

Nandan Denim

26 June 2015

Reuters: NANE.BO; Bloomberg: NAND IN

Nandan Denim (NDL) is second-largest denim manufacturing company in India and is a part of the Chiripal Group, a leading business conglomerate. NDL commenced its operations in 1994 with textile trading and forayed into textile manufacturing in 2004. The company manufactures denim, cotton fabrics and khaki cloth. It also has fully integrated facilities for manufacturing a range of products viz. woven fabrics, circular knitted fabrics, polar fleece fabrics, cotton hosiery, denim, etc. We attended the analyst meet organised recently by NDL to know the company's business plans and prospects. Mr. Deepak Chiripal, director, and Mr. Govind Sharda, president, were present. Key highlights are as follows:

- NDL has one of the largest denim fabric manufacturing capacities in the world and will be the largest in India with a denim capacity of 110mn metres per annum or mmpa (post expansion), in line with Arvind, which has a capacity of 108mmpa. Aarvee Denim is third-largest in India with a capacity of 85mmpa followed by Sudarshan Jeans with a capacity of 70mmpa and Etco Denim as well as Jindal Worldwide with a capacity of 50mmpa each.
- NDL will become the fourth-largest denim manufacturer in the world, in capacity terms, post expansion. The company will have a capacity of 110mmpa trailing behind Vicunha Textil (230mmpa), ISKO (200mmpa) and Tavex (160mmpa). Arvind will slip to fifth position on the list with a capacity of 108mmpa.
- NDL was set up with a focus on the domestic market, with its products launched being priced for the mid-segment, unlike Arvind whose sole purpose is to cater to the premium segment
- Since the past two years, NDL has started focusing on premiumisation. Currently, ~88% of the company's sales take place in domestic market and export markets account for the rest. NDL's realisation improved YoY from Rs111.7/metre in FY13 to Rs120.2/metre in FY14 to Rs132.7/metre in FY15. Arvind derived 44% volume from exports, with blended realisation at Rs179/metre.
- With greater challenges for Chinese manufacturers like increased employee costs, rise in power costs, unfavourable cotton policy (higher MSP or minimum sales price on domestic cotton leading to a fall in production), environmental concerns etc, Chinese manufacturers have slowed down denim production. On the other hand, NDL plans to increase its exports from 12% currently to ~30% in the next three years so as to fill in the vacuum created by Chinese players. **However, export incentives given by the government have declined by ~2% from ~7%-9% earlier to ~5%-7% currently.** Therefore, we believe this will have a negative impact on NDL's export margin.
- NDL has chalked out capacity expansion in denim fabric, spinning and shirting segments. The total capex requirement stands at Rs6,120mn, which will be funded with a D/E ratio of 70:30 and the expanded plant to start operations by March 2016.
- **Phase I expansion:** a) Expansion of denim fabric capacity will help the company to increase its domestic market share as well as diversify its operations on a global scale through a rising share of exports, b) Addition of new shirting capacity to further diversify its operations, and c) Capex incurred stands at Rs3,049mn.
- **Phase II expansion:** a) Expansion of spinning capacity will support the increased denim fabric capacity of 110mmpa, and b) Backward integration through spinning capacity expansion will help the company to improve operating flexibility and margins.
- NDL plans to backward integrate by expanding its spinning capacity from 64tpd (tonne per day) to 124tpd in FY16E. This backward integration will result in savings of Rs5/kg to the company or ~10%-15% savings when compared to purchase of yarn from the market, leading to higher operating margin and improved return ratios.
- NDL is going for all-round aggressive expansion of its existing facilities so as to avail the benefits laid out by Gujarat government. These benefits include: Gujarat textile policy: 5% (7% - spinning facility) interest subsidy and power subsidy @ Re1/unit for five years, value added tax or VAT/entry tax reimbursement for eight years and 100% stamp duty reimbursement.
- TUFS (Central government textile policy): 5% interest subsidy and capital subsidy of 10% for processing capacity and 15% for looms for a period of seven years. NDL is entitled to 5% interest subsidy and 15% capital subsidy for a period of seven years.
- As per the rules framed under Gujarat government's textile policy, NDL is entitled for VAT refund only on the machinery excluding land and other costs. Thus, out of Rs6,120mn, NDL will enjoy the benefit of VAT refund of Rs4,500mn.

NOT RATED

Sector: Textile

CMP: Rs97

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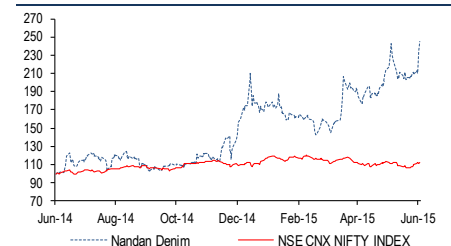
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Key Data

Current Shares O/S (mn)	45.5
Mkt Cap (Rsbn/US\$m)	4.4/69.7
52 Wk H / L (Rs)	102/40
Daily Vol. (3M NSE Avg.)	317,601

One-Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Nandan Denim	12.5	56.5	140.2
Nifty Index	0.3	2.7	10.9

Source: Bloomberg

Exhibit 1: Financials

Y/E March (Rsmn) cons.	FY11	FY12	FY13	FY14	FY15
Revenue	5,074	5,738	7,031	8,944	10,965
YoY (%)	35.0	13.1	22.5	27.2	22.6
EBITDA	679	826	1,069	1,333	1,655
EBITDA (%)	13.4	14.4	15.2	14.9	15.1
Adj. PAT	174	188	311	400	514
FDEPS (Rs)	3.8	4.1	6.8	8.8	11.3
YoY (%)	49.7	8.3	65.3	28.6	28.6
RoE (%)	12.7	12.3	18.1	20.0	21.6
RoCE (%)	7.4	9.0	12.2	10.9	12.2
RoIC (%)	7.2	8.8	11.9	10.5	12.4
P/E (x)	25.6	23.7	14.3	11.1	8.7
P/BV (x)	3.1	2.8	2.4	2.1	1.7
EV/EBITDA (x)	9.8	8.3	7.4	6.0	4.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Capacity expansion plan

Capacity	Pre-expansion	FY15		FY16E	
		Addition	Year-end	Addition	Year-end
Spinning (tpd)					
Open-end spinning	38	6	44	40	84
Ring spinning	16	4	20	20	40
Fabric (mmpa)					
Denim	71	19	90	-	110*
Shirting	-	10	10	-	10

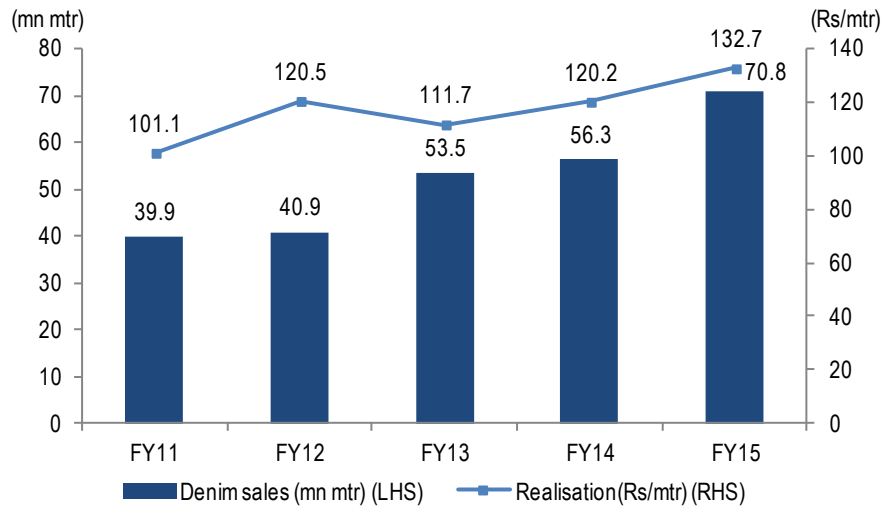
Note: *Ongoing expansion

Source: Company, Nirmal Bang Institutional Equities Research

• Cotton: region-wise scenario

- **Global:** Global share of cotton in textiles is 35%, with the balance 65% being MMF (man-made fibre). Cotton production is expected to decline by 5.2% while consumption is likely to increase by 4.5% (expected to be driven by China). However, because of healthy stock, cotton prices have limited triggers for an upside.
- **China:** Cotton consumption is up after a four-year slide. Currently, cotton inventory comprises 58% of global stock.
 - If this is released, global trade will decline, exerting downward pressure on international cotton prices.
 - If this is not released, cotton imports will increase, providing impetus to exporters and making Chinese textile industry uncompetitive.
- **India:** Production is expected to shrink by 3%-6% FY16. However, Cotton Corporation of India or CCI had inventory of four months to meet industry demand and therefore prices are likely to remain soft. In addition, a benign monsoon will also keep cotton prices soft.
- Global denim market is currently worth US\$17bn, of which Asia accounts for 70% of denim fabric production. Indian denim apparel market (14%-15%) is fast outpacing global denim apparel market (3%-5%). India controls ~10% of this market while NDL accounts for ~10% of Indian market. Therefore, effectively, NDL accounts for ~1% of global denim market.
- India is fourth-largest denim exporter after China, Pakistan and Turkey. Per capita jeans consumption is currently at 0.3x in India compared to 8.0x-9.0x globally. 7% of the population drives 49% consumption in India whereby 85% is accounted for by men and the rest by women and children. Estimated domestic market CAGR is ~18% and international market CAGR is 3%-5%.

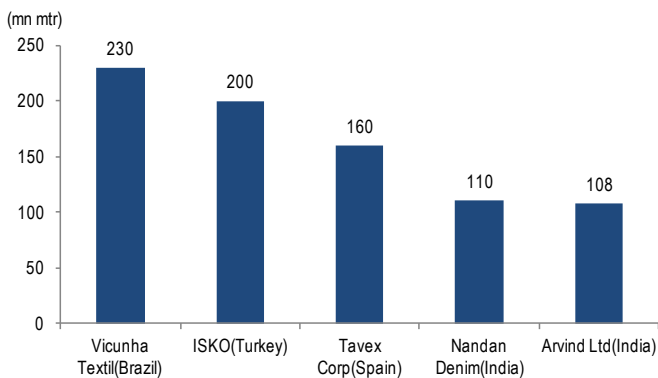
Exhibit 3: Denim realisation (Rs/metre) of NDL



Source: Company, Nirmal Bang Institutional Equities Research

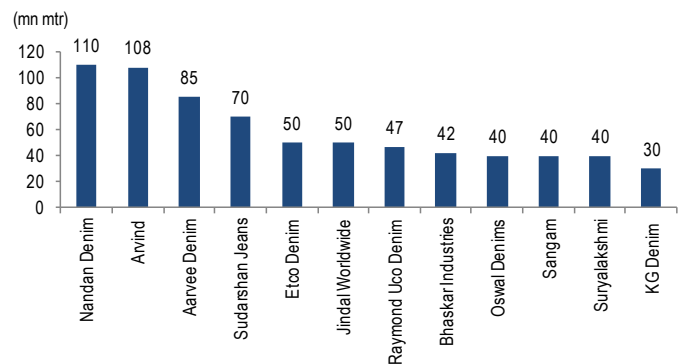
- NDL currently derives 88% of its revenue from domestic market and 12% from exports. The management stated that it is focusing on exports as in India the production of denim is more than the demand. Therefore in order to achieve higher margin and realisation, NDL is concentrating more on the export segment and targets revenue contribution of 25%-30% from it, up from 12% currently. Export incentives given by the government have reduced from 7%-9% earlier to 5%-7% currently. Therefore, we believe this will have a negative impact on export margin.
- With its focus on premiumisation, RoCE of NDL increased from 10.9% in FY14 to 12.2% in FY15.
- NDL plans to backward integrate by expanding its spinning capacity from 64tpd to 124tpd in FY16E. This backward integration will result in savings of Rs5/kg to the company or ~10%-15% savings when compared to purchase of yarn from the market, leading to higher operating margin and improved return ratios.
- Main export markets for NDL are Latin America, Africa and Bangladesh. It exports mainly to wholesalers and local players currently.
- Shirting business is in project stage and is likely to be fully operational by FY16. Out of Rs6,120mn expansion budget, 50% has already been spent while the balance amount is likely to be spent in 3QFY16 and 4QFY16.

Exhibit 4: NDL is likely to be fourth-largest denim producer globally



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Post-expansion, NDL will be top denim producer in India



Source: Company, Nirmal Bang Institutional Equities Research

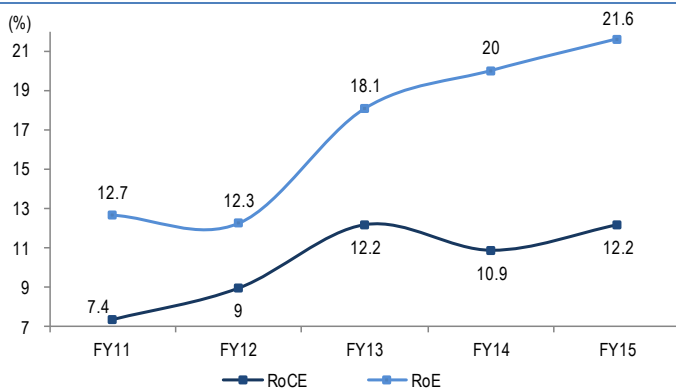
Exhibit 6: Spinning economics

Cost per kg of captive yarn-coarse count#	
Cotton(kg/per kg of yarn)	1.14
Cotton blended price(Rs/kg of cotton)	112.0
Transport cost(Rs/kg of cotton)	1.0
Commission (Rs/kg of cotton)	0.6
VAT on cotton@5%(Rs/kg of cotton)	5.6
Electricity cost (Rs/kg)	11.0
Electricity required(kwh/kg)	1.7
Electricity cost (Rs/kwh)	6.4
Labour and other costs(Rs/kg)	2.7
Total cost of captive yarn(Rs/kg)	150.2

Cost per kg of market yarn-coarse count#	
Cost of market yarn(Rs/kg)	165.0
Transport cost-market yarn(Rs/kg)	1.0
VAT on market yarn@5%(Rs/kg)	8.3
Commission(Rs/kg of yarn)@0.5%	0.8
Total cost of market yarn(Rs/kg)	175.1

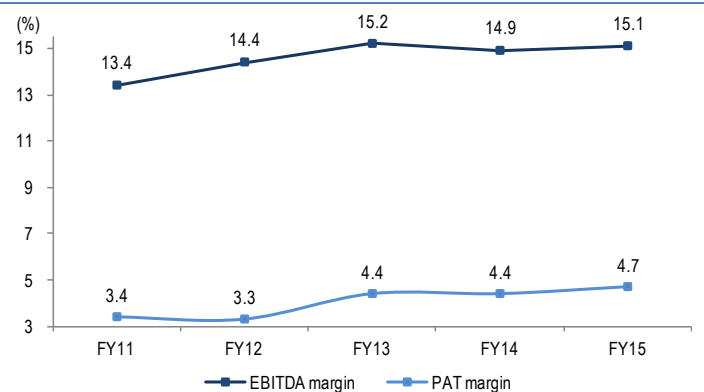
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Improving return ratios



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Trend in operating and net profit margin



Source: Company, Nirmal Bang Institutional Equities Research

Financials (standalone)

Exhibit 9: Income statement

Y/E March (Rsmn)	FY11	FY12	FY13	FY14	FY15
Net sales	5,074	5,738	7,031	8,944	10,965
% growth	35.0	13.1	22.5	27.2	22.6
Raw material costs	3,042	3,512	4,258	4,655	7,440
Staff	147	192	254	310	438
Purchase of stock-in-trade	734	579	620	1,594	138
Others	473	630	829	1,052	1,295
Total expenditure	4,395	4,913	5,962	7,611	9,311
EBITDA	679	826	1,069	1,333	1,655
% growth	17.9	21.6	29.5	24.7	24.1
EBITDA margin (%)	13.4	14.4	15.2	14.9	15.1
Other income	3	5	15	40	30
Extraordinary items	-	43	-	-	-
Interest costs	168	278	318	320	377
Gross profit	513	596	767	1,053	1,308
% growth	25.4	16.1	28.8	37.3	24.2
Depreciation	254	333	409	497	596
Profit before tax	259	263	358	556	712
% growth	41.6	1.4	36.0	55.3	28.2
Tax	86	75	47	156	198
Effective tax rate (%)	33.1	28.6	13.2	28.1	27.8
Net profit	174	188	311	400	514
% growth	49.7	8.3	65.3	28.6	28.6
Reported net profit	174	188	311	400	514
% growth	49.7	8.3	65.3	28.6	28.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Balance sheet

Y/E March (Rsmn)	FY11	FY12	FY13	FY14	FY15
Equity	455	455	455	455	455
Reserves	999	1,134	1,380	1,710	2,133
Net worth	1,454	1,589	1,836	2,165	2,588
Short-term loans	784	673	1,004	1,078	1,451
Long-term loans	1,523	1,869	2,651	2,807	2,777
Total loans	2,307	2,542	3,655	3,885	4,229
Deferred tax liability	188	203	175	216	249
Liabilities	3,949	4,334	5,666	6,266	7,066
Gross block	3,668	4,346	5,152	6,704	7,251
Depreciation	1,004	1,332	1,740	2,181	2,776
Net block	2,664	3,014	3,412	4,523	4,474
Capital work-in-progress	146	47	541	-	-
Long-term Investments	34	3	4	42	73
Inventories	1,213	984	1,198	1,385	1,409
Debtors	550	695	912	1,214	1,472
Cash	69	155	199	261	601
Other current assets	261	362	509	492	568
Total current assets	2,094	2,196	2,818	3,352	4,051
Creditors	457	345	458	576	683
Other current liabilities	531	581	651	1,075	849
Total current liabilities	989	926	1,109	1,651	1,533
Net current assets	1,105	1,270	1,710	1,701	2,518
Total assets	3,949	4,334	5,666	6,266	7,066

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Cash flow

Y/E March (Rsmn)	FY11	FY12	FY13	FY14	FY15
EBIT	425	493	660	836	1,059
(Inc./dec. in working capital)	413	(79)	(395)	70	(477)
Cash flow from operations	838	414	265	906	582
Other income	3	5	15	40	30
Depreciation	254	333	409	497	596
Deferred liabilities	29	15	(28)	41	34
Interest paid (-)	(168)	(278)	(318)	(320)	(377)
Tax paid (-)	(86)	(75)	(47)	(156)	(198)
Dividends paid (-)	-	(53)	(64)	(64)	(425)
Net cash from operations	868	403	233	944	241
Capital expenditure (-)	(436)	(583)	(1,302)	(1,068)	(546)
Net cash after capex	432	(180)	(1,068)	(125)	(306)
Inc./(dec.) in short-term borrowing	(1,741)	(111)	331	74	373
Inc./(dec.) in long-term borrowing	1,330	346	782	156	(30)
Inc./(dec.) in total borrowings	(411)	235	1,113	231	343
(Inc./dec.) in investments	-	31	(1)	(38)	(32)
Equity issue/(buyback)	-	-	-	-	-
Cash from financial activities	(411)	266	1,112	193	312
Others	-	-	-	-	334
Opening cash balance	48	69	155	199	261
Closing cash balance	69	155	199	261	601
Change in cash balance	21	86	44	61	340

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Key ratios

Y/E March	FY11	FY12	FY13	FY14	FY15
Per share (Rs)					
EPS	3.8	4.1	6.8	8.8	11.3
Book value	32	35	40	48	57
Valuation (x)					
P/E	25.6	23.7	14.3	11.1	8.7
P/sales	0.9	0.8	0.6	0.5	0.4
P/BV	3.1	2.8	2.4	2.1	1.7
EV/EBITDA	9.8	8.3	7.4	6.0	4.8
EV/sales	1.3	1.2	1.1	0.9	0.7
Return ratios (%)					
RoIC	7.2	8.8	11.9	10.5	12.4
RoCE	7.4	9.0	12.2	10.9	12.2
RoE	12.7	12.3	18.1	20.0	21.6
Margins (%)					
EBITDA margin	13.4	14.4	15.2	14.9	15.1
PBIT margin	8.4	8.6	9.4	9.3	9.7
PBT margin	5.1	4.6	5.1	6.2	6.5
PAT margin	3.4	3.3	4.4	4.5	4.7
Turnover ratio					
Asset turnover ratio (x)	1.3	1.3	1.2	1.4	1.6
Avg. inventory period (days)	144	101	101	107	68
Avg. collection period (days)	39	44	47	49	48
Avg. payment period (days)	54	35	39	45	33
Solvency ratios (x)					
Debt-equity	1.6	1.6	2.0	1.8	1.6
Interest coverage	2.5	1.8	2.1	2.6	2.8
Debt/EBITDA	2.5	1.8	2.1	2.6	2.8
Growth (%)					
Sales	35.0	13.1	22.5	27.2	22.6
EBITDA	17.9	21.6	29.5	24.7	24.1
PAT	49.7	8.3	65.3	28.6	28.6

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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