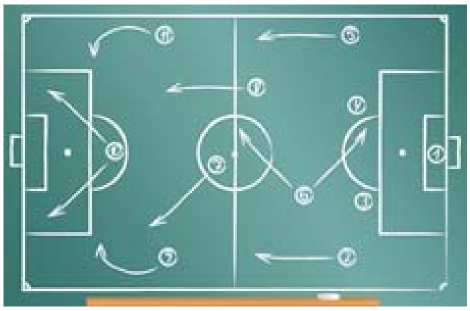
The Pitch



14 July 2017 For private circulation only

INITIATING COVERAGE

SUTLEJ TEXTILES AND IND. LTD (STIL)

RECOMMENDATION - BUY					
CMP (Rs)	Target Price (Rs)	Investment Horizon	52 Week High/Low (Rs)	Market Cap (Rs Cr)	3 Months Avg daily Vol. (Nos)
902	1220	18 Months	965/631	1478	6175

We initiate BUY recommendation on Sutlej Textiles and Ind. Ltd (STIL)

Sutlej Textiles and Industries Ltd was incorporated on 22.06.2005 and was created out of a corporate restructuring exercise in which the textiles division of Sutlej Industries Ltd. (SIL) and Daman Ganga Processors Ltd were demerged w.e.f. July 1, 2005. A flagship unit of the multi-business conglomerate promoted by Dr. K. K. Birla, Sutlej is among India's leading textile producers with a value-chain extending from yarns and fabrics to home textiles. STIL is among India's leading producers of dyed spun yarn and value added/speciality yarn. It also manufactures home textiles. It has a presence right from spinning (man-made & cotton yarns) to dyeing to weaving (processing of home textiles) and processing/finishing. It is amongst the few exclusive spinners in India for specialty yarns such as Modal, Lyocell and Tencel in the country. Its manufacturing facilities are located in Bhawanimandi (Rajasthan), Kathua (Jammu & Kashmir) and Daheli (Gujarat). The company also has its own captive power plants to ensure steady supply of electricity for uninterrupted production.

60% of its spindle age is less than a decade old. Along with steady capacity additions in Yarn segment, STIL is also aggressively scaling up its Home Textiles business. STIL has a competitive edge, given its leadership, diversified product offerings with increasing focus on value added yarns (like Cotton Melange Yarn, which is a specialized yarn requiring special set of manufacturing skills), strong clientele (domestic & global) and brand recall, steady capacity additions in yarn, aggressive expansion plans in high margin home textiles segment (with increasing focus on fast growing categories like Curtains and Upholstery fabrics) and strong credit ratings (upgrades from CARE in 2017, thus resulting in low credit risks). STIL is placed comfortably to leverage its strength and exploit the available opportunities in the Indian textile space. **While yarn accounts for 95% of total turnover, home textiles contribute just 5%.**

Profile: Quite Impressive

Sutlej has been a consistent dividend payer since its incorporation. The dividend amount has increased from Rs.4.4 crore in FY2006 to Rs.21.3 crore in FY2017. In % terms, the average dividend payouts over FY2012-17 stood at 12.7%, which is low, but still encouraging, considering aggressive expansion plans undertaken by the company during the same period. What we like about STIL is that it has paid dividends even during periods of slowdown.

STIL has a strong global footprint with presence spanning over 60 countries across Europe, North America, South-East Asia, etc. The company exports around 27% of its revenues to major developed and emerging economies like Australia, Argentina, Bangladesh, Bahrain, Belgium, Brazil, Canada, China, Chile, Cuba, Egypt, France, Germany, Hong Kong, Italy, Morocco, New Zealand, Peru, Philippines, Poland, Portugal, Russia, Saudi Arabia, Sri Lanka, Turkey, USA, UAE and UK, among others. **The company is one of the largest exporters of value added synthetic and blended dyed spun yarn in the country.**

The revenue share of exports has remained in the range of 25-26% over the years. **While the long term target of exports share remains at 25%, the management could increase its share of exports in the near term due to slowdown in the domestic demand.** While maintaining its customers & geographies, the company has a leverage of increasing / reducing its export share by 8-10% depending upon the demand situation in the domestic market. In Home Textiles, **STIL has plans to increase its exports from current 25% to 50% over the next few years.**

The company progressively widened its presence across the yarn value chain (cotton to polyester to viscose to acrylic to modal to lycra to teflon to linen) and strengthened its ability to manufacture multi-fibre (synthetic and natural) yarn across diverse blends (grey, dyed and mixed) and counts (Ne 6's - 50's).

Aggressive capacity addition over the years

The company successfully completed the acquisition of Birla Textile Mills (BTM) from Chambal Fertilizers in September 2015 which added to its capacity 83, 376 spindles to produce 60 tonnes per day of spun yarn to the portfolio.

STIL has grown its net block by 37% in last one year and has gone up by 100% in the last 4 years.

Over the decade, the company has invested about Rs.1,060 crore in expansion, modernization and acquisition of cutting-edge technology.

STIL has increased its yarn capacity consistently by nearly 2.5x since FY2005 to 4.16 lac spindles till date (Post the ramp up of 35,280 spindles at Rajasthan facility in Q4FY2017). The expanded capacity is fully dedicated towards production of value added cotton melange yarn, which would improve the segment's overall realization and margins.

STIL has been aggressively scaling up its Home Textiles business with capacity addition of nearly 7.1 million (mn) metres since FY2014 (current capacity stands at 9.6 mn metres). Capacity expansion along with higher share from high margin Home textiles and value added products is expected to improve STIL's revenue growth and margin trajectory going forward.

STIL is expanding its yarn capacity at Baddi by 28,800 spindles (dedicated towards manufacturing of 100% polyester industrial yarn and other grey blended specialty synthetic yarn) at the cost of Rs.215 crore, which is expected to go on stream from Q4FY2019.

These investments in capacity additions will consolidate and help the company improve its earnings going forward.

Other reasons for our conviction in the stock emanates from the following developments

Recent reforms undertaken to boost the overall sector growth

In an effort to boost the textile made-ups sector, the government has recently approved interventions in a time-bound manner within the approved budget of Rs.6,006 crore for the apparel package with the objective of creating large-scale direct and indirect employment of up to 11 lac persons over the next three years in the made-ups sector. The government would work towards providing production incentive through enhanced Technology Upgradation Fund Scheme (TUFS) subsidy of additional 10% for made-ups similar to what is provided to garments based on the additional production and employment after a period of three years.

Low leverage, healthy return ratios, steady dividend payouts

STIL's gross block has increased at a steady pace of 9.4% CAGR over the last four years. Despite this, the company has managed to reduce its debt-equity from 2.65x in FY2012 to 1.3x in FY2017, which is encouraging. Debt-Equity has remained near 1.1x-1.3x since FY2015 till date despite aggressive capacity expansions. With no major CAPEX likely to be incurred over the next two years, we expect Debt-Equity to reduce further, as the company is likely to repay its borrowings in part from surplus cash generated (operating & free cash flows to improve).

Despite being in an industry, which is highly capital intensive in nature, STIL enjoys decent return ratios with ROCE at 17% and ROE at 19% in FY2017. With profits set to improve, we expect the return ratios to remain healthy going forward.

The board has also approved split of its shares into ten shares from one share which will improve the liquidity of shares ten times in the market.

It is also one of the few attractive stocks still trading at a single digit PE of 9.3x its FY2017 EPS of Rs.96.4 when other small and mid cap stocks are trading at abnormal valuations to their earnings.

Oil Price Fall will act as a boon to the company

Crude oil prices have again fallen below $50 a barrel - it is down over 58% from its 2014 peak ($115 a barrel) and are down over 17% after peaking out post-OPEC deal. We believe that on rising US production and oversupply in the market lower crude oil prices are here to stay. Hence we believe that STIL, which uses both natural fiber and synthetic fiber for manufacturing cotton and synthetic textiles, would be the major beneficiary of the crash in input prices with some time lag.

Outlook and Valuation

In the long-term, we expect the textile exports of the country to go up significantly as China is phasing out slowly. As its cotton yarn production and its currency also strengthened substantially over Indian rupee in the last 5 years. STIL with significant increases in capacities would be in a better position to capitalize the opportunities to be available on export front going forward.

Our take is that the textile industry would change its prospects significantly in the next 2 to 3 years. **Sutlej Textiles & Industries, with recent acquisitions and expansions is in a formidable position to grow its fundamentals substantially in the next 2 to 3 years.** We also expect the textile industry to expand its valuation multiple on the stock market significantly in the next 2 to 3 years along with anticipated recovery in the textile exports. We find it an appealing BUY at the current market price. Hence we initiate a BUY on the stock with a target price of Rs.1,220 (which is 10x it's FY2019E EPS of Rs.122).

Risk to our View

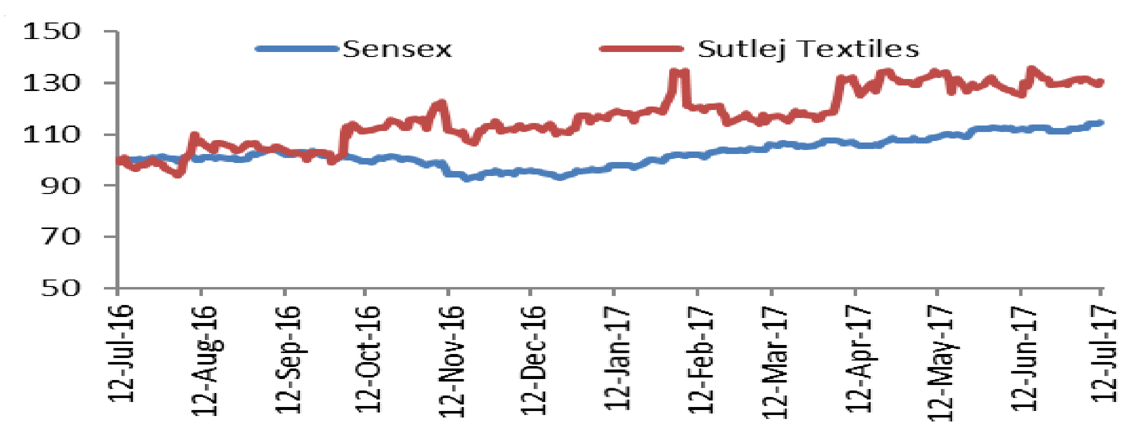
Any possibility of deficit in availability of cotton in the domestic market due to below average rainfall and a spike in crude oil prices could impact the input prices of the raw materials and act as a risk to the company.

Financial Summary

FY ended (Rs Cr)	Net Sales (Rs Cr)	Change (%)	PAT (Rs Cr)	Change (%)	EPS (Rs)	Change (%)	P/E (x)
FY2017	2.249.6	8.4	157.9	7.7	96.4	7.7	9.3
FY2018E	2,505.0	11.3	170.5	8.0	104.0	8.0	8.7
FY2019E	2993.0	19.5	201.2	18.0	122.0	18.0	7.4

Source: Company, Equinomics Research & Advisory Private Ltd

one year stock performance vis a vis index



Source: Equinomics, BSE. On base of 100