HDFC securities

Equity Research

Pick of the week

RETAIL DESK

Industry	CMP	Recommendation	Add on dips to	Sequential Targets	Time Horizon
Textile	Rs 367	Buy at CMP and add on declines	Rs 327-333	Rs 419 & Rs 467	3-4 Quarters

HDFC Scrip Code	SPALTDEQNR
BSE Code	540048
NSE Code	SPAL
Bloomberg	SPAL IN
CMP (9-Mar-18)	367.05
Equity Capital (Rs Cr)	25.2
Face Value (Rs)	10
Eq. Shares O/S (Cr)	2.52
Market Cap (Rs Cr)	923.8
Book Val (Rs)	152.1
Avg.52 Wk Volume	49280
52 Week High	484.0
52 Week Low	301.2

Shareholding Pattern % (Dec-2017)	
Promoters	60.2
Institutions	16.4
Non Institutions	23.4
Total	100.0

FUNDAMENTAL ANALYST
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Promoted originally as a partnership firm by Mr P Sundararajan in 1989, S.P. Apparels Ltd (SPAL) is an integrated readymade-garment manufacturer of 100% cotton garments, primarily for the children's wear export market. Its manufacturing facilities located in Tamil Nadu, the Company has 23 manufacturing units in and around Avinashi, District Tirrupur (knitting, processing, garmenting, and printing and embroidery facilities) and Salem (spinning facility). The exports are made to renowned brands/marketers in the EU & US, lending stability to operations. It entered domestic retail market in FY07 by acquiring a 70% equity stake in Crocodile Products Pvt. Ltd., the Indian arm of the Singapore-based Crocodile International Pte. Ltd. (which markets the menswear brand, Crocodile). SPAL came out with an IPO of 89.2 lakh equity shares @ Rs 268 in August-2016.

Investment Rationale:

- Global childrenswear market to reach US$ 322bn by 2024
- Shifting base of apparel industry from China to benefit India
- High entry barriers marked by stringent compliance requirements
- Expanding retail presence of Crocodile brand
- Enhancing capacity and backward integration to become fully integrated company

Concerns:

- Labour intensive operations
- Geographical and customer concentration
- Delay in retail outlet expansion & sales pickup
- Competition from other emerging market companies

View and Valuation

SPAL has been adding new customers outside of UK which has reduced its client concentration as well as geographic concentration risks. Its retail venture in India and UK subsidiary SPUK have turned around and could become profitable at PAT levels in FY18. It has been adding capacity to meet the increasing order flows from customers. Backward integration is expected to be complete by FY19 post which the company is likely to witness strong margin expansion. Shifting of apparel exports from China to other emerging markets due to cost competitiveness has opened up a big opportunity for companies like SPAL and it is fully geared to grab it.

SPAL seems to be a quality midcap stock engaged in a recession proof business and growing at a decent pace (though having its own share of risks) and the current valuations leave scope for a rerating.

At CMP of Rs 367 the stock quotes at 11.4x FY20E EPS. We feel investors could buy the stock at CMP and add on dips to Rs 327-333 band (10.25x FY20E EPS) for sequential targets of Rs 419 (13x FY20E EPS) and Rs 467 (14.5x FY20E EPS) in 3-4 quarters.

KEY HIGHLIGHTS

- ***Global market for childrenswear is forecast to reach US$321.6 bn by 2024. Countries like Germany, UK, France, and Italy are the leading countries in per child spending on apparel***
- ***Shifting base of apparel industry from China, creating a potential market of US$ 280+ bn. India is uniquely positioned to capitalize on this opportunity***
- ***High entry barrier with Governments across the developed countries enacting laws to ensure minimum safety standards of childrenswear***
- ***Setting up new facility to have all activities in-house by FY19 making SPAL an integrated company, adding to margins***
- ***Expanding retail presence of Crocodile brand which has turned positive on net level***

Financial Summary - Consolidated

Particulars (Rs Cr)	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)	FY17	FY18E	FY19E	FY20E
Operating Income	162.9	146.5	*11.2*	166.1	*-1.9*	635.7	651.7	772.3	888.9
EBITDA	30.1	26.6	*13.4*	23.5	*28.1*	107.3	101.7	125.9	150.2
Reported PAT	14.1	15.9	*-11.7*	9.5	*48.4*	61.9	54.7	67.0	81.0
EPS (Rs)	5.6	6.3		3.8		24.6	21.7	26.6	32.2
P/E (x)						14.9	16.9	13.8	11.4
EV/EBITDA (x)						9.3	9.3	7.5	6.1
RoNW (%)						25.6	13.8	14.7	15.4

Source: (Company, HDFC sec)

Company Overview

Promoted as a partnership firm by Mr P Sundararajan in 1989, S.P. Apparels Ltd (SPAL) is an integrated readymade-garment manufacturer of 100% cotton garments, primarily for the children's wear export market. Its manufacturing facilities located in Tamil Nadu, the Company has 23 manufacturing units in and around Avinashi, District Tirrupur (knitting, processing, garmenting, and printing and embroidery facilities) and Salem (spinning facility). The exports are made to renowned brands/marketers in the European Union (EU) & US, lending stability to operations. It entered domestic retail market in FY07 by acquiring a 70% equity stake in Crocodile Products Pvt. Ltd., the Indian arm of the Singapore-based Crocodile International Pte. Ltd. (which markets the menswear brand, Crocodile). SPAL came out with an IPO of 89.2 lakh equity shares @ Rs 268 in August-2016.

Effective capacity of all units put together depends on the product mix (basic vs fashion, kid vs adult) and also the batch size. The ballpark capacity of all units put together was 50 mn pieces in March 2017. SPAL enjoys full support and confidence from the promoters as they have subscribed to Rs 20cr of 10% Reedemable Preference Shares maturing in 2021 and also advanced loans of Rs 17.4cr.

Garment Division

SPAL is a leading manufacturer and exporter of knitted garments for infants and children. These are manufactured at its integrated facilities that provide end-to-end garment manufacturing services from greige fabric to finished products. SPAL's core competency lies in clear understanding of the specifications of knitted garments in the infants and children category, the buying preferences of customers and ability to deliver products of a consistent high quality that meet the product specifications and stringent compliance requirements of international customers. The long-standing relationship with major customers has been one of the most significant factors contributing to growth. Garments division accounted for 91.6% revenues in FY17.

SPAL makes basic as well as fashion garments. Fashion garments take a longer time to be completed as the number of processes are higher as compared to basic garments. Consequently realisation for fashion garments are significantly higher than basic. The company is targeting a ratio of 50:50 between fashion and basic garments by FY19 as compared to 75:25 in FY17.

Retail Division

SPAL manufactures and retails menswear garments in India under the brand 'Crocodile'. It has exclusive right to manufacture, distribute and market products under the 'Crocodile' brand in India. It sells the 'Crocodile' branded products through sales and distribution network and third-party e-commerce platforms. It also has agreements with distributors in relation to the sale, marketing and distribution of 'Crocodile' products. Retail division contributed to 8.4% of revenues in FY17.

Subsidiaries

Crocodile Products Private Limited

Crocodile Products Private Limited – (CPPL), is a 70:30 joint venture between SPAL and Crocodile International Pte. Ltd. (CIPL). It is engaged in the business of establishing and managing units to manufacture, trade, deal, import and export garments under the technology license agreement with CIPL for the exclusive manufacture, distribution and marketing of menswear products like shirts, polo shirts, t-shirts, trousers, jeans, sweaters, jackets and innerwear products like vests, briefs, boxer shorts under the trademark 'Crocodile' in India. All garments sold in this company (apart from innerwear which is sourced from SPAL) are outsourced. As of December-2017, the company had 51 exclusive outlets across Tier II, III and IV cities in 9 states. In FY17 the retail venture earned revenues of Rs 56.8cr and a profit of Rs 16lk against revenues and loss of Rs 34.6cr and Rs 84lk in FY16 respectively.

S.P. Apparels (UK) (P) Limited

SPUK was incorporated in 2014 to explore possible marketing opportunities and engage in trading activities with new customers in the UK, Ireland and other European countries. SPUK has a design studio and has hired experienced designer consultants that provide design support services to customers. SPUK also provides after sales service to its customers for any technical and other grievance. SPUK banks on the reputation of SPAL and undertakes small batch order sizes which it gets outsourced from anywhere in the world. SPUK earned revenues of £ 14.7lk in FY17 against £ 2lk in FY16. It broke even at the PAT level compared to a loss of £ 15.6lk in FY16.

Key company milestones

Year	Milestone
1989	Started export operations as a partnership firm
1998	Set-up manufacturing facility at Neelambur
2003	Set-up first in-house embroidery facility at Thekkalur
2004	Set-up flagship factory at Avinashi with full garment conversion process (from cutting to packing)
2005	Set-up first in-house printing facility at Avinashi. Commissioning of dyeing plant at SIPCOT, Perundurai
2006	Investment by NYLIM Jacob Ballas. Acquisition of majority shareholding in Crocodile Products JV

2007	Amalgamation of S.P. TexFab Private Limited
2008	Amalgamation of Sri Balaji Bakkiam Spinning Mills
2013	Investment by Euro Asia pursuant to the Investment Agreement
2014	Incorporation of a wholly-owned subsidiary, SPUK in the United Kingdom.
2016	Listed on stock exchanges
2017	Expansion of Crocodile brand by setting up COCO stores

Investment Rationale

Global childrenswear market to reach US$ 322bn by 2024

According to a report by Global Industry Analysts the global market for childrenswear is forecast to reach US$321.6 billion by 2024, driven by factors such as growing exposure of children to media and the ensuing rise in materialism, excessive consumption and impulsive purchases; enhanced role of children in purchase decisions; growing affluence of parents; and widening range of choices of luxury and designer clothing brands.

Childrenswear market is divided into two categories; infant and toddler wear (0-3 years) which account for 20% and kids wear (4-14 years) which contributes to 80%. The global infant and childrenwear market is marked by its inelasticity to pressures on economic conditions and the impulsive buying of children's clothing by parents. Also, the purchase of children clothing involves regular spending as they quickly outgrow clothes, making purchase of new apparel an absolute necessity.

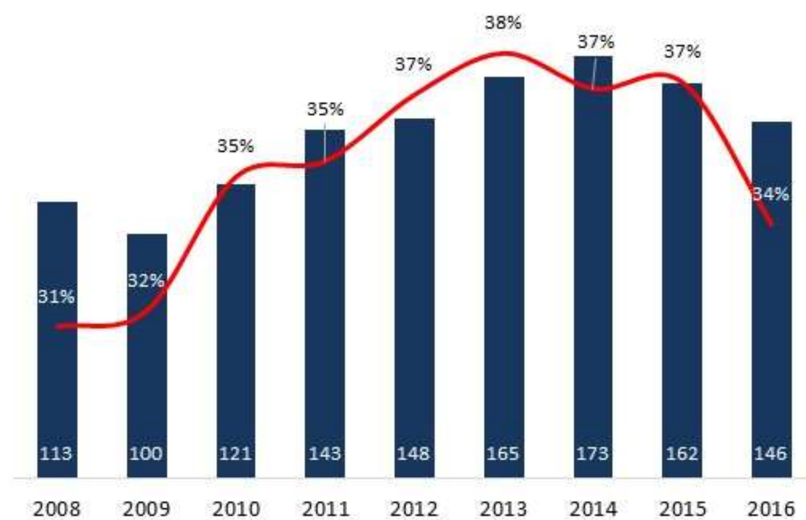
The United States is the largest market for childrenswear with a market size of US$ 58.3bn followed by China (US$ 44.4bn) according to Marketline Technopak Analysis, 2014. However, European countries like Germany, UK, France, and Italy are the leading countries in per child spending on apparel. The growth of childrenswear market in developing countries like China, India, Russia, Brazil etc. has been higher with CAGR in the range of 8% to 12%, owing to their low base. Among the emerging economies, increasing penetration of brands in childrenwear categories and the rising willingness of parents to spend on children are contributing to the growth of this market.

As per fspretail.com, over the past 5 years, childrenswear has consistently grown faster than both menswear and womenswear. In 2015 alone, growth was at 6% compared to 4% for adult clothing and the UK market is expected to grow by 13% to over £6bn over the next 5 years.

Shifting base of apparel industry from China to benefit India

China has been dominating the global textile and apparel markets till 2015 due to availability of cheap labor, infrastructure facilities and export-friendly government policies. However, with wage cost rising and Yuan gaining strength, apparel industry is shifting base from China, creating a potential market of US$ 280+ bn for other countries. India is uniquely positioned to capitalize on this opportunity. Although Bangladesh and Vietnam have benefitted immensely post Multi-Fibre Agreement (MFA) regime due to availability of low cost labor and duty-free access to US and Europe, they have been grappling with some fundamental challenges such as inadequate infrastructure, poor energy supplies, widespread corruption, inefficient regulatory practices, political volatility and shortage of skilled labor.

China's share in global textile and apparel exports



(Source: International Trade Centre, HDFC Sec)

Stronger ability of Indian manufacturers to adhere to compliance norms in comparison to other low-cost manufacturing countries, abundant supply of cotton, government support for apparel manufacturing and presence across the chain of textile industry – spinning, weaving, knitting, dyeing, garmenting, finishing and quality compliance, strengthens India's position as a key manufacturer and exporter of children wear.

Country	Export Value (US$ bn)		Export share (%)		CAGR (%)
	2011	2016	2011	2016	
China	143.2	146.5	35.2%	33.7%	0.4%
Bangladesh	19.2	32.6	4.7%	7.5%	11.2%
Vietnam	12.8	24.8	3.1%	5.7%	14.1%
India	13.7	17.0	3.4%	3.9%	4.3%
Turkey	13.5	14.8	3.3%	3.4%	1.8%
Pakistan	4.0	4.6	1.0%	1.1%	2.8%

(Source: International Trade Centre, HDFC Sec)

Further SPAL has the option to enter manufacturing menswear and womenswear in future that can be manufactured out of knitting machines. For other apparels it needs to add machines.

High entry barriers marked by stringent compliance requirements

While the childrenswear market is very large, Governments across the developed countries have enacted many laws to ensure minimum safety standards of childrenswear which the exporting companies have to adhere. This creates an entry barrier for new entrants. The key regulatory considerations for childrenswear in these markets include regulations related to flammability of children's sleepwear, use of sharp edges and small parts and possible choking hazards, presence of cords and drawstrings in neck area, product labelling, use of chemicals in apparel and accessories etc. Within childrenswear, norms are more stringent for infant and toddler wear.

Key Safety Requirements of Childrenswear

Safety Concern	Application /Age	Potential Hazard
Cords and Drawstrings	Garments intended for children between 0-14 years	Strangulation and entrapment
Flammability of Nightwear	0-14 years, more stringent for 0-6 months	Burning injuries, death due to burns
Non-Separable Small Parts	Children between 0 to 3 years	Injuries from detached objects
Separable Small Parts	Children between 0 to 3 years	Choking hazards
Sharp Points	Children between 0 to 3 years	Injuries from sharp objects

(Source: RHP, HDFC Sec)

Expanding retail presence of Crocodile brand

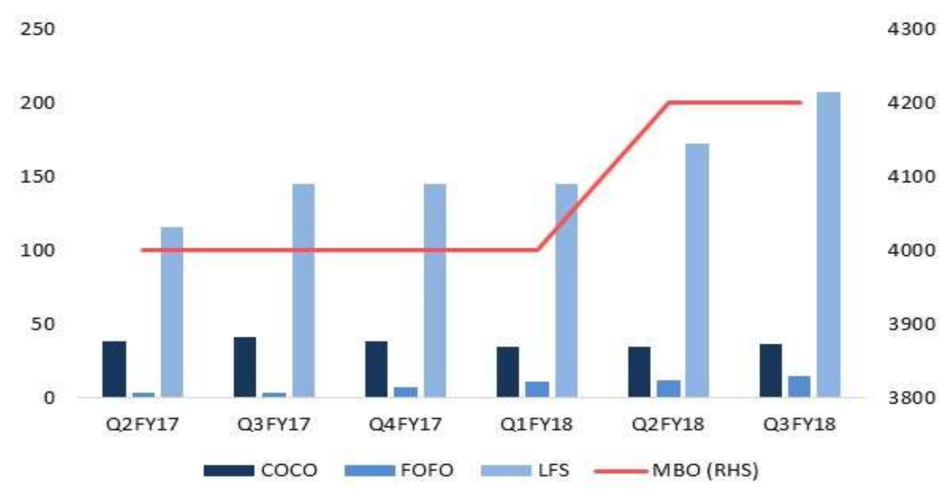
SPAL in 2014 entered into a 70:30 JV with Singapore based Crocodile International Pte. Ltd. and has the sole rights to manufacture and sell Crocodile brand menswear in India. Growing aspiration levels of people in Tier II, III and IV cities in India along with rising brand awareness and higher disposable income is making these smaller urban areas as focal points for expansion. SPAL intends to capitalize on this opportunity to grow its menswear products under the 'Crocodile' brand.

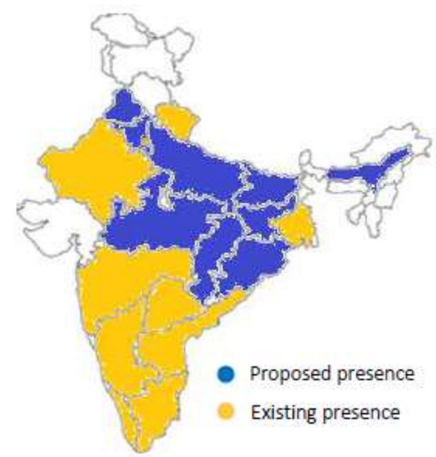
Present across most of the major LFS

(Source: Company, HDFC Sec)

SPAL undertakes manufacturing and retailing activities in India under the 'Crocodile' brand. SPAL sells wide range of adult menswear products like shirts, polo shirts, t-shirts, trousers, jeans, sweaters, jackets and innerwear products like vests, briefs, boxer shorts. In addition to Exclusive Brand Outlets (EBOs) and Multi Brand Outlets (MBOs) it also has a presence in large format stores (LFS) and e-commerce platforms like Myntra and Amazon. As of Dec-2017, SPAL had a presence in 9 states with 51 EBOs (36 company owned and 15 franchisee owned), 207 LFS and 4,200 MBOs. It had planned capex of ~Rs 27.9cr (as per RHP) for establishing 70 new retail outlets and expanding its presence from 9 states to 18 states in India over next 3 years. As of December-2017 SPAL had spent Rs 11.6cr to establish 11 stores. At the end of December-2017 SPAL had 36 COCO and 15 FOFO outlets across 9 states with outlets size ranging between 400-1500 sq ft. Further the brand is also present in 207 LFS and 4200 MBO.

Retail Presence across India

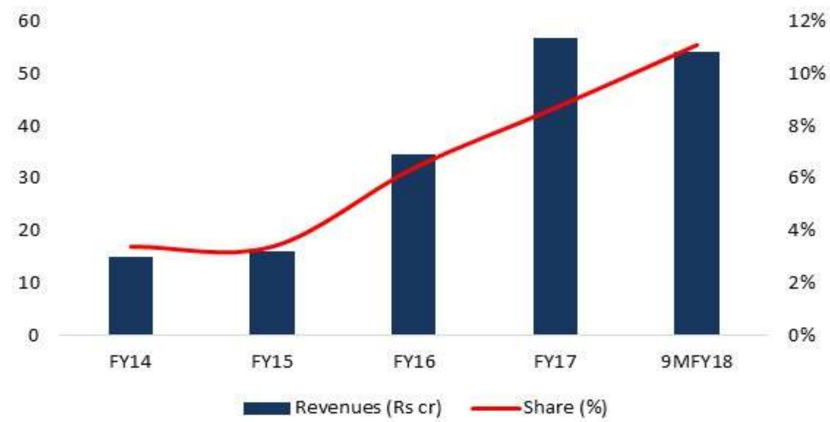




(Source: Company, HDFC Sec)

SPAL has been partnering with LFS in metros and Tier I cities as rentals are very high and opening either COCO or FOFO stores in Tier II, III and IV cities. Presence through LFS has increased from 116 in Q2FY17 to 145 in Q3FY18 and that through MBOs from 4,000 to 4,200 while number of stores has gone up from 41 to 51. Revenues from retail segment has increased from Rs 15.1cr in FY14 to Rs 56.8cr and Rs 54.3cr in FY17 and 9MFY18 respectively. Revenue share has increased from 3.4% in FY14 to 11.1% in 9MFY18. The operations of Crocodile JV have resulted in EBITDA of 14.3% in Q3FY18.

Retail Revenues and Share



(Source: Company, HDFC Sec)

Preferred vendor to reputed international brands

Over the years, SPAL has steadily developed a robust base of international retailers of garments for infants and children, including with reputed established brands with global operations such as TESCO, Primark, Mothercare, etc. This has been possible due to its ability to offer end-to-end garments manufacturing services from the design to the manufacture of the garments. SPAL has the expertise to concurrently manage multiple large orders with a diversified product range including body suits, sleep suits, tops and bottoms. Although it does not have any long-term supply agreements with its customers, it has continually received repeat business from many of them indicating their level of confidence and reliability on SPAL. The company has never faced bulk returns from customers since inception.

Customers include reputed international brands

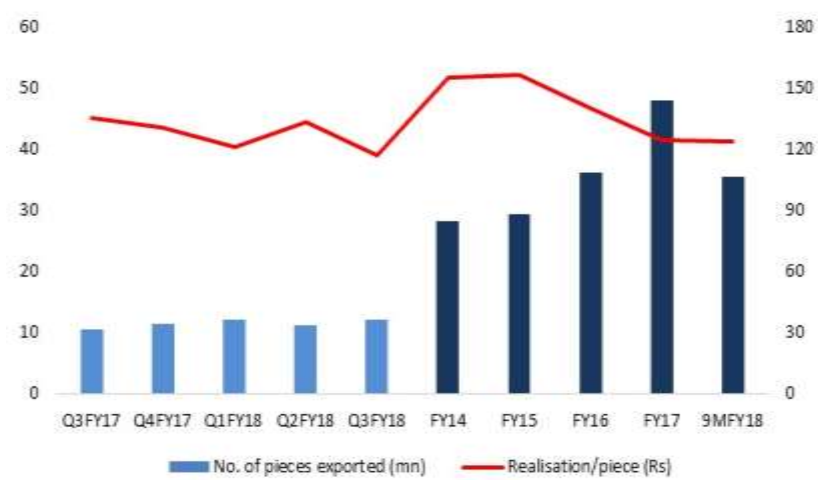
TESCO
ASDA Save money. Live better.
GARAN Incorporated
PRIMARK
mothercare
DUNNES STORES Always Better Value
kmart

(Source: Company, HDFC Sec)

SPAL had been strong in UK region historically with 80% revenue share (down from 88% a few years back), but off-late it has been adding non-UK customers. In Q2FY18 it added 2 US customers i.e. Garan and K-Mart, and Kiabi from France. The focus of the company going forward will be to diversify the customer base across different geographies globally. It has started working with a big retailer in UK known as Arcadia Group, which is now entering into kids segment under the brand called OUTFIT.

As SPAL shifts towards a product mix of 50:50 between fashion and basic, realisation per piece has declined from ~Rs 155 to Rs 123 currently. Currently basics account for ~40 of revenues.

Realisation per piece trend overall



Customerwise Realisation

Customer	Realisation/piece (Rs)
Tesco	140-150
ASDA	140-150
Mothercare	130-135
Dunnes	135-140
Primark	50-60
Garan	90-100
K-Mart	50-60
Krabi	140-150

(Source: Company, HDFC Sec)

Enhancing capacity and backward integration to become fully integrated company

SPAL faced capacity constraints in the past, which hampered its ability to add new clients restricting revenue growth. It came out with an IPO in August-2016 and raised Rs 215 cr which it has utilized to increase its capacity and reduce debt. The company has added 300 sewing machines in FY17 and further 350 sewing machines in Feb-2018. It plans to add another 200 sewing machines over the next few months. SPAL currently outsources knitting and part of dyeing and spinning activities. It is now setting up a new facility and planning to have all activities in-house by FY19. This would make SPAL an integrated company and will also add to margins.

Capacity Expansion Plans

Particulars	FY15	FY18
Blow-room capacity	3,200 kg/day	15,015 kg/day
Spinning machines	90 count	45 count
No. of spindles	16,896	22,272
Knitting machines	0	40
Dyeing machines	24,000	27,000
Sewing machines	3,290	4,400

(Source: Company, HDFC Sec)

Utilisation of IPO proceeds

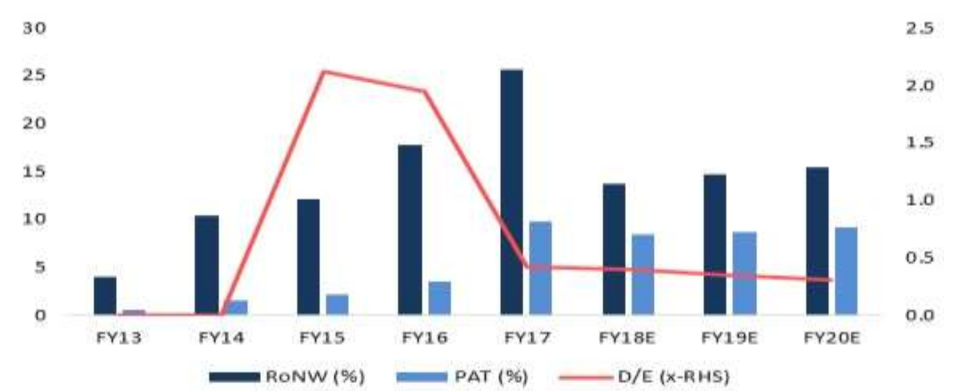
(Rs Cr)	Utilisation planned	Amount utilised (till Dec-17)	Pending utilisation
Expansion and modernisation of manufacturing facility	70.2	15.6	54.6
Repayment or prepayment of debt	63.0	63.	0.0
Opening of new stores for the sale of 'Crocodile' products	27.9	11.6	16.3
Addition of balancing machineries for existing dyeing unit	4.9	4.9	0.0
General Corporate Purposes and Issue Expenses	49.1	49.1	0.0
Total	**215.0**	**144.1**	**70.9**

(Source: Company, HDFC Sec)

Attractive financial parameters

SPAL's return ratios were lower due to higher debt and low margins on account of interest expenses. Post IPO, the company has repaid a significant amount of debt which has resulted in lower finance costs consequently improving the return ratios. Debt-Equity is also comfortable at 0.4x

RoNW, PAT Margins and D/E



(Source: Company, HDFC Sec)

Low capital intensity and high sales to fixed assets ratio

SPAL is in the business with low capital intensity. New machines cost ~Rs 2lk with an additional expenditure of ~0.5lk on facilities. Against this, each machine has a potential to earn revenues of ~Rs 16-17lk per annum resulting in a high sales to fixed assets ratio.

Growth in Gross Block trend

(Source: Company, HDFC Sec)

Q3FY18 results review

SPAL's Q3FY18 revenues grew by 11.2% YoY to Rs 162.9cr largely due to strong retail revenues. Garment revenues remained subdued at Rs 141.4cr due to changes in duty drawback structure and adverse currency movement. Retail revenues jumped by 88.1% to Rs 21.5cr on account of new store openings and pick up in sales of stores opened in H1FY18. EBITDA margins in garment declined sharply due to increase in cotton prices. However positive retail EBITDA margin led to an overall EBITDA margins improvement of 35bps YoY. Absence of other income in this quarter coupled with higher finance costs led to PAT falling by 11.7% to Rs 14.1cr and PAT margin declining 224bps to 8.6%

UK subsidiary SPUK recorded revenues of £ 10.5lk (~Rs 8.6cr) in Q3FY18, up 112% YoY with an EBITDA margin of 4.2% vs a los in Q3FY17. Contribution from US customers stood at 13%. SPAL is looking to increase the contribution from non-UK customers as it added two new non-UK customers during Q3FY18. Once these customers are through with first orders SPAL will have a base of 10 customers across the globe who can give orders in high volumes.

SPAL currently has 4,310 sewing machines with a utilization rate of 79%. Management expects optimum utilization to facilitate another 15% growth in topline with existing machines. Current order book stood at Rs 276cr. SPAL opened 1 COCO, 3 FOFO outlets and 35 new LFS stores in Q3FY18, with plans to increase these to 300 LFS stores by Mar'19.

Particulars (Rs Cr)	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)	9MFY18	9MFY17	YoY (%)
Operating Income	**162.9**	**146.5**	***11.2***	**166.1**	***-1.9***	**479.7**	**475.8**	***0.8***
Material consumed	61.6	57.9	*6.4*	67.8	*-9.1*	188.9	189.5	*-0.3*
Employee expenses	41.4	35.8	*15.8*	38.2	*8.5*	118.0	110.7	*6.6*
Other expenses	29.8	26.3	*13.4*	36.7	*-18.8*	100.4	95.9	*4.7*
Total expenses	**132.8**	**119.9**	***10.7***	**142.6**	***-6.9***	**407.3**	**396.1**	***2.8***
EBITDA	**30.1**	**26.6**	***13.4***	**23.5**	***28.1***	**72.4**	**79.6**	***-9.1***
Depreciation	5.8	5.1	*13.7*	5.3	*8.8*	16.6	14.3	*15.8*
Other Income	0.0	7.6	*-100.0*	4.5	*-100.0*	15.0	15.5	*-3.2*
Finance cost	4.3	3.7	*16.8*	7.7	*-43.8*	18.7	15.5	*20.7*
PBT	**20.0**	**25.4**	***-21.3***	**15.0**	***33.0***	**52.2**	**65.4**	***-20.2***
Tax expenses	5.2	9.5	*-45.3*	6.0	*-13.5*	17.8	21.3	*-16.1*
PAT	**14.8**	**15.9**	***-6.9***	**9.0**	***63.9***	**34.4**	**44.1**	***-22.1***
Minority Interest	-0.3	-0.2	*86.7*	0.3	*-193.3*	-0.2	-1.1	*-85.5*
Reported PAT	**15.1**	**16.1**	***-6.0***	**8.7**	***72.7***	**34.5**	**45.2**	***-23.7***
EPS (Rs)	6.0	6.4	*-6.0*	3.5	*72.7*	13.7	18.0	*-23.7*
EBITDA (%)	18.5%	18.1%	*35 bps*	14.2%	*433 bps*	15.1%	16.7%	*-164 bps*
PAT (%)	9.3%	11.0%	*-170 bps*	5.3%	*400 bps*	7.2%	9.5%	*-231 bps*

(Source: Company, HDFC sec)

Concerns

Labour intensive operations

The products manufactured by the company are labour intensive (number of employees in FY17 10070) and it has to keep hiring new people to expand its operations. It faces problem of finding skilled labour whenever it is looking to add capacity. Any disruptions due to unionisation could lead to company not being able to meet its commitments to its global customers and loss of reputation. SPAL is aware of this risk and has spread out its operations across 23 facilities as per the availability of labour.

Geographical concentration

SPAL has been supplying mostly to UK based customers which account for ~80% of its revenues in FY17. Though it has added non-UK based clients recently, UK still commands major share of its revenues. Slowdown in the UK markets (and/or fluctuation in GBP/INR exchange rate) could result in subdued growth for SPAL.

H1FY18 was not good for SPAL due to Brexit fears and its impact on consumer spending, volatility in GBPINR rates and its impact on order placement and acceptance. Things have however settled now but similar occurrences in future in UK (till SPAL achieves diversification) can impact the top and bottomline of the company.

Customer concentration
Revenues of SPAL are highly concentrated with top 3 client accounting for more than 75% of sales. Loss of any client could hurt its revenues significantly. SPAL has been adding clients to mitigate this risk. In FY17 it added 3 clients, in Q2FY18 it added another 3 clients and in Q3FY18, 2 more clients were added.

Delay in retail outlet expansion & sales pickup
SPAL intends to invest a significant part of the IPO funds in retail outlets expansion. Strong growth in retail revenues is expected to come from an increase in number of EBOs and LFS outlets and by entering new territories. Delay in expansion of retail outlets and corresponding pickup in sales from newer and existing outlets can negatively affect SPAL’s retail revenue growth.

Forex risk
SPAL derives 80-85% of its revenues from export of its products. Currently it is exposed the most to GBP. Any major moves in the pair could impact its margins. The company has a policy to hedge 80% of its exposure. The balance 20% of the exposure is open to forex fluctuation risk.

Competition from other emerging market companies
Companies from other emerging markets like Bangladesh, Vietnam, etc. compete for the same orders which could reduce order flows to SPAL.

Changes in export incentives
SPAL received a rebate of ~11% in pre-GST regime which has reduced to ~7.5-8% post the implementation of GST. Additionally the company take an input tax credit on procured raw material. Overall it had an impact of 2.5-3% on margins in FYY18. Any future adverse changes could impact top and bottom line

Low dividend payout ratio
Although the company paid its first dividend of Re 0.50 in FY17, the payout ratio was very low at just 2%.

No brand play (except through Crocodile)
SPAL does not have any of its own brands currently except for women’s essential wear category under the ‘Natalia’ brand which is lying dormant.

Seasonality in earnings
SPAL witnesses slightly lower revenues in Q3 and Q4 due to lower number of working days.

Peer comparision:

Kitex is the largest childrenswear exporter from India with a production capacity of 165mn pieces followed by SPAL with 50mn pieces. Kitex mainly sells basic garments to US based companies while SPAL is mainly present in fashion garment with a customer base mainly in UK. All operations of Kitex are carried out in a single plant at one place whereas SPAL operates through 23 manufacturing facilities located close to families of labourers, which reduces transportation cost and attrition rate – a key industry concern.

Company	CMP*	Mcap	Revenues	% growth	EBITDAM	PATM	EPS	BVPS	P/E	P/BV	D/E	RoNW
Kitex	246.7	1640.6	545.9	0.0%	31.3%	15.8%	12.9	68.5	19.1	3.6	0.0	18.9%
SPAL	367.1	923.8	635.7	19.3%	16.9%	9.7%	24.6	147.1	14.9	2.5	0.4	16.7%

CMP as on 9-Mar-2018 *(Source: Cline, HDFC Sec)*

View and Valuation

SPAL has been adding new customers outside of UK which has reduced its client concentration as well as geographic concentration risks. Its retail venture in India and UK subsidiary SPUK have turned around and could become profitable at PAT levels in FY18. It has been adding capacity to meet the increasing order flows from customers. Backward integration is expected to be complete by FY19 post which the company is likely to witness strong margin expansion. Shifting of apparel exports from China to other emerging markets due to cost competitiveness has opened up a big opportunity for companies like SPAL and it is fully geared to grab it.

SPAL seems to be a quality midcap stock engaged in a recession proof business and growing at a decent pace (though having its own share of risks) and the current valuations leave scope for a rerating.

At CMP of Rs 367 the stock quotes at 11.4x FY20E EPS. We feel investors could buy the stock at CMP and add on dips to Rs 327-333 band (10.25x FY20E EPS) for sequential targets of Rs 419 (13x FY20E EPS) and Rs 467 (14.5x FY20E EPS) in 3-4 quarters.

Financial Statements - Consolidated

Income Statement

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Income from operations	**532.8**	**635.7**	**651.7**	**772.3**	**888.9**
Cost of materials consumed	204.2	254.3	258.7	305.8	350.2
Employee Cost	121.1	147.3	157.7	185.3	211.6
Other expenses	139.0	126.8	133.6	155.2	176.9
Total expenses	464.4	528.3	550.0	646.4	738.6
EBITDA	**68.4**	**107.3**	**101.7**	**125.9**	**150.2**
Depreciation	20.1	20.8	22.3	24.6	26.2
Other Income	53.3	107.6	105.4	127.6	151.6
EBIT	4.9	21.0	26.1	26.3	27.6
Finance Cost	25.3	13.5	23.9	26.5	28.7
Profit Before Tax	28.0	94.1	81.5	101.1	122.9
Tax Expenses	9.3	33.5	27.3	33.6	40.9
Profit After Tax	**18.7**	**60.6**	**54.2**	**67.5**	**82.0**
Adj. PAT	**18.8**	**61.9**	**54.7**	**67.0**	**81.0**
EPS	**11.0**	**24.6**	**21.7**	**26.6**	**32.2**

Cash Flow statement

Particulars	FY16	FY17	FY18E	FY19E	FY20E
Profit Before Tax	28.0	94.1	81.5	101.1	122.9
Depreciation	20.1	20.8	22.3	24.6	26.2
Others	25.7	5.9	28.8	25.0	25.9
Change in working capital	-35.8	-76.0	-10.9	-45.9	-25.9
Tax expenses	10.8	-18.5	-27.3	-33.6	-40.9
CF from Operating activities	**48.8**	**26.3**	**94.4**	**71.1**	**108.1**
Net Capex	-25.8	-37.8	-15.0	-50.0	-35.0
Other investing activities	0.8	-56.7	-40.0	0.0	-40.0
CF from Investing activities	**-28.1**	**-116.5**	**-55.0**	**-50.0**	**-75.0**
Proceeds from Eq Cap	0.0	200.3	0.0	0.0	0.0
Borrowings / (Repayments)	6.1	-89.4	10.0	2.0	4.0
Dividends paid	-0.7	-4.4	-1.5	-3.0	-4.5
Interest paid	-25.3	-14.6	-23.9	-26.5	-28.7
CF from Financing activities	**-19.8**	**91.8**	**-15.4**	**-27.5**	**-29.3**
Net Cash Flow	**0.9**	**1.7**	**24.0**	**-6.4**	**3.9**

Balance Sheet

Particulars	FY16	FY17	FY18E	FY19E	FY20E
EQUITY AND LIABILITIES					
Share Capital	17.2	25.2	25.2	25.2	25.2
Reserves and Surplus	115.6	365.1	418.3	482.2	558.7
Shareholders' Funds	**132.7**	**390.3**	**443.5**	**507.4**	**583.9**
Minority interest	-5.9	-7.2	-7.7	-7.2	-6.2
Long Term borrowings	96.5	31.4	21.4	13.4	7.4
Deferred Tax Liabilities (Net)	37.2	39.8	39.8	39.8	39.8
Other Long Term Liabilities	0.0	0.0	14.9	19.8	24.5
Long Term Provisions	4.1	6.0	9.0	9.4	10.8
Non-current Liabilities	**137.8**	**77.2**	**85.1**	**82.4**	**82.4**
Short Term Borrowings	162.7	134.2	154.2	164.2	174.2
Trade Payables	116.8	79.6	98.3	97.1	111.7
Other Current Liabilities	6.8	6.7	7.5	9.0	10.0
Short Term Provisions	10.4	2.7	4.1	4.2	4.9
Current. Liabilities	**296.7**	**223.2**	**264.1**	**274.5**	**300.8**

Financial Ratios

Particulars	FY16	FY17	FY18E	FY19E	FY20E
EPS (Rs)	11.0	24.6	21.7	26.6	32.2
Cash EPS (Rs)	22.7	32.8	30.6	36.4	42.6
BVPS (Rs)	77.4	155.0	176.2	201.6	232.0
PE (x)	33.4	14.9	16.9	13.8	11.4
P/BV (x)	4.7	2.4	2.1	1.8	1.6
Mcap/Sales (x)	0.0	0.0	0.0	0.0	0.0
EV/EBITDA	17.1	9.3	9.3	7.5	6.1
EBITDAM (%)	12.8	16.9	15.6	16.3	16.9
EBITM (%)	10.0	16.9	16.2	16.5	17.1
PATM (%)	3.5	9.7	8.4	8.7	9.1
ROCE (%)	14.0	22.7	17.9	19.6	20.9
RONW (%)	17.8	25.6	13.8	14.7	15.4

TOTAL	**561.2**	**683.5**	**785.0**	**857.0**	**960.9**
ASSETS					
Net Block	**276.9**	**297.1**	**289.8**	**315.2**	**324.1**
Capital work-in-progress	3.6	0.0	0.0	0.0	0.0
Non current Investments	0.4	0.3	0.3	0.3	0.3
Long-Term Loans and Advances	29.0	16.9	14.9	17.7	20.4
Other Non-current Assets	0.0	0.0	12.0	15.6	20.4
Non-current Assets	**29.4**	**17.1**	**27.2**	**33.5**	**41.0**
Current Investments	0.2	58.2	98.2	98.2	138.2
Inventories	127.5	102.4	122.9	143.6	163.1
Trade Receivables	81.6	134.3	147.4	166.9	183.2
Cash and Bank Balances	11.1	35.2	59.3	52.9	56.8
Short-Term Loans and Advances	30.7	38.0	39.7	45.8	53.4
Other Current Assets	0.3	1.2	0.7	0.9	1.2
Current Assets	**251.3**	**369.3**	**468.1**	**508.3**	**595.9**
TOTAL	**561.2**	**683.5**	**785.0**	**857.1**	**960.9**

Current Ratio (x)	0.8	1.7	1.8	1.9	2.0
Quick Ratio (x)	0.4	1.2	1.3	1.3	1.4
Debt-Equity (x)	2.0	0.4	0.4	0.3	0.3
Debtor days	58	68	86	81	78
Inventory days	87	72	69	69	69
Creditor days	88	62	54	50	47

(Source: Company, HDFC sec)

1-year Price chart

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