.

Significant revenue potential from foray into PU leather segment

The domestic PU leather market with a size of 18mm/month is currently 95% import dependent due to limited technical-knowhow and high investment requirement. Buoyed by a strong R&D team, an existing footwear clientele base and sufficient funding from internal accruals, we believe the company is well placed to explore this opportunity. MUL is setting up a PU leather unit in Gwalior with an initial investment of INR 150 cr in 2 tranches (INR 90 cr and INR 50 cr) for 2 manufacturing lines of 0.5 mm /month between FY19 and FY21 to capitalize on this opportunity. Each PU line has the potential to generate ~INR 120 cr in topline. Eventually, MUL plans to scale this unit up to 5 lines over the next 5 years, creating a revenue potential of INR 500-600 cr. Additionally, with the current PVC utilisation reaching 75%, it is setting up a new 4-line PVC leather facility in Mysore to cater to rising demand in South India while also reducing logistics cost. The unit is expected to come on stream by FY20.

Mercedes' nod to open doors to European luxury car segment

MUL's presence in the automotive segment has, so far, been restricted to the domestic market and bulk carmakers in US & Asian countries. However, the company has now set its sights on entry in European luxury car makers. Companies like Mercedes, BMW and Audi represent a standard quality management system called VDA, meeting which makes an automotive vendor like MUL eligible for supplying to all the 3. MUL is in the midst of a process to get Mercedes' approval, bagging which will open the doors to other European luxury car makers as well. With one final round of inspection due from Mercedes in May 2018, MUL can potentially generate revenue from FY20. While this will add ~5-7% to the company's existing top line initially, the uptick potential in the medium term is significant.

Increased cost efficiency measures to further aid margin improvement

The company's backward integration in fabric manufacturing has been immensely beneficial pruning fabric cost per unit by 24% in the past 5 years and improving margins . Going forward, MUL is looking to expand this unit to keep pace with rising volumes.

Valuation & recommendation

MUL's strategy of PU expansion and client diversification backed by a a strong balance sheet will mark its future growth trajectory. This, coupled with a core - ROCE (net of cash and investments) of 58%, makes MUL one of the best plays in the industry. We value the company at 20x FY20E EPS of INR33 and initiate with 'BUY' recommendation and target price of INR 653/share.

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues (INR Cr)	496	482	564	660	838
Rev growth (%)	-2	-3	17	17	27
EBITDA (INR Cr)	131	129	153	177	247
Net Profit (INR Cr)	77	77	95	109	148
P/E (x)	29.9	29.7	23.7	20.8	15.3
EV/EBITDA (x)	17.8	17.7	14.6	12.7	9.0
Core RoCE (%)	54.4	50.6	58.4	51.3	53.1
RoAE (%)	25.0	21.9	22.9	21.8	23.9

Date: 27th April 2018

MUL has steadily established its credentials as a quality supplier to marquee automobile players in the US with the management now eyeing the European luxury car segment. Moreover, the company is foraying into Polyurethane (PU) leather by setting up a manufacturing unit in Gwalior which would entail a peak revenue potential of INR 500-600 cr. MUL's business strategies towards product expansion and client diversification backed by a strong balance sheet will mark its future growth trajectory. This, coupled with a core - ROCE (net of cash and investments) of 58%, makes MUL one of the best plays in the industry.

Significant growth in revenues while maintaining margins due to a

	FY16	FY17	FY18E	FY19E	FY20E
Revenue	496	482	564	660	838
Gross Margin (%)	44.1	45.9	45.1	45.0	47.0
EBITDA Margin (%)	26.4	26.8	27.2	26.8	29.5
PAT margin (%)	15.6	16.0	16.9	16.5	17.7

Capex funded by internal accruals

	FY16	FY17	FY18E	FY19E	FY20E
Capex	14	10	15	150	65
Net Cash from Operations	73	77	101	98	134
Core ROCE (%)	54%	51%	58%	51%	53%

Free cash flows from FY20 with scope for further expansion

	Multiple	Price Target
BAL	20x	653
	25x	937

Entry = INR 500 + **PAT CAGR of 25% over FY18-20E** + **Free cash flow generation to lead to an exit multiple of FY20E 20x**

Upside of 31%

Risk-reward highly favourable

Price Target	**INR 653**	Our target price is arrived at by assigning 20x P/E multiple FY20E EPS of INR 32.5 driven by 25% bottom line CAGR between FY18 - FY20, >50% core-ROCE coupled with strong operating cash flows.
Bull 25x 2020E EPS	**INR 937**	MUL is undergoing capex in PU leather and putting up additional PVC lines both of which have quick ramp ability (90% compared to 70% expected). The company could also achieve better gross margins (52% compared to 48% expected) on account of cost rationalisation measures. This makes for a compelling bull case scenario with a potential rerating of exit multiple 25x on an EPS of 37.5 in FY20E.
Base 20x 2020E EPS	**INR 653**	We value the company at 20x FY20E EPS of INR33 assuming 25% bottom line CAGR between FY18-FY20, >50% core-ROCE in FY20 coupled with strong operating cash flows
Bear 17x 2020E EPS	**INR 442**	In the bear case scenario, we have assumed all risks to materialise including slow PU ramp up, non-approval from Mercedes and delay in base volume growth. Assigning a lower multiple of 17x FY20E on an EPS of INR 26 gives us a target price of INR 442/share, downside limited to 9% from CMP

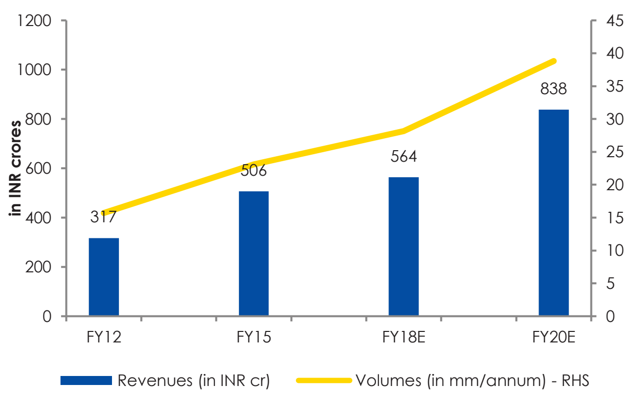
Average Daily Turnover (INR cr)			Stock Price (CAGR)				Relative to Sensex, CAGR (%)			
3 months	6 months	1 year	1 year	3 years	5 years	Since Inception	1 year	3 years	5 years	Since Inception
2.8	6.3	4.7	36%	4%	38%	77%	22%	-2%	26%	62%

Business Value Drivers

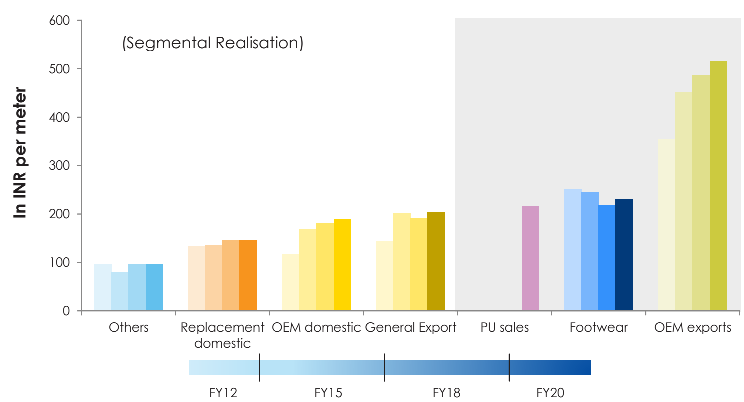
Nature of Industry	Synthetic leather industry in India is highly diversified in nature with nearly half the industry being unorganised. Varying requirements across end-user industries such as footwear and automobiles has led to varying industry dynamics in terms of pricing power and competitiveness.
Opportunity Size	Global synthetic leather was 22 mn tonnes in 2015; production is expected to grow at a 7% CAGR during 2015–20E to ~34 mn tonnes. Increased demand from Asia-pacific and western markets on account of rising natural leather substitution would entail the growth in demand. India comprises of 3% of the global market in which MUL is only ~10% of the market by value thus creating a huge opportunity for itself going ahead.
Capital Allocation	MUL has been prudent in capital allocation. The management considers both PVC leather lines and knitted fabric machines as part of its capital allocation. While volumes uptick into high-margin segments in one part of growth strategy, cost rationalisation through appropriate capex in fabrics (28% of cost) is another. Further, capex in PU leather and set up of new PVC plant in Mysore out of internal accruals are rational capital allocation decisions.
Predictability	MUL's financials are partly influenced by crude price volatility. Any changes thereon could impact realisations and revenues of the company. However, high customer stickiness makes volume predictable across end user segments.
Sustainability	Synthetic leather industry has been consistently on the rise barring few slowdown phases led by economic and regulatory changes. Global acceptability of synthetic leather and recognition of MUL as a high-quality global supplier will further ensure business sustainability.
Disproportionate Future	MUL can achieve high revenues in case of rise in crude prices. However, its profits are less likely to be impacted because of the same. Further, any large export OEM order could also lead to very high volumes and margins growth.
Business Strategy & Planned Initiatives	MUL has been strategically shifting to automobile industry and exports to reduce its footwear concentration and open more growth avenues. Currently, the company in attempting to develop relationships with luxury automobile players in Europe and also venturing into PU leather for its next leg of growth.
Near Term Visibility	The demand for PVC leather is expected to remain strong in the near term due to new client addition and increasing market penetration in both footwear and automobile segments. Further, the expected supply nod from Mercedes could be margin accretive and add to the bottom line.
Long-Term Visibility	As the market for synthetic leather is growing, demand of high and standard quality suppliers is also increasing. In such scenario, we believe the R&D strength built by MUL in the past decade will set ground for all its future endeavours and give longevity to the business.

Focus Charts – Story in a nutshell

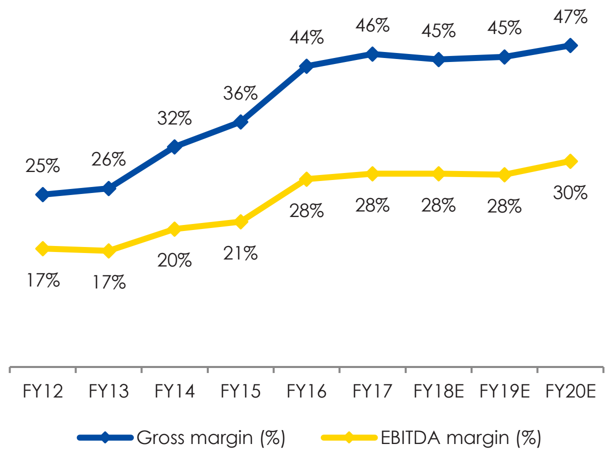
Volume growth sticky despite crude volatility driven pricing



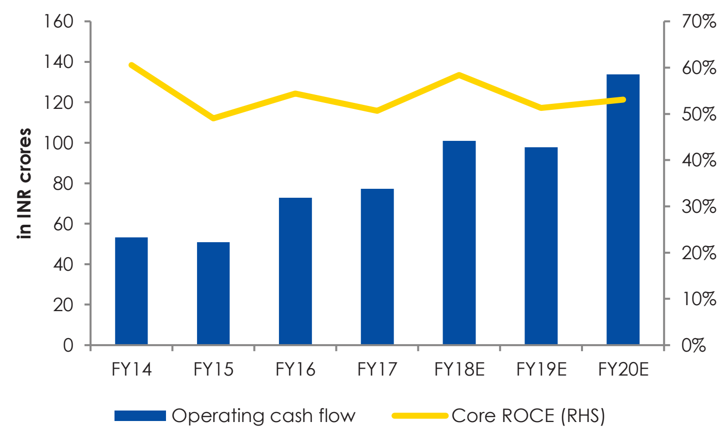
Increased focus on high realisation segments



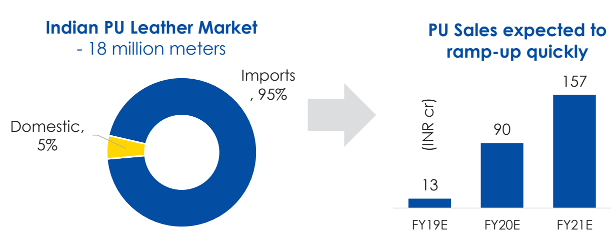
Margin accretion led by improved product mix and cost efficiency measures



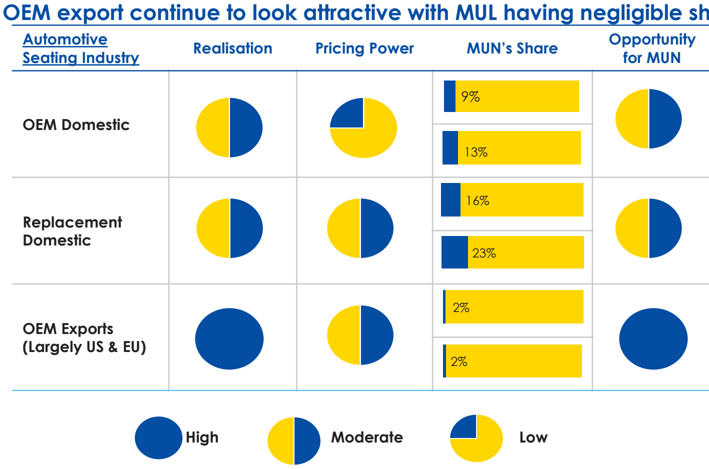
Consistent increase in CFO with strong core ROCE profile



Huge opportunity in import dominated PU leather market



OEM export continue to look attractive with MUL having negligible share



Source: Edelweiss Investment Research

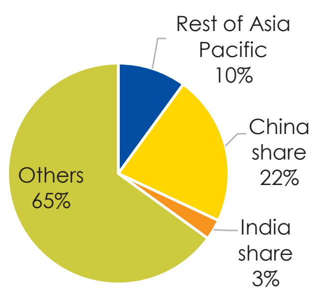
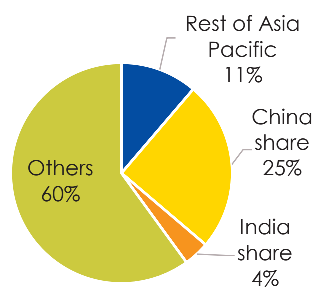
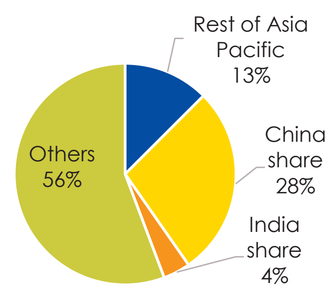
I. Synthetic leather: Industrydynamics

a. Global synthetic leather market: Organised players gaining marketshare in an diversified market

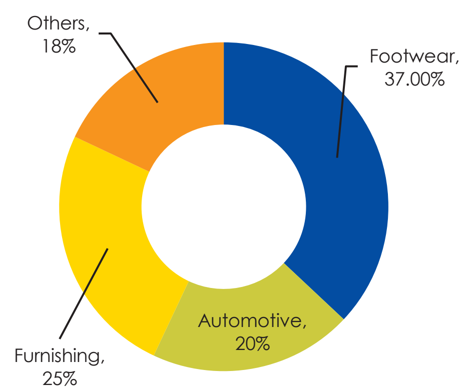
Synthetic leather has found increasing acceptance in global markets (traditionally dominated by natural leather) as cost efficiencies have gained prominence. Synthetic leather, being 4-5x cheaper than natural leather, has become the preferred choice in mass market products such as footwear and automotive.

Apart from the cost differential, synthetic leather has found favour over natural leather due to a variety of reasons, key being higher flexibility, better durability, reduced pollution and animal cruelty concerns associated with leather tanning.

Steady growth expected to sustain with rising dominance of Asian markets

	2010	2015	2021
Global synthetic leather market (billion USD)	**15.3**	**22.5**	**33.8**
Geographical Share			
Capacity in mln meters	**11,600**	**15,780**	**21,529**
Average price INR/linear meter	**86**	**93**	**102**

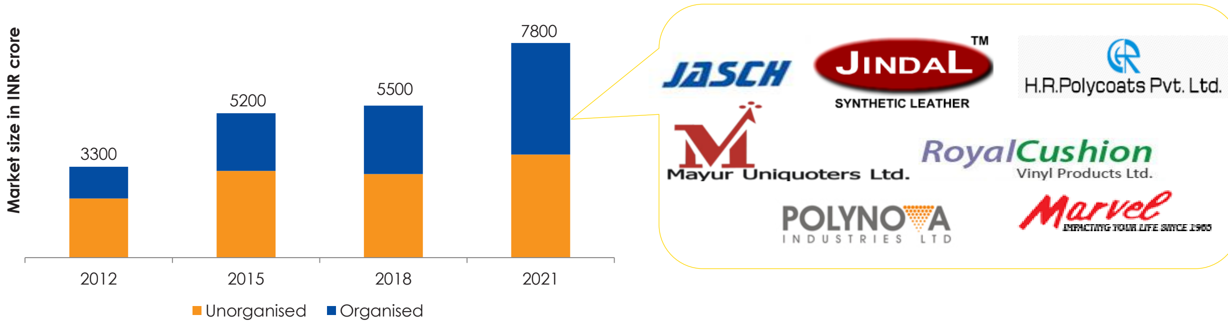
End-user industry exposure



Source: Edelweiss Investment Research

b. Indian synthetic leather market: Well diversified market and growing share of organised players

The synthetic leather industry in India is pegged at INR 5,500 crore. The organised sector accounts for less than 50% of this market comprising 20-25 players including a few big companies such as MUL, Jindal Coaters, HR Polycoats, Polynova, Jasch Industries, among others. However, the organised players' share as % of the total market has improved by 1000 bps between 2012 to 2018 and the trend is likely to continue.



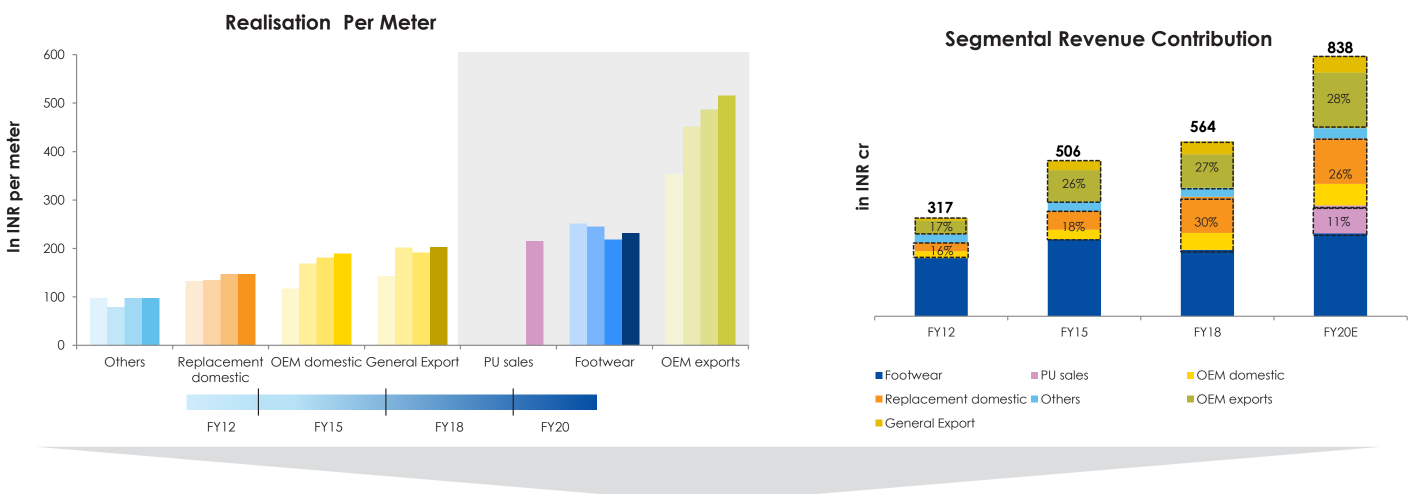
Source: Edelweiss Investment Research

c. MUL: Changing product mix for better margins and growth prospects

The global synthetic industry is dominated by the high volume, low value footwear and furnishing segments. However, these being low realisation businesses with significant unorganised presence, do not provide very lucrative growth opportunities. Hence, MUL has changed its business mix in favour of automotive interiors, especially OEM exports, with exports proportion as % of sales increasing from 17% in 2012 to 27% in 2018

While footwear continues to be a steady growth business with strong volume growth potential, the inherent sectoral dynamics and high unorganised presence leave little on the table to fuel significant value accretion.

Shifting to automotive spurred by higher realisation, bigger expansion opportunity



- **Low pricing power and significant competition in footwear has restricted growth beyond existing levels**
- **Highly underpenetrated domestic automotive segment provided quick scale-up led by edge in quality and design**
- **Exposure to high-realisation exports market has increased significantly as MUN set-up its own subsidiary in the US and added Ford, Chrysler and GM as clients**

Source: Edelweiss Investment Research

II. Footwear: Major end user of synthetic leather

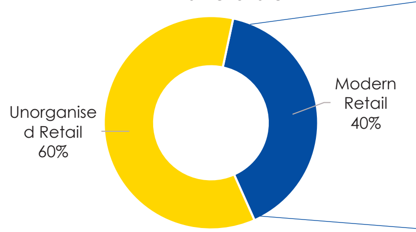
a. Industry: Limited organised share in footwear, coupled with low pricing power in PVC leather restricts growth

Footwear industry in India is one of the largest (10%+) globally, second only to China (60%+). Although, synthetic leather is used in 80% of footwear industry, the footwear market has significant share of unorganised players. This limits the potential for MUL as the later only supplies to organised players.

Domestic footwear: market dynamics and its influence on MUL

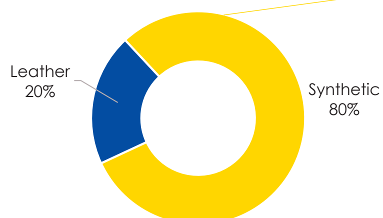
Size of the domestic footwear market: INR 30,000 crore/year

Market Share



VKC Paragon LIBERTY action Bata RELAXO

Type of footwear based on material



Key characteristics	Synthetic leather	
	PVC leather	PU leather
Usage	Insole	Outer sole
Customisation	Low	High
Quality	Moderate	High
Fast fashion impact	Low	High
Unorganised domestic presence	High	Low
Pricing power	Low	Moderate-High
Import dependency	0-5%	90-95%

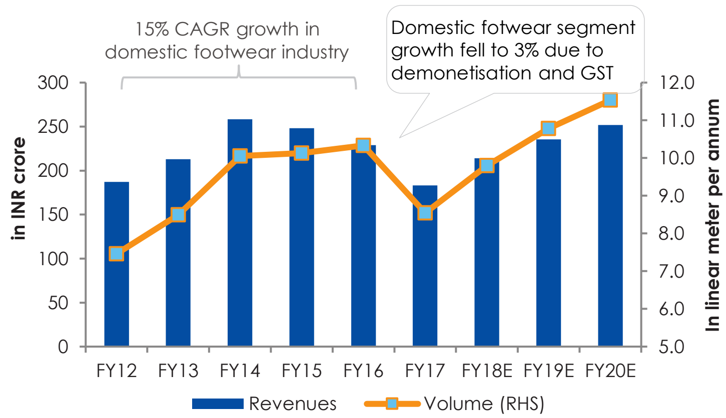
Source: Edelweiss Investment Research

In the synthetic leather market, PVC and PU leather are two types with varying technology and usage. While PVC is an explored market in India with multiple players, PU is niche with over 95% dependence on imports from China. Currently, MUL is also present only in PVC leather.

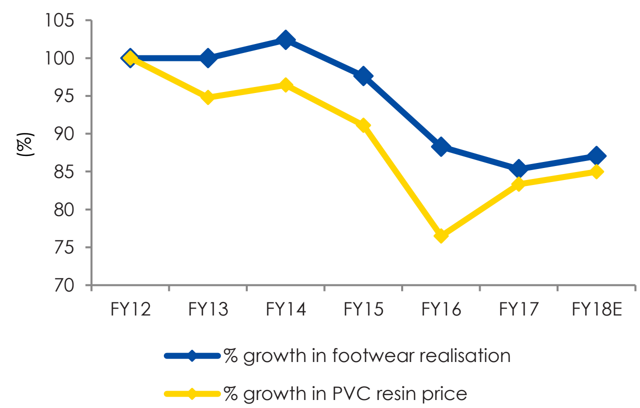
b. Low pricing power makes MUL vulnerable to industry and raw material undercurrents

Both PVC leather and footwear industries are highly competitive with significant share of unorgansied participants. This reduces the pricing power of players like MUL making them vulnerable to changing industry dynamics on both sides, footwear and PVC leather. On one hand, slowdown in footwear industry has direct bearing on MUL's volumes off-take, while changes in PVC raw material prices directly impacts MUL's realisations.

Industry dynamics impact MUL's revenues from footwear



PVC resin price volatility impact footwear realisations



Source: Edelweiss Investment Research

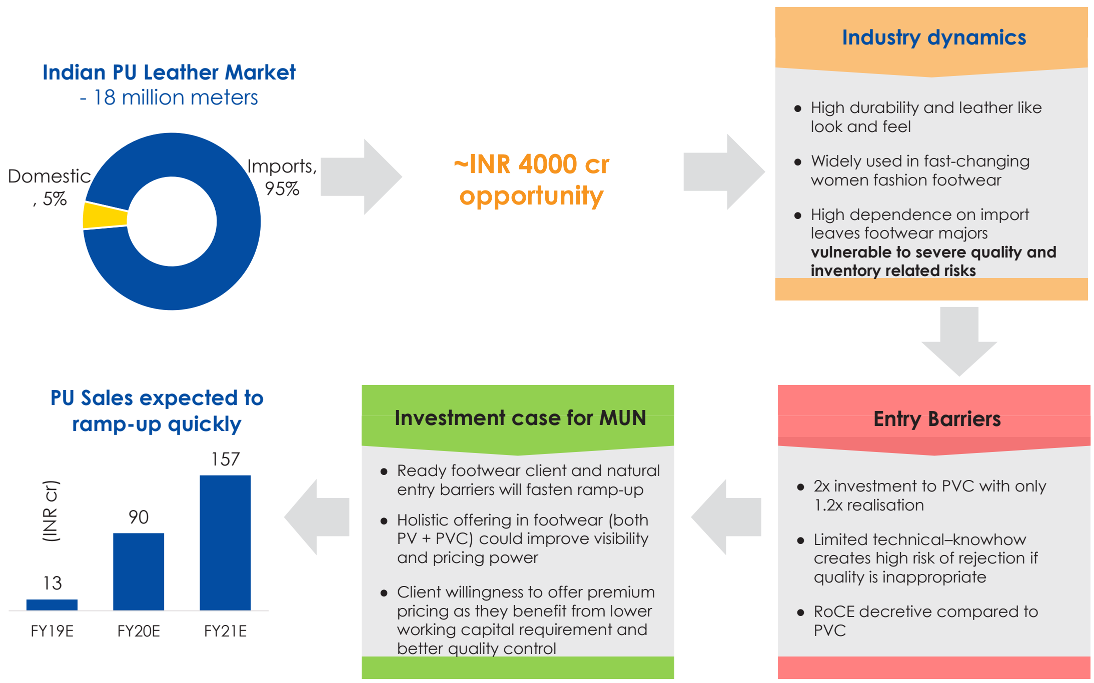
Strong traction in the footwear industry with 15% CAGR between FY12 and FY16 led to significant volume growth in MUL's footwear segment. However, demonetisation and GST implementation in FY17 led to muted growth in the footwear industry, which took a toll on leather demand as well. Further, fall in PVC resin prices (key raw material) directly impacted MUL's footwear realisation.

While growth in footwear industry is expected to be positive for MUL, we believe the segment to be only a moderate growth driver for the company.

c. **MUL for PU: Attractive opportunity for next leg of growth**

High investment requirement and niche technical know-how limits competition

Key features of PU synthetic leather such as durability and gloss render it a closer and more preferred alternative to natural leather, leading to demand doubling over the past 5 years. While PVC leather is a scattered market in India with numerous players, nearly 95% of PU is still imported from China. Domestic players have been wary of entering the segment due to limited technical know-how and large investment requirement. This has made all domestic footwear players dependent on Chinese PU supplies, exposing them to severe quality and inventory related risks.



Source: Edelweiss Investment Research

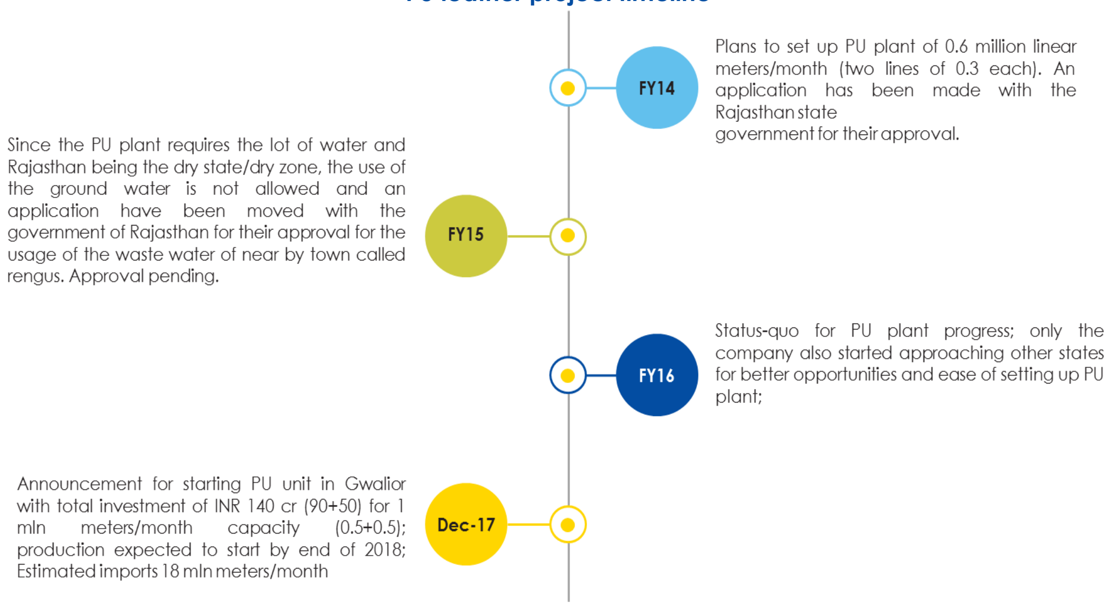
With appropriate technical ability and financial strength, MUL is set to initiate PU leather plant

MUL has a strong R&D team speerheaded by Mr. Ramdas Acharya, a qualified research personnel with 30-years experience in the US synthetic leather industry. This has aided the company in deveoping the technical for PU leather manufacturing. Additonally, MUL has internal accruals of ~INR 190 crore in FY18E. Thus, the company is righty positioned to take advantage of the lucrative opportunity in PU leather manufacturing. Further, on the client side, having relationship with all leading organised footwear players will aid the company in ramping up its PU capacities.

Post a 4-year delay, PU plant expected to come on-stream in Q4FY19

MUL had undertaken plans to start PU leather lines first in FY14 in Rajasthan. However, a series of constraints relating to waste-water treatment kept the porject from materialising. Post failure to resolve regulatory issues in Rajasthan, MUL has shifted its PU plant to Gwalior (Madhya Pradesh). Since the region does not require any environment clearance, the plant only needed pollution clearance to get pass regulations.

PU leather project timeline



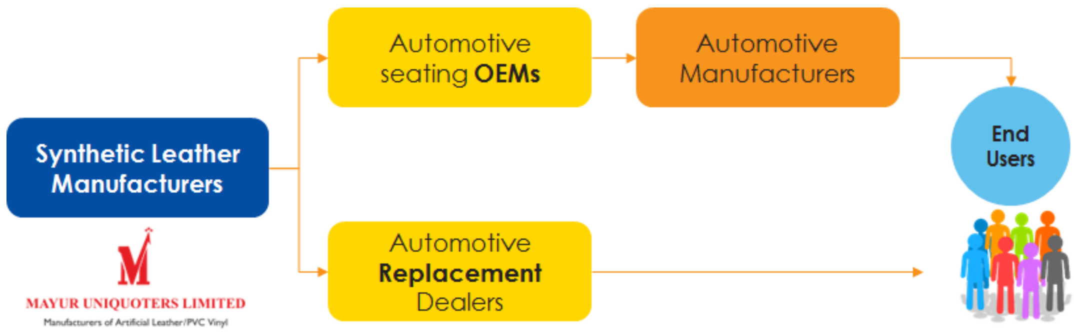
Source: Company, Edelweiss Investment Research

Having completed land acquisition, phase I (first line) production is expected to commence from Q4FY19 and phase II (2nd line) by Q4FY20. With each line entailing potential to generate ~INR 120 crore revenue, the company is planning to scale this unit up to 5 lines over the next 5 years, creating a revenue potential of INR 500-600 crore.

III. Automotive interiors: quality oriented end-user offering high margins

a. Industry: Diverse dynamics across sales channels in automotive interiors

The automotive seating industry is one of the most lucrative segments for the synthetic leather industry, consuming ~20% of global production while maintaining its niche for quality standards and pricing. Demand for synthetic leather—key raw material in the automotive seating industry—is directly correlated with industry growth. Further, considering higher aesthetic value of seating and shorter life span owing to wear and tear compared the life of a vehicle, there is a larger replacement market where additional seat covers are sold along with other auto accessories.



	Original Equipment Manufacturers (OEMs)	Replacement
Decision maker	Auto manufacturers	Third-party vendors
Quality focus	High	Moderate
Design focus	Low	High
Pricing power	Low-moderate; owing to competition bidding	Moderate-high; led by design innovation
Stickiness	Very high; auto players typically stick to vendors for specific projects	Moderate-high; end-user demand and retail margin driven

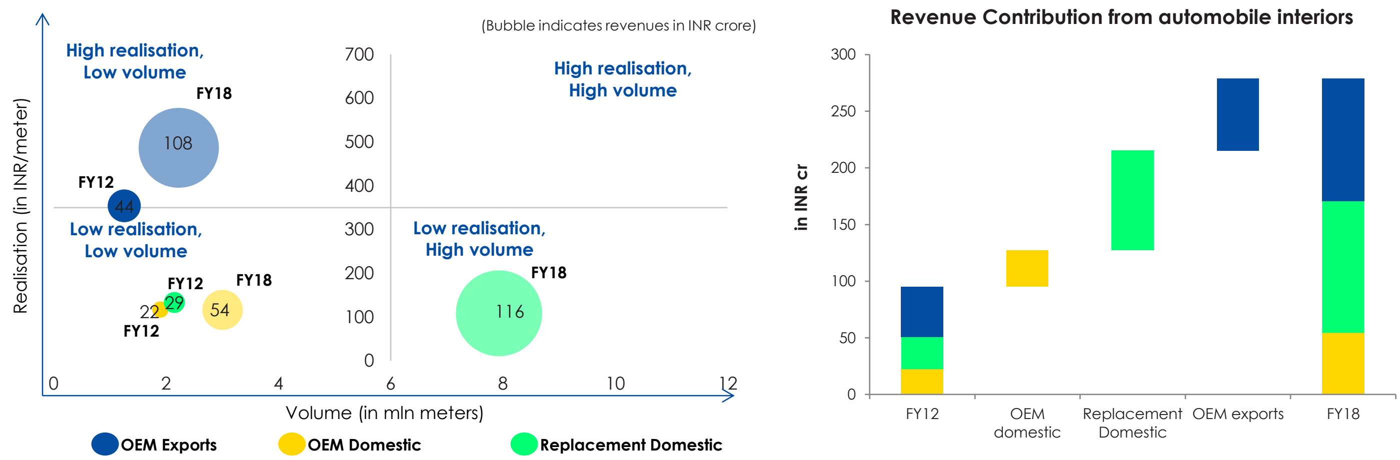
Source: Edelweiss Investment Research

b. MUL: Scaling up from mass-market to luxury cars

Volume-led replacement market and bulk exports dominated MUL's growth up to FY18

OEMs provide a steady margin business with volumes being directly correlated with the off-take of respective models. However, growth in domestic OEMs remains restricted owing to presence of multiple established players and highly competitive bidding. The replacement market, on the other hand, provides faster scalability owing to low brand loyalty and higher inclination towards innovative designing.

High volume contribution by domestic replacement market and high value by exports drive growth



Source: Edelweiss Investment Research

From a volume base of 1.7-2.6mm /month each across the 3 segments in FY13, MUL has ramped up its replacement volumes at 24% CAGR to ~8mm /month in FY18, while OEMs (domestic and exports) clocked mere 6-7% CAGR. However, OEM exports, being a higher realisation segment, contributed significantly to revenue like replacement segment.

Significant share in domestic OEMs and replacement markets; exports still lucrative

While the domestic replacement market had spearheaded MUL's growth with aggressive dealer addition supported by high quality, innovative designs and competitive pricing, we expect growth from this segment to moderate going forward considering high competition coupled with a high base. Exports, however, is a much wider market with MUL's presence being limited to the US and few Asian economies. Therefore, the company is looking up to this segment for its future expansion.

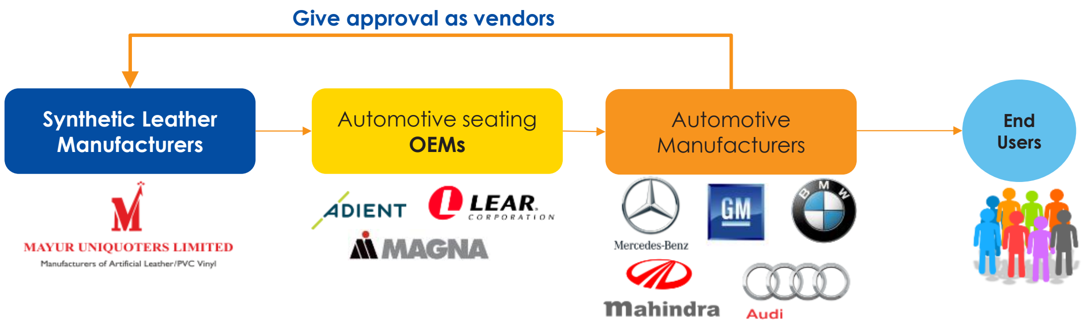
Automotive Seating Industry	Realisation	Pricing Power	Market Size Estimate	MUN's Share	Opportunity for MUN	Rationale
OEM Domestic	Moderate	Low	33 Mn meters	9%	Moderate	• Industry led growth expected • High competition limits scope to increase market share
			~INR 400 crs	13%		
Replacement Domestic	Moderate	Moderate	49 Mn meters	16%	Moderate	• Having already on boarded Maruti vendors, future growth is limited on a high base • Yet, design innovation to aid in outgrowing industry by tad bit
			~INR 500 crs	23%		
OEM Exports (Largely US & EU)	High	Moderate	122 Mn meters	2%	High	• Small presence gives wider room for expansion • Addition of Merc, BMW OEMs to aid in strong growth
			~INR 6000 crs	2%		

High **Moderate** **Low**

Source: Edelweiss Investment Research

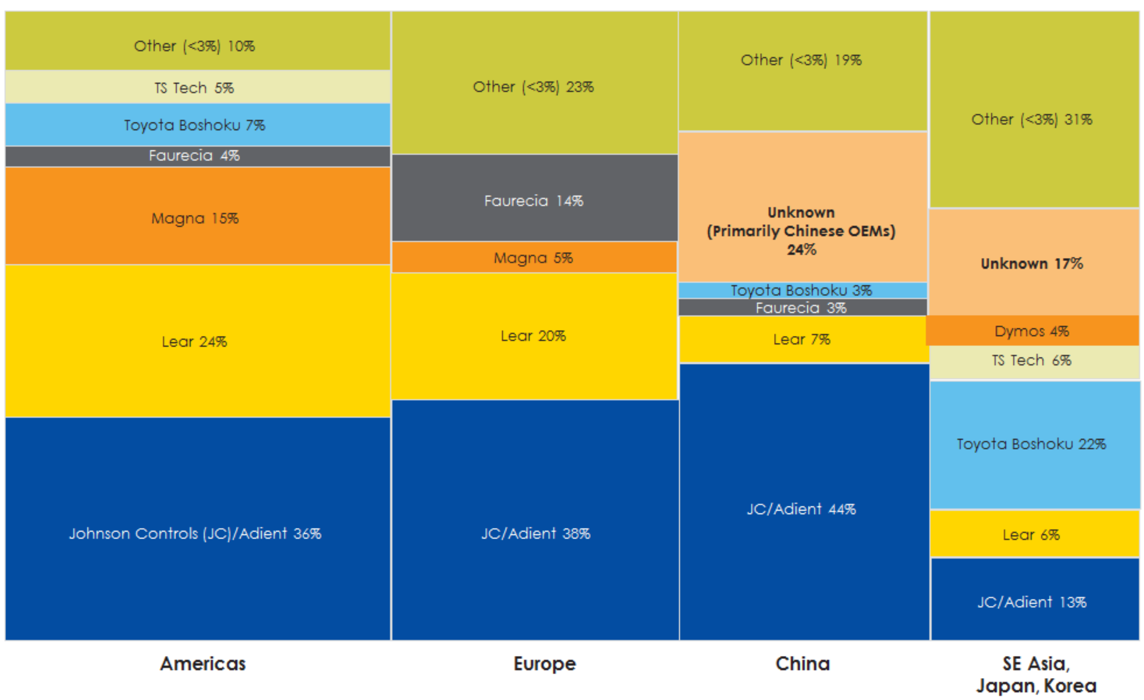
OEM exports: Established relations with global players to aid in growth

As discussed in section (III a), MUL is a level 3 participant in the automobile industry supplying to automotive seating OEMs who in turn will supply these seats to the carmakers' assembling unit. In order to control quality of parts, the carmakers themselves approve vendors from which the OEMs can procure parts.



MUL has steadily established its credentials as a quality supplier to automotive players globally over the past 7 years. Among automotive seating OEMs, MUL is already a supplier to market leaders Adient, Lear and Magna in limited capacity. We expect the company to benefit from this relationship in expanding its exports presence.

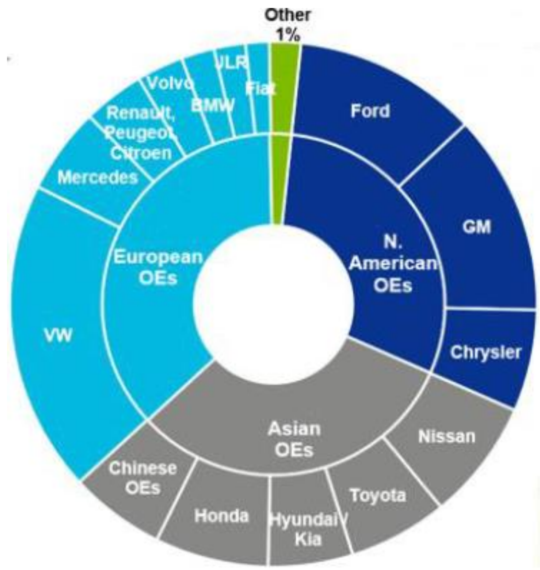
Automotive seating OEMs JC, Lear and Magna have significant market share across major regions



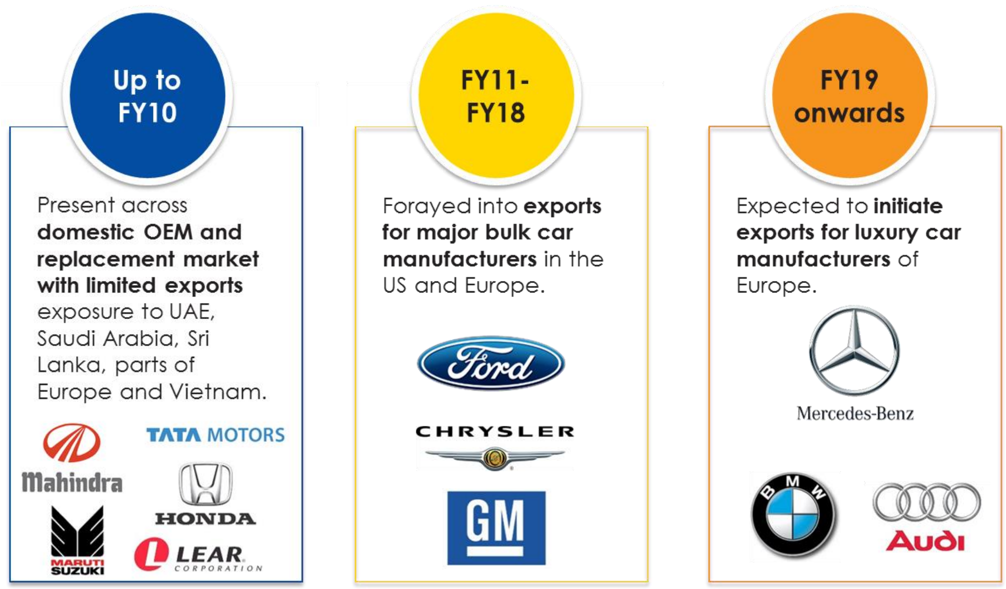
Source: Edelweiss Investment Research

Already catering to large automakers in US and Asia; yet to tap European luxury players

Global automotive industry can broadly be divided into North America (the US), Europe and Asia. While Asian and North America markets comprise of mass market automotive brands, most luxury and niche carmakers are European. While MUL has already tapped into the US and Asian markets, it is at the onset of being a vendor to European luxury carmakers starting Mercedes.



Source: Edelweiss Investment Research



Source: Edelweiss Investment Research

Mercedes' nod post meeting VDA standards can open the doors to larger European market

- **Mercedes looking for PVC leather vendor:** Mercedes, so far, had 2 synthetic leather suppliers viz., Hornschuch and Benecke-Kaliko. However, in June, 2017, Hornschuch was absorbed into Benecke by the parent company Continental to form Benecke-Hornschuch Surface Group, leaving Mercedes vulnerable to a single-source for its synthetic leather supply. Although MUL was on the prowl to start supplies to European major automakers since FY14, it is only post the Benecke-Hornschuch merger that Mercedes has started taking keen interest in the company.

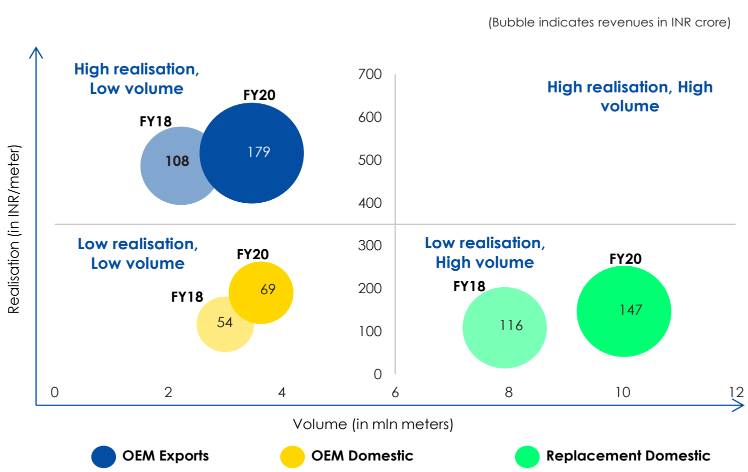
- **On verge of bagging approval once meets VDA standards:** Mercedes has already conducted 2 rounds of VDA* standard inspection in MUL's facilities in August and November 2017 with the latest one being a yellow signal (in November, 2017) indicating requirement of a few modifications. MUL expects the next round of inspection in May 2018, which the management expects to be final. Considering the pace of inspections and minor nature of changes required, we expect the relationship with Mercedes to materialise in FY19 and revenue contribution to start FY20 onwards.

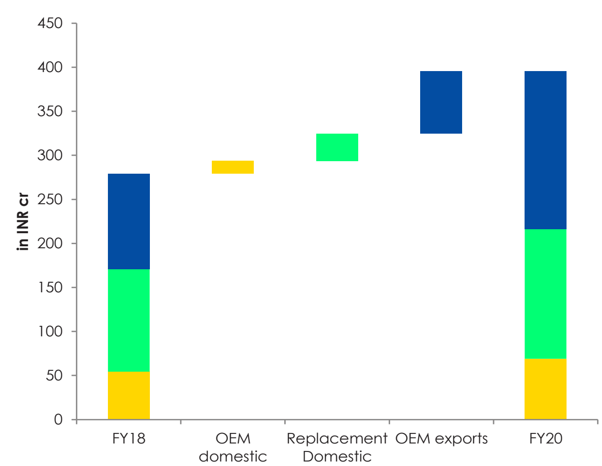
- **Strong revenue potential with margin accretion:** The volume offtake from Mercedes will primarily depend upon nature of the agreement and volume offtake of respective models that MUL will be supplying to. Considering the historical average sales volume of Mercedes per model class of 300,000-400,000, MUL can generate volumes of at least 0.5mm per year even with 20% share in one model class, leading to revenue contribution of at least INR 30 crore in FY20. By FY22, this could scale up to INR 100 crore p.a. with 40% EBITDA potential.

- **VDA approval opens door to other luxury brands:** Upon clearing VDA standards, MUL will get to participate in projects of the other 2 major VDA member carmakers BMW and Volkswagen. We believe, this will be a significant stepping stone for MUL and open doors to a much wider exports market besides the US.

**[Verband der Automobilindustrie (VDA) is a German interest group of the German automobile industry, both automobile manufactures and automobile component suppliers. It represents carmakers BMW, Volkswagen, and Mercedes-Benz parent Daimler and counts foreign suppliers and foreign-owned carmakers among its members. They have released a German Quality Management System (QMS) standard called VDA 6.1 and any company seeking certification must achieve at least 90% compliance.]*

Export OEM market of existing and new clients to spearhead MUL's growth from automotive industry



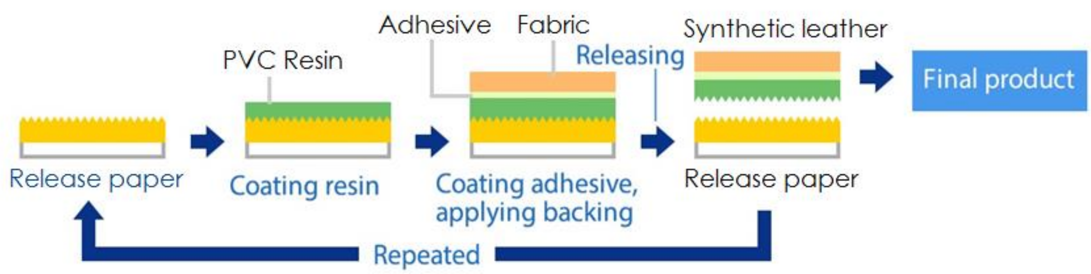


Source: Edelweiss Investment Research

IV. Cost efficiency measures and improved product mix boost margin

Backward integration into fabrics pruned cost of production significantly

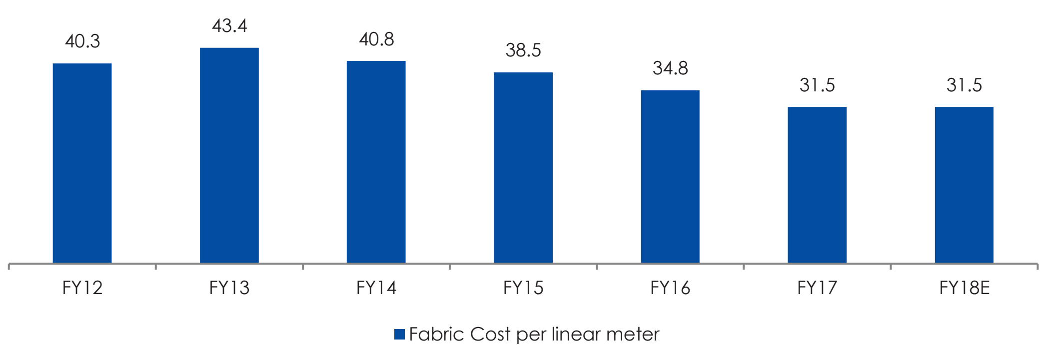
Contribution to cost		Price control	
Release paper	5%	Moderate	Stable and standard; improved efficiency for reusability has reduced per unit cost by 13%
Fabric	28%	High	With an investment of ~INR 40 crore, the company reduced its fabric cost as % of sales by nearly 4% by reducing the per unit fabric cost by 23% while getting better quality control
Chemicals	67%		Nearly 70% of chemicals are crude linked
PVC resin (40-45% of chemicals)		Low	Globally determined prices; largely linked to crude oil with ability to partially pass on changes
Other Chemicals/adhesives		Moderate	Adhesives and other chemicals for improving quality; procured from various regions depending on order requirements; low control



Source: Edelweiss Investment Research

In the synthetic leather manufacturing process, fabric is the second most important cost contributor after PVC resins. Since fabric is used as a backing for resin and goes into the final product, its quality is of primary importance.

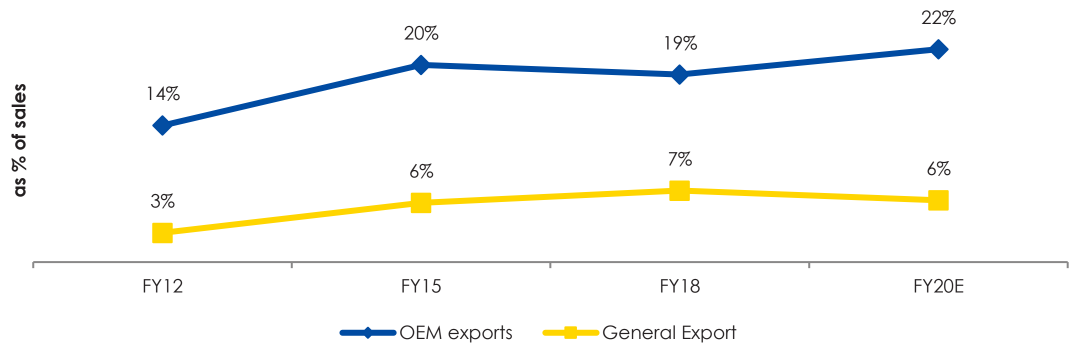
MUL started its own knitted fabric manufacturing unit in September 2012 to gain an edge in cost and quality. With an investment of INR 40 crore, the company has achieved backward linkage in knitted fabric. This brought down the per unit fabric cost by ~23% and, in turn, improved margin. Further, by controlling raw material quality, MUL was able to achieve a lower rejection rate, which in turn, burnished its reputation and profitability. Additionally, this backward integration led to a significant reduction in product development time from 2-3 months to 3-4 weeks.



Source: Edelweiss Investment Research

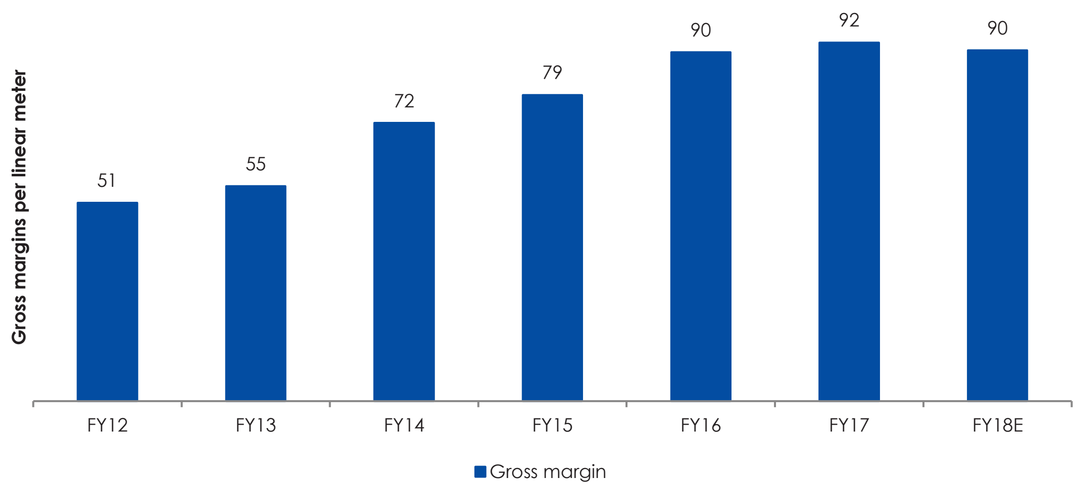
Higher revenue contribution of margin-accretive exports

MUL changed its product mix by increasing share of exports sales from 17% to 27% in overall revenue between FY12 and FY18. Going forward, we expect revenue from exports, especially auto OEMs, to outpace overall sales and boost margin further.



Source: Company, Edelweiss Investment Research

Higher exports contribution coupled with cost efficiencies aided gross margin accretion

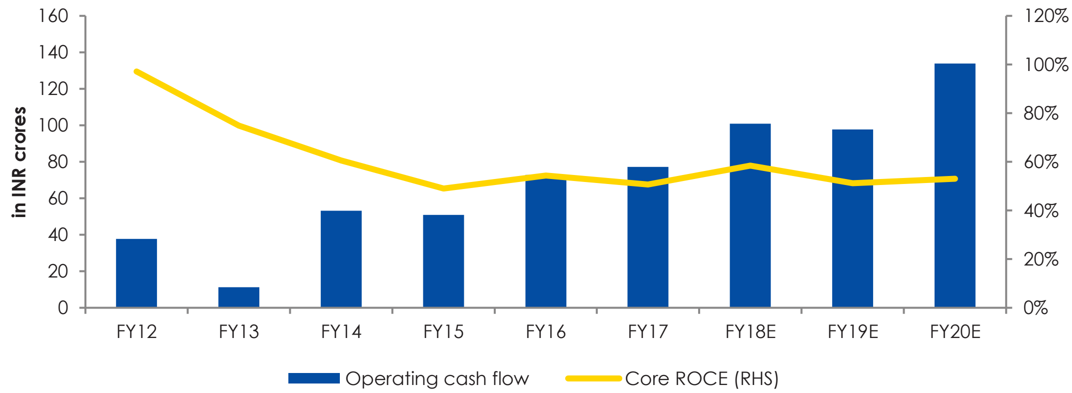


Source: Company, Edelweiss Investment Research

Going forward, we expect gross margin to improve further riding the company's several cost efficiency measures:

- MUL is planning to expand its knitted fabric capacity to meet rising volumes.
- It aims to reduce transportation cost by setting up a dedicated manufacturing unit in Mysore for its clientele in South India. The unit should be operational by FY20.

V. Sufficient internal accruals for capex and strong operating ROCE makes case for rerating



Source: Company, Edelweiss Investment Research

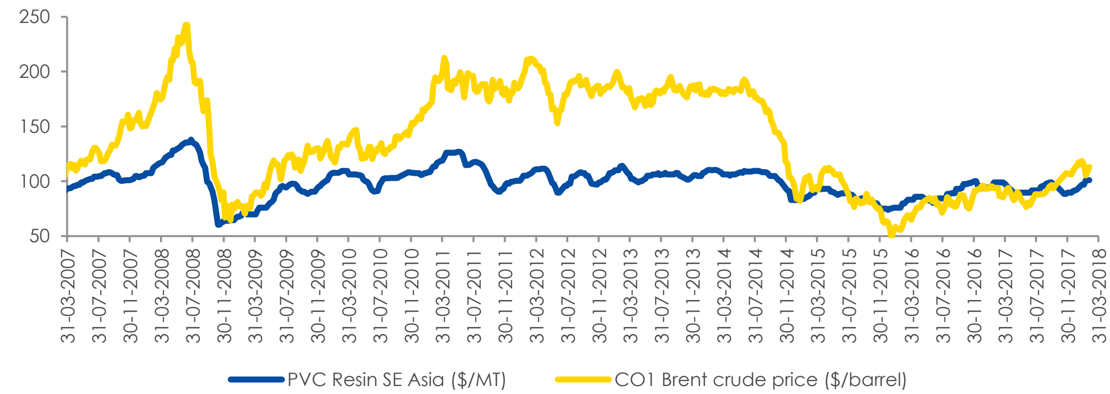
MUN has been maintaining internal accruals of above INR 100 crores since FY15, due to negligible capex requirements apart from maintenance. Further, the company has been maintaining returns of above 50% on its capital employed (excluding cash and investments). Going forward, with a planned capex of nearly INR 215 crore, the company should still be able to maintain its ROCE profile due to quick ramp-up of new capacities and strong operating leverage.

Risks and sensitivity

Volatility in PVC resin prices

As discussed in section IV, PVC resins form 40-45% of the total chemicals cost of MUN. Strong linkage with crude oil makes the company vulnerable to cost volatility. In fact, nearly 70% of MUN's overall chemicals cost are linked to crude oil prices. Considering the inherent volatility in PVC resin prices due to crude linkage, MUN is expected to remain exposed to such risks.

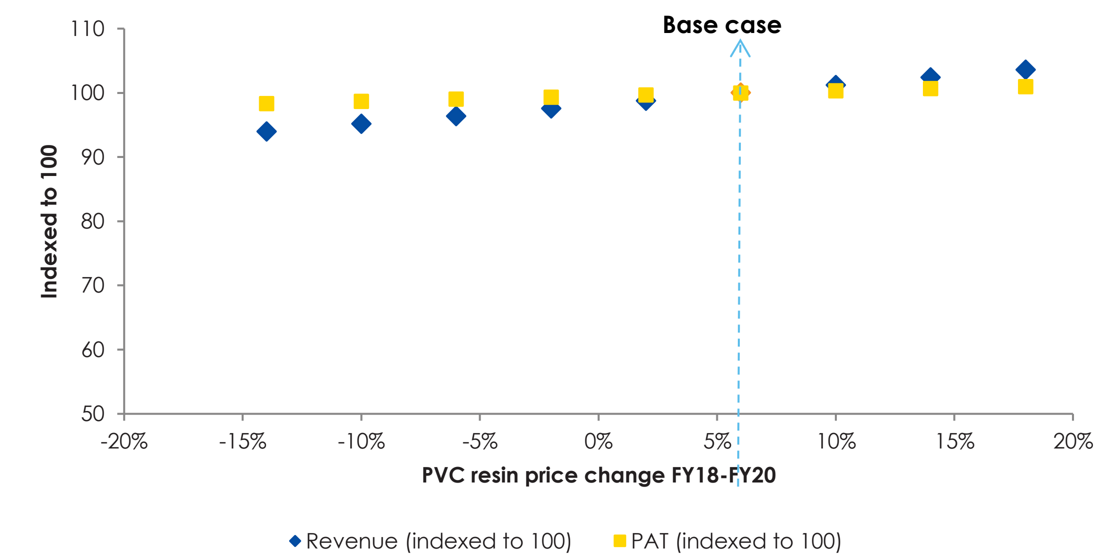
Fall in PVC resin (~40% of production cost) prices in line with crude further



Source: Bloomberg, Edelweiss Investment Research

While impact of PVC resin price change on overall revenue is unavoidable due to change in realisations from footwear segment (directly correlated and forms 38% of revenues), we expect profits to remain immune due to similar impact on cost of goods sold.

PVC resin price sensitivity to revenues is material but absolute profits remain immune

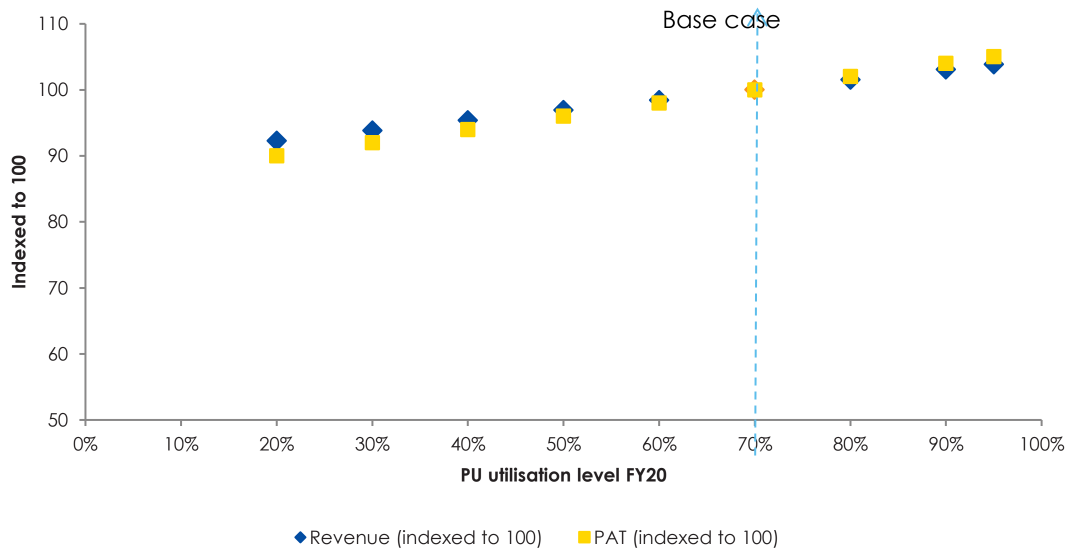


Source: Edelweiss Investment Research

Delay in ramp-up of PU leather capacity in Gwalior

We expect production at the PU leather facility to commence from Q4FY19 with 70% utilisation of the 1st line by FY20. However, in case of any delays in project commencement or longer ramp-up time, our financial expectations can get adversely impacted.

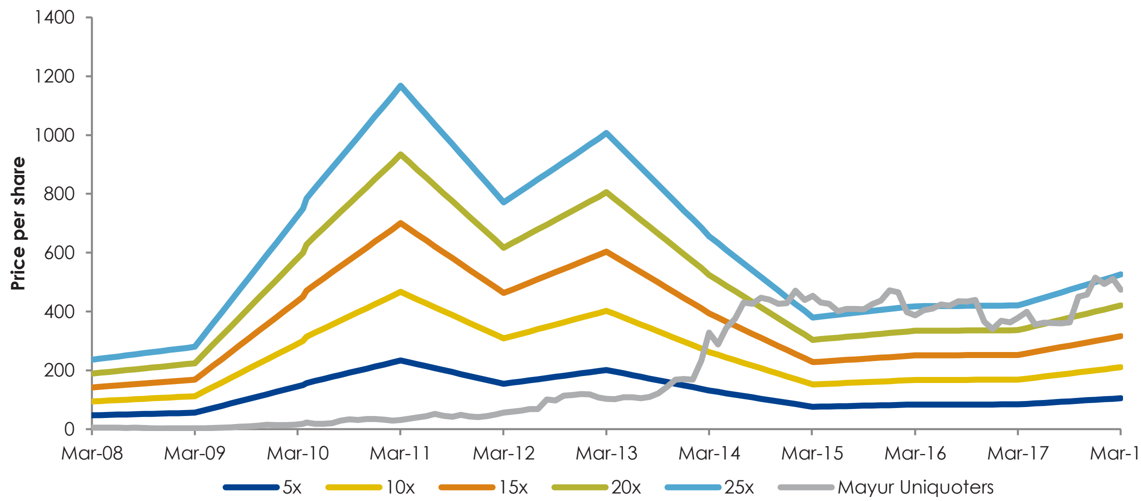
However, considering that PU is expect to form only 11% of MUL's FY20 revenues, the overall impact on the company remains limited.



Source: Edelweiss Investment Research

Valuations

MUL's business strategies towards product expansion and client diversification backed by a a strong balance sheet will mark its future growth trajectory. This, coupled with estimated internal accruals of INR 188 cr for FY18 and ROCE (net of cash and investments) of 58%, makes MUL one of the best plays in the industry. Our earnings estimates per share for FY18/FY19/FY20 are INR 21/24/33 respectively. We value the company at 20x FY20E EPS of INR33 and initiate with 'BUY' recommendation and target price of INR 653/share.



Source: Edelweiss Investment Research

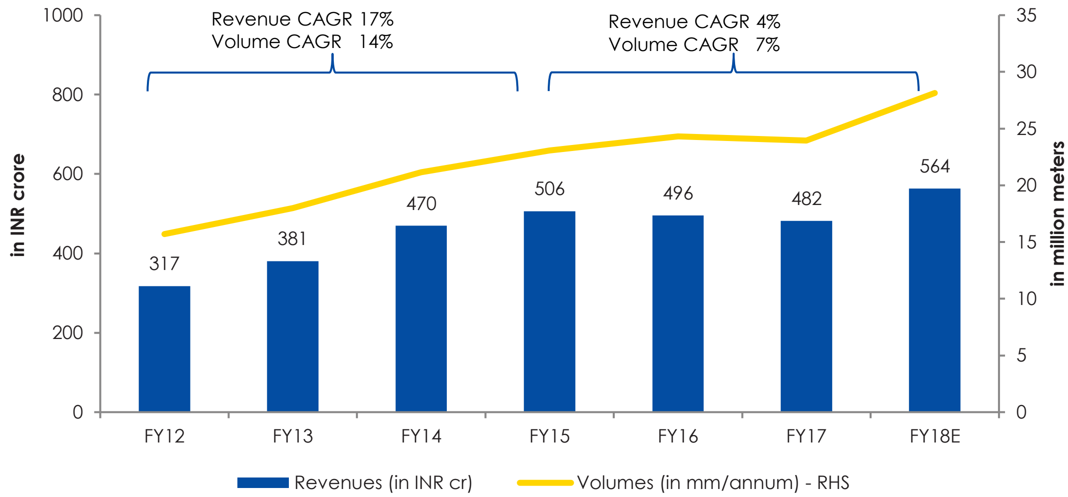
(Note: There are no relevant peers of the company in the listed space. Hence, peer comparison could not be shown.)

Key management personnel

Name	Age	Experience	Designation	Qualification	Background
Mr. Suresh Kumar Poddar	70	47	Chairman & Managing Director	B.Sc.	Founded MUL in 1992, has been the Chairman of the Board of Directors since July 27, 2000
Mr Arun Kumar Bagaria	44	20	Executive Director	B.Com. (Hons) & MBA	Did his MBA from University of Strathclyde Graduate Business School, UK & has been in the company since 2007.
Mr. Guman Mal Jain	44		Chief Financial Officer	CA	CFO since 2015 & serves as General Manager of Accounts and Finance
Mr. Ramdas Acharya	70		Senior VP (Technical).	Chemical Eng., Msc. , MBA from Michigan State University, USA	30 years' experience in the US synthetic leather industry, specializing in the automotive OEM Segment. Ex company – Uniroyal Engineered Products.

Financial Analysis

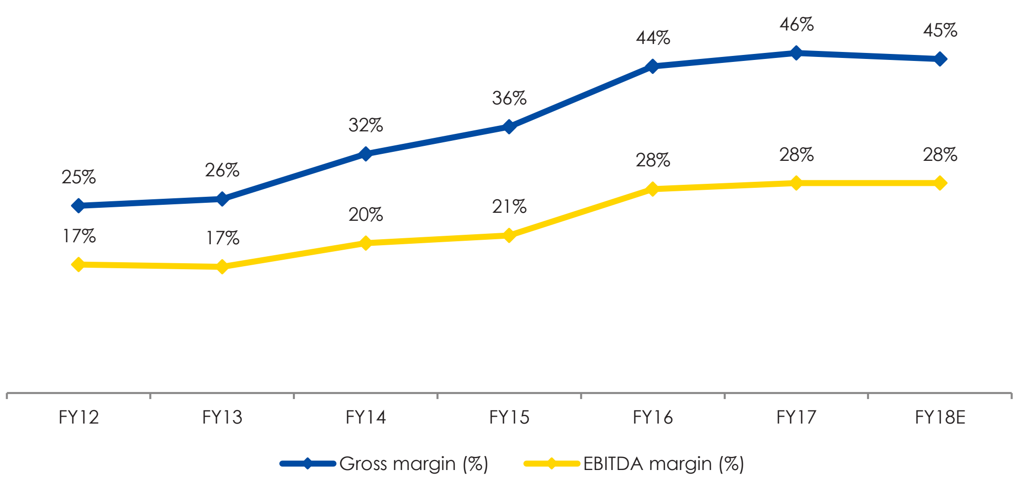
1. Revenues remain range-bound since FY15 owing to volatility in PVC resin prices



Source: Edelweiss Investment Research

Revenue growth for MUL was significantly high between FY12-15 as against FY15-18. While growth in the first phase was driven by significant penetration in automobile segment, the second phase was dampened due to adverse impact of sectoral weakness in footwear (49% of MUL's revenue in FY15). Going forward, with its new capex in PU and expected addition of new clients, we expect revenues to grow steeply by 22% CAGR between FY18-20.

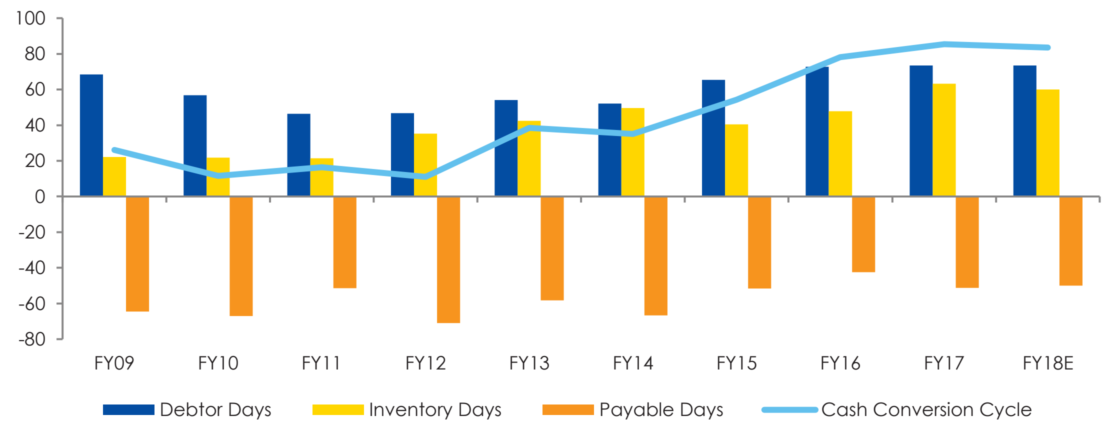
2. EBITDA improvement driven by change in product mix



Source: Edelweiss Investment Research

MUL witnessed ~1100 bps improved in its operating margins between FY12-18E driven largely by change in product mix towards high-margin exports. In fact, gross margins of the company improved by a whopping ~2000 bps during this period but increase in employee and marketing expenses kept EBITDA growth limited. Going forward, we further expect EBITDA to see a steady uptick of ~200 bps by FY20 led by higher share of exports.

3. Increase in working capital to meet inventory and credit requirements of export clients



Source: Edelweiss Investment Research

Working capital days of MUL have been on a consistent upward trajectory since FY12 led by higher inventory and debtor days. It is attributed to the following factors:

- Rise in imported raw materials to meet quality standards of clients
- Higher inventory maintenance to meet just-in-time requirement of clients and gain competitive advantage.
- Shift in payment cycle (from the US) from advance payments to 30 days credit as the company switched from third-party vendors to its own subsidiary in FY16.
  - For supply consistency in the US, MUL maintains 45-60 days of inventory equivalent to shipping time. Further, it would recognize sales only once the same was recognised by the subsidiary adding to the inventory holding period in the entities' books.

We believe working capital days to remain north of the current levels at ~90 days considering increase in exports share and start of PU plant operations in the near term.

Financials

Income statement (INR crs)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Income from operations	496	482	564	660	838
Total operating expenses	365	353	410	483	591
EBITDA	131	129	153	177	247
Depreciation and amortisation	16	17	18	25	34
EBIT	114	112	135	152	214
Interest expenses	3	2	1	0	0
Profit before tax	117	117	142	162	220
Provision for tax	40	38	47	53	72
Core profit	77	79	95	109	148
Extraordinary items	0	-2	0	0	0
Profit after tax	77	77	95	109	148
Adjusted net profit	77	77	95	109	148
Equity shares outstanding (mn)	5	5	5	5	5
EPS (INR) basic	17	17	21	24	33
Diluted shares (Cr)	5	5	5	5	5
EPS (INR) fully diluted	17	17	21	24	33
Dividend per share	4	1	1	2	2
Dividend payout (%)	21	4	7	7	7

Common size metrics- as % of net revenues

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Operating expenses	73.6	73.2	72.8	73.2	70.5
Depreciation	3.3	3.5	3.1	3.7	4.0
Interest expenditure	0.7	0.5	0.1	0.0	0.0
EBITDA margins	26.4	26.8	27.2	26.8	29.5
Net profit margins	15.6	16.0	16.9	16.5	17.7

Growth metrics (%)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Revenues	(2.1)	(2.8)	17.0	17.1	27.0
EBITDA	28.3	(1.2)	18.7	15.7	39.6
PBT	25.3	0.4	21.1	14.3	35.7
Net profit	17.1	2.2	21.1	14.3	35.7
EPS	10.2	0.6	25.2	14.3	35.7

Ratios

Year to March	FY16	FY17	FY18E	FY19E	FY20E
ROAE (%)	25.0	21.9	22.9	21.8	23.9
ROACE (%)	32.8	29.3	31.7	30.3	34.3
Core RoCE (%)	54.4	50.6	58.4	51.3	53.1
Debtors (days)	73	73	73	75	75
Current ratio	2.8	3.0	3.2	3.1	3.2
Debt/Equity	0.1	0.0	0.0	0.0	0.0
Inventory (days)	48	63	60	65	65
Payable (days)	42	51	50	50	50
Cash conversion cycle (days)	78	85	83	90	90
Debt/EBITDA	0.2	0.1	0.0	0.0	0.0
Adjusted debt/Equity	0.0	0.0	-0.1	0.0	0.0

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Diluted EPS (INR)	16.7	16.8	21.1	24.1	32.7
Y-o-Y growth (%)	*10.2*	*0.6*	*25.2*	*14.3*	*35.7*
CEPS (INR)	20	21	25	30	40
Diluted P/E (x)	29.9	29.7	23.7	20.8	15.3
Price/BV(x)	6.9	5.9	5.0	4.1	3.3
EV/Sales (x)	4.7	4.7	4.0	3.4	2.7
EV/EBITDA (x)	17.8	17.7	14.6	12.7	9.0
Diluted shares O/S	4.6	4.6	4.5	4.5	4.5
Basic EPS	16.7	16.8	21.1	24.1	32.7
Basic PE (x)	29.9	29.7	23.7	20.8	15.3
Dividend yield (%)	0.7	0.1	0.3	0.3	0.4

Balance sheet (INR crs)

As on 31st March	FY16	FY17	FY18E	FY19E	FY20E
Equity share capital	23	23	23	23	23
Preference Share Capital	0	0	0	0	0
Reserves & surplus	312	362	426	528	665
Shareholders funds	336	385	449	550	688
Secured loans	24	11	0	0	0
Unsecured loans	2	1	0	0	0
Borrowings	26	12	0	0	0
Minority interest	0	0	0	0	0
Sources of funds	**362**	**397**	**449**	**550**	**688**
Gross block	194	204	219	369	434
Depreciation	59	76	94	118	152
Net block	135	128	126	251	282
Capital work in progress	8	4	0	0	0
Total fixed assets	142	132	126	251	282
Unrealised profit	0	0	0	0	0
Investments	97	120	155	105	155
Inventories	65	83	93	118	149
Sundry debtors	99	97	113	136	172
Cash and equivalents	19	22	33	24	32
Loans and advances	12	11	13	15	19
Other current assets	0	0	0	0	0
Total current assets	195	214	253	292	373
Sundry creditors and others	58	68	77	90	115
Provisions	11	2	3	3	3
Total CL & provisions	69	70	80	93	118
Net current assets	126	143	173	199	255
Net Deferred tax	-5	-4	-4	-4	-4
Misc expenditure	1	6	0	0	0
Uses of funds	**362**	**397**	**449**	**550**	**688**
Book value per share (INR)	73	84	99	121	152

Cash flow statement (INR crs)

Year to March	FY16	FY17	FY18E	FY19E	FY20E
Net profit	77	81	95	109	148
Add: Depreciation	16	17	18	25	34
Add: Misc expenses written off	0	-5	6	0	0
Add: Deferred tax	0	-1	0	0	0
Gross cash flow	93	92	119	134	182
Less: Changes in W. C.	21	15	18	36	48
Operating cash flow	73	77	101	98	134
Less: Capex	16	7	11	150	65
Free cash flow	**57**	**71**	**90**	**-52**	**69**

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Vinay Khattar

Head Research

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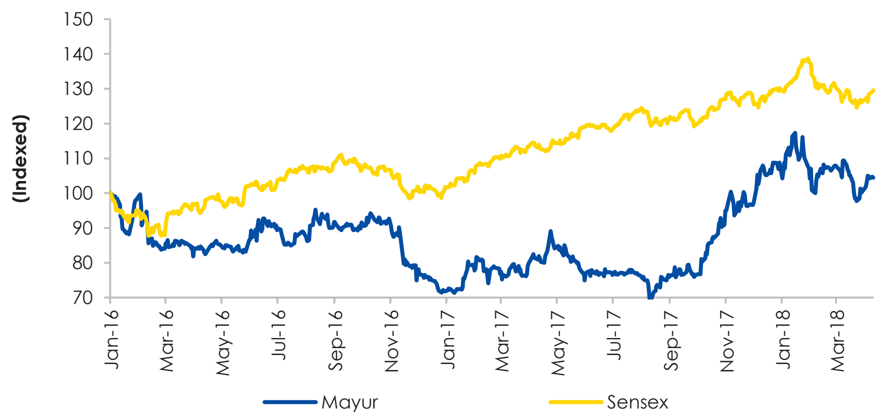
Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period



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