

Kitex Garments

BSE SENSEX	S&P CNX
28,504	8,660
Bloomberg	KTG IN
Equity Shares (m)	47.5
M.Cap. (INR b)/(USD b)	31.1/0.5
52-Week Range (INR)	656/117
1, 6, 12 Rel. Per (%)	3/132/516
Avg Val/Vol *000	54/152
Free float (%)	45.8

CMP: INR654
TP: INR850 (+30%)
Buy

Strong margin expansion drives PAT beat, re-rating imminent

Kitex Garments Ltd (KTG) reported 4QFY15 numbers, with a revenue of INR1.58b (est. INR1.82b), compared to INR1.42b in 4QFY14, marking a YoY growth of 11.1%. Garments segment reported a robust growth of 28% YoY; however, revenue growth was negatively impacted by 33% decline in fabric revenue. EBITDA grew by 58% this quarter to INR660m (est. INR573m), while EBITDA margin stood at 41.7% (est. 31.5%) in 4QFY15, compared to 29.3% in 4QFY14, an expansion of 13% YoY completely driven by an improvement in gross margin and higher revenue contribution from garments division. Hence, PAT for 4QFY15 stood at INR416m (est. INR350m), compared to INR211m in 4QFY14, marking a YoY growth of 97%. Management expects to double sales in three years, with minimal capex of INR100m annually and expects 20-25% sales growth for FY16, 30-35% sales growth for FY17, 35-40% sales growth for FY18.

In final stages of brand launch

KTG is in the final stages of a tie-up with an US brand and the first shipment will begin in October. Commercials for the brand will only be based on royalty and management guides that there will be no upfront investment. From a two to three-year perspective, KTG will look at having two to three private labels and an own brand. Given the popularity of the private label (well-known toys brand in the US), management believes KTG will not have to invest significantly in brand promotion. It expects additional capacities to be devoted exclusively towards private label and the own brand. In five years time, management targets to have 100% of revenue from direct sales, thus transitioning it into a complete B2C player.

Valuation and view

With foray into the brands business, we expect strong 23% revenue CAGR along with 400bp margin expansion, driving 37% PAT CAGR over FY15-17. Further, capital expenditure over the next three years will be limited to INR0.4-0.5b, thus resulting in significant free cash generation. We upgrade FY16E/17E earnings by 2%/7% each to factor stronger margins. With huge scalability, strong return ratios and free cash generation, we believe KTG deserves a multiple of 22x one-year forward. We maintain **Buy** with a target price of INR850, valuing the stock at 22x FY17E earnings.

Financials & Valuation (INR Billion)

Y/E MAR	2015E	2016E	2017E
Sales	5.1	6.3	7.7
EBITDA	1.7	2.2	2.9
NP	1.0	1.3	1.8
EPS (INR)	20.7	28.1	38.7
EPS Gr. (%)	71.6	35.7	37.6
BV/Sh. (INR)	55.6	80.2	111.8
RoE (%)	44.9	41.4	40.3
RoCE (%)	45.1	50.9	58.1
P/E (x)	31.6	23.3	16.9
P/BV (x)	11.8	8.2	5.8

Estimate change
7%
TP change
18%
Rating change


Quarterly performance

Y/E March	(INR Million)											
	FY14				FY15				FY14	FY15	FY15	Var
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		4QE	%	
Net Sales	1,005	1,001	995	1,422	1,028	1,282	1,221	1,580	4,422	5,111	1,820	-13.2
YoY Change (%)	58.1	52.1	3.0	56.1	2.3	28.1	22.8	11.1	39.5	15.6	28.0	
Total Expenditure	846	828	792	1,005	756	946	802	921	3,471	3,424	1,247	
EBITDA	159	173	203	417	272	337	419	660	951	1,687	573	15.1
Margins (%)	15.8	17.2	20.4	29.3	26.5	26.2	34.3	41.7	21.5	33.0	31.5	10.2
Depreciation	22	22	25	28	50	52	53	58	97	212	53	
Interest	25	24	26	32	36	41	66	49	106	192	40	
Other Income	98	53	20	-37	24	53	51	6	133	134	50	
PBT	210	180	172	320	210	296	352	558	882	1,416	530	5.3
Tax	81	60	59	109	66	103	121	142	308	432	180	
Rate (%)	38.4	33.3	34.1	34.1	31.4	34.8	34.3	25.4	34.9	30.5	34.0	
Reported PAT	130	120	113	211	144	193	231	416	574	984	350	18.9
Adj PAT	130	120	113	211	144	193	231	416	574	984	350	
YoY Change (%)	79.6	197.0	9.5	171.4	11.3	61.4	104.0	97.4	95.3	71.6	66.0	
Margins (%)	12.9	12.0	11.4	14.8	14.0	15.1	18.9	26.3	13.0	19.3	19.2	

E: MOSL Estimates

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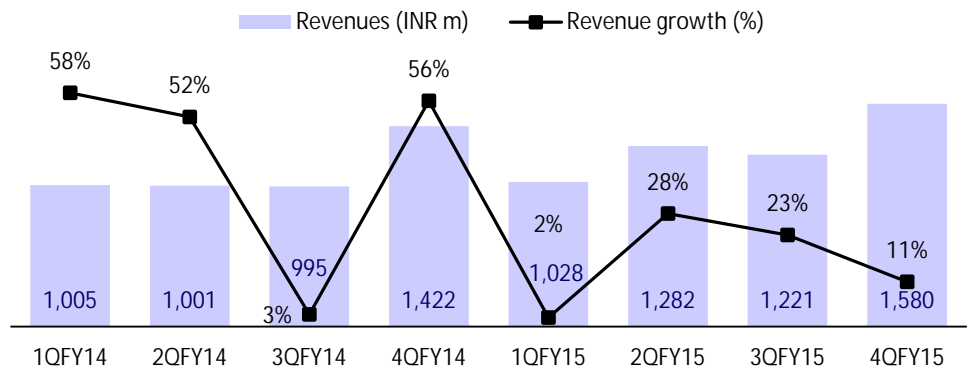
Investors are advised to refer through disclosures made at the end of the Research Report.

 Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Strong margin expansion drives profitability

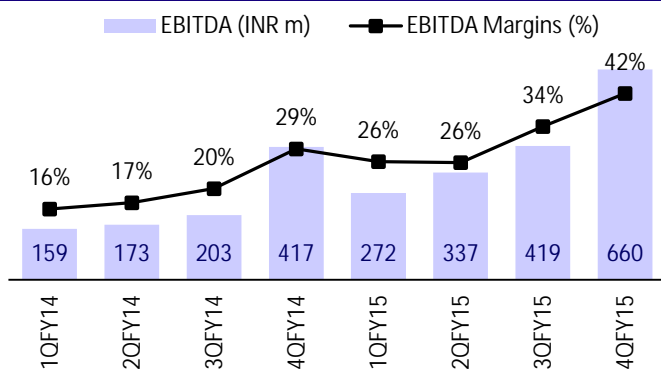
- n Kitex Garments Limited reported 4QFY15 numbers with a top-line of INR1,580m (est. INR1,820m) as compared to INR1422m in 4QFY14, marking a YoY growth of 11.1%.
- n EBITDA grew by 58% this quarter to INR660m (est. INR573m), EBITDA margins stood at 41.7% (est. 31.5%) in 4QFY15 as compared to 29.3% in 4QFY14 an expansion of 13% YoY completely driven by improvement in gross margins and higher revenue contribution from garments division.
- n Consequently, PAT for 4QFY15 stood at INR416m (est. INR350m) as compared to INR211m in 4QFY14 marking a YoY growth of 97%.
- n Kitex Children’s wear has been buying specialized fabric from outside vendors, which has to some extent impacted growth for Kitex Garments fabric division.
- n With <5% sales from Europe, Euro decline will not impact margins.

Exhibit 1: Revenue growth trend



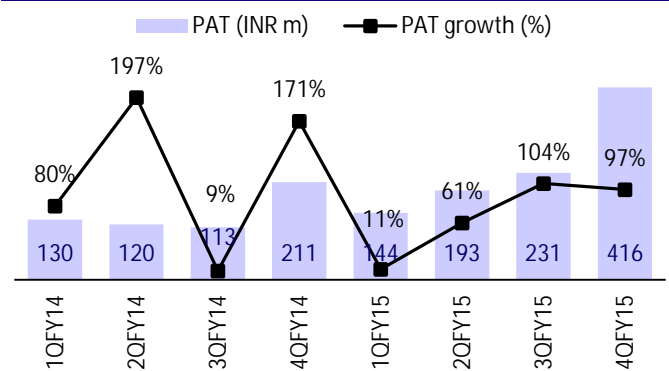
Source: Company, MOSL

Exhibit 2: EBITDA and EBITDA margins trend



Source: Company, MOSL

Exhibit 3: PAT growth trend



Source: Company, MOSL

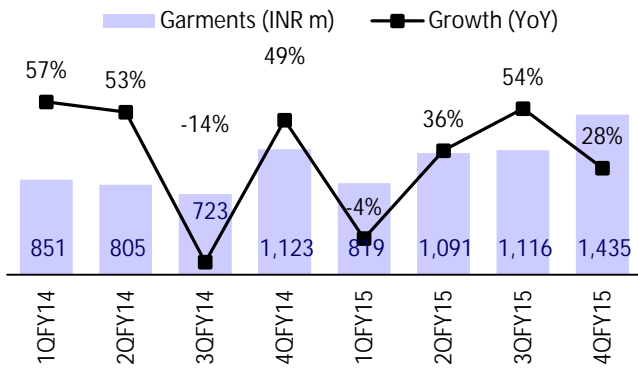
In final stages of brand launch

- n KTG is in final stages for tie-up with a US brand for which the first shipment will begin in October. Commercials for the brand will be only be based on royalty, and management guides that there will be no upfront investment.
- n From a 2-3 year perspective, KTG will be eventually looking at having 2-3 private labels and 1 own brand.
- n Management has hired designers for private label business who are free lancers currently, also working for other prominent brands like Toys R Us.
- n With regards marketing, management believes they're well placed as KTG's marketing head has 17 years work experience with Toys R Us and is working with KTG since 4 years. KTG will not have to invest heavily in brand promotion.
- n Business from existing clients will stay constant, additional capacities will be devoted towards private label and own brand.
- n In 5 years management targets to have 100% of revenues from direct sales.

Garments segment reports strong growth and margins

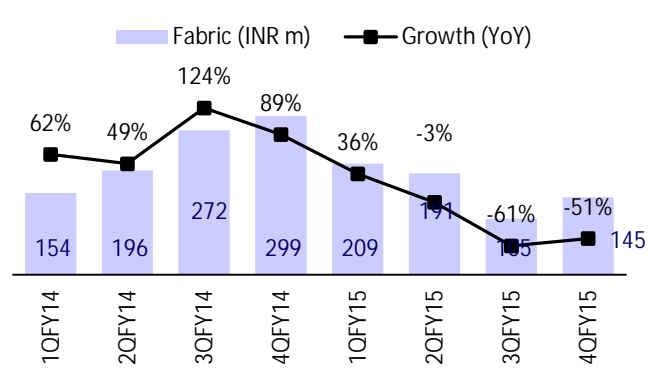
- n During 4QFY15, garments segment grew 28% to INR1,435m while net fabric revenues de-grew 51% to INR145m.
- n Garment business contribution to total revenue has increased to 91% as against 79% in 4QFY14 which has resulted in improvement in margins.
- n Garment margins improved from 36% from 4QFY14 to 46% in 4QFY15 while fabric margins declined from 12% in 4QFY14 to 7% in 4QFY15.

Exhibit 4: Garment revenues and growth



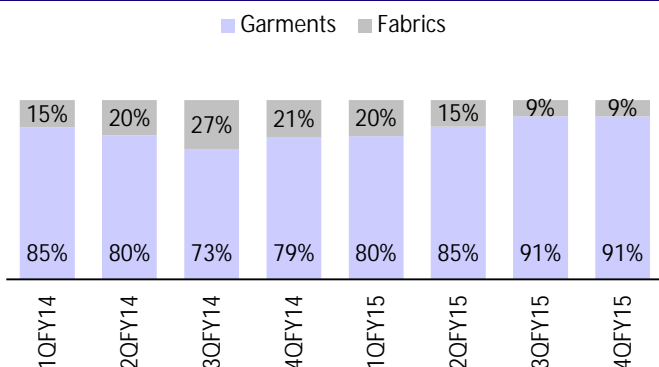
Source: Company, MOSL

Exhibit 5: Fabric revenue and growth



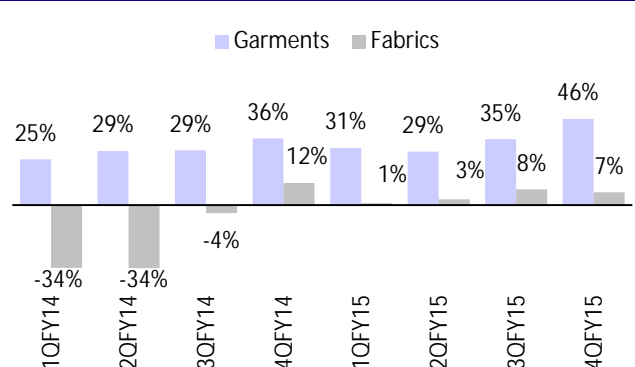
Source: Company, MOSL

Exhibit 6: Segment revenue mix (%)



Source: Company, MOSL

Exhibit 7: Segment margins (%)



Source: Company, MOSL

Growth outlook robust – expect to double revenues in 3 years

- n Management expects to double sales in 3 years, 20-25% sales growth for FY16, 30-35% sales growth in FY17, 35-40% sales growth in FY18.
- n With regards capacity, not adding any machines, INR50-100m annual capex required, INR300-500m maximum aggregate capex seen over next 3 years.
- n Management believes market demand is not a concern as far as growth is concerned; key constraint is managing higher production scale.
- n Lack of skilled labor, need for continuous training are key factors that limit quick scalability.
- n Management is targeting higher use of technology with same labor strength to drive capacities higher. Incremental growth to come from higher technology investments.

Margins driven higher by production efficiencies

- n Management highlighted that wastage reduction, better technology are key factors driving margins higher.
- n KTG has agreement with buyers with predefined formulas – hence raw material inflation / deflation will not affect margins.
- n Management re-iterated that margins are certainly sustainable at current levels.
- n With new foreign trade policy, even if incentives go down, KTG will be able to sustain margins due to agreements with clients.
- n Other operating income includes duty drawbacks – 7.5% incentive.

Merger / Increase in authorized share capital

- n E&Y still working on the merger process, should look to conclude in FY16.
- n Kitex Children wear Ltd does revenues of INR2.5b; however its profitability is lower than KTG, its debt free on net basis.
- n With regards proposal to increase authorized share capital, management said it is considering various alternatives including bonus share issue.
- n The board has recommended a dividend of INR1.25/share.

Exhibit 8: Quarterly metrics (%)

	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	4QFY15
Sales Growth												
Garments	-5	18	27	17	57	53	-14	49	-4	36	54	28
Fabrics	-60	-43	-26	-3	62	49	124	89	36	-3	-61	-51
Sales Mix												
Garments	85	80	87	83	85	80	73	79	80	85	91	91
Fabrics	15	20	13	17	15	20	27	21	20	15	9	9
EBIT Margin												
Garments	22	28	23	25	25	29	29	36	31	29	35	46
Fabrics	-10	-8	-6	-5	-34	-34	-4	12	1	3	8	7
EBIT Contribution												
Garments	109	108	104	104	133	140	106	92	99	98	98	99
Fabrics	-9	-8	-4	-4	-33	-40	-6	8	1	2	2	1

Source: Company, MOSL

Valuation and view

We value KTG at 22x FY17E EPS, higher than its historical average of 8.3x and in-line with its current one-year forward multiple of 23.3x, which we believe is justified considering:

Large opportunity: Kitex has presence in the highly niche USD20b global infant-wear clothing market and is the 3rd largest vendor globally. With India’s market share being low single-digit, and with India’s growing competitiveness against erstwhile low-cost countries like China (~52% market share), we believe the long term opportunity for KTG is large.

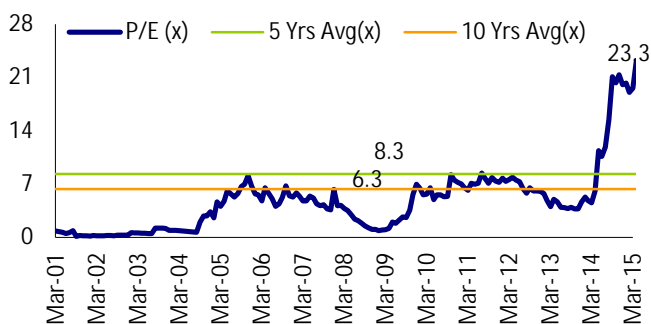
High entry barriers: KTG is the largest exporter of infant-wear clothing out of India and commands a 70% market share for all infant-wear clothing exports out of India. Adhering to stringent safety measures, maintaining high quality standards, higher degree of complexity (than adult garments) due to involvement of small sizes, need for greater variety, smaller batch size orders and high labor requirements are some of the key entry barriers that support superior profitability for the company.

Industry leading return ratios: KTG commands strong, industry leading return ratios (45.1% RoCE and 44.9% RoE), with its business model generating robust free cash generation (INR3.0b over FY15-17). We believe KTG stands out amongst listed textile exporters (with most of them present in capital intensive, low RoCE businesses of yarn and fabric manufacturing (averaging ~10% RoCE).

Opportunity to enter the brands business: We expect KTG to capture a larger pie of the infant-wear value chain through its forward integration with its launch of own brand in the US market as well as licensing of private labels in the US market. Forward integration holds high significance for the company as margins in its own brand will be double of the current business (~60% versus current margins of ~30%), along with higher realizations.

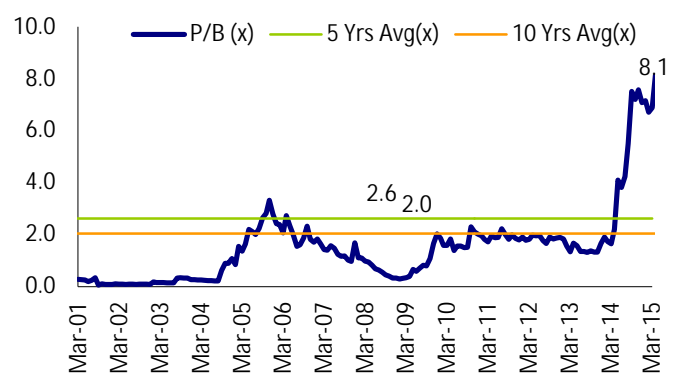
We thus expect current multiples of 23.3x one year forward earnings to sustain, and value the stock at 22x FY17E EPS of INR38.7, arriving at a March-2016 price target of INR850. Maintain **Buy**.

Exhibit 9: 15 year PE band



Source: Company, MOSL

Exhibit 10: 15 year PB band



Source: Company, MOSL

Operating metrics

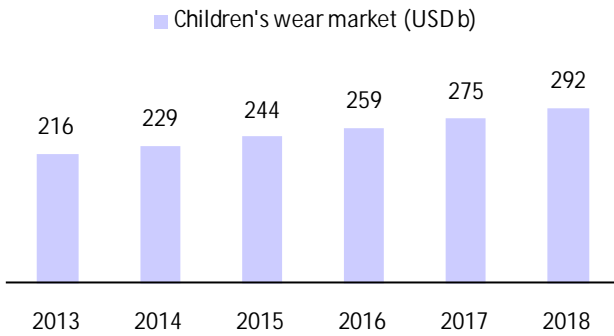
Exhibit 11: Operating metrics and key assumptions

Y/E March (INR m)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Growth (%)						
Garments		15	31	27	23	22
Fabric		-36	82	-29	25	25
Net Revenues		2	40	16	23	22
Contribution (%)						
Garments	75	84	79	87	87	87
Fabric	25	16	21	13	13	13
Net Revenues	100	100	100	100	100	100
EBIT Margins (%)						
Garments	19	21	27	32	34	37
Fabric	9	-7	-10	4	10	12
Segment EBIT	16.5	16.2	19.3	28.8	30.9	33.6
EBIT Contribution (%)						
Garments	86	107	111	98	96	95
Fabric	14	-7	-11	2	4	5
Segment EBIT	100	100	100	100	100	100

Source: Company, MOSL

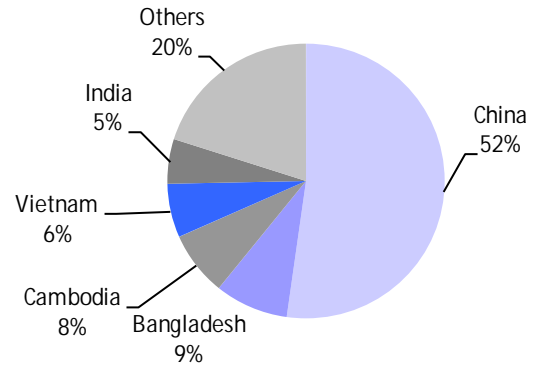
Story in charts

Exhibit 12: Global children's wear market size is huge



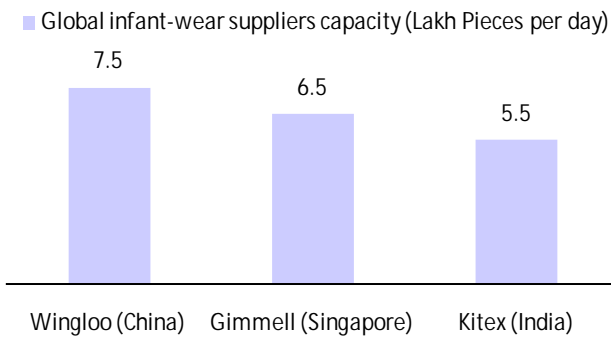
Source: Company, MOSL

Exhibit 13: India has high potential for infant-wear sourcing



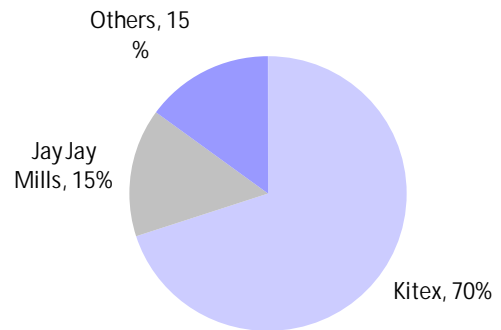
Source: Company, MOSL

Exhibit 14: Kitex is the 3rd largest infant-wear player



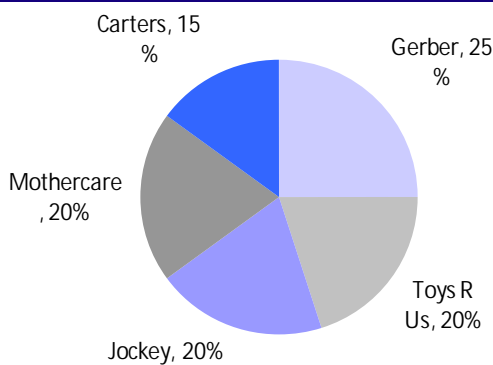
Source: Company, MOSL

Exhibit 15: Kitex dominated infant-wear exports from India



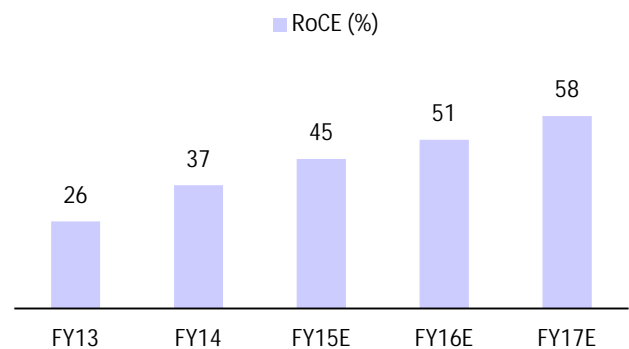
Source: Company, MOSL

Exhibit 16: Diversified client mix augurs well for margins



Source: Company, MOSL

Exhibit 17: Kitex reports strong capital efficiency



Source: Company, MOSL

Financials and valuations

Income Statement						(INR Million)		
Y/E March	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	2,676	2,561	3,120	3,170	4,422	5,111	6,300	7,710
Change (%)	34.5	-4.3	21.9	1.6	39.5	15.6	23.3	22.4
EBITDA	437	453	582	601	951	1,687	2,186	2,853
Margin (%)	16.3	17.7	18.7	19.0	21.5	33.0	34.7	37.0
Depreciation	66	69	69	86	97	212	237	262
EBIT	372	384	514	515	855	1,474	1,949	2,590
Int. and Finance Charges	152	125	176	115	106	192	109	24
Other Income - Rec.	59	53	64	40	133	134	154	177
PBT bef. EO Exp.	278	312	401	440	882	1,416	1,994	2,743
EO Expense/(Income)	0	0	0	0	0	0	0	0
PBT after EO Exp.	278	312	401	440	882	1,416	1,994	2,743
Current Tax	76	93	124	149	254	432	658	905
Deferred Tax	17	13	6	-2	55	0	0	0
Tax Rate (%)	33.4	34.0	32.4	33.3	34.9	30.5	33.0	33.0
Reported PAT	185	206	271	294	574	984	1,336	1,838
PAT Adj for EO items	185	206	271	294	574	984	1,336	1,838
Change (%)	85.7	11.5	31.5	8.3	95.3	71.6	35.7	37.6
Margin (%)	6.9	8.1	8.7	9.3	13.0	19.3	21.2	23.8

Balance Sheet						(INR Million)		
Y/E March	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Equity Share Capital	48	48	48	48	48	48	48	48
Total Reserves	505	689	927	1,176	1,694	2,591	3,760	5,265
Net Worth	552	736	974	1,224	1,742	2,639	3,808	5,312
Minority Interest	0	0	0	0	0	0	0	0
Deferred Liabilities	144	157	163	162	216	226	226	226
Total Loans	697	1,084	1,015	1,012	1,342	1,408	408	0
Capital Employed	1,393	1,977	2,153	2,397	3,299	4,272	4,441	5,538
Gross Block	1,435	1,540	1,613	1,638	2,374	2,660	2,960	3,260
Less: Accum. Deprn.	249	317	385	465	562	775	1,012	1,275
Net Fixed Assets	1,187	1,223	1,228	1,172	1,812	1,885	1,948	1,986
Capital WIP	8	9	4	23	7	0	0	0
Total Investments	0	0	0	0	0	0	0	0
Curr. Assets, Loans&Adv.	635	1,267	1,443	1,755	2,219	3,468	3,651	5,088
Inventory	223	566	520	459	108	112	136	158
Account Receivables	52	393	318	506	531	627	713	873
Cash and Bank Balance	81	64	365	412	1,036	2,033	1,965	3,054
Loans and Advances	279	244	240	378	544	696	836	1,003
Curr. Liability & Prov.	437	522	522	553	738	1,081	1,157	1,536
Account Payables	295	393	348	333	402	548	585	716
Provisions	142	129	174	221	337	532	572	819
Net Current Assets	198	745	921	1,202	1,481	2,387	2,494	3,553
Appl. of Funds	1,393	1,977	2,153	2,397	3,299	4,272	4,442	5,538

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Basic (INR)								
EPS	3.9	4.3	5.7	6.2	12.1	20.7	28.1	38.7
Cash EPS	5.3	5.8	7.2	8.0	14.1	25.2	33.1	44.2
BV/Share	11.6	15.5	20.5	25.8	36.7	55.6	80.2	111.8
DPS	0.3	0.4	0.6	0.8	1.0	1.3	3.0	6.0
Payout (%)	9.0	10.8	12.2	15.1	9.7	7.1	12.5	18.1

Valuation (x)

P/E					54.1	31.6	23.3	16.9
Cash P/E					46.3	26.0	19.7	14.8
P/BV					17.8	11.8	8.2	5.8
EV/Sales					7.1	6.0	4.7	3.6
EV/EBITDA					33.0	18.0	13.5	9.8
Dividend Yield (%)					0.2	0.2	0.5	0.9

Return Ratios (%)

RoE	39.5	32.0	31.7	26.7	38.7	44.9	41.4	40.3
RoCE	28.6	28.5	30.3	26.3	37.2	45.1	50.9	58.1

Working Capital Ratios

Asset Turnover (x)	1.9	1.3	1.4	1.3	1.3	1.2	1.4	1.4
Inventory (Days)	30	81	61	53	9	8.0	7.9	7.5
Debtor (Days)	7	56	37	58	44	45	41	41
Creditor (Days)	40	56	41	38	33	39	34	34
Wkg. Capital Turnover (Days)	16	97	65	91	37	25	31	24

Leverage Ratio (x)

Current Ratio	1.5	2.4	2.8	3.2	3.0	3.2	3.2	3.3
Debt/Equity	1.3	1.5	1.0	0.8	0.8	0.5	0.1	0.0

Cash Flow Statement

(INR Million)

Y/E March	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
NP/(Loss) before Tax & EO Items	278	312	401	440	882	1,416	1,994	2,743
Depreciation	66	69	69	84	97	212	237	262
Interest & Finance Charges	113	130	176	115	106	192	109	24
Direct Taxes Paid	0	-86	-134	-139	-242	-432	-658	-905
(Inc)/Dec in WC	516	-582	114	-256	315	90	-174	30
CF from Operations	873	-156	626	244	1,158	1,471	1,508	2,155
(inc)/dec in FA	-23	-107	-68	-48	-720	-280	-300	-300
CF from Investments	-14	-104	-57	-44	-716	-280	-300	-300
(Inc)/Dec in Debt	-682	390	-69	-5	334	66	-1,000	-408
Interest Paid	-113	-130	-176	-115	-106	-192	-109	-24
Dividend Paid	-11	-16	-22	-33	-45	-69	-167	-333
CF from Fin. Activity	-807	242	-267	-153	183	-194	-1,276	-766
Inc/Dec of Cash	53	-18	302	47	625	997	-68	1,089
Add: Beginning Balance	28	81	64	365	412	1,036	2,033	1,966
Closing Balance	81	64	365	412	1,036	2,033	1,966	3,055

Corporate profile

Company description

Kitex Garments Ltd (KTG) is based in Kochi, India. Incorporated in 1992, its first public issue was in 1995. Its promoters are Mr MC Jacob, Mr Bobby Jacob and Mr Sabu Jacob. KTG is in the business of manufacturing and exporting infant garments. Company derives 80% of its revenue from the sale of infant garments and the balance 20% from the sale of fabric to Kitex Childrenwear.

Exhibit 18: Sensex rebased

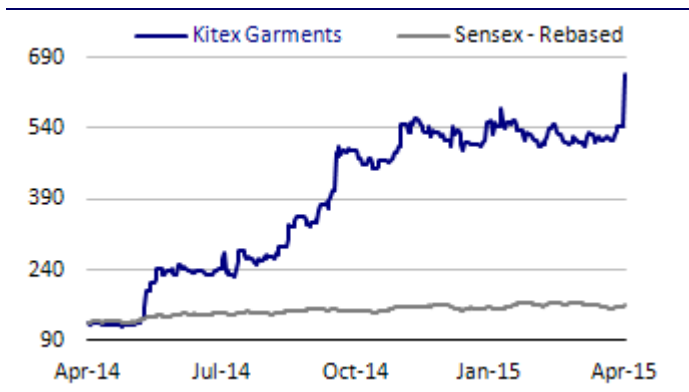


Exhibit 19: Shareholding pattern (%)

	Dec-14	Sep-14	Dec-13
Promoter	54.2	54.2	54.2
DII	0.1	0.0	0.0
FII	2.4	0.6	0.0
Others	43.3	45.2	45.8

Note: FII Includes depository receipts

Exhibit 21: Top management

Name	Designation
Sabu M Jacob	Chairman & MD
Benni Joseph	Director
K L V Narayanan	Director
Erumala Mathew Paulose	Director
C Mohan	Director

Exhibit 23: Auditors

Name	Type
Kolath & Co	Statutory
Ernst & Young LLP	Internal
Rajendran, Mani & Varier	Cost Auditor

Exhibit 20: Top holders

Holder Name	% Holding
C K G Super Market Limited	6.4
Gopinathan C K	5.2
Acumen Capital Market (India) Ltd	2.9
Jinsha Nath C K	2.9
Sethuparvathy	1.5

Exhibit 22: Directors

Name	Name
Sabu M Jacob	Erumala Mathew Paulose*
Benni Joseph*	C Mohan
K L V Narayanan*	

*Independent

Exhibit 24: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY15	20.7	18.4	12.5
FY16	28.1	23.5	19.4
FY17	38.7	33.0	17.5

NOTES

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