Indo Count – ***Should Investors count on it ??***



**Date** **–** **05/01/2016**.

**Business Snapshot** **–** Company is a pure and one of the rare asset play in the textile sector sourcing grey fabrics from the market, processing it with its latest technologies and exporting the value added products. Company also has a spinning division where the focus is not much. Company earns 90% of its revenues from processing and sewing and 10% from spinning. 10% spinning segment production is captively consumed by processing division. Company had 45MMPA capacity in processing till March 2015. It added 23MMPA this year to make it 68MMPA by 2016. 50% of the increased capacity is already utilized and the rest is planned to be utilized by 2017 max. 12MMPA(out of this 23MMPA) additional capacity utilization yielded 37-39% sales growth till 9months ended Dec 2015. Company has also planned to expand its capacity from 68MMPA to 90MMPA which will be completed by end of December 2017 max (stated in the latest Q3 concall). Based on current figures, expansion of 12MMPA every year will lead to at least 20-24% sales growth every year for next 4 years till 2019. As per the Q3 concall management clearly told that they hedge their revenues once the order is booked. Hence they were not able to take advantage of the dollar appreciation. So, 37-39% processing segment revenue is without the foreign exchange gain effect. There was a de-growth in spinning division of some 9-10% which resulted in overall TTM sales growth of 27% (source-screener.in). Company has 6-7 patents for its innovative processing techniques in bed and bed sheets. This proves how innovative and quality products the company has in its portfolio. Over next 2-3 years we should see expansion of 300-400 BPS at EBITDA levels due to operating leverage and added capacities and increasing the share of the value added (patented) products from mere 5% to 30%. As per the latest concall mgmt, has re-assured 20% EBITDA margin guidance as minimum in future. Company has already entered into B2C model through e-commerce platforms out of India (under its brand “Indo count”). But, that is just 1% of its revenues. Company is even planning to enter Indian markets through its brand “Indo Count” in next 3-4 years. Currently trading at a PE of 18-19, stock can get a re rating once it increases its B2C business in its portfolio. Company went into CDR and has successfully come out of it now. Debt/Equity ratio has been consistently decreasing and interest coverage ratio has strengthened. Company in past had also ventured into assembling business of consumer durables and supplying the same to the brands in white goods segment like whirlpool. This segment of the business failed to make profits over years and finally was wiped off the books. Management had to incur a huge loss due to foreign exchange losses incurred in 2008 due to which it went into CDR. We feel, the management has learned a lot of lessons over years, and good is there to come for the company in coming years. Company also plans to do a further capital expansion worth 300crores where it wants to further its backward integration (either by adding spinning capacities or adding weaving capacities – not yet disclosed by company). This will be its phase 2 expansion plan which is not yet disclosed by the company. This will be known by end of the financial year.

**Products –**

* **Bed sheets**: Flat sheet, fitted sheet and pillow cases.
* **Fashion bedding**: Comforters, bed in bag, quilts and coverlets, decorative pillows, etc.
* **Utility bedding**: Basic white bedding, mattress pads, protectors, white filled comforters filled with poly fill fibre.
* **Institutional linen**: Flat sheets, pillow cases, duvet covers and shams; caters to hotels, hospitals and others.

**Company has started innovating different value added products lately like “Thermal Balance”, “Color sense”, “True Grip”, “Touch Sense”, “Smart Cell”, “Linen Soft”, “Aero Sateen”, etc. All these products are patented and company enjoys good reputation in market for these products. This has helped the company to increase its OPM from mere 13% to 21%.**

**For instance, Thermal Balance helps to maintain the temperature of body with the temperature of bed. This gives comfort sleep. These products are in huge demand in global markets especially in US.**

10% of the revenues come from spinning yarn business. This is a low quality yarn produced by the company. Only some of the portion of this is captively consumed since the low quality yarn cannot be used for manufacturing the high quality bed sheets and bedding the company provides.

Company plans to increase the proportion of these value added products from 5% to 30% in the total portfolio over next 2 years.

**Raw Materials -**

* Company purchases grey fabric from outside, processes it and converts them into finished products.
* In case of spinning business, cotton is the main raw material.

In home textiles business, any increase in the raw material prices can be simply passed on to the clients due to the good quality of products and long relationships with the clients. Any rise in the cotton prices might not be allowed to pass on easily which may impact the margins – but again the segment contributes a mere 10% of the total revenues.

**Valuations** – (valuations as on the date of report).

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| --- | --- |
| **Particulars** | **Value (in cr)** |
| TTM Sales | 1969 |
| TTM Net Profit | 212 |
| M.Cap | 3799 |
| TTM PE | 16.49 |
| TTM EPS | 55 |

**Financials -**

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| --- | --- | --- | --- | --- |
| **Sr.No.** | **Particulars** | **Value** | **Remarks** | **Comments** |
|   |   |   |   |   |
| 1 | M.Cap. | 3799 cr. | **YES** | **M.Cap should be more than 500cr.** |
| 2 | Debt-Equity Ratio | 1.06 | **YES** | **Debt-Equity should be less than 2** |
| 3 | TTM EPS  | 55 |  |  |
| 4 | TTM P/E  | 16.49 | **YES** | **Sustainable PE for this industry is 20-22.** |
| 5 | Equity Capital | 39.48cr. |  |  |
| 6 | Dividend Yield | 0.00% | **No** | **It should be a dividend paying company.** |
| 7 | TTM Price/Sales  | 0.48 | **Good** |  |
| 8 | ROE | 64.00% | **YES** |  |
| 9 | ROCE | 30.00% | **YES** |  |
| 10 | OPM last year | 13.00% |  |  |
| 11 | TTM OPM | 21.00% | **Good** | **if OPM increases compared to last year = "Good"** |
| 12 | NPM last year | 8.61% |  |  |
| 13 | TTM NPM | 11.50% | **Good** |  |
| 14 | 3 years Cash flows | 303cr. |  |  |
| 15 | Operating Cash Flow last year | 241cr. | **YES** | **"YES" if positive cash flow.** |
| 16 | 3 years Sales growth | 29.00% | **-** | **We should not check this parameter in case of this company.** |
| 17 | TTM Sales growth | 30.00% | **Good** | **"BAD" if TTM sales growth lower than the 3 year sales growth.**  |
| 18 | 3 years profit growth | 132% | **-** | **We should not check this parameter in case of this company.** |
| 19 | TTM Profit Growth | 52% | **Bad** | **"BAD" if TTM profit growth lower than the 3 year profit growth.**  |
| 20 | Interest Coverage Ratio | 6.77 | **Good** | **Good if more than 3** |
| 21 | Debtors/Sales Ratio last year | 10% | **Good** |  |
| 22 | Debtors/Sales Ratio preceding year | 10% | **Good** |  |
| 23 | EBIDA/OCF | 1.19 | **Good** | **Good if close to 1** |
| 24 | Asset turnover ratio | 2.78 | **Good** |  |
| 25 | TTM Promoter Stake | 59.00% | **YES** | **YES if more than 40%.** |

**Risk** –

* Increase in raw material price can be a risk.
* TPP implementation can be a risk to the entire textile sector. However, after talking to the IR of the company, found some interesting facts – India is the largest producer of cotton in the world. The high and mid size cotton are available only in India. Vietnam and Bangladesh both are rich in small size cotton crop. Since the company deals into rich segment (high quality products for which we require high quality cotton), it is not possible for these countries to enter into the high quality segment due to lack of availability of high quality cotton there. Establishing a unit and importing high quality cotton from India, will take 10 years time to breakeven. If these countries purchase yarn from India and manufacture garments in their countries, the TPP benefit goes away. If TPP is implemented also, we can easily think of starting a plant in the member countries.
* Management has burnt their hands previously in doing different businesses like being OEM for the white goods segment. They went into CDR just because of not hedging their foreign currency risk exposure. Lately, we think that they have understood their mistake and started concentrating on the textile segment where they are expert. Company has 7 patents for their bed and bed sheet products.

**Moat/Advantages** –

* Company has 7-8 patents for its unique products which are heavily demanded by its clients.
* Company has started selling its products through e-commerce globally (not yet in India) – thereby entering into B2C channel. Company plans to enter India as a B2C brand – “Indo Count” in next 3-4 years time span. This can provide a great moat for the company’s business.
* This is the only company in the textile division which is operating on asset light basis. All other competitors like Welspun and Himatsingka, etc have low ROEs compared to Indo count. Alok is a big player in this sector niche, but since couple of years it has led itself into a big trouble and has recently gone into SDR (strategic debt restructuring). This has benefited the other companies and decreased the competitive forces/pressures to a great extent.
* Suppliers of cotton and grey fabric are more fragmented, which leads to less bargaining power to them against indo count. Customers demand the good quality of products offered by Indo count which helps Indo count have more bargaining power over its clients. Company provides differentiated products which no other competitor provides/can provide. Competition is low because of the big player Alok out of the market and bleeding badly. We believe, the industry to be favorable and Indo count being well poised for its long term growth.

**Expansion/Trigger** –

* Company has enhanced its processing/weaving capacity from 45MMPA to 68MMPA last year. Out of this half the capacity is already utilized giving a topline growth of 37-39% (only processing segment considered which is 90% of total sales). The rest 50% capacity will be utilized next year. So we can rest assure at least 25-30% sales growth next year also.
* Company has also planned to enhance this capacity further from 68MMPA to 90MMPA which will get utilized over next 2-3 years (by 2018-19). This will ensure the consistency of 30% sales growth year on year.
* Company has also put on paper - expansion of 300cr in backward integration over next 2 years. This will be either investment in spinning division or fabric division. EBITDA margins shall expand 400-500 BPS over next 2 years.
* Company wants to go B2C at the end of 3-4 years in India. Margins expected to enhance further due to this. This can give a good PE re rating to the stock. The B2C model is in depth covered in the updates given to this initial coverage.

**Conclusion** –

Considering consistent growth of 30% in topline over next 4 years and company planning to go B2C after that, we can invest in the company which is available at a below 20 PE. If EPS grows at a mere 30% (considering sales growth of 30%), stock can go 30% up (assuming no PE re-rating) for next 2-3 years. After that, we can see PE re-rate due to the B2C brand “Indo count” which can give some great returns.

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**Updates –**

**Date – 26/02/2016**

**Business Update -**

Company has planned to float a subsidiary wherein indo count will be holding 85% and Mr. Asim Dalal will be holding 15% of the company. Asim Dalal is a renowned businessmen and has around 22 years of experience in the Indian retail markets and owns some of the most reputed stores/brands like “The Bombay Store”, “Food&Inns” and the “Elephant brand”. Asim Dalal’s father Bhupendra Dalal has been convicted for his part in Harshad Mehta scam. He was given a one year jail and ordered some monetary penalty. Asim’s Dalal and his brother, Milan Dalal have also been inquired by SEBI in past for market manipulation and other similar charges. The transactions were entered into to evade taxes. If we look at Mr. Asim Dalal as a businessman, we find him great person who can do wonders for Indo Count. In a scenario where he is going to have 15% (minority) stake in the company with only marketing related decisions under his authority where he is already great, we feel Indo count has made the right decision.

**Financial Updates –**

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| **December Qtr update** |
| **Particulars** | **Q-on-Q** | **Y-on-Y** |
| **Sales** | -13.74% | 17.34% |
| **Profit** | -3.80% | 45.41% |

**Q-on-Q growth should not be compared here in this business.** September qtr tends to be high due to seasonality. TTM sales growth is 27% and TTM profit growth is 51.78%. The stock has corrected recently and is trading at a forward PE of 14-15. The upside is high from here. Management is walking the talk. According to the mgmt interview last year, they kept a topline growth expectation of 20% minimum. Need to inquire more into the B2C model and the appropriateness of Mr. Asim Dalal for this venture. But the company has a long way to go from here and at PE of 14-15, it is a good buy.