

October 24, 2016

# **N**ano **N**ivesh



## Key risks to investing in Nano stocks

- Nano stocks may not be in the limelight and inherently being micro cap in nature will have a high risk return profile
- We advise clients to be disciplined in investing at all times. Allocate only a small proportion of your investible income to these stocks and diversify well
- Try to diversify your exposure within the Nano stocks as well by investing equal proportions in several picks
- These stocks may have low volumes and trade infrequently
- Micro cap stocks the world over are, to a large extent, affected by the “Pump and Dump” phenomenon of inflated price buying and depressed price selling
- As explained above, the clients should be patient and trade only through limit orders on any side of the trade.
- The risk of volatility remains in such micro cap stocks as they can move up or down with large buy/sell orders
- The fair value of Nano stocks are subject to expected growth potential in the future. Though due diligence has been done to a fair extent, the actualisation of growth still has a degree of uncertainty attached to it

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**Nano stocks report tries to highlight companies with good and scaleable business models, dependable management and sound financials. However, these stocks may not be in the limelight and have a high risk high return potential. Please watch out for the following factors before investing in these stocks:**

**Allocate a small proportion of your investible income to these stocks and diversify well.** If you choose to invest in these stocks, most of your assets allocated towards equity should remain in more stable investments like stocks of large companies. Moreover, try to diversify your exposure within the nano stocks as well by investing equal proportions in several picks. This will help you avoid losing too much of your total wealth if the investments do not turn out well. When you invest in micro-cap stocks there is a higher risk of impairment.

**These stocks may have low volumes and trade infrequently.** This can create a situation in which you may not be able to find any willing buyers for your stocks when you wish to sell. We advise our clients to be patient and trade only through limit orders to avoid volatile fluctuations, both while putting a buy and sell order in these stocks.

## Premco Global (PREGLO)

Premco Global is a technical textile unit manufacturing woven & knitted narrow elastic fabric, which finds application in innerwear. On account of increasing consumer brand & quality consciousness and Premco's ability to move up the value chain, the company's prospects look robust. Premco is a supplier to brands like Rupa, Lux in the domestic market and Hanes (US) & Jockey (US) in the international market. On the back of impressive expansion in Vietnam, we expect sales & PAT to grow at a CAGR of 19.0% & 16.3%, respectively, in FY16-19E.

### Highlights

- **Niche segment-narrow elastic fabric/tapes:** Premco has a niche business model wherein it manufactures narrow elastic tapes. It has an installed capacity of 11 crore metre with FY16 sales volume at 9 crore metre with blended realisation at ~₹ 8/metre. It is largely an export oriented unit with exports share in the total sales mix at ~66%. Premco primarily exports value added products in export markets, which fetches higher realisations and consequent high EBITDA margins. Its moat is technical know-how of its product profile, long gestation period of customer approval (entry barrier) & innovative product solutions
- **Impressive expansion plans; first phase commissioned:** Premco is currently setting up a narrow elastic fibre plant in Vietnam with a capex of ~₹ 20 crore. The plant in Vietnam is a result of natural preference of its customers to expand its manufacturing base in Vietnam amid low employee costs and benefits associated with Trans Pacific Pact (TPP). The capex is being implemented in two phases with each phase having a capacity of 3.5 crore metre with revenue potential of ~₹ 25 crore each. The first phase has already been commissioned in Q2FY17. On the back of commissioning of Vietnam facility we expect volumes to grow at a CAGR of 17.6% over FY16-19E to 14.7 crore metre in FY19E (9 crore metre-FY16)
- **Unlevered balance sheet; robust return ratios, moat to sustain:** Premco has a debt free balance sheet with surplus cash on books (₹ 17 crore as of FY16). Sustained EBITDA margins have resulted in healthy return ratios with FY16, RoE, RoCE & RoIC at 25%, 33% & 56%, respectively. Going forward, we expect sales & PAT to grow at a CAGR of 19.0% & 16.3%, respectively, in FY16-19E. We value Premco at ₹ 825-880, i.e. 15.0-16.0x P/E on FY18E & FY19E average EPS of ₹ 55.0. \*Taking into account the low liquidity in the scrip and its listing only on the BSE platform, we recommend a buying range of ₹ 550-600 as the entry price into the counter

### Buy Price Range

₹ 550-600\*

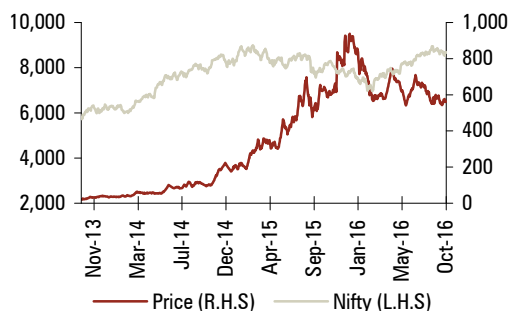
### Recommendation

Buy

### Fair value

₹ 825-880

### Price performance



### Key risks-

#### Business specific

**Change in consumer preference, innovation a continuous process:** The prime moat of Premco is its ability to innovate continuously matching up to consumer requirements. Therefore, given the present continuous change in consumer preferences both domestically as well as globally; it is important for such kind of businesses to innovate on a regular basis. Any failure to match up to the consumer taste will result in a likely loss of business and muted profitability for Premco Global.

#### Company specific

**Client concentration:** A large part of exports are targeted at Hanes (US) and its various subsidiaries. Out of the total share of exports i.e. 66% more than 50% is consumed by Hanes, total contribution of Hanes to Premco's topline is in excess of 33%. Therefore, there exists a high client concentration risk and that too for products that are value added in nature and fetch enhanced margins and profitability. Henceforth, any ramp down at Hanes will have consequent effects at Premco.

**Elongated working capital cycle:** Premco has an elongated working capital cycle with net working capital days at 108 days as of FY16. Working capital is elongated largely on account of higher share of exports in the total product mix (66% in FY16). In exports, the company needs to provide its product on just-in-time basis to its key customers. Hence, it has to maintain a good repository of the same in its inventory. Inventory days in FY16 were at 80 days. On the debtor front, the company gives a regular 60 day credit period to its customers. On the creditor's front, by virtue of a cash rich balance sheet, Premco procures its raw material paying upfront and, hence, has low creditor days at 20 days only. However, any further elongation of the working capital cycle will adversely affect the financial health of Premco.

### Description

Premco Global is a Maharashtra based (Mumbai) technical textile unit manufacturing woven & knitted narrow elastic fabric, which finds application in innerwear. Currently, it has four manufacturing facilities across Maharashtra viz. Dadra, Vapi, Palghar and Mumbai. It has an installed capacity to manufacture 11 crore metre of elastic tapes annually with capacity utilisation as of FY16 at 85% (~9 crore metre). Polyester constitutes the main raw material for Premco with share of total raw material costs at 47% followed by rubber at 24% & nylon at 19%. In FY16, set sales were at ₹ 73.5 crore with EBITDA at ₹ 20.1 crore (EBITDA margins at 27.3%). PAT in FY16 was at ₹ 12.6 crore with corresponding EPS at ₹ 38.1.

### History and track record

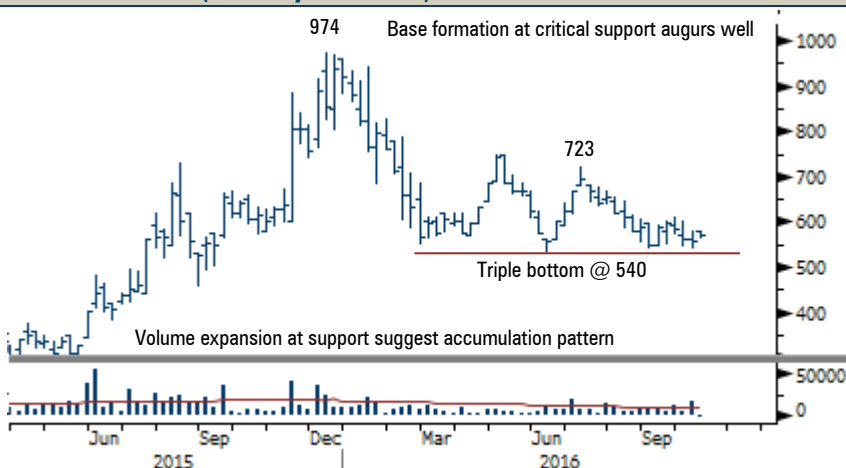
- Premco Group was established in 1966 and was primarily involved in manufacturing and export of high-fashion ready-made garments to department, chain stores and boutiques in international markets across the US, Europe, and Latin America
- In 1977, Premco Global ventured into manufacturing of high-quality woven and knitted elastic fabric, which find application in the apparel, lingerie, sports-related, medical, footwear, luggage and automotive fields. Premco's product usage is gender agnostic
- In FY13, Premco witnessed a turnaround with >50% increase in sales and >800 bps improvement in EBITDA margins. This led the company to report PAT of ₹ 5.2 crore vs. usual rate of ₹ 1-2 crore
- The turnaround in FY13 was largely led by increasing focus on exports vis-à-vis domestic business and savings of costs namely raw materials and other operating expenses
- Premco also supplies to brands like Fruit of the Loom, QST International and other reputed brands in the international market
- The company is currently headed by Ashok Harjani (Chairman), Executive Director-Lokesh Harjani and CEO -DK Jain

### Earnings estimates

₹ crore	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	72.3	73.5	80.1	108.4	123.7
EBITDA	20.3	20.1	20.4	28.2	32.8
EBITDA Margins (%)	28.0	27.3	25.5	26.0	26.5
Net Profit	12.1	12.6	12.3	16.5	19.8
EPS	36.5	38.1	37.3	50.0	60.0

Source: Company, ICICIdirect.com Research

### Technical Chart (Monthly Bar chart)



Source: Bloomberg, ICICIdirect.com Research

### Stock data

Market Capitalization (₹ crore)	190.0
52 Week High / Low (₹)	974 / 530
Promoter Holding (%)	64.0
FII Holding (%)	0.2
DII Holding (%)	2.2
Dividend Yield (%)	0.4
12M / 6M stock return (%)	(9) / (4)
Debt (₹ crore)	4.0
Cash and Cash Equivalent (₹ crore)	21.0
Enterprise Value (₹ crore)	173.0
5 Year Revenue CAGR (%) (FY11-16)	11.7
5 Year EBITDA CAGR (%) (FY11-16)	47.3
5 Year PAT CAGR (%) (FY11-16)	55.2

### Valuation

	FY16	FY17E	FY18E	FY19E
P/E	15.1	15.4	11.5	9.6
Target P/E	21.6	22.1	16.5	13.8
EV / EBITDA	8.6	8.7	6.0	4.6
P/BV	3.7	3.1	2.5	2.0
RoNW	24.8	19.9	21.6	21.1
RoCE	32.5	26.1	30.1	29.0
ROIC	56.4	38.3	42.2	48.0

Source: ICICIdirect.com Research

### Quarterly performance

(₹ crore)	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Sales	22.4	19.9	15.3	18.7
EBITDA	5.1	5.2	5.8	4.4
EBITDA Margin (%)	22.8	26.1	38.0	23.8
Depreciation	0.5	0.6	0.6	0.7
Interest	0.2	0.3	0.3	0.3
Other Income	0.8	0.8	0.6	0.3
PAT	3.5	3.3	3.4	2.3
EPS (₹)	10.1	10.0	10.3	6.8

Source: ICICIdirect.com Research

### Shareholding trend (%)

Key Shareholders	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Promoter group	63.4	64.0	64.0	64.0
FII	0.0	0.0	0.2	0.0
DII	2.1	2.2	2.2	2.4
Non-institutional	34.5	33.9	33.7	33.7

Source: ICICIdirect.com Research

### Technical View

The share price of Premco Global had a fabulous run through 2014 and 2015. The deep correction off life-time highs of ₹ 974 since the beginning of 2016 presents a fresh entry opportunity in the stock as it witnesses a basing formation at key support levels.

After a nearly 50% correction from life-time highs, in February 2016, the share price has entered a time correction phase. The stock hit the potential Triple bottom formation around ₹ 530 over the past six months and is expected to head higher in months to come. Historically, during 2011 and 2013, the share price reversed higher after correcting ~50% from the respective tops. Therefore, a similar magnitude of correction from 2016 top presents a favourable reward/risk set-up for investors

We believe the share price is poised to head higher after a healthy correction to an intermediate target of ₹ 730



## What's the story?

### Global & domestic innerwear industry; premiumisation story intact, benefits Premco Global!

Globally, innerwear is a highly brand conscious market (US\$ 160 billion) with relatively stable consumption patterns. The US innerwear market (one of the largest) is valued at US\$21 billion as of CY15 with the share of branded innerwear at 85%. The global innerwear market is expected to grow at 2-5% with premiumisation share largely intact. Hanes US (sales US\$5.7 billion, MCap US\$10.8 billion) is one of the largest player in the innerwear category globally with market share positioning as either first or second across key categories across nations like US, Canada, Europe, Mexico & Brazil. Domestically, the Indian innerwear market size is pegged at ₹ 20,000 crore (2014) with the share of the organised sector at ~52%. It constitutes ~8% of the overall Indian apparel industry and is the fastest growing segment of the market. It is expected to grow at 13% CAGR to ₹ 68000 crore by 2024. The women's innerwear market constitutes 60% of overall innerwear market with market size at ~₹ 12,500 (2014) crore. Men's innerwear constitutes the rest 40% of the domestic market with market size at ~₹ 7500 crore (2014). Domestically, with rising per capital income, higher discretionary spending, rising urbanisation and growing fashion consciousness, innerwear industry is on a strong footing with increasing premiumisation, going forward.

### Premco: Niche business model, moat to sustain!

Premco has a niche business model wherein it manufactures narrow elastic tapes used in innerwear for both men & women. Out of the entire ambit of technical textiles, this narrow elastic tape is a small category with a huge share of unorganised segment largely based out of Tiruppur (Tamil Nadu). Most domestic manufacturers of innerwear (Rupa, Lux, VIP, etc, except Page Industries) procure these elastic tapes from outside and do not manufacture them indigenously. These players procure the normal commodity type tapes from the unorganised segment but rely on players like Premco for their value added requirements (broad width, name tapes, printed elastic, etc). Domestically, apart from Premco, these elastic tapes are manufactured by Arrow Textiles and Spica Elastic Pvt Ltd in the organised segment. Premco's USP is providing cost effective solutions catering to customer requirements by altering its raw material mix (polyester, rubber & nylon) while at the same time maintaining product's aesthetics & feel towards human body. Premco's moat is technical knowhow of product profile (elastic tapes), long gestation period of customer's approval (entry barrier) and innovative product solutions.

### Impressive capacity addition in Vietnam; volume to lead growth to sustain in FY16-20!

The current domestic capacity of Premco is 11 crore metre. The company is operating at 85% utilisation levels with production & sales volume at ~9 crore metre as of FY16. This has largely been stagnant in FY15-16 with limited room for volume led growth. Sensing this limitation; Premco is currently executing an impressive capex programme wherein it is setting up a narrow elastic fibre manufacturing plant in Vietnam at an initial outlay of ₹ 20 crore. The company will hold an 85% stake in the venture with the remaining stake being held by a local partner. The plant in Vietnam is a result of natural preference of its customers to expand manufacturing in Vietnam amid low employee costs and benefits associated with Trans Pacific Pact (TPP). The capex is being implemented in two phases with each phase having a capacity of 3.5 crore metre with revenue potential of ~₹ 25 crore each. The company intends to supply value added products from this facility and intends to realise almost margins as in Indian operations (~25%+). The first phase of the said facility has already been commissioned with the first shipment made in Q2FY17. On the back of commissioning of the Vietnam facility, we expect volumes to grow at a CAGR of 17.6% to 14.7 crore metre in FY19E (~9 crore metre in FY16). We expect sales volumes from the Vietnam plant at 1.4 crore metre for FY17E, 3.5 crore metre for FY18E & 5.3 crore metre for FY19E. At peak capacity, the Vietnam facility can generate RoCE in excess of 50%.

### Balance sheet strength to grow, robust return ratios and strong earnings trajectory warrant re-rating!!!

By virtue of healthy cash flow from operations in FY14-16 (~₹ 12 crore/year), a relatively stable working capital cycle (~100 days) and minimal capex spend, Premco has a debt free balance sheet with surplus cash on books at ₹ 17 crore (FY16). This, along with further CFO over FY17E, will take care of capex being executed at Vietnam. Sustained EBITDA margins have resulted in healthy return ratios with FY16, RoE, RoCE & RoIC at 25%, 33% & 56%, respectively. Going forward, on the back of commissioning of the plant in Vietnam we expect sales to grow at a CAGR of 19.0% in FY16-19E led by volume growth of 17.6% in the aforesaid period. EBITDA & PAT, however, are expected to grow at a CAGR of 17.7% & 16.3%, respectively, in FY16-19E largely taking into account initial ramp up costs at Vietnam (limited margin expansion) and increasing depreciation and lower other income incidence (due to utilisation of cash towards capex). We value Premco at ₹ 825-880, i.e. 15.0-16.0x P/E (~1x PEG) on FY18E & FY19E average EPS of ₹ 55.0. Taking into account the low liquidity in the script and its listing only on the BSE platform, we recommend a buying range of ₹ 550-600 as the entry price in the counter.

## Financial summary (Consolidated)

Profit and loss statement		₹ Crore			
(Year-end March)	FY16	FY17E	FY18E	FY19E	
Net Sales	70.1	77.8	105.2	120.1	
Other Operating Income	3.4	2.3	3.2	3.6	
<b>Total Operating Income</b>	<b>73.5</b>	<b>80.1</b>	<b>108.4</b>	<b>123.7</b>	
Growth (%)	1.7	9.0	35.3	14.1	
Raw Material Expenses	31.3	34.1	46.1	52.6	
Employee Expenses	7.6	8.8	11.4	13.0	
Selling Expense	0.0	0.0	0.0	0.0	
Other Operating Expense	14.5	16.8	22.8	25.4	
Total Operating Expenditure	53.4	59.7	80.2	90.9	
<b>EBITDA</b>	<b>20.1</b>	<b>20.4</b>	<b>28.2</b>	<b>32.8</b>	
Growth (%)	-0.8	1.7	37.9	16.3	
Depreciation	2.2	3.1	4.1	4.7	
Interest	1.0	0.9	0.8	0.7	
Other Income	2.6	2.2	2.2	3.6	
PBT	19.5	18.7	25.5	31.1	
Total Tax	6.9	6.2	8.4	10.2	
Minority Interest	0.0	0.2	0.6	1.0	
<b>PAT</b>	<b>12.6</b>	<b>12.3</b>	<b>16.5</b>	<b>19.8</b>	
Growth (%)	4.1	-2.0	34.0	20.0	
EPS (₹)	38.1	37.3	50.0	60.0	

Source: Company, ICICIdirect.com Research

Balance sheet		₹ Crore			
(Year-end March)	FY16	FY17E	FY18E	FY19E	
<b>Liabilities</b>					
Equity Capital	3.3	3.3	3.3	3.3	
Reserve and Surplus	47.5	58.8	73.3	90.7	
<b>Total Shareholders funds</b>	<b>50.8</b>	<b>62.1</b>	<b>76.6</b>	<b>94.0</b>	
Total Debt	4.3	4.5	3.5	3.0	
Deferred Tax Liability	0.9	0.9	0.9	0.9	
Minority Interest / Others	1.3	1.5	2.0	3.0	
<b>Total Liabilities</b>	<b>57.2</b>	<b>68.9</b>	<b>83.0</b>	<b>100.9</b>	
<b>Assets</b>					
Gross Block	24.8	37.1	45.1	48.1	
Less: Acc Depreciation	15.1	18.6	22.7	27.4	
Net Block	9.7	18.5	22.4	20.7	
Capital WIP	4.3	7.0	1.0	0.0	
<b>Total Fixed Assets</b>	<b>14.0</b>	<b>25.5</b>	<b>23.4</b>	<b>20.7</b>	
Investments	18.6	12.5	21.0	36.5	
Inventory	15.6	17.1	21.6	23.0	
Debtors	9.1	12.8	17.3	19.7	
Loans and Advances	1.8	1.9	1.9	2.2	
Other Current Assets	1.5	1.6	1.9	2.2	
<b>Cash</b>	<b>2.4</b>	<b>3.5</b>	<b>3.7</b>	<b>5.6</b>	
<b>Total Current Assets</b>	<b>30.4</b>	<b>36.8</b>	<b>46.4</b>	<b>52.7</b>	
Current Liabilities	4.1	4.3	5.8	6.6	
Provisions	1.9	2.1	2.3	2.6	
Current Liabilities & Prov	6.0	6.4	8.1	9.2	
Net Current Assets	24.4	30.4	38.4	43.5	
Others Assets	0.6	0.6	0.3	0.3	
<b>Application of Funds</b>	<b>57.2</b>	<b>68.9</b>	<b>83.0</b>	<b>100.9</b>	

Source: Company, ICICIdirect.com Research

Cash flow statement		₹ Crore			
(Year-end March)	FY16	FY17E	FY18E	FY19E	
Profit after Tax	12.6	12.3	16.5	19.8	
Add: Depreciation	2.2	3.1	4.1	4.7	
(Inc)/dec in Current Assets	0.8	-5.2	-9.4	-4.4	
Inc/(dec) in CL and Provisions	-0.8	0.4	1.7	1.1	
Others	1.0	0.9	0.8	0.7	
<b>CF from operating activities</b>	<b>15.7</b>	<b>11.5</b>	<b>13.7</b>	<b>21.9</b>	
(Inc)/dec in Investments	-8.3	6.1	-8.5	-15.5	
(Inc)/dec in Fixed Assets	-6.1	-14.6	-2.0	-2.0	
Others	0.2	-0.2	0.9	1.0	
<b>CF from investing activities</b>	<b>-14.1</b>	<b>-8.7</b>	<b>-9.6</b>	<b>-16.5</b>	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	1.0	0.2	-1.0	-0.5	
Interest & Dividend paid	-2.2	-1.9	-2.8	-3.0	
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0	
Others	0.2	0.0	0.0	0.0	
<b>CF from financing activities</b>	<b>-1.1</b>	<b>-1.6</b>	<b>-3.8</b>	<b>-3.5</b>	
Net Cash flow	0.6	1.1	0.2	1.9	
Opening Cash	1.8	2.4	3.5	3.7	
<b>Closing Cash</b>	<b>2.4</b>	<b>3.5</b>	<b>3.7</b>	<b>5.6</b>	

Source: Company, ICICIdirect.com Research

Key ratios		₹ Crore			
(Year-end March)	FY16	FY17E	FY18E	FY19E	
<b>Per share data (₹)</b>					
EPS	38.1	37.3	50.0	60.0	
Cash EPS	44.8	46.7	62.4	74.0	
BV	153.6	187.8	231.7	284.5	
DPS	3.0	2.5	5.0	6.0	
Cash Per Share (Incl Invst)	63.6	48.4	74.8	127.3	
<b>Operating Ratios (%)</b>					
EBITDA Margin	27.3	25.5	26.0	26.5	
PAT Margin	17.1	15.4	15.2	16.0	
Inventory days	81.2	80.0	75.0	70.0	
Debtor days	47.6	60.0	60.0	60.0	
Creditor days	21.3	20.0	20.0	20.0	
<b>Return Ratios (%)</b>					
RoE	24.8	19.9	21.6	21.1	
RoCE	32.5	26.1	30.1	29.0	
RoIC	56.4	38.3	42.2	48.0	
<b>Valuation Ratios (x)</b>					
P/E	15.1	15.4	11.5	9.6	
EV / EBITDA	8.6	8.7	6.0	4.6	
EV / Net Sales	2.5	2.3	1.6	1.3	
Market Cap / Sales	2.7	2.4	1.8	1.6	
Price to Book Value	3.7	3.1	2.5	2.0	
<b>Solvency Ratios</b>					
Debt/EBITDA	0.2	0.2	0.1	0.1	
Debt / Equity	0.1	0.1	0.0	0.0	
Current Ratio	4.7	5.2	5.3	5.1	
<b>Quick Ratio</b>	<b>2.1</b>	<b>2.5</b>	<b>2.6</b>	<b>2.6</b>	

Source: Company, ICICIdirect.com Research

## **RATING RATIONALE**

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Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



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