

Sintex Industries – The dark horse

28 June 2017

Business, and Clients

Clientele: Who's who of the fashion world



(src: Sintex investor Presentation)

Why is Sintex Industries a dark horse?

We personally believe that majority of investors have significant retrospective bias against Sintex for performing poorly over last decade. They curse the textile business which has marred the brilliant valuations plastics business would have got.

I believe the tree is now fully grown and now is the time to pluck the fruits. The valuations of Sintex Industries after de-merger are so attractive that we cannot reject the idea without even properly studying it.

Some key facts –

- **FY17 Sales: 1900+ cr; FY17 net profit: 134 cr ; Mcap: 1400cr ; Debt: 4000 cr**
- **Book Value: 72 ; Q3FY16 NPM = 9.5%; Q4FY16 NPM = 8%**

Thought process is simple – Not to judge business from any bias, be it retrospective or textile bias. We have disconnected the bias and opinions from the facts and have taken a fresh look at the business from all aspects. Numbers and details are from results, AR, and concalls

Only for study purposes

Existing Capacity

Sintex capacity till Q4 FY 16: 8 lakh spindles

Capacity Addition: 3 lakh spindles in Phase 1 (by June 2017) and 3 lakh spindles in Phase 2 (by August 2017). Capacity increase: by 75% taking total capacity to 175% of the current capacity.

Sintex Q4 FY16 Sales: 660 crore; EPS ~ 1

With phase 1 going live in June 17 and Phase 2 in Aug 17, capacity will almost become 1.75 times, generating sales of around 1155 cr per quarter and with a quarterly EPS of 1.75 at full utilization. Annually the expected sales could be 4620 cr and expected EPS 7 on full capacity utilization.

OPM Expansion

Technology & associated improvements: New mills are generally 6-8% more efficient due to new equipment and new technology which would results in better margins.

Current OPM is around 11-12%, while NPM is 8.5% in FY16 Q4. Their new capacity has new equipment's which are on an average 6-7% more efficient.

Secondly, management has mentioned in the concall that the OPM of existing business and phase 1 would be 17% and OPM of phase 2 capacity being the premium product would be 21-22%.

So 75% sales would be with around 17% OPM and 25% sales with 21% OPM bringing the average to 18%. OPM is also expected to increase post capex completion.

At 18% OPM from current 11-12%, EPS would increase by at least 50% bringing **EPS to around 10.5**.

Capacity utilization: Full capacity utilization might take a year to achieve which roughly puts Aug –sep 2018 when the full capacity utilization will be complete.

Debt & Loans, including Subsidies

Sintex has around 4000 cr debt out of which less than 10% is short term and remaining long term.

Short term debt is generally for working capital and long term debt for capex.

Now, here is the lesser known fact – The rate of interest is mere 2% because of Govt. Subsidy & Tufts Subsidy.

Power unit subsidy of Rs 1 per unit will give huge operation advantage for next 5 years.

Only for study purposes

These subsidies is available to them till 2022-23. However, government has now announced that any expansion post 2017 will not get subsidy benefit. Going forward, it is safer to assume that they will repay the short term faster through internal accruals which has higher interest rate leading to better margins.

Moat: This low interest debt is the real moat which prevents further entry of any other textile player.

Even Sintex shelved the third phase of expansion of 4 lakh spindles as the subsidy is ending this year.

This decision was taken recently by the govt.

Sintex plants are near port (within 10 KM distance) which will result in lower logistics cost.

In sum, given the debt and subsidies available, Sintex Industries is going to be **lowest Cost of Capital** business.

Let us talk valuations

We can safely assume that a business having 18% OPM is generally valued at around 18-20 PE. Even in the worst case with an EPS of 7 and PE of 10 the price target would be 70 (3 times current price of 23)

At current pace the TTM EPS would be 4 and at a multiple of 10 the company would be valued at 40 (by November 2017). However we expect PE also to expand significantly (welspun currently trades at at PE of 23. Don't look at screener numbers, see consolidated full year EPS from their last Quarter result)

We can refer to below table on how the value would vary with EPS and PE multiple change.

Any improvement in margins and multiples would take it much higher.

EPS		PE								
		10	11	12	13	14	15	16	17	18
Mar-18	4	40	44	48	52	56	60	64	68	72
	5	50	55	60	65	70	75	80	85	90
Mar-19	6	60	66	72	78	84	90	96	102	108
	7	70	77	84	91	98	105	112	119	126
Sep-19	8	80	88	96	104	112	120	128	136	144
	9	90	99	108	117	126	135	144	153	162
	10	100	110	120	130	140	150	160	170	180

Price Target Range: 72-180 in 3 years.

Only for study purposes

Competitive landscape

Advantages Sintex enjoys Vis a Vis other competitors

1. New machinery which is 5-6% more efficient
2. Competitors have more than 30% debt as short term which would be having higher interest rate compared to Sintex which has less than 10% as ST debt
3. Electricity subsidy (not sure about other players)
4. VAT subsidy (not sure about other players but this may be carried in some form to GST)

Management

Company has taken right steps to on-board right people to run the business. Most important, people who knows how to run a Textile business. Sintex has hired CEO and Group CEO from Welspun and Trident to run the textile business. This reflects management shifting from family led to professional.

Management decisions play critical role in deciding fate of the business no matter good growth is. Sintex decision making needs to be monitored closely.

Concerns

Can the full capacity be utilized?

I believe Yes, Sintex initially planned for 10 lakh spindles expansion but shelved 4 lakh of 3rd phase due to subsidy ending announcement. We can assume that company would have assessed the utilization of incremental capacity. With lower capacity the utilization would definitely be higher.

However, it is important to analyze capacity utilization every quarter to observe a miss from expected utilization. The industry outlook looks good (refer news articles at the end of this paper)

Risks:

1. Inefficient use of capital leading to no improvement in margins
2. **Equity dilution (Promoters have a history of such misadventures but hope no more is coming.)**
3. Full capacity not being utilized – with a premium product in high demand and having high valued customers, this can be mitigated moreover as mentioned earlier it's a recession proof business.
4. Raw Material Prices: with India being one of the largest producers of cotton any scarcity could be ruled out notwithstanding drought
5. Further Expansion: Management may again revive their plan of another 4 lakh spindle if the government may again announces subsidy. This would delay the returns. However, management has land for further expansion so only machinery cost will be added in case further expansion.

Only for study purposes

Shareholding

Promoters hold 32.47% stake in the company with no reduction in last one year. Of the above holding, the promoters have pledged almost 70% of their shareholding.

Nearly 26% of the stock is held by Foreign Institutional Investors. Also, Government of Singapore and other Foreign Companies hold an additional 4.83% stake

Key Take Away

- The debt is large, but it is cheap – 2% rate of interest & pay back of debt will be significantly faster than its peers
- With Newly added capacity company will be India's largest compact yarn manufacturing business.
- Competitors are unlikely to have financial advantage that Sintex currently enjoys
- Cost advantage given its presence near cotton producing area & vicinity of the port, reducing logistic costs by a big leap
- Peer comparison places Sintex at cheapest valuation
- Effect of GST: Positive-Neutral

Industry Outlook

<https://www.ibef.org/news/indias-garment-exports-may-hit-usd-20-billion-in-fy18>

<https://www.ibef.org/news/indiaaustralia-to-boost-collaboration-in-clothing-fashion>

<http://www.moneycontrol.com/news/business/economy/dnp-textiles-gst-relief-on-one-hand-whammy-on-the-other-2313557.html>

Could GST be the demonetization moment?

Today there is no tax on fabric while there is tax on garments and yarn. Most people in the un-organized sector sell their products showing it as fabric and do not pay any tax. Now that the entire chain has become taxable, the entire industry will gradually shift toward organized players from un-organized ones.

Disclaimer: This report is for study purpose only. This document is not intended to recommend any buy or sell of underlying security/Equity/Stocks of the said company. Please speak with your registered investment advisor before taking any decision

Only for study purposes