MOTILAL OSWAL

16 October 2014

2QFY15 Results Update | Sector: Textiles

Kitex Garments

BSE SENSEX	S&P CNX
25,999	7,748
Bloomberg	KTG IN
Equity Shares (m)	47.5
M.Cap. (INR b)/(USD b)	22.0/0.4
52-Week Range (INR)	526/58
1, 6, 12 Rel. Per (%)	27/257/657

Financials & Valuation (INR Million)

Y/E MAR	2015E	2016E	2017E
Net Sales	5,499	6,856	8,561
EBITDA	1,501	1,961	2,508
Adj PAT	872	1,238	1,621
EPS (INR)	18.4	26.1	34.1
Gr. (%)	52.0	41.9	31.0
BV/Sh.(INR)	52.8	75.3	102.4
RoE (%)	41.0	40.7	38.4
RoCE (%)	43.7	53.9	57.3
P/E (x)	25.2	17.8	13.6
P/BV (x)	8.8	6.1	4.5

CMP: INR463 TP: INR650 Buy

- **Stellar show:** Kitex Garments Ltd (KTG) reported 2QFY15 numbers with a revenue of INR1.28b (est. INR1.26b), compared to INR1b in 2QFY14, marking a YoY growth of 28.1%. Infant garments revenue grew by 36% YoY to INR1.09b, while net fabric revenue de-grew by 3% to INR191m. EBITDA grew by 95% this quarter to INR337m (est. INR252m), while EBITDA margin stood at 26.2% (est. 20%) in 2QFY15, compared to 17.2% in 2QFY14, an expansion of 900bp YoY primarily due to an improvement in gross margin. Garment division's margins were flat YoY at 29%, while fabric division's margins expanded significantly from -34% to +3%. Hence, PAT for 2QFY15 stood at INR193m (est. INR153m), compared to INR120m in 2QFY14, marking a YoY growth of 61.4%. KTG has strong revenue visibility amounting to >INR2.5b for 2HFY15 and >INR5.0b for FY16.
- **Market leadership and forward integration – key growth strategies:** Management is confident of ramping up capacities from the current level of 5.5 lakh pieces/day to 11 lakh pieces/day over the next three years. This should translate into 25-30% revenue CAGR and No. 1 leadership position, ahead of Wingloo (7.5 lakh pieces/day) and Gimmell (6.5 lakh prices/day). Over the long term, KTG plans to substitute the current sales to global brands (Gerber, Toys R Us, Jockey, Mothercare, Carters etc) with its own brands. Management plans to focus on smaller retailers as key customers and hence will not be competing with current clients, thus avoiding conflict of interest. During the quarter, KTG set up a merchandise office in the US, and is planning to in-license brands for the US market to forward integrate. Further, KTG plans to launch its own brand which will be sold through the e-commerce platform. Forward integration will ensure significantly higher mark-ups and margins versus the current business model.
- **Valuation and view:** We upgrade our FY15E and FY16E EPS estimates by 10% and 6% resp. We expect KTG to post 24.6% revenue CAGR coupled with 800bp margin expansion over FY14-17E. Hence, we expect PAT to post 41% CAGR over FY14-17E. Given the strong balance sheet and significant free cash flows, RoCE and RoE should improve from ~37% and 39% respectively to ~58% and 39% over FY14-17E. At CMP, the stock trades at 25.2x FY15E, 17.8x FY16E and 13.6x FY17E EPS. Maintain **Buy** with a revised target price of INR650 (25x FY16E).

Quarterly performance (INR Million)

Y/E March	FY14				FY15				FY14	FY15E	FY15	Var
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	%
Net Sales	1,005	1,001	995	1,422	1,028	1,282	1,343	1,848	4,422	5,499	1,261	1.7
YoY Change (%)	58.1	52.1	3.0	56.1	2.3	28.1	35.0	30.0	39.5	24.3	26.0	
Total Expenditure	846	828	792	1,005	756	946	1,007	1,294	3,471	3,997	1,009	
EBITDA	159	173	203	417	272	337	336	555	951	1,501	252	33.4
Margins (%)	15.8	17.2	20.4	29.3	26.5	26.2	25.0	30.0	21.5	27.3	20.0	6.2
Depreciation	22	22	25	28	50	52	52	53	97	209	51	
Interest	25	24	26	32	36	41	25	25	106	104	30	
Other Income	98	53	20	-37	24	53	26	15	133	113	50	
PBT	210	180	172	320	210	296	285	492	882	1,301	221	33.9
Tax	81	60	59	109	66	103	88	152	308	429	69	
Rate (%)	38.4	33.3	34.1	34.1	31.4	34.8	31.0	31.0	34.9	33.0	31.0	
Reported PAT	130	120	113	211	144	193	196	339	574	872	153	26.6
Adj PAT	130	120	113	211	144	193	196	339	574	872	153	
YoY Change (%)	79.6	197.0	9.5	171.4	11.3	61.4	73.2	60.8	95.3	52.0	27.5	
Margins (%)	12.9	12.0	11.4	14.8	14.0	15.1	14.6	18.3	13.0	15.9	12.1	

E: MOSL Estimates

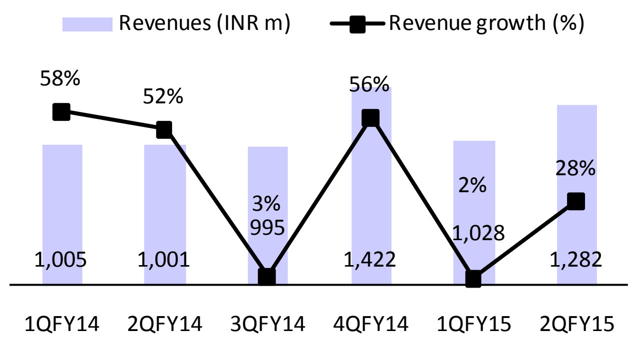
Niket Shah (Niket.Shah@MotilalOswal.com); +91 22 3982 5426

Atul Mehra (Atul.Mehra@MotilalOswal.com); +91 22 3982 5417

Strong revenue growth with robust margin accretion

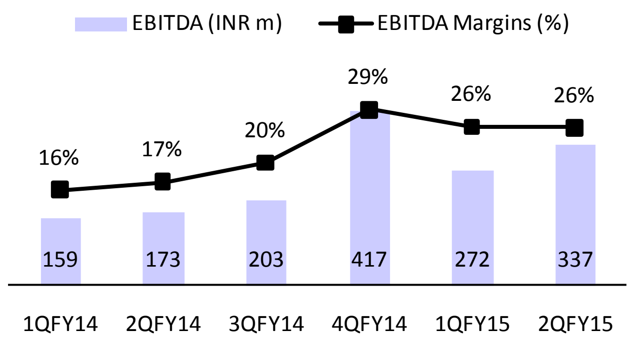
- Kitex Garments Limited reported 2QFY15 numbers with a top-line of INR1,282m (est. INR1,261m) as compared to INR1,001m in 2QFY14, marking a YoY growth of 28.1%.
- EBITDA grew by 95% this quarter to INR337m (est. INR252m), EBITDA margins stood at 26.2% (est. 20%) in 2QFY15 as compared to 17.2% in 2QFY14 an expansion of 900bps YoY primarily due to improvement in gross margins.
- Consequently, PAT for 2QFY15 stood at INR193m (est.INR153m) as compared to INR120m in 2QFY14 marking a YoY growth of 61.4%.

Exhibit 1: Robust revenue growth



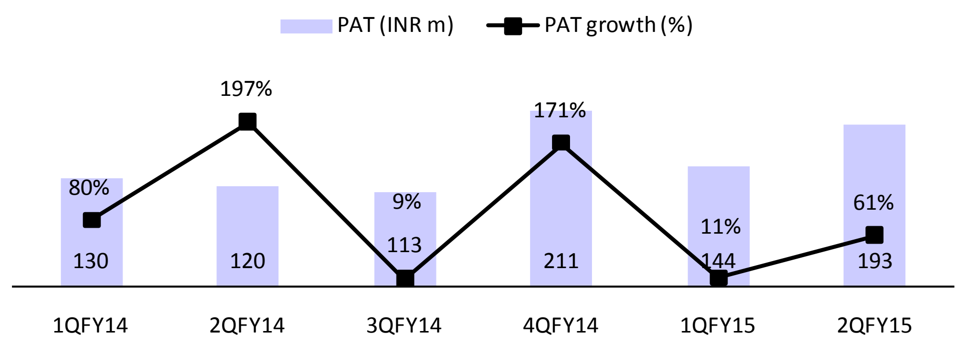
Source: Company, MOSL

Exhibit 2: Strong improvement in EBITDA margins



Source: Company, MOSL

Exhibit 3: PAT growth strong at 61%

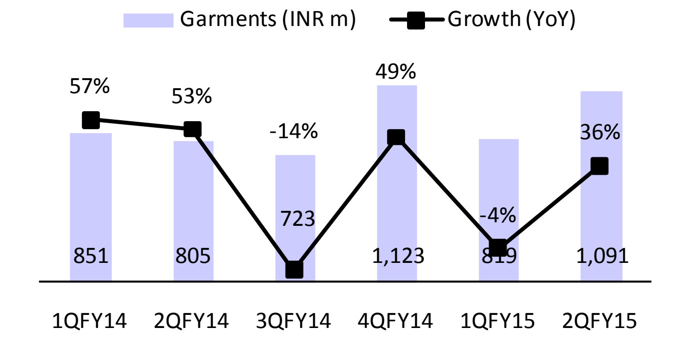


Source: Company, MOSL

Garments - strong growth; Fabrics – drives margin improvement

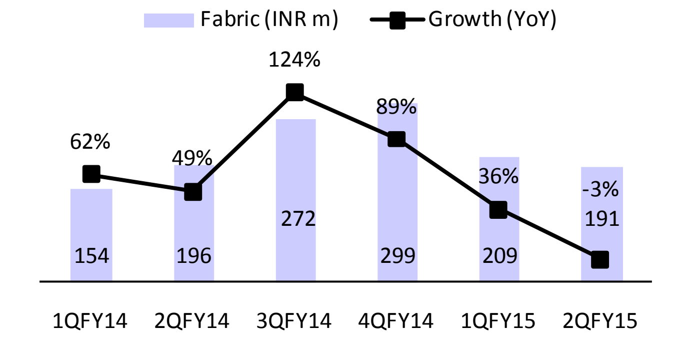
- Infant garments revenues grew by 36% YoY to INR1091m while net fabric revenues de-grew by 3% to INR191m.
- Consequently, revenue mix has improved in favor the garments division as against the fabrics division with revenue contribution standing at 85%:15% in 2QFY15 as against 80%:20% in 2QFY14.
- Garment division margins were flat YoY at 29%. Fabric division margins expanded significantly from -34% to +3% as the production level increased to 100% capacity which led to strong increase in fabric sales.
- Higher sales mix in favor of garments coupled with higher fabric margins have resulted in higher overall blended margins for Kitex which have improved from 17% in 2QFY14 to 26% this quarter.

Exhibit 4: Garments - Revenues and growth



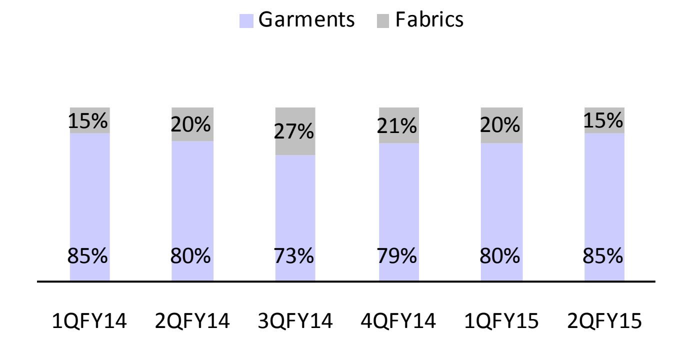
Source: Company, MOSL

Exhibit 5: Fabrics - Revenues and growth



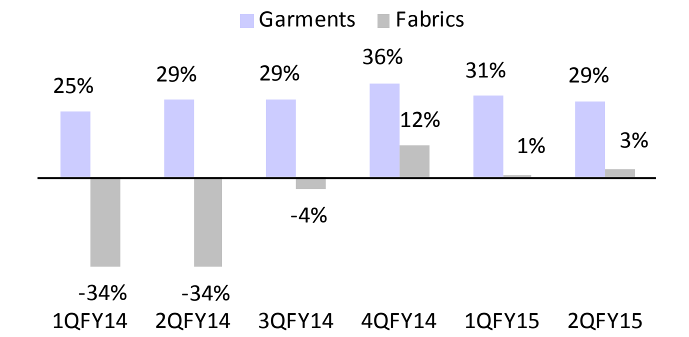
Source: Company, MOSL

Exhibit 6: Segment mix - Revenues



Source: Company, MOSL

Exhibit 7: Segment mix - Margins



Source: Company, MOSL

Market leadership and forward integration – key growth strategies

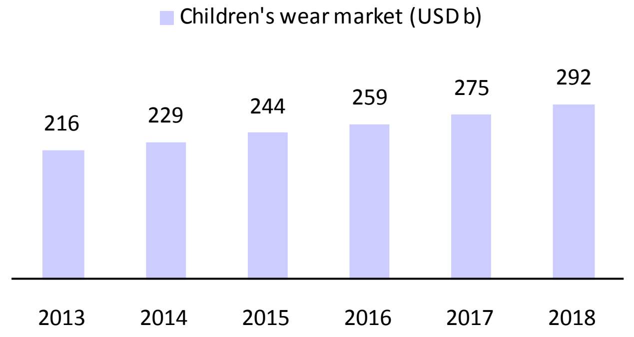
- Management is confident of ramping up the capacities from the current level of 5.5 lakh pieces / day to 11 lakh pieces / day over the next 3 years.
- This should translate into 25-30% revenue CAGR and No. 1 leadership position ahead of Wingloo (7.5 lakh pieces / day) and Gimmell (6.5 lakh prices / day).
- Over the long term, Kitex plans to substitute current sales to global brands (ber, Toys R Us, Jockey, Mothercare, Carters, etc) with own brand sales.
- Management plans to focus on smaller retailers as key customers and hence will not be competing with current clients, thus avoiding conflict of interest.
- During the quarter, KTG has set up a merchandise office in the US, and is looking forward to in-license brands for the US market to forward integrate.
- As per the management, the US registration process will get concluded. Post registration of subsidiary, registration of its own brand and brand license will take place.
- Forward integration will ensure significantly higher mark-ups and margins from the current line of business.

Other key highlights from the conference call

- KTG has strong revenue visibility amounting to >INR2.5b for 2HFY15 and >INR5.0b for FY16.
- Cotton prices have fallen down from INR40,000/kg to INR32,000/kg. However, the fall in cotton prices does not impact the yarn prices immediately due to lag effect. In 3QFY15, the impact will be visible.
- KTG has already invested INR150m for the technology upgradation where the company is replacing machines which are more than 5 years old. Technology upgradation will save 15% of the labor cost as one machine replaces two labors. Going forward, KTG will invest INR250-300m annually to double its capacity.
- The company has shifted its process from FOB to LDP (landed Duty Paid). This shift will help 100-150bp improvement in EBITDA margins.
- KTG does not have a hedging policy currently and will opportunistically look to hedge going forward.
- KTG caters to clients with a minimum FOB order of USD12-15m and maximum of US$25-30mn. Once a client would approach USD30m revenue, KTG would look to add one more client in their list. This ensures minimal client concentration risk and maximum margins.
- KTG expects to register a growth of 25%-30% in the next couple of years on the account of shift of business from China to India. KTG is able to provide superior quality product at similar prices as Vietnam, China and Bangladesh which is helping the company gain new business.
- Realization for the company stood at INR33/unit. Unit realization is not the right way to measure performance due to huge disparity in size of different garments. For example, 2,000-2,500 pieces of sleepwear can be manufactured in one line (24 machines) compared to Mitons which can be manufacture 20,000-25,000 pieces in one line.
- The company shares good relationships with clients and has been able to ensure minimal client churn over the years. For example, since inception of infant-wear business in 2000 Gerber has been its clients and it’s been over 14 years with Gerber continuing to be a client. On other hand, if the company does not meet the criteria of min USD12-15m, the company ends its association with the client. For instance, KTG discontinued its relationship with Tesco as revenues couldn’t surpass USD6m.
- KTG gets 7.1% duty drawback from the government. INR50m is the sales realization which is the drawback, accounted in other income. The other operating income includes forex gain/loss.

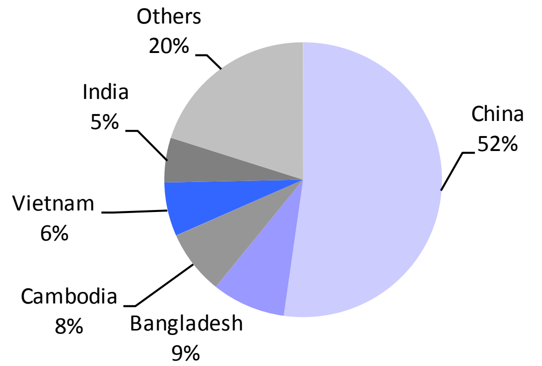
Story in charts

Exhibit 8: Global children's wear market size is huge



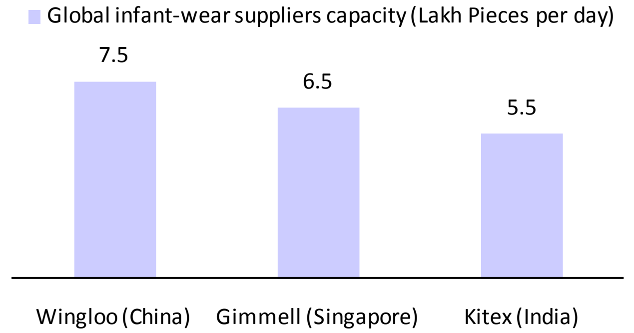
Source: Company, MOSL

Exhibit 9: India has high potential for infant-wear sourcing



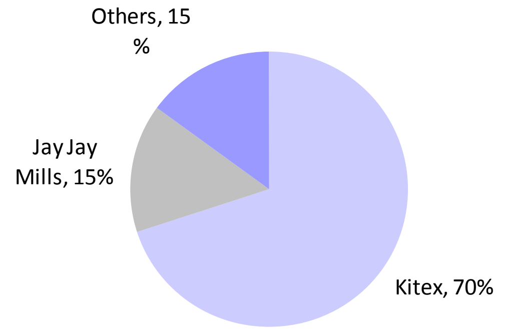
Source: Company, MOSL

Exhibit 10: Kitex is the 3rd largest infant-wear player



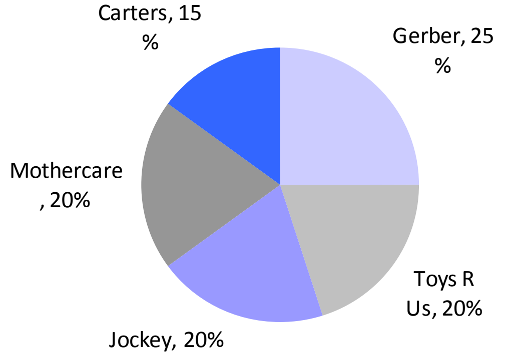
Source: Company, MOSL

Exhibit 11: Kitex dominated infant-wear exports from India



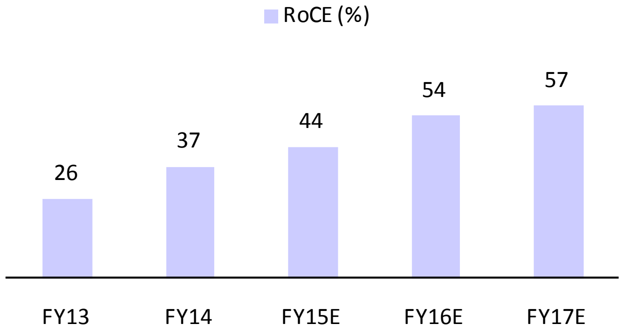
Source: Company, MOSL

Exhibit 12: Diversified client mix augurs well for margins



Source: Company, MOSL

Exhibit 13: Kitex reports strong capital efficiency



Source: Company, MOSL

Kitex Garments: an investment profile

Company description

Kitex Garments Ltd (KTG) is based in Kochi, India. Incorporated in 1992, its first public issue was in 1995. Its promoters are Mr MC Jacob, Mr Boby Jacob and Mr Sabu Jacob. KTG is in the business of manufacturing and exporting infant garments. Company derives 85% of its revenue from the sale of infant garments and the balance 15% from the sale of fabric to Kitex Childrenwear.

Key investment arguments

- Kitex Garments Ltd (KTG) has a strong presence in the highly specialized infant wear (0-2 years) market – a segment where competitors have found the going tough due to stringent safety norms.
- KTG has diversified its clients mix from a single client in FY09 to five currently, reducing client concentration risk and improving margins.
- Going forward, KTG intends to improve its revenue mix in favor of high margin clients like Toys R Us, Jockey and Mothercare, who procure high value-added products which will drive continued margin improvement.
- KTG plans to buy/license a brand for the US market. Also, it aims to be a wholesaler like Gerber. Apart from this, KTG plans to launch its products through the e-commerce channel for the US market.

Valuation and view

- We upgrade our FY15E and FY16E EPS estimates by 10% and 6% resp.
- We expect KTG to post 24.6% revenue CAGR coupled with 800bp margin expansion over FY14-17E. Hence, we expect PAT to post 41% CAGR over FY14-17E.
- Given the strong balance sheet and significant free cash flows, RoCE and RoE should improve from ~37% and 39% respectively to ~58% and 39% over FY14-17E.
- At CMP, the stock trades at 25.2x FY15E, 17.8x FY16E and 13.6x FY17E EPS. Maintain **Buy** with a revised target price of INR650 (25x FY16E).

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
463	650	40.4	Buy

EPS: MOSL forecast v/s consensus (INR)

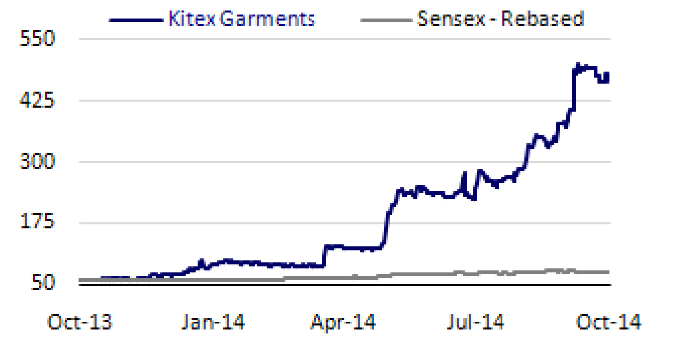
	MOSL Forecast	Consensus Forecast	Variation (%)
FY15	18.4	16.1	14.6
FY16	26.1	21.2	22.9

Shareholding pattern (%)

	Jun-14	Mar-14	Jun-13
Promoter	54.2	54.2	54.2
DII	0.0	0.0	0.0
FII	0.4	0.0	0.0
Others	45.4	45.8	45.8

Note: FII Includes depository receipts

Stock performance (1-year)



Financials and valuations

Income statement (INR Million)

Y/E Mar	2014	2015E	2016E	2017E
Net Sales	**4,422**	**5,499**	**6,856**	**8,561**
Change (%)	39.5	24.3	24.7	24.9
EBITDA	**951**	**1,501**	**1,961**	**2,508**
EBITDA Margin (%)	21.5	27.3	28.6	29.3
Depreciation	97	209	234	259
EBIT	**855**	**1,292**	**1,726**	**2,249**
Interest	106	104	21	0
Other Income	133	113	142	170
Extraordinary items	0	0	0	0
PBT	**882**	**1,301**	**1,847**	**2,419**
Tax	308	429	610	798
Tax Rate (%)	34.9	33.0	33.0	33.0
Reported PAT	**574**	**872**	**1,238**	**1,621**
Adjusted PAT	**574**	**872**	**1,238**	**1,621**
Change (%)	95.3	52.0	41.9	31.0
Min. Int. & Assoc. Share	0	0	0	0
Adj Cons PAT	**574**	**872**	**1,238**	**1,621**

Balance sheet (INR Million)

Y/E Mar	2014	2015E	2016E	2017E
Share Capital	48	48	48	48
Reserves	1,694	2,460	3,531	4,819
Net Worth	**1,742**	**2,508**	**3,579**	**4,866**
Debt	1,342	842	0	0
Deferred Tax	216	216	216	216
Total Capital Employed	**3,299**	**3,566**	**3,795**	**5,082**
Gross Fixed Assets	2,374	2,674	2,974	3,274
Less: Acc Depreciation	562	771	1,006	1,265
Net Fixed Assets	**1,812**	**1,903**	**1,968**	**2,009**
Capital WIP	7	55	69	86
Investments	0	0	0	0
Current Assets	**2,219**	**2,507**	**2,899**	**4,518**
Inventory	108	301	184	230
Debtors	531	603	751	938
Cash & Bank	1,036	951	1,180	2,410
Loans & Adv, Others	544	653	783	940
Curr Liabs & Provns	**738**	**899**	**1,141**	**1,530**
Curr. Liabilities	402	456	569	711
Provisions	337	443	572	819
Net Current Assets	**1,481**	**1,608**	**1,758**	**2,988**
Total Assets	**3,299**	**3,565**	**3,795**	**5,082**

E: MOSL Estimates

Ratios

Y/E Mar	2014	2015E	2016E	2017E
Basic (INR)				
EPS	**12.1**	**18.4**	**26.1**	**34.1**
Cash EPS	14.1	22.8	31.0	39.6
Book Value	36.7	52.8	75.3	102.4
DPS	1.0	1.9	3.0	6.0
Payout (incl. Div. Tax.)	9.7	12.1	13.5	20.6
Valuation(x)				
P/E	38.4	25.2	17.8	13.6
Cash P/E	32.8	20.3	14.9	11.7
Price / Book Value	12.6	8.8	6.1	4.5
EV/Sales	5.0	4.0	3.0	2.3
EV/EBITDA	23.4	14.6	10.6	7.8
Dividend Yield (%)	0.2	0.4	0.6	1.3
Profitability Ratios (%)				
RoE	38.7	41.0	40.7	38.4
RoCE	37.2	43.7	53.9	57.3
Turnover Ratios (%)				
Asset Turnover (x)	1.3	1.5	1.8	1.7
Debtors (No. of Days)	43.8	40.0	40.0	40.0
Inventory (No. of Days)	8.9	20.0	9.8	9.8
Creditors (No. of Days)	42.2	41.7	42.4	42.9
Leverage Ratios (%)				
Net Debt/Equity (x)	0.8	0.3	0.0	0.0

Cash flow statement (INR Million)

Y/E Mar	2014	2015E	2016E	2017E
OP/(Loss) before Tax	882	1,301	1,847	2,419
Depreciation	97	209	234	259
Others	0	0	0	0
Interest	106	104	21	0
Direct Taxes Paid	242	429	610	798
(Inc)/Dec in Wkg Cap	315	-213	79	0
CF from Op. Activity	**1,158**	**972**	**1,572**	**1,880**
(Inc)/Dec in FA & CWIP	-720	-348	-314	-317
(Pur)/Sale of Invt	0	0	0	0
Others	4	0	0	0
CF from Inv. Activity	**-716**	**-348**	**-314**	**-317**
Inc/(Dec) in Net Worth	0	0	0	0
Inc / (Dec) in Debt	334	-500	-842	0
Interest Paid	-106	-104	-21	0
Divd Paid (incl Tax)	-45	-106	-167	-333
CF from Fin. Activity	**183**	**-709**	**-1,029**	**-333**
Inc/(Dec) in Cash	**625**	**-85**	**229**	**1,230**
Add: Opening Balance	412	1,036	951	1,180
Closing Balance	**1,036**	**951**	**1,180**	**2,410**

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In respect of any matter arising from or in connection with the research you could contact the following representatives of Motilal Oswal Capital Markets Singapore Pte Limited:

Anosh Koppikar
Email : anosh.Koppikar@motilaloswal.com
Contact : (+65)68189232
Office Address : 21 (Suite 31),16 Collyer Quay,Singapore 04931

Kadambari Balachandran
Email : kadambari.balachandran@motilaloswal.com
Contact : (+65) 68189233 / 65249115

Motilal Oswal Securities Ltd
Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025
Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com