NIRMAL BANG
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July 30, 2015

Sutlej Textiles & Industries Limited
“Increasing value - added products and healthy volume growth”

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
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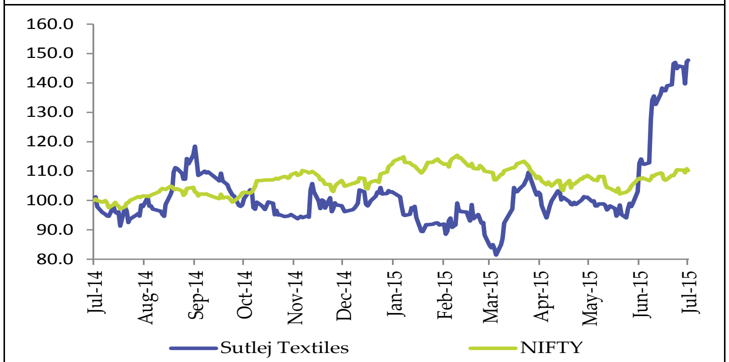
Initiating Coverage — Sutlej Textiles & Industries Limited

Recommendation	BUY
CMP (Rs.)	Rs.555
Target Price (Rs.)	Rs.796 (Upside 43%)

Stock Details

BSE Code	532782
Bloomberg Code	SUTJ IN
Market Cap (Rs. cr)	909
Free Float (%)	36.2
52- wk HI/Lo (Rs)	574/292
Avg. Volume (Monthly)	37460
Face Value (Rs)	10.0
Dividend(%) (FY 15)	100
Shares o/s (Crs)	1.6

Relative Performance	1M	3M	6M	1Yr
SUTJ IN (%)	35.6	53.7	59.4	58.4
NIFTY (%)	0.7	1.6	-6.4	8.1



Shareholding Pattern as on 30th June, 2015

Promoters Holding	63.8%
Institutional (Incl. FII)	-
Corporate Bodies	0.5%
Public & others	35.7%

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Snapshot: Incorporated in the year 2005, Sutlej Textiles and Industries Limited (Sutlej Textiles) is India's largest spun-dyed yarn manufacturer and a leading player in value-added/specialty yarns with 293736 spindles.

Investment Rationale

Capacity expansion will drive growth over FY16-FY18: Sutlej Textiles' total spindles capacity will increase from ~ 293736 in FY15 to ~ 408216 by March, 2017. This will include recently acquired Birla Textiles Mills (83376 spindles). Furthermore, the company is also diversifying into home textiles by increasing capacity from 2.5 MMPA in FY15 to 9.6 MMPA by March, 2017 with total CAPEX of Rs88.5 crs. We believe massive capacity expansion will lead to ~ 15 per cent CAGR in net sales over the next three years.

Levers to margin improvement: Increasing contribution of mélange yarn (33 per cent premium to blended realization) in total sales, favorable operating leverage benefit and increase in export revenue mix from current 25 per cent will result into EBIDTA margin expansion in FY17 and FY18. We expect EBIDTA margins to improve from 12.4 per cent to 14.2 per cent in FY18.

Strong balance sheet and healthy return ratios: On the back of healthy cash flows, the company has been able to fund CAPEX without any stress on financial ratios. Recent credit upgrade by rating agency (from A+ to AA-) also reflects underlying strong balance sheet and business operation. The company has been delivering healthy return on capital employed over the last five years. We believe strong balance sheet with healthy growth & return ratios is a significant value differentiation in textiles sector, which will be recognized by the market.

Multiple operational levers: The company, which derives a major portion of its revenues from the Jammu plant, has the benefit of cheap power and availability of labour at low cost. The company also avails lower cost of funding (@ 7.5 per cent per annum) through TUFS.

Valuation & Recommendation: Sutlej Textiles posted an adjusted PAT of Rs.116.1 crore on net sales of Rs.1878.2 crore in FY'15. We expect Sutlej Textiles to clock 25.9 per cent CAGR in net profit aided by 14.6 per cent CAGR in net sales and improvement in EBIDTA margins. Healthy net sales growth outlook, EBIDTA margin improvement, efficient working capital management and strong balance sheet are key value drivers for stock performance over the medium term. At Rs555, the stock trades 5.0x FY17 EV/ EBIDTA and 3.4x FY18 EV EBIDTA, which makes it an attractive valuation given the strong earnings growth outlook and healthy return ratio. **We value the company at 4.5x EV/EBITDA for FY'18E to arrive at a price target of Rs.796 over the next 12-15 months, providing an upside of 43 per cent from the present level.**

Particulars (Rs Cr)	Net Sales	*Growth (%)*	EBITDA	PAT	EPS (Rs)	P/E (x)	EV/EBITDA (x)
FY'15	1,878.2	*-0.1%*	232.1	116.1	70.5	7.9	6.3
FY'16E	2,410.2	*28.3%*	289.9	151.2	92.3	6.0	5.4
FY'17E	2,510.0	*4.1%*	319.0	172.1	105.1	5.3	5.0
FY'18E	2,830.0	*12.7%*	402.4	231.9	141.6	3.9	3.4

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INVESTMENT RATIONALE

Capacity expansion will drive growth over FY16-FY18

Total spindles capacity will increase from ~ 293736 in FY15 to ~ 408216 by March 2017.

Sutlej Textiles' total capacity will increase from ~ 293736 spindles in FY15 to ~ 408216 spindles by March, 2017. This will include recently acquired Birla Textiles Mills (83376 spindles). The company has acquired Birla Textile Mills (BTM) at Rs235 crs (inclusive of current assets). Furthermore, the company is also diversifying into home textiles by increasing capacity from 2.5 MMPA in FY15 to 9.6 MMPA by March, 2017 with total CAPEX of Rs88.5 crs. Capacity addition in home textiles will increase home textile revenue mix from 5 per cent in FY15 to 8 per cent in FY 18 with 15 per cent EBIDTA margins. The company is also spending ~ Rs53 crs towards modernization of plants, which will increase efficiency and output going ahead. The company added mélange yarn-dedicated 31104 spindles at its Jammu plant last year. The current year will see full impact of expanded capacity of value-added products (mélange yarn) into financials. We believe capacity expansion through organic and inorganic routes coupled with increasing share of value-added products will drive growth at Sutlej over the next few years.

In terms of cash flows, we have built CAPEX of Rs315 crs and Rs247 crs in FY16 & FY17 respectively, which will increase free cash flows to firm up from Rs67 crs in FY15 to Rs256.1 crs in FY18. We believe healthy operating cash flows and strong balance sheet will smoothly fund CAPEX without any stress on overall financial position of the company.

We expect massive capacity expansion will lead to ~ 15 per cent CAGR in net sales over the next three years.

Capacity expansion and CAPEX Details Spindles	FY15	Addition (FY16-FY17)	end of FY17
Yarn			
CTM, Jammu	203304	-	203304
RTM, Rajasthan	90432	31104	121536
BTM	-	83376	83376
	293736	**114480**	**408216**
Home Textile (MMPA)			
DHT	2.5	7.1	9.6

Total CAPEX (Rs in crore)	
RTM	235
Home Textile	88.5
Modernization of existing manufacturing facilities	53
Total	376.5

Source: Company Note: CTM, RTM, BTM and DHT stand for Chenab Textile Mills, Rajasthan Textile Mills, Birla Textile and Damanganga Home Textile.

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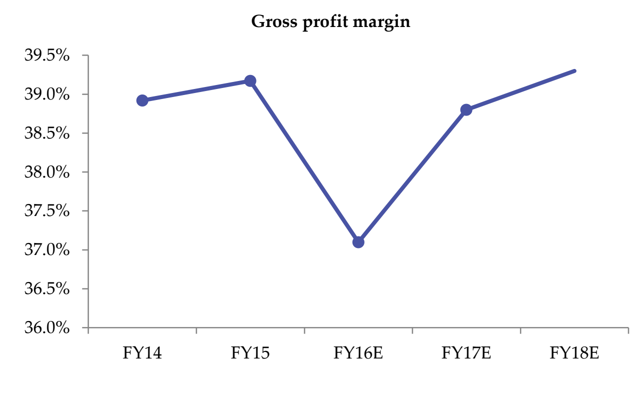
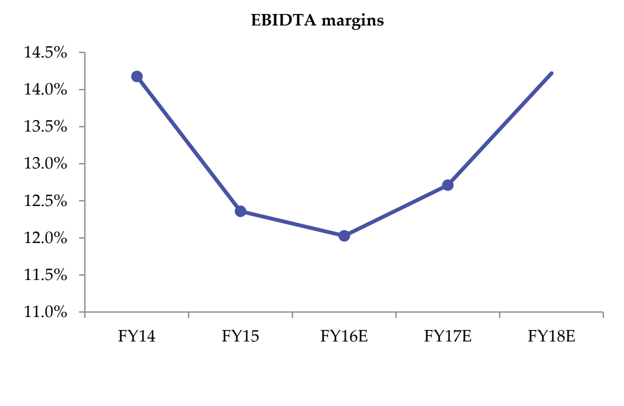
Levers to margin improvement

The company sold 80,040 MT yarn (up 0.5per cent) at realization of Rs219 per Kg (down 1.3per cent) leading to flat net sales in FY15. Decline in cotton price (~ 17per cent) was the primary factor for weak realization during FY15. Consequently, EBIDTA margins have declined from 14.2 per cent in FY14 to 12.4 per cent during the same period. Given the excess cotton supply in the global cotton market, industry experts expect cotton prices to be stable over the next 12 months. The company has 293736 spindles, of which ~ 96,000 spindles are dedicated for cotton mélange production. Brownfield capacity (cotton mélange) at Jammu commenced in November, 2014, and the company is looking to ramp-up utilization from the new facility in FY16.

We believe increasing contribution of mélange yarn (33 per cent premium to blended realization) in total sales, favorable operating leverage benefit and increase in export revenue mix from current 25 per cent will result in EBIDTA margin expansion in FY17 and FY18. We expect EBIDTA margins to improve from 12.4 per cent to 14.2 per cent in FY18. However, the company will see some dip in margins due to BTM's acquisition (10 per cent EBIDTA margin compared to 12.4 per cent Sutlej's EBIDTA margin) in FY16.

Gross profit and EBIDTA to improve over FY16-18





Source: Nirmal Bang PCG Research

Strong balance sheet; efficient working capital cycle and healthy return ratios

On the back of healthy cash flows, the company has been able to fund CAPEX without any stress on financial ratios. Additionally, recent credit upgrade by rating agency (from A+ to AA-) also indicates underlying strong balance sheet and business operation.

Working capital management at Sutlej has been consistent and superior with 100days inventories and 27days debtors and total working capital cycle at 61.4 days. We believe stable margin profile coupled with consistent working capital cycle is a reflection of the underlying superior business operations.

Overall, the company has been delivering healthy return on capital employed over the last five years. The company reported 18 per cent RoCE and 22.6 per cent RoE, due to large CAPEX on capacity expansion in

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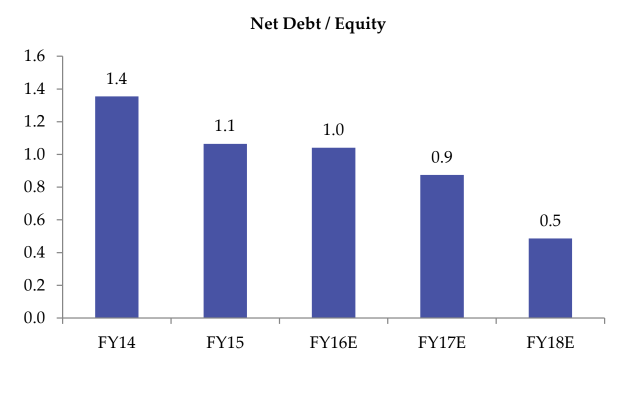
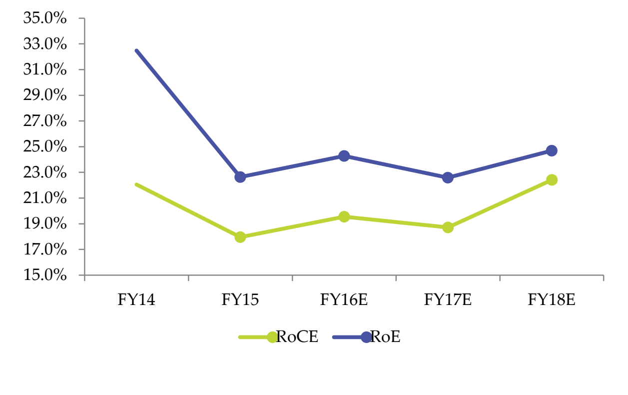
FY15. We expect RoCE to improve from 18% in FY15 to 22.4% in FY18 aided by 15% CAGR in net sales and 25.9% CAGR in net profit over FY15-FY18. We believe strong balance sheet with healthy growth & return ratios is a significant value differentiation in textiles sector, which will be recognized by the market over the medium term.

Strong Return on capital employed and contained financial leverage





Source: Nirmal Bang PCG Research

Multiple operational levers in place

The company enjoys cheap power cost and availability of labour at low cost compared to western & southern region players. Notably, out of Rs1878 crs net sales, J&K manufacturing facilities contributed ~ Rs1200 crs in FY15. Moreover, the company also avails lower cost of funding (@ 7.5 per cent per annum) through TUFS.

A textile facility mainly requires labour and power as its key components on an operational basis. The company's facilities are located in Kathua (Jammu), Bhawanimandi (Rajasthan) and Daheli(Gujarat). The facilities at Jammu (70 per cent) and Rajasthan (24 per cent) contribute 94 per cent to the total revenues. With the commencement of the new facility, this figure is expected to go up further.

The cost of power per unit for Jammu plant comes to Rs.3.35 per unit, which is one of the lowest in the country. With regard to Bhawanimandi, the company has captive power plant of 12MW to meet the complete requirement (through coal procured from Southern Colleries). In addition to the same, the company has the option of purchasing the same either from Power Exchange or Rajasthan Electricity Board.

With a modernization capex of Rs.1023 crore incurred over the last 10 years, the facilities of Sutlej Textiles are equipped with latest and highly automated systems. Moreover, the labour cost in Jammu is relatively much lower compared to other parts in the country, thereby leading to higher margins.

The company's facility at Jammu hires labourers who migrate from Punjab considering the proximity (of about 100-150 kilometers) from the factory location. The company provides them training, post which they are inducted into the system.

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Sutlej Textiles has a dedicated R&D facility in place which focuses on value engineering, thereby reducing the cost of raw material to the maximum possible extent.

A diversified geographical presence with major focus on Jammu, has enabled the company access to various benefits. In addition to the lower cost of funding on account of TUFS, the company enjoys the benefit of lower tax rates as well. The company pays tax under MAT and shall continue to do so till the year FY'18E.

Sutlej Textile's unit at Kathua (J&K) is availing incentives under the industrial policy of J&K state in the form of:

1. reimbursement of insurance premium paid towards fire policy of capital investments;
2. interest subsidy to the extent of 3 per cent on the working capital advanced to the unit by banks;
3. exemption from payment of CST on sale of their finished goods outside the state;
4. no additional toll tax on the raw materials fuel and consumables procured from outside the state;

The company's other unit at Bhawanimandi, also receives benefit of interest subsidy to the extent of 2.5 per cent on the term loans raised by the company for its recent expansion-cum-modernization of projects.

Impeccable track record

Sutlej Textiles has had an impeccable track record in the textile sector. Being the No.1 spun-dyed yarn manufacturer in the country, the company has performed well on all the parameters and has braved the ups and downs of the sector. The company is a one-stop-shop for all types of yarns with major focus on value-added yarns: spun-dyed and cotton mélange. On one hand, the company has never defaulted even for a single day to its bankers while on the other, has never skipped dividend in its entire history!

It should be noted that FY'09 was turbulent not only for the Indian economy but also for the textile sector. Sutlej Textiles had posted a loss in the year due to unforeseen circumstances but inspite of the loss, the company did not skip the dividend.

Over the last five years, the company has registered a CAGR of 10 per cent in net sales leading to a 34 per cent surge in PAT during the corresponding period.

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Effective raw material procurement policy in place

The company has an effective and centralized raw material procurement policy in place. The key raw materials for the company and the source of procurement is as follows:

Particulars	Break-up (%)
Cotton	60%
Polyester	30%
Viscose Fiber	10%
Total	**100.00%**

Source: Nirmal Bang PCG Research

1. Cotton (Shankar 6 variety) – Sutlej Textiles procures the same from Gujarat. Considering the fact that cotton is not available throughout the year, the company purchases and stores the same for both the facilities for a period of about 120-135 days in advance.
2. Viscose Staple Fibre Yarn from Grasim
3. Polyester from Reliance Industries

Currently, cotton, polyester and viscose fiber prices are ruling at Rs34,000 / candy (1 candy = 356 kg), Rs85 per kg and Rs150 per kg respectively.

Marquee client base in the domestic markets as well

The company has a marquee list of clients in the domestic market as well. The company is a key supplier to Birla group companies like Grasim, Madura Garments, among others. Other customers of Sutlej Textiles include names like Digjam, Donear, Siyaram, Arrow, Raymonds(Maker brand), among others. The company also caters to major hosiery companies like Page Industries, Rupa & Company to name a few. Sutlej Textiles has effectively managed the concentration risk with no single customer contributing more than eight per cent and top five customers contributing 22 per cent to the revenues.

Concerns with regarding to appreciating rupee misplaced

We do not expect any major reduction in the margins of the company on account of rupee appreciation. In the domestic market, a customer approaches the company with regard to the requirement for a particular colour and type of yarn, the company prepares the required sample using computerized colour tinting machines in its research laboratory. Post processing of the same, it is sent to the customer for approval. Once it gets approved, the rates are finalized based on the cost of inputs prevailing. Thus, the company's products are pre-sold for a period of minimum two months considering the changing dynamics in fashion since the company manufactures grey yarn.

With regard to exports (to 60-plus countries), the company has marketing offices in Ludhiana, Bhilwara, Mumbai, Coimbatore and Delhi. With the commencement of the new facility at Kathua, the contribution of cotton mélange, which is a high-value product, in the overall product mix, is expected to increase, thereby leading to higher margins.

Sutlej Textiles has already initiated steps for marketing the cotton mélange so as to ensure a steady client base for the new facility at Jammu.

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Backed by a strong legacy

Sutlej Textiles Limited is a part of the K. K. Birla Group. The company is presently run by the Chairman, Mr. Chandrashekhar Nopany. The shareholding pattern in the company indicates that the promoter holding as well as investment by group companies is relatively high and consistent over the last several years. This clearly suggests that the free float is much less than what it appears. The promoter holding in the company stands at ~64 per cent. We believe that around 72 per cent of the holding is in stronger hands and is not a part of the free-float.

Entity	Percentage holding (%)	Description
Promoter holding	63.8	Promoter holding
Birla Institute of Technology & Sciences	6.9	Held by group company
Pilani Investment and Industries Corp	1.1	Held by group company
Total holding	**71.8**	

Source: Nirmal Bang PCG Research

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RISKS & CONCERNS

Weak state of group companies

The other two companies in the group – Oudh Sugar and Upper Ganges Sugar are bleeding on account of the prevailing weak scenario in the sugar sector. A portion of the promoter's shareholding (12.2%) is pledged with financial institutions to provide for the working capital requirements of these two sugar companies.

Sector exposed to volatility in raw material prices

Over the last twelve months, the price of cotton has decreased from Rs.41,000 per candy to Rs.34,000 per candy. Any spurt in the price of raw materials, mainly cotton, if not passed on, would lead to pressure on the operating margins of the company.

COMPANY BACKGROUND

Incorporated in the year 2005, Sutlej Textiles and Industries Limited (Sutlej Textiles) is a focused and integrated textile company with wide range of products spreading across yarn to fabrics to home furnishing. The company has presence in textile production, with its facilities being vertically integrated, from spinning and weaving to dyeing and finishing to make home textile furnishing.

Sutlej Textiles has a global footprint with presence across Australia, Argentina, Bangladesh, Canada, China, Egypt, England, France, Germany, Greece, Hong Kong, Indonesia, Pakistan, Panama, Philippines, Sri Lanka, Turkey, United States of America, UAE, Vietnam, among others.

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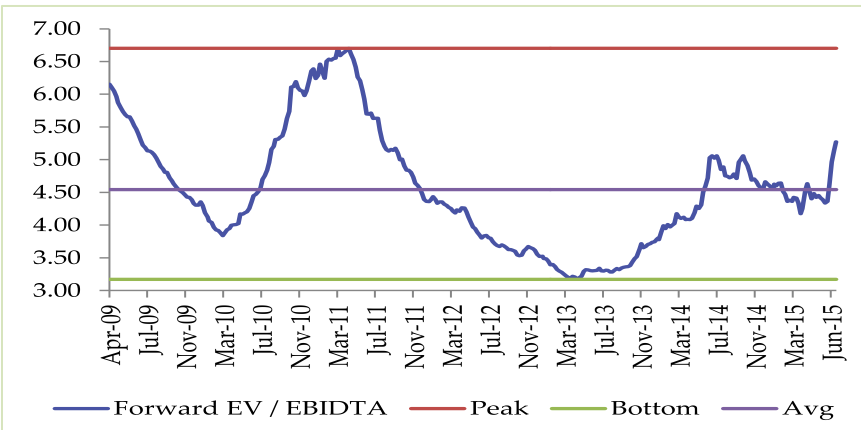
VALUATION AND RECOMMENDATION

Sutlej Textiles has been delivering stable and consistent operating performance compared to other yarn manufacturers over the last three years with lower volatility in operating margins. Sutlej Textiles posted an adjusted PAT of Rs.116.1 crore on net sales of Rs.1878.2 crore in FY'15. We expect Sutlej Textiles to clock 25.9 per cent CAGR in net profit aided by 14.6% CAGR in net sales and improvement in EBIDTA margins. Healthy net sales growth outlook, EBIDTA margin improvement, efficient working capital management and strong balance sheet are key value drivers for stock performance over the medium term.

At Rs555, the stock trades 5.0x FY17 EV/ EBIDTA and 3.4x FY18 EV EBIDTA, which makes it an attractive valuation given the earnings growth outlook and healthy return ratios. **We value the company at 4.5x EV/EBITDA for FY'18E to arrive at a price target of Rs.796 over the next 12-15 months, providing an upside of 43 per cent from the present levels. We recommend a BUY on the stock with a price target of Rs796 over 12-15 months.**

Forward EV / EBIDTA Valuation Range over the last five years



Source: ACE Equity, Nirmal Bang PCG Research

FY15	Banswara Sy	Nitin Spinners	RSWM	Sangam (India)	Sutlej Textiles	VTL	Industry
Sales	1226.2	616.8	3003.4	1476.9	1878.2	6952.2	
Growth	1.2%	26.2%	4.9%	2.6%	-0.1%	11.4%	7.7%
EBIDTA	137.7	100.4	365.5	217.4	232.1	1284.0	
PAT	8.0	41.0	84.9	51.6	115.5	400.2	
EBIDTA margins	11.2%	16.3%	12.2%	14.7%	12.4%	18.5%	14.2%
ROE	3.7%	27.4%	20.2%	14.7%	22.6%	13.5%	17.0%
Asset turnover	2.5	1.3	2.7	2.3	2.1	1.6	2.1
Inventories days	195	90	81	114	102	171	125.7
Debtors days	41	24	24	62	27	36	35.6
Creditors days	47	7	12	22	11	14	18.7
TTM PE	16.9	8.9	9.0	14.8	7.6	11.6	11.5
TTM EV/ EBIDTA	5.2	5.2	5.2	6.2	5.5	6.2	5.6

Source: ACE Equity, Nirmal Bang PCG Research

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FINANCIALS

Rs in crore	FY14	FY15	FY16E	FY17E	FY18E
Income Statement					
Net sales	**1880.6**	**1878.2**	**2410.2**	**2510.0**	**2830.0**
EBIDTA	**266.6**	**232.1**	**289.9**	**319.0**	**402.4**
Other income	39.0	39.7	45.0	48.0	50.0
Depreciation	75.2	69.9	84.0	87.0	100.0
EBIT	230.4	201.9	250.9	280.0	352.4
Interest expense	58.1	53.0	57.0	60.0	56.0
Profit before tax	172.4	148.9	193.9	220.0	296.4
Tax expense	40.3	32.8	42.7	47.9	64.5
Adjusted PAT	**132.0**	**116.1**	**151.2**	**172.1**	**231.9**
Balance sheet					
Equity share capital	16.4	16.4	16.4	16.4	16.4
Reserve & Surplus	446.1	541.9	671.4	819.8	1026.1
Net worth	462.5	558.2	687.7	836.2	1042.5
Debt	630.3	597.6	725.6	745.6	520.6
Other non-current liabilities	45.5	50.2	50.2	50.2	50.2
Current liabilities	128.8	128.1	214.9	214.9	248.1
Total	1272.9	1340.8	1685.1	1853.5	1868.1
Fixed assets	563.2	687.2	918.2	1078.2	1028.2
Other non-current assets	91.8	91.1	91.1	91.1	91.1
Inventories	383.6	320.7	394.6	399.8	447.1
Trade receivables	154.3	138.6	171.7	178.8	201.6
Cash and bank balances	3.9	3.3	9.6	13.9	13.4
Short term loans and advances	28.2	38.3	38.3	30.0	25.0
Other current assets	44.6	61.7	61.7	61.7	61.7
Total	1272.9	1340.8	1685.1	1853.5	1868.1
Cash Flow Statement					
Operating cash flow	159.1	262.0	227.0	267.0	306.1
CAPEX	-101.7	-195.0	-315.0	-247.0	-50.0
Free cash flow	57.4	67.0	-88.0	20.0	256.1
Cash flow from investing	-73.9	-154.6	-270.0	-199.0	0.0
Cash flow from financing	-86.1	-105.4	49.3	-63.7	-306.6
Change in cash	-0.9	2.0	6.3	4.3	-0.5
Opening balance	4.0	3.1	5.1	11.4	15.7
Closing balance	3.1	5.1	11.4	15.7	15.2

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RATIOS	FY14	FY15	FY16E	FY17E	FY18E
Growth					
Net sales	11.9%	-0.1%	28.3%	4.1%	12.7%
EBIDTA	35.6%	-12.9%	24.9%	10.0%	26.1%
PAT	70.7%	-12.1%	31.0%	13.8%	34.8%
EPS	-43.1%	75.8%	31.0%	13.8%	34.8%
Margins					
Gross profits	38.9%	39.2%	37.1%	38.8%	39.3%
EBIDTA margins	14.2%	12.4%	12.0%	12.7%	14.2%
EBIT	12.3%	10.7%	10.4%	11.2%	12.5%
PBT	9.2%	7.9%	8.0%	8.8%	10.5%
PAT	7.0%	6.1%	6.3%	6.9%	8.2%
Return Ratios					
ROA	10.8%	8.8%	10.0%	9.7%	12.5%
ROE	32.5%	22.6%	24.3%	22.6%	24.7%
ROCE	22.0%	18.0%	19.5%	18.7%	22.4%
Leverage					
Gross Debt / Equity	1.4	1.1	1.1	0.9	0.5
Net Debt / Equity	1.4	1.1	1.0	0.9	0.5
Net Debt / EBIDTA	2.3	2.6	2.5	2.3	1.3
Efficiency					
Inventories days	122	102	95	95	95
Debtors days	30	27	26	26	26
Creditors days	12	11	15	15	15
Working capital turnover	3.9	4.4	5.3	5.5	5.8
Working capital days	94	84	68	66	63
Per share data					
Adjusted EPS	40.1	70.5	92.3	105.1	141.6
DPS	8.0	10.0	11.0	12.0	13.0
BVPS	141.1	170.4	209.9	255.3	318.2
Price to earnings (x)	13.8	7.9	6.0	5.3	3.9
Price to book (x)	3.9	3.3	2.6	2.2	1.7
EV/EBIDTA (x)	5.6	6.3	5.4	5.0	3.4

Source: Nirmal Bang PCG Research

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