S.P. Apparels Ltd

Initiating Coverage

Equirus

Knitting the right strategy!

January 15, 2018

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S.P. Apparels Ltd.

Initiating Note | Regular Coverage

Absolute : LONG
Relative : Overweight
22% ATR in 17 Months

Knitting the right strategy - Initiate with LONG

Textiles

Rating Information	
Price (Rs)	412
Target Price (Rs)	541
Target Date	30th Jun'19
Target Set On	15th Jan'18
Implied yrs of growth (DCF)	15
Fair Value (DCF)	543
Fair Value (DDM)	49
Ind Benchmark	SPBSMIP
Model Portfolio Position	NA

Stock Information	
Market Cap (Rs Mn)	10,268
Free Float (%)	39.78 %
52 Wk H/L (Rs)	484/345
Avg Daily Volume (1yr)	56,007
Avg Daily Value (Rs Mn)	23
Equity Cap (Rs Mn)	252
Face Value (Rs)	10
Bloomberg Code	SPAL IN

Ownership	Recent	3M	12M
Promoters	60.2 %	0.0 %	0.1 %
DII	9.0 %	1.2 %	2.7 %
FII	7.4 %	0.0 %	1.6 %
Public	23.4 %	-1.2 %	-4.5 %

Price %	1M	3M	12M
Absolute	2.3 %	0.7 %	16.9 %
Vs Industry	-4.8 %	-12.9 %	-26.6 %
Kitex Garments	8.3 %	44.7 %	3.9 %
-	-	-	-

Consolidated Quarterly EPS forecast

Rs/Share	1Q	2Q	3Q	4Q
EPS (17A)	6.5	6.4	5.6	6.4
EPS (18E)	4.4	3.9	5.8	6.1

The global childrenswear market is characterized by its ever-increasing demand and stringent safety and quality norms. Though India's overall textile export growth has slowed down, it remains a preferred childrenswear supplier due to its strict adherence to compliance requirements. S.P. Apparels Ltd (SPAL), India's second largest childrenswear manufacturer known for its reliability, consistency and quality, is well-poised in this scenario. With an enviable client base and on-going backward integration and expansion, SPAL is set to deliver 10%/18% revenue/PAT CAGR, and ~260/300bps expansion in its EBITDA margins/core ROIC over FY17-20E. We initiate coverage on the stock with LONG rating and a Jun'19 TP of Rs 541.

Huge opportunities in childrenswear; capacity addition, rigorous retail outlet expansion to drive 10% revenue CAGR: The childrenswear industry is marked by stringent quality regulations and ever-increasing demand. SPAL, with more than two decades of operations and strict adherence to quality norms and regulations, has carved a space for itself. Expansion of the customer wallet share backed by incremental capacity addition, new customer additions and their gradual scale-up, along with strong retail outlet expansion will drive 10% revenue CAGR over FY17-20E.

Backward integration, higher utilization to push up margins; expect EBITDA/PAT CAGR of 16%/18% over FY17-20E: Fully backward-integrated production will allow SPAL to have better control over costs while removing any bottlenecks that restricted margin expansion in the past. Additionally, increasing the share of basic garments in the sales mix will improve capacity utilization, thus aiding margins. We expect EBITDA/PAT to grow at a CAGR of 16%/18% over FY17-20E.

Strict WC control, stable FCF generation to improve return ratios: Fully integrated production will significantly reduce third-party dependence resulting in strict control over working capital. With stable working capital requirements, IPO funded capex and strong operating cash-flows, SPAL should generate FCFF of ~Rs 1.4bn over the next three years. Strong margin expansion and stable WC turns should improve core ROIC by ~300bps to ~15% over FY17-FY20E.

Initiate with LONG, Jun'19 TP of Rs 541: SPAL currently trades at 14x Mar'19 EPS, at a ~22% discount to Kitex which trades at 18x. We expect a re-rating for the stock given strong EPS CAGR of 18% and improvement in returns ratios over FY17-FY20E. We initiate coverage on SPAL with TP of Rs 541 set at a 17x Jun'19 EPS of Rs 32.

Consolidated Financials

Rs. Mn YE Mar	FY17A	FY18E	FY19E	FY20E
Sales	6,357	6,310	7,238	8,500
EBITDA	1,073	949	1,278	1,655
Depreciation	208	228	257	274
Interest Expense	135	195	147	129
Other Income	210	244	217	255
Reported PAT	619	509	732	1,010
Recurring PAT	619	509	732	1,010
Total Equity	3,831	4,310	4,996	5,945
Gross Debt	1,660	1,620	1,580	1,540
Cash	934	1,079	1,134	1,469
Rs. Mn YE Mar	FY17A	FY18E	FY19E	FY20E
Earnings	24.6	20.2	29.1	40.1
Book Value	152	171	199	236
Dividends	0.5	1.0	1.5	2.0
FCFF	-35.2	16.0	13.4	24.7
P/E (x)	16.6	20.2	14.0	10.2
P/B (x)	2.7	2.4	2.1	1.7
EV/EBITDA (x)	10.7	11.8	8.6	6.4
ROE (%)	24 %	13 %	16 %	18 %
Core ROIC (%)	12 %	9 %	12 %	15 %
EBITDA Margin (%)	17 %	15 %	18 %	19 %
Net Margin (%)	10 %	8 %	10 %	12 %

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Company Snapshot

How we differ from Consensus

	-	Equirus	Consensus	% Diff	Comment
EPS	FY18E	20.2	23.2	-13 %	We expect muted FY18 in terms of revenues and margins. FY19 to see strong margin expansion resulting from backward integration
	FY19E	29.1	29.5	-1 %	
Sales	FY18E	6,310	6,955	-9 %	
	FY19E	7,238	7,918	-9 %	
PAT	FY18E	509	593	-14 %	
	FY19E	732	750	-2 %	

Our Key Investment arguments:

- Huge market opportunities in infant garmenting, strong capacity addition, and retail outlets expansion to drive 10% revenue CAGR.
- Margins to improve on vertically integrated production and increase in capacity utilization, expect EBITDA/PAT CAGR of 16%/18% over FY17-20E
- Strict control over working capital and stable FCFF generation to improve return ratios.

Key Assumptions:

Particulars	FY17	FY18E	FY19E	FY20E
Garment Revenues (In Rs Mn)	5,955	5,754	6,507	7,594
YoY Growth	19%	-3%	13%	17%
Retail Revenues (In Rs Mn)	568	717	913	1,119
YoY Growth	64%	26%	30%	20%
Number of pieces exported	47.9	49.1	59.0	70.8
Export Realization per piece (Rs)	100	99	94	92

Risk to Our View

Prolonged impact of Brexit, Delay in pickup of orders from new as well as existing customers, forex volatility and heavy cotton price fluctuations

Key Triggers

- Strong order inflow from existing and new customers along with margin expansion.

Sensitivity to Key Variables	% Change	% Impact on EPS
Revenue	5 %	6 %
EBITDAM	1 %	5 %
-	-	-

DCF Valuations & Assumptions

Rf	Beta	Ke	Term. Growth	Debt/IC in Term. Yr
6.7 %	1.0	12.7 %	5.0 %	23.1 %

-	FY18E	FY19E	FY20-22E	FY23-27E	FY28-32E
Sales Growth	-1 %	15 %	14 %	12 %	11 %
NOPAT Margin	8 %	9 %	12 %	13 %	12 %
IC Turnover	1.20	1.25	1.40	1.38	1.28
RoIC	9.2 %	12.4 %	17.6 %	19.0 %	16.5 %

Years of strong growth	1	2	5	10	15
Valuation as on date (Rs)	122	204	389	426	470
Valuation as of Jun'19	141	236	449	492	543

Based on DCF, assuming 15 years of 11% CAGR growth and 17% average ROIC, we derive current fair value of Rs 470 and 30th Jun'19 fair value of Rs 543.

Company Description:

SPAL is one of the leading manufacturers and exporters of knitted garments for infants and children in India which provides end-to-end garment manufacturing from greige fabric to finished products including body suits, sleep suits, tops and bottoms. SPAL is the preferred vendor through long standing relationships with reputed international clients like TESCO, ASDA, Primark, Mothercare, etc. SPAL is also the sub-licensee to manufacture, distribute and market adult menswear products in India under the 'Crocodile' brand.

Comparable valuation			Mkt Cap	Price	Target	EPS			P/E			BPS	P/B	RoE			Div Yield	
Company	Reco.	CMP	Rs. Mn.	Target	Date	FY17A	FY18E	FY19E	FY17A	FY18E	FY19E	FY17A	FY18E	FY17A	FY18E	FY19E	FY17A	FY18E
SP Apparels	LONG	409	10,282	541	30th Jun'19	24.6	20.2	29.1	16.6	20.2	14.0	152.2	2.4	24 %	13 %	16 %	0.1 %	0.2 %
Kitex Garments	LONG	311	20,954	303	31st Mar'18	13.9	15.1	17.3	22.3	20.5	18.0	68.5	3.9	22 %	20 %	21 %	0.5 %	1.0 %
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

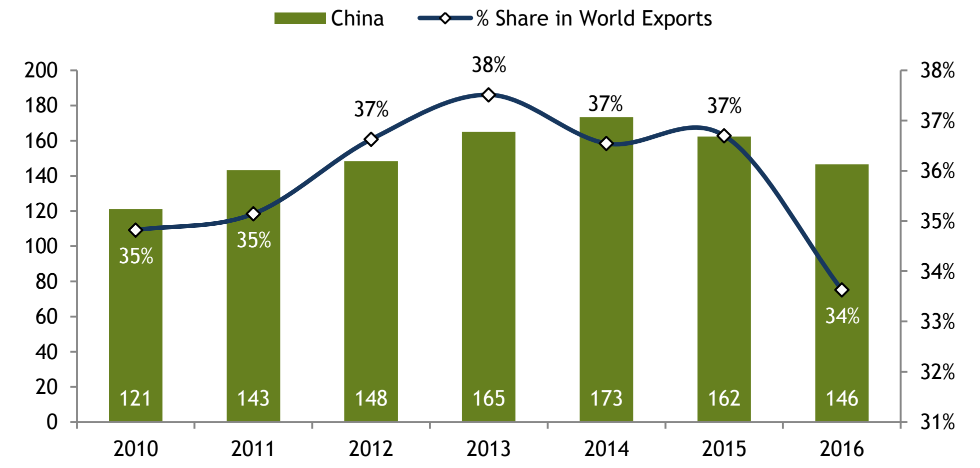
Investment Rationale

Favorable industry dynamics = huge market opportunities

India in best position to capitalize on China's falling apparel exports

Till 2014, China dominated the global exports market for many years mainly due to availability of cheap labor, infrastructure facilities and export-friendly government policies. However, in past few years, China has started losing its manufacturing competitiveness in the global market owing to its rising labor and energy costs.

Exhibit 1:China's share in global textile and apparel exports declining (US$ bn)



Source: International Trade Centre (ITC), Equirus Securities

China's decelerating exports have opened up new opportunities for countries like Bangladesh, Vietnam and India, who have successfully increased their exports (Exhibit 2). While Bangladesh and Vietnam have benefitted due to cheap labor, duty free or lower tariff access to EU and US markets; 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.

Exhibit 2:Rising share of developing countries in apparel exports

	Export Value (US$ bn)	Export Value (%)		CAGR %
	2016	2010	2016	(2010-16)
China	146.5	34.8%	33.6%	3.9%
Bangladesh	33.5	4.3%	7.7%	17.7%
Vietnam	24.7	2.9%	5.7%	19.5%
India	17.0	3.0%	3.9%	9.8%
Turkey	14.8	3.6%	3.4%	3.6%
Sri Lanka	4.6	1.0%	1.1%	6.8%
Pakistan	4.6	1.0%	1.1%	6.0%

Source: International Trade Centre (ITC), Equirus Securities

International buyers who follow stringent quality norms, environment, labor and other social practices, prefer countries like India with a strong reputation of meeting quality/ compliance requirements and executing orders on time. Apart from this, abundant cotton availability, strong government support and presence across the textile value chain - right from spinning, weaving, knitting and dyeing to garmenting, finishing and quality compliance - makes India a preferred supplier over other countries.

Global childrenswear market to reach US$300bn by 2019

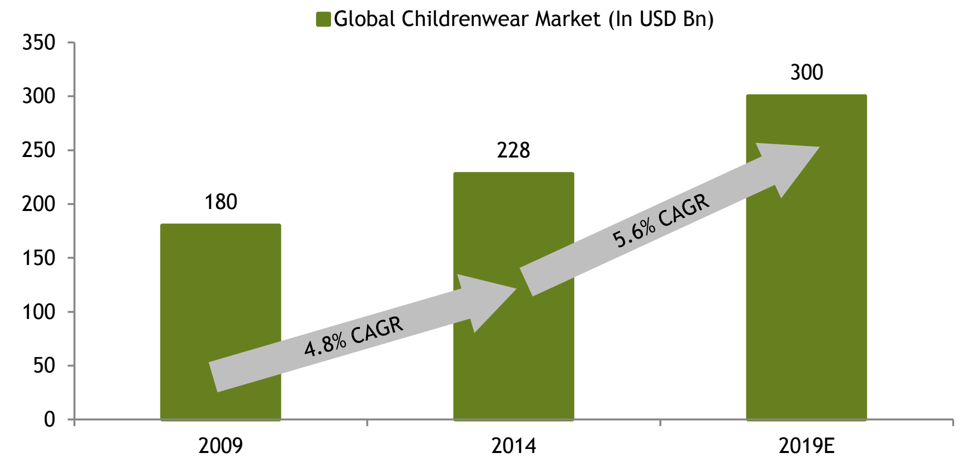
Childrenswear market is the fastest growing category in the apparel industry mainly due to rising brand awareness for kids-wear products, and growing desire to pay a premium for better quality products with higher safety elements. In emerging economies, increasing penetration of kids-wear brands and rising willingness to spend on children are aiding market growth. Additionally, rising media exposure, increasing disposable incomes, growing peer pressure, and greater fashion and brand consciousness among children are fuelling growth further.

Childrenswear market is divided into two categories; infant and toddler-wear (0-3 years) and kids-wear (4-14 years). The childrenswear market is largely immune to economic conditions and benefits from impulsive purchase decisions of adults. Also, given the tendency of children to outgrow clothes quickly, the frequent purchase of new apparels becomes an absolute necessity.

The global childrenswear market stood at US$ 228bn in 2014, of which children's apparel (4-14 years) commanded 80% and toddler apparels (0-3 years) only the remaining ~20%.

While the market has grown at a 4.8% CAGR between 2009 and 2014 amid improving global-economic conditions, the growth rate should touch 5.6% CAGR between 2014 and 2019 to reach a value of US$ 300bn in 2019.

Exhibit 3: Global children-wear market to grow at 5.6% CAGR over 2014-2019E



Source: RHP, Equirus Securities

Huge market opportunities marked by stringent compliance requirements

The US is the largest market for childrenswear with a market size of US$ 58.3bn followed by China at US$ 44.4bn. On the other hand, many European countries like Germany, UK, France and Italy lead in child apparel spending.

While the childrenswear market is very large, exporting countries need to meet stringent safety requirements - from the raw material used (mostly cotton) to colors for designs, accessories, embroidery, and buttons - to qualify for exports, particularly to the US and Europe. Mandated by governments of various developed nations, all brands and retailers have to strictly adhere to quality standards, especially in case of infant and toddler-wear.

Exhibit 4: Safety requirements of childrenswear

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

Source: RHP, Equirus Securities

Global childrenswear imports to grow at a steady pace

Global childrenswear imports increased at a 6% CAGR, from US$ 58bn in 2009 to US$ 78bn in 2014. Imports are pegged to grow at a 7% CAGR to touch US$ 110bn in 2019. The global childrenswear market was 16.9% of the global apparel market and accounted for 16.6% of global apparel imports in 2014. Assuming the same share of childrenswear market in global apparel market and global apparel imports, the global childrenswear market should touch US$ 439bn with global childrenswear imports scaling to US$ 150bn in 2025E - thus opening up huge opportunities for exporters like SPAL.

India among key sourcing destinations in an expanding childrenswear market

The childrenswear market in major importing countries is steadily growing amid buoyant economic conditions. Low manufacturing costs and better integrated facilities is forcing a shift in manufacturing to developing countries. China has been and still remains the largest exporter of childrenswear with a market share of 36.1%, followed by Bangladesh at 6.5% and India at 4.2%.

India has many distinct advantages in childrenswear exports over Bangladesh and Vietnam, which have emerged strongly over the past few years (Exhibit 5).

Exhibit 5:Advantages that differentiate India from other countries

Source: Equirus Securities

Enviable customer profile

Serving marquee international retailers for over two decades

SPAL is the second largest childrenswear manufacturer in India and the fourth largest in the world after Wingloo (China), Gimmell (Singapore) and Kitex (India). With 23 factories spread across Tamil Nadu (TN), it supplies garments to some of the largest retail giants in the world for more than 20 years. SPAL has emerged as one of the most reliable, consistent and quality suppliers to global retailers over the years, with a well-entrenched presence in fashion garments for infants and children.

International customers of SPAL include TESCO, ASDA, Primark, Mothercare, Dunnes stores, Garan and K-Mart. While the company does not have any long-term commitments with any of these players, it continues to generate repeat business from all customers and is among the preferred vendors in India for some of them. This reflects the strong customer confidence in SPAL for its ability to understand latest trends and ensure timely delivery of quality products.

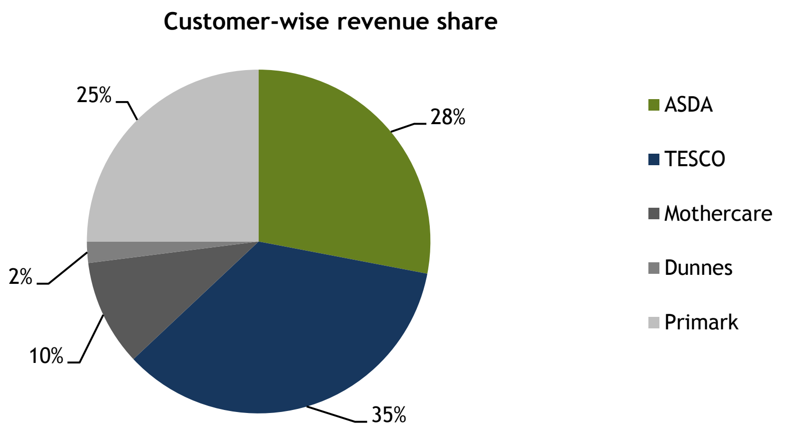
Exhibit 6: SPAL's major customers

Source: Equirus Securities

Supplier of fashion garments with small batch sizes

Unlike larger peers like Kitex Garments (KTG) that specialize in basic garments, SPAL focuses primarily on manufacturing fashion garments for infants and children. Fashion garments involve extra processes of printing and embroidery, and SPAL uses latest technology, such as automated embroidery and sewing assembly lines, for its products. Moreover, the batch size is smaller (20,000-50,000 pieces) for fashion garments as against (>100,000 pieces) for basic products. SPAL's in-house designing capabilities, adoption of latest technology, and ability to source skilled labor and materials give it a competitive edge and higher realization/piece. However, with the increase in the share of Primark with relatively lower realizations, SPAL's realization/piece slid to Rs 100 in FY17 from Rs. 117 in FY16.

Exhibit 7: Customer-wise revenue share (FY17)



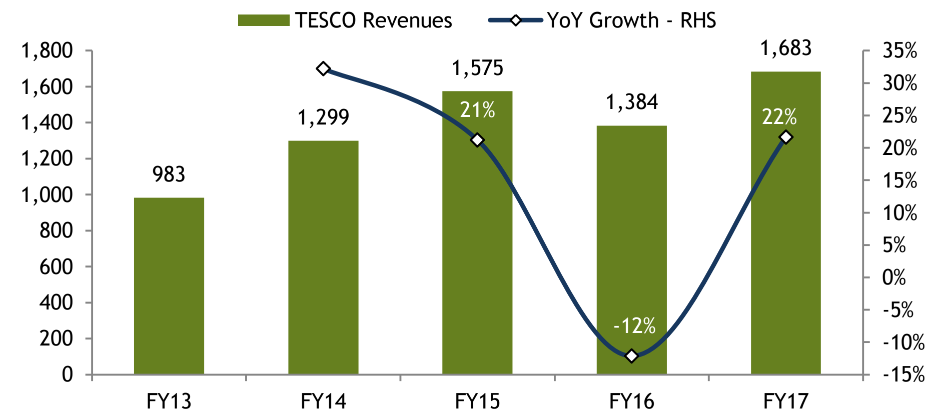
Source: Equirus Securities

TESCO & ASDA - the largest customers

For many years, TESCO and ASDA have been among SPAL's largest customers, accounting for more than 60% of total garment revenues in FY17. TESCO is the largest retail chain in the UK and the third largest in the world in terms of revenues. With a revenue share of close of 35% in FY17, TESCO is one of the top contributors to SPAL's topline. ASDA, which generates ~25% of SPAL's revenues, is the third-largest supermarket chain in Britain and a subsidiary of Walmart.

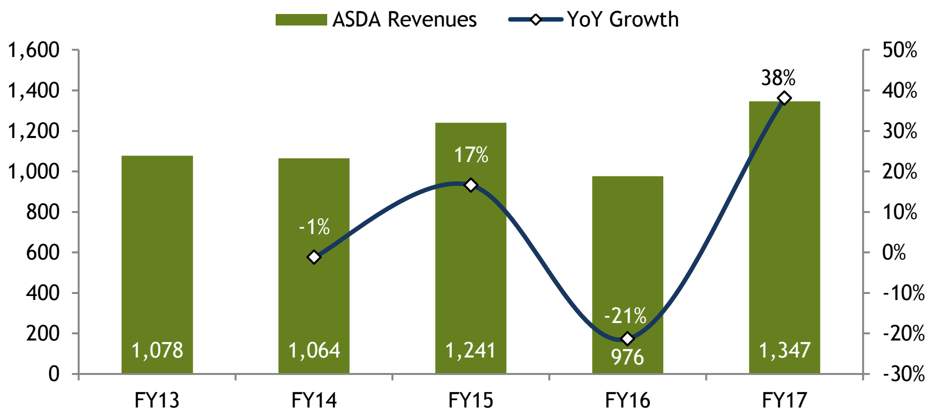
The realization/piece for Tesco and ASDA is among the highest at Rs 140-150. Revenues from both companies combined grew at 10% CAGR over FY13-FY17. However, revenues declined in FY16 due to an overall slowdown in the UK as Brexit affected the purchasing power of customers; nevertheless, FY17 saw a sharp recovery as TESCO/ASDA revenues grew 24%/38% yoy. With incremental capacities in place, we expect revenues from TESCO and ASDA to grow at a healthy rate in the coming years as well.

Exhibit 8: Revenues from TESCO grew at 10% CAGR over FY13-FY17



Source: Equirus Securities

Exhibit 9: Revenues from ASDA grew at 6% CAGR over FY13-FY17



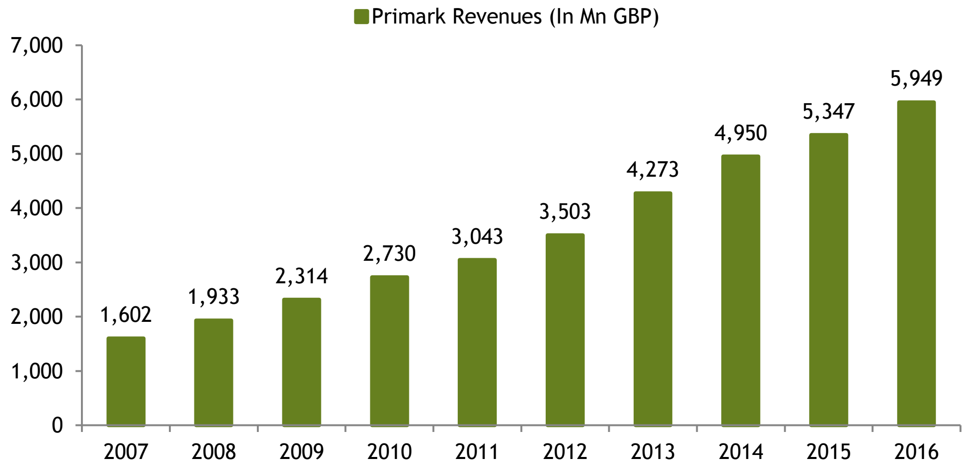
Source: Equirus Securities

Primark to drive growth in SPAL's garment revenues

Founded in 1969, Primark is one of the world's largest clothing retailers based out of Ireland. It currently has 335 outlets in 11 countries which include UK, Ireland, Spain, Portugal, Germany, Netherlands, Belgium, Austria, France, Italy and US.

With most of its outlets in the UK - SPAL's major export market - Primark serves a huge set of customers looking for quality, up-to-minute designs at value-for-money prices. Primark's organic growth came from its unique ability of sourcing quality goods at low prices along with latest fashion and lean operations. Growing customer acceptance from latest designs and value-for-money products push up the company's revenues by 16% CAGR over CY07-CY16.

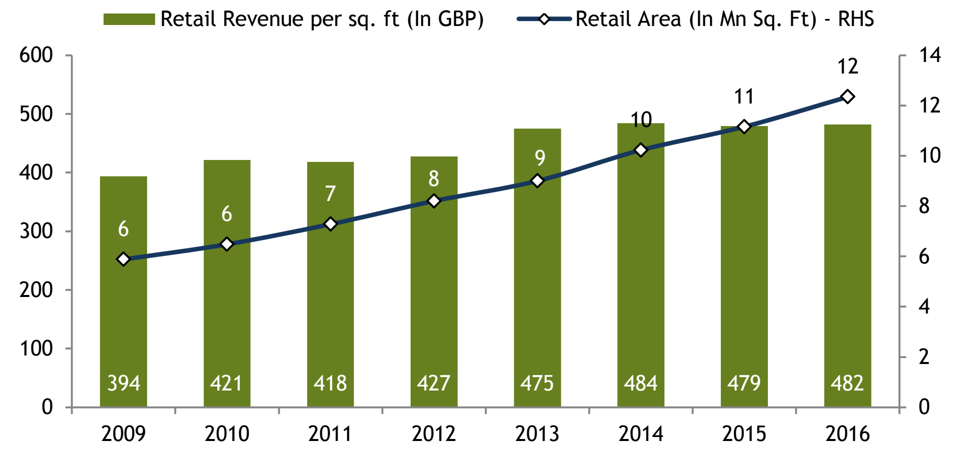
Exhibit 10: Primark revenues grew with a robust 16% CAGR growth over CY07-CY16



Source: ABF Annual Reports, Equirus Securities

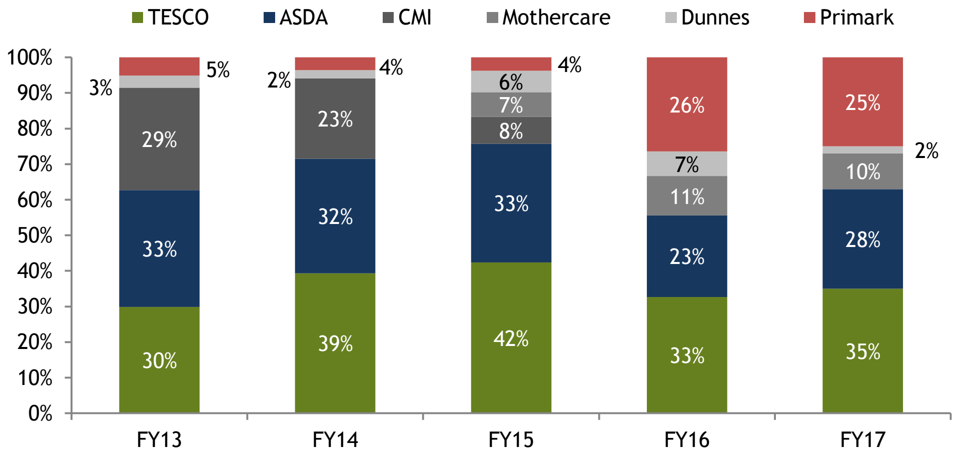
Backed by its robust business model and value offerings, Primark has successfully entered new territories and gained market share. Along with continued outperformance in the UK (market share: ~15%), it has received outstanding response in non-UK markets as well, as reflected in its revenue growth and outlet expansion rate every year. In 2016, the company opened 22 new outlets (1.2 mn sq. ft) in 9 different countries and plans to add another 1.3mn sq. ft in 2017. Within a short span of 10 years, Primark has become a market leader in Spain. It also entered into the US with four new outlet openings at prime locations. It has received a positive feedback, particularly for its exceptional value-for-money and breadth of its product range. The international expansion of Primark is very much in infancy stage outside UK (one-sixth size of H&M/Inditex).With its current success rate in newer markets, we expect Primark revenues to grow at a strong rate.

Exhibit 11:Rigorous outlet expansion by Primark aids growth in revenue per sq. ft.



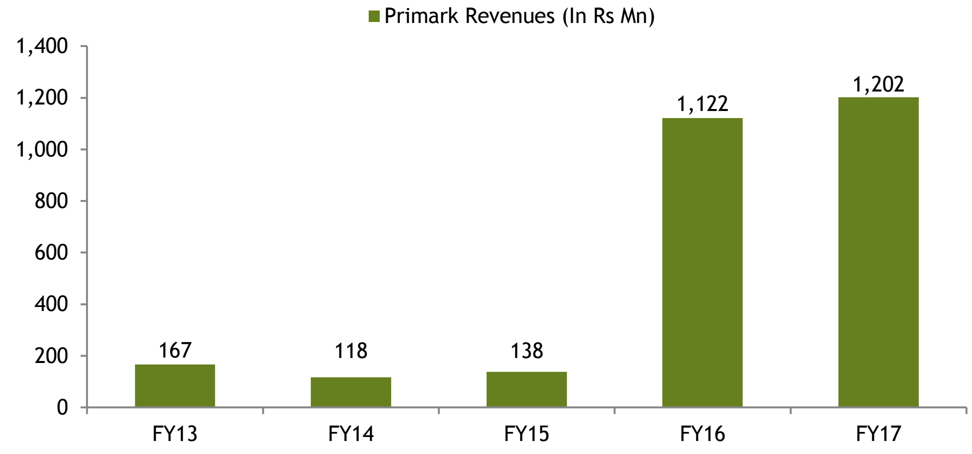
Source: ABF Annual Reports, Equirus Securities

Exhibit 12:Primark's share in SPAL's revenue mix grew strongly in last 2 years



Source: Equirus Securities

Exhibit 13: Revenues from Primark spiral up from FY16 post dedicated capacity allocation



Source: Equirus Securities

Known for its servicing capabilities and adherence to quality norms, SPAL has been one of Primark's preferred suppliers for infant and childrenswear. In the past, due to capacity constraints, revenues were restricted to ~Rs 50mn per annum which, post FY15, zoomed up to ~Rs 100mn per month in FY17 after SPAL allocated a dedicated capacity for Primark. On an annual basis, revenues from Primark increased from Rs 138mn (~4% revenue share) in FY15 to ~Rs 1.24bn in FY17 (25% revenue share).

After serving Primark for more than a decade, SPAL has developed strong business relationships while understanding client needs and supplying orders as per agreements. In tandem with rising revenues of Primark in the coming years, we expect SPAL's revenues from the company to grow on a strong footing.

New customer additions to further boost topline

While SPAL's existing customers will continue to grow at a strong pace, new customer addition will further add to the topline. The company had been in talks with seven customers and of them, added two customers (US-based Garan Inc. & K-Mart) to its client portfolio in 4QFY17. It is also in advanced talks with France-based Kiabi. All three have been SPAL's customers in the past, but were dropped due to capacity or serviceability constraints. Since SPAL has added back their old customers, we see huge revenue potential from them as they are big retail giants with decades of operating experience. Shipments to Garan and K-Mart have already begun in smaller quantities. Revenue from new customers stood at ~Rs 200mn in H1FY18 and are expected to reach ~Rs 600-650mn in FY19E once order quantities are scaled up.

SPAL is also in talks with two new customers which it expects to add by Mar'18. Continuous addition of new customers and their gradual scaling up will not only help SPAL in reducing client concentration risk but also provide a significant boost to revenues.

Exhibit 14: Brief profile of newly added/about to be added customers of SPAL

New customers	Country of operations	Comments
K- Mart	U.S.	Department outlet chain with 591 outlets operating in 2017 and revenues at US$1.5bn
Garan Incorporated	U.S.	Subsidiary of Berkshire Hathaway and has been into childrenswear manufacturing & retailing for more than 50 years
Kiabi	France	A fashion retailer with strong online presence serving over 20mn customers and operating more than 500 outlets worldwide

Source: Equirus Securities

Utilization of IPO funds to expand capacities and remove bottlenecks

Despite being a high-quality childrenswear garment manufacturer that adhered to all quality norms, SPAL could neither scale up existing clients nor add new clients due to capacity constraints. This in turn restricted revenue growth, hampering its ability to repay debt quickly. And so in 2016, the promoters decided to break this vicious circle and come out with an IPO – a move which not only helped SPAL in paying off debt but also generate funds for expansion and remove existing bottlenecks.

Exhibit 15: Planned utilization of IPO proceeds & pending utilization till Sep'17

Particulars (In Rs Mn)	Amount Allotted	Amount Utilized	Pending Utilization
Repayment of debt	630	630	0
Opening of new "Crocodile" outlets	279	87	192
Expansion & modernization of manufacturing facility	702	148	554
Addition of balancing machines for existing dyeing unit	49	49	0
General corporate purposes	491	491	0
Total	**2,150**	**1,405**	**745**

Source: Equirus Securities

Exhibit 16: Capacity expansion to significantly improve SPAL's serviceability

Particulars	Till FY15	By FY18-end
Blow-room Capacity	3,200 kg/day	15,015kg/day
Spinning Machines	90's count	45's count
Number of Spindles	16,896	22,720
Knitting Machines	-	40
Dyeing Machines	24,000	27,000
Sewing Machines	3,290	4,400

Source: Equirus Securities

Spinning capacity - Debottlenecking existing unit, adding new capacity to improve efficiency: At the current spinning facility at Valapady, SPAL manufactured yarn with 45s and 90s count (in ratio of 10:6) as against the requirement of 45s count for manufacturing childrenswear garments. This was mainly due to blow-room capacity constraints (only 3,200 kg/day as against spinning capacity of 16,896 spindles); a blow room typically opens, cleans and blends the cotton fibre before feeding it into the spindles for spinning. Consequently, the company had to sell its entire 90s count yarn production in the open market and purchase 45s count yarn.

With an expansion project of ~Rs 28mn, SPAL will increase its blow-room capacity from 3,200 kg/day to 15,015 kg/day. This will allow it to produce the 45s count yarn, the prime requirement for childrenswear garments. Along with this, the company will also expand its spinning capacity by increasing its spindle count from 16,896 currently to 22,272. Besides, it will add compactors, enabling it to undertake customized orders and achieve an overall improvement in fabric quality; compactors ensure accuracy of the output fabric density.

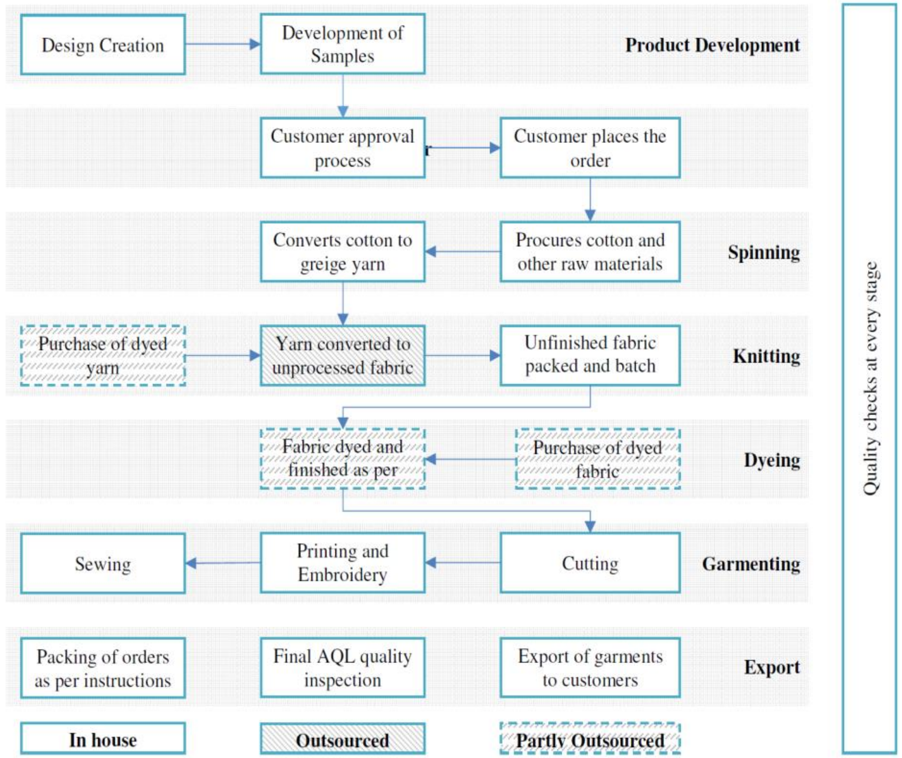
Knitting capacity - Addition of machines to reduce third-party dependence, to enhance productivity: In the absence of own knitting machines, SPAL was fully dependent on third parties for its knitting requirements. With IPO funds, it will set up a new knitting facility, adjacent to its spinning facility at Valapady, and install new knitting machines. Addition of the knitting facility will (1) enhance the precision over output fabric, enabling SPAL to serve customized orders, and (2) reduce transportation costs, thereby increasing production efficiency with minimal wastage and bottlenecks. Till Sep'17, SPAL had already installed 20 knitting machines and put them to production. It plans to add a total of 40 machines by FY18-end.

SPAL has already added balancing machines for its existing dyeing and drying process at its processing facility at SIPCOT, Perundurai.

Sewing capacity - Adequate to add 10-15% to topline: Inadequate sewing machines restricted SPAL in taking incremental orders from smaller customers, resulting in lower revenue growth. In FY16, the company had a total of 3,410 sewing machines which it increased by 300 in FY17. The current capacity utilization of sewing machines stands at ~80-82%, which the company feels can easily increase to ~90-95% led by an improvement in efficiencies and labor productivity. The machine count at the Sep'17-end was 4,050, and with an increase in the utilization rate, it can add ~10-15% growth to topline. Hence, management's current focus is to improve the productivity of existing machines.

Besides, SPAL had purchased a factory at Kovilpatti in the past, where the construction process has begun and production is expected to start from FY19-beginning. A total of 350 sewing machines would be added at this factory to be utilized for serving incremental order inflows from both, new as well as existing customers.

Exhibit 17: Production process flow-chart



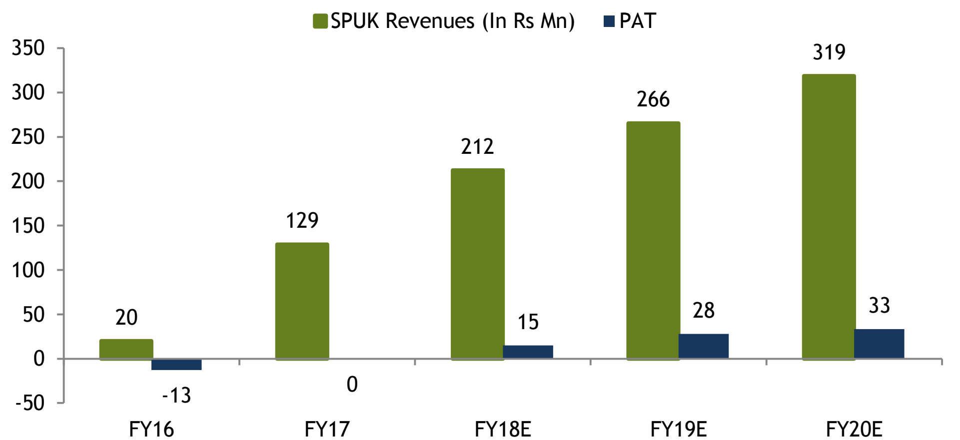
Source: RHP, Equirus Securities

Wholly-owned subsidiary SPUK to complement growth

Incorporated in 2014, SP Apparels (UK) Ltd. (SPUK) - 100% subsidiary of SPAL - is in the business of trading and marketing activities with new customers in UK, Ireland and other EU countries. It acts as a bridge between the sourcing and manufacturing sides with specific requirements. It also takes up orders not fulfilled by SPAL due to small volumes and places it with third parties. SPUK has a design studio and hired experienced designer consultants for its customers. It also provides after sales service for any technical and other grievances.

With long-term relationships with existing clients, new client addition (added Landmark, BHS International and Peacock in Q1FY18 and 2-3 additional customers in pipeline) strong technical and designing capabilities and a growing business, SPUK is expected to contribute meaningfully to SPAL's topline in the next few years. SPUK revenues have grown from GBP 0.2mn (~Rs 19mn) in FY16 to GBP 1.47mn (~Rs 129mn) in FY17 and Rs 165mn in H1FY18. SPUK also achieved PAT-level breakeven in FY17 vs. losses of Rs 1.6mn in FY16. We expect revenues from SPUK to grow at 35% CAGR over FY17-FY20E off a very small base to Rs 319mn in FY20E. PAT is set to grow to Rs 33.5mn in FY20.

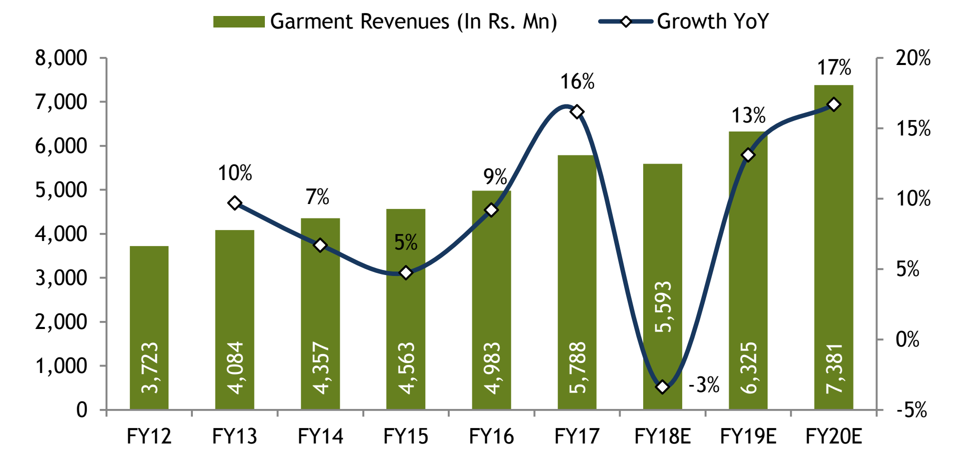
Exhibit 18: SPUK's H1FY18 revenues ~28% higher than FY17 revenues; PAT-level breakeven attained in FY17



Source: Equirus Securities, Company

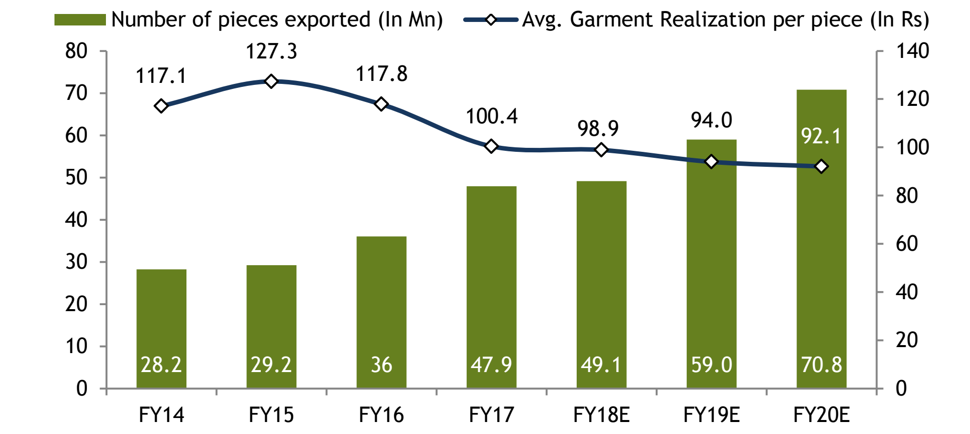
With further growth from existing customers and ramp-up in newly-added customers backed by incremental capacity addition, we expect overall garment revenues to grow at 8% CAGR over FY17-FY20E to Rs 7.4bn. While revenues from TESCO, ASDA and others will continue to grow at a healthy pace, strong growth in business from Primark along with a pick-up in order flows from new customers would shore up SPAL's topline.

Exhibit 19: Expect garment revenues to grow at 8% CAGR over FY17-FY20E



Source: Equirus Securities, Company

Exhibit 20: Scaling up to increase quantity exported; high basics to hit realizations



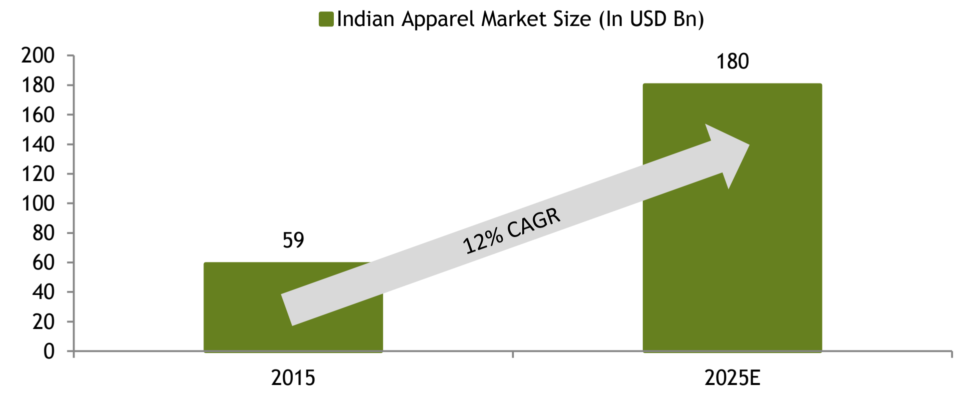
Source: Equirus Securities

Increasing presence across retail formats

Menswear major contributor to growing Indian apparel market

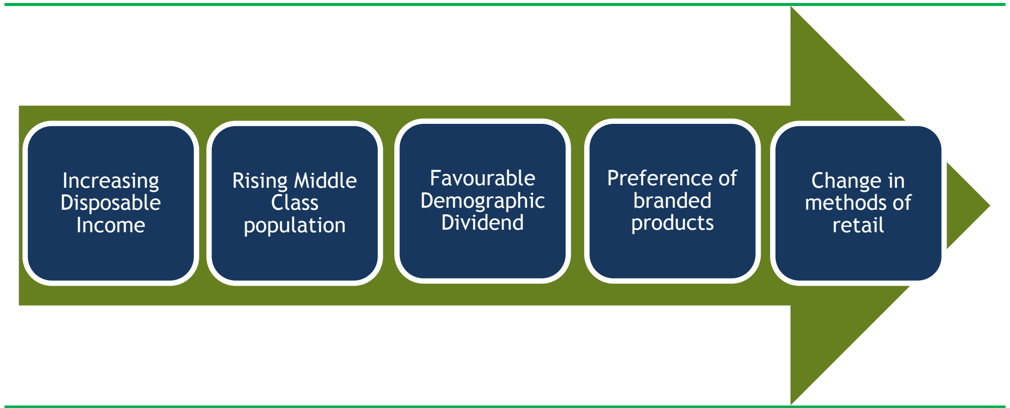
India's total apparel market size in 2015 was US$ 59bn and is set to reach US$180bn in 2025, representing a 12% CAGR over 2015-25E. While the Indian Apparel Market is the fourth largest in the world (considering EU-28 as one) after EU-28, US, China and Japan, it is almost one-fifth in size of USA and one-fourth of China's apparel market.

Exhibit 21: Indian apparel market to grow at 12% CAGR over FY15-FY25E



Source: Wazir Analysis, Equirus Securities

Exhibit 22: Indian apparel market - Key growth drivers

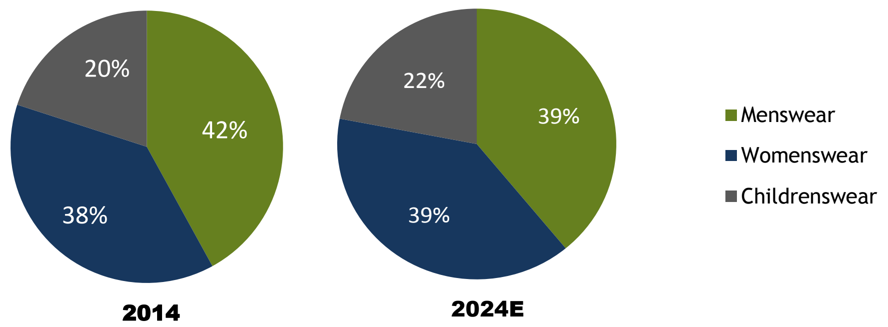


Source: Equirus Securities

While developed nations remain important centers from an overall apparel consumption perspective, developing countries like India will see almost a 2-3x jump in the per capita expenditure on apparels which currently is very low vis-à-vis developed nations. US per capita spend on apparels in 2015 stood at US$ 978 versus just US$ 45 for India. With all growth drivers in place, India's per capita expenditure on apparels is set to touch US$123 in 2025E and should significantly benefit domestic apparel manufacturers like SPAL.

Menswear segment has been the largest contributor to India's total apparel market with a share of 42% in 2014, followed by womenswear and childrenswear at 38% and 20% respectively. While the menswear market would continue dominating the market in 2024E, increased penetration in womenswear and childrenswear brands would push down menswear contribution to 39%. Accordingly, the menswear market is expected to grow from ~US$ 25bn in FY14 to ~US$ 70bn in FY24, an 11% CAGR over FY14-FY24E.

Exhibit 23: Menswear segment contribution to dip marginally on growing penetration of womenswear and childrenswear



Source: Technopak Analysis, Equirus Securities

Brand preference in the Indian menswear market has been higher than that for womenswear and childrenswear owing to the long presence of various brands in the market and a higher skew towards western clothing. Also, the Indian menswear consumer is increasingly factoring in parameters like quality, design and style consciousness, fit and size specification. Consequently, demand for private labels and regional branded apparels that offer value for money has been increasing over the years.

SPAL, through its subsidiary, Crocodile Products Private Limited (CPPL), a JV between SPAL (70% share) and Crocodile International Pte. Ltd. (CIPL; 30% share) is in the business of manufacturing and retailing menswear garments under the *Crocodile* brand. CPPL has entered into a technology license agreement with CIPL for the exclusive manufacture, distribution and marketing of menswear products under the trademark *Crocodile* in India.

Exhibit 24: Crocodile Retail outlet

Source: Equirus Securities

Under the *Crocodile* brand, SPAL operates in two models (a) B2C retail segment where it sells men's shirts, polo, t-shirts, trousers, jeans, sweaters, jackets, and (b) B2B essentials segment where it sells men's innerwear products like vests, briefs and boxer shorts. B2C products are sold through EBOs - COCO (Company-Owned Company-Operated) and FOFO (Franchise-Own Franchise-Operated) outlets and large format outlets (LFS) like Arvind Unlimited and Central and Reliance Market. On the other hand, B2B products are sold through 85 distributors and ~4,200 Multi-Brand Outlets (MBO).

Exhibit 25: Increased focus, aggressive outlet expansion to drive retail revenue growth

Retail Network	Sep-17
EBOs- COCO	35
EBOs- FOFO	12
MBOs	4,200
LFS	172
No of States	9
Outlet size (Sq. Ft)	400-1500

Source: Company, Equirus Securities

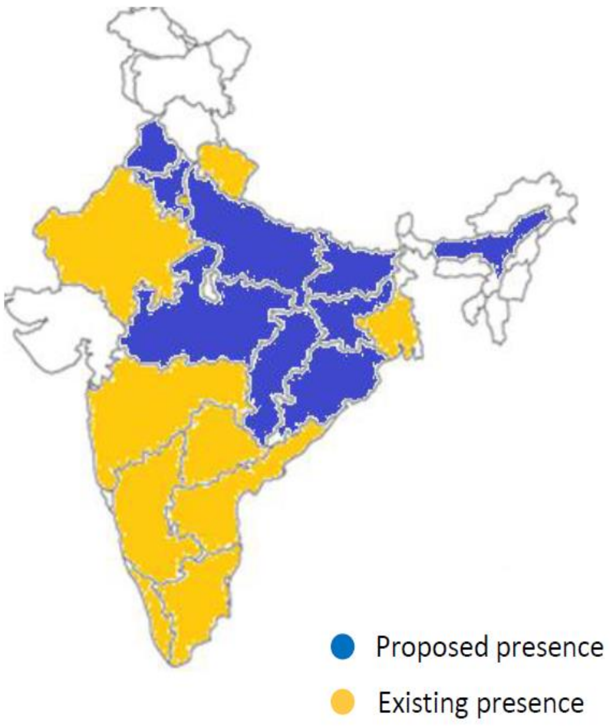
Most of SPAL's outlets are in South India, mainly due to the company's operations in the region. However going ahead, it plans to aggressively enhance in central and northeast India by opening new outlets, thus expanding its presence from nine states currently to 18 states over the next three years. SPAL has already set aside Rs 280mn as capex requirement for this expansion from its IPO proceeds.

Retail expansion to take place through LFS and MBO channels

As part of its strategy to increase the brand presence of *Crocodile*, the company has planned to expand B2C sales through the LFS route mainly due to (a) better penetration in a short period of time, (b) higher walk-ins right from day one, and (c) shorter breakeven period as compared to COCO outlets and (d) lower investment requirements. While the company will continue to open COCO outlets at a gradual pace, focus would be to open more LFS outlets going ahead. In addition to the existing 172 LFS outlets as of Sep'17, another 140 outlets are expected to be added over the next three years, taking the total count to ~300 outlets. Additionally, the company's endeavor would be to open more franchise outlets while gradually converting existing COCO outlets to FOFO outlets.

On the Essentials front, addition of MBO outlets along with an increase in the number of distributors across India would boost B2B revenues.

Exhibit 26: Aggressive expansion in central and northeast India to boost retail topline

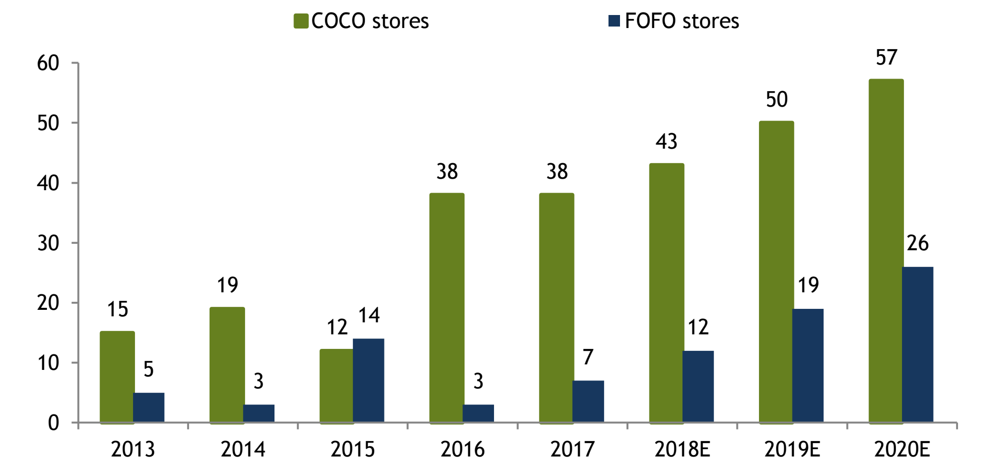


Source: Equirus Securities

Exhibit 27:Presence in most major LFS and e-commerce platforms

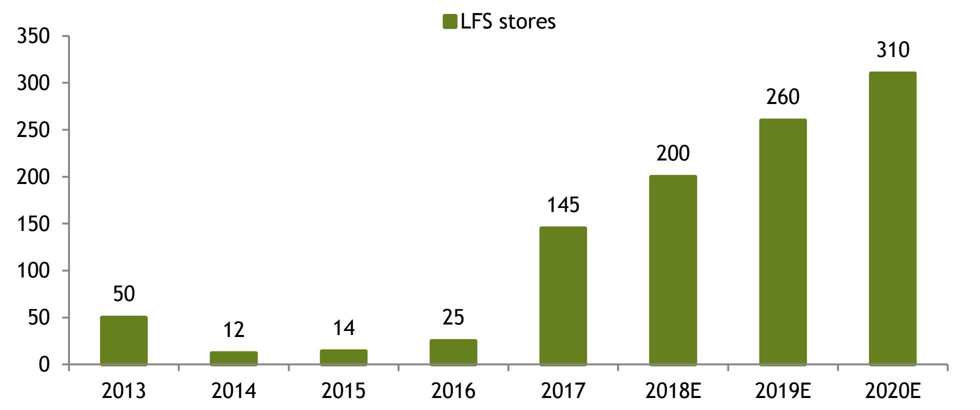
Source: Equirus Securities

Exhibit 28: New COCO and FOFO outlet additions to enhance brand presence



Source: Equirus Securities

Exhibit 29:Rigorous addition of LFS outlets to provide strong boost to retail revenues

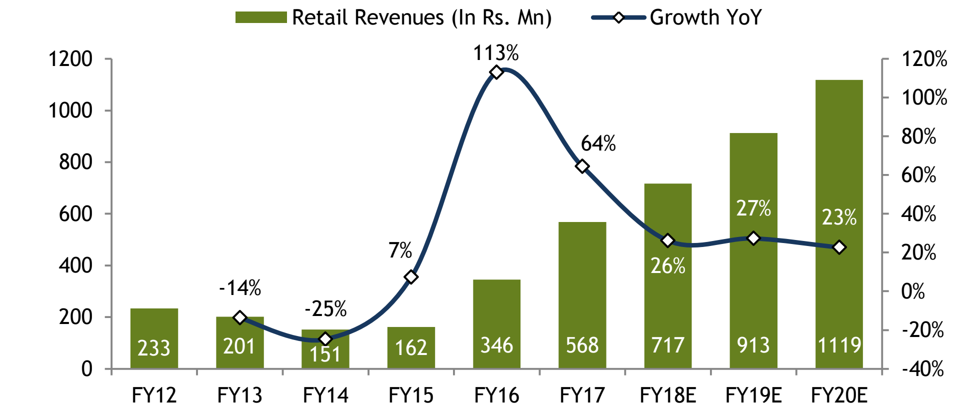


Source: Equirus Securities

Low base + higher focus + rigorous expansion = strong retail revenue growth

High debt and capacity constraints refrained SPAL to undertake extensive retail expansion; consequently, management focused on increasing garment revenues while gradually reducing debt. However post IPO, greater capacity along with lower debt levels allowed the management to pursue expansion of all retail channels - EBOs, MBOs, and LFS. With the drafted expansion plan, we expect retail revenues to grow at a 25% CAGR off a smaller base over FY17-FY20E.

Exhibit 30: Retail revenues to grow at 25% CAGR over FY17-FY20E



Source: Equirus Securities, Company

SPAL's post-IPO backward integration -Knitting the right strategy

Pre-IPO blues: Financial crises curbs capex in FY11-FY15; poor servicing capabilities lead to client attrition

During the financial crisis of 2007-08, SPAL was involved in hedging activities and booked losses of ~Rs 850mn. To recover the losses, company sold off its windmill assets (Rs 200-250mn) and promoters provided a loan of Rs 200mn to the company; while the remaining losses were made up from internal accruals over a period of time. A strained balance sheet with high leverage levels restricted expansion, which in turn limited new customer additions. Inadequate capacities amid robust demand conditions restricted revenue growth to just 6.5% CAGR over FY11-FY15.

Most of SPAL's customers were international retail chains following stringent quality norms and demanded dedicated capacity requirements. Since this became increasingly difficult for the company, it stopped servicing some of its customers and narrowed its focus to a few customers so as to leverage them while increasing their wallet share. Focusing on fewer clients implied meeting lower compliance requirements along with effective capacity allocation, thus ensuring they are serviced efficiently.

Post-IPO vertically integrated production to boost margins

One of the important objectives for going public, apart from paying off debt, was to carry out backward integration and make the production process vertically integrated. This would not only make them highly competitive but also reduce their dependence on third parties.

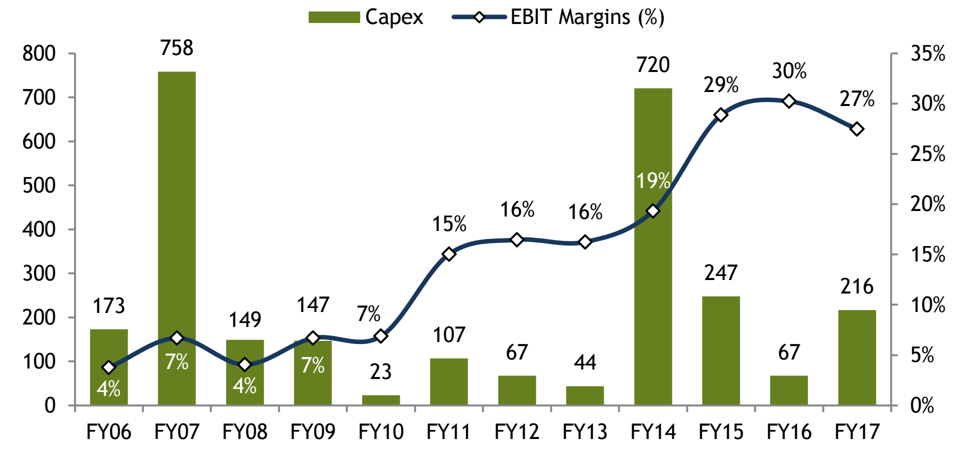
a. Backward integration

A total of Rs 750mn from IPO funds were targeted towards the entire backward integration; of this, ~Rs 200mn have been already utilized as of Sep'17 in adding spinning machines, expanding the blow-room capacity, adding new knitting machines and adding balancing machines for the dyeing facility. A major portion of the remaining amount would be invested in expansion of the spinning capacity (increasing number of spindles to 22,720 by FY19-end), adding knitting and dyeing machines, and towards new building construction for sewing machines at Valapady.

The backward integration process will make SPAL a fully vertically integrated player with presence in entire textile production chain, giving it significant operating leverage to deal with large customers. Vertical integration would not only enhance control over the manufacturing process but also increase operating efficiencies and ability to meet stringent customer requirements. The entire exercise of backward integration (projected to complete by FY19-end) would add ~3-5% to margins as the company would benefit in the form of:

- Lower spinning costs due to complete manufacturing of required yarn in-house.
- Decline in knitting costs as knitting was entirely outsourced earlier.
- Addition of sewing capacities.

Exhibit 31: Kitex's backward integration/expansion in FY07/FY14 boosted margins in ensuing years



Source: Equirus Securities

Kitex Garments embarked on a capex of a similar magnitude towards backward integration and expansion in FY07 and FY14 (Exhibit: 31), which pushed up margins by ~10% in the ensuing years. We expect a similar kind of uptick in SPAL's margins once full benefits of backward integration flow to the bottom-line.

b. Shift from fashion to basic products to improve utilization levels

Most of SPAL's customers dealt in fashion products and hence placed orders for fashion childrenswear garments. Exhibit 32 outlines the per unit realization of SPAL's customers. TESCO and ASDA have been the company's largest customers with per unit realization of Rs 140-150/piece; other major customers also fetched similar realizations. Manufacturing of fashion garments resulted in low machine utilization (~75-80% in FY17).

Exhibit 32: Realization per piece of customers of SPAL

Customers	Realization per piece (In Rs.)
TESCO	140-150
ASDA	140-150
Mothercare	130-135
Dunnes Stores	135-140
Primark	50-60
Garan Inc*	90-100
K-Mart*	60-70
Kiabi (Not added yet)	140-150

Source: Company, Equirus Securities (*) New customers

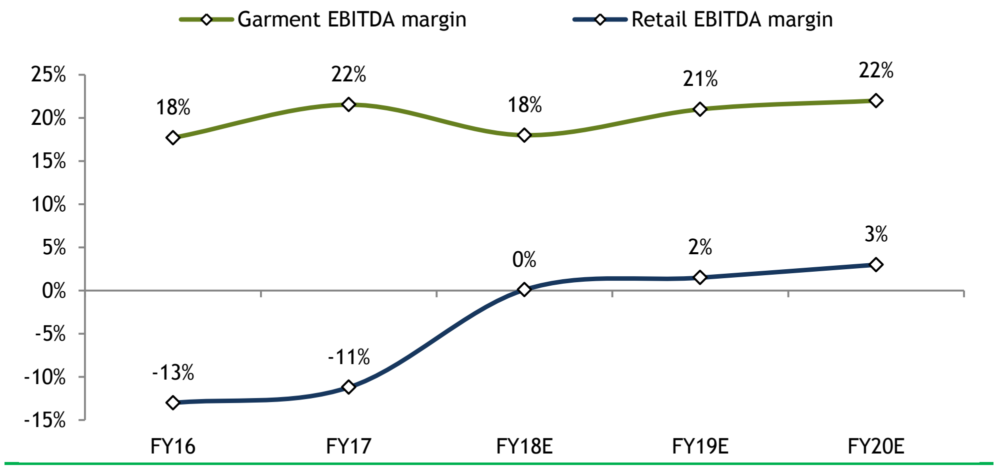
With the share of Primark, which is into basic garments, growing in SPAL's overall business, management has decided to gradually increase the share of basic garments in its portfolio. Additionally, new customers that were added in FY17-FY18E were also medium fashion customers.

Management's conscious decision to increase the share of basic garments will lead to:

1. **Increase in capacity utilization**: As the batch size of basic garments will be larger than fashion garments, machine productivity would increase as they would run for more time with minimal breaks; this in turn would enhance capacity utilization.
2. **Benefits of scale**: Unlike fashion garments where per unit cost is high due to a small batch size (25K-50K pieces per batch), basic garments have large batch sizes (>1 lakh pieces per batch), resulting in lower per unit costs.
3. **Better labor productivity**: With the share of basic garments in total mix increasing, labor productivity would increase as constantly difficult designs hurt productivity.

The split between fashion and basic garments, earlier in the favor of fashion at 70:30, has currently reduced to 60:40 and would further go down to 50:50. A higher share of basic garments would improve machine utilization levels from 70-75% currently to ~90% in the next 2-3 years.

Exhibit 33: Garment margins to decline on Brexit impact; retail to break even in FY18, FY19E to see margin expansion



Source: Equirus Securities, Company

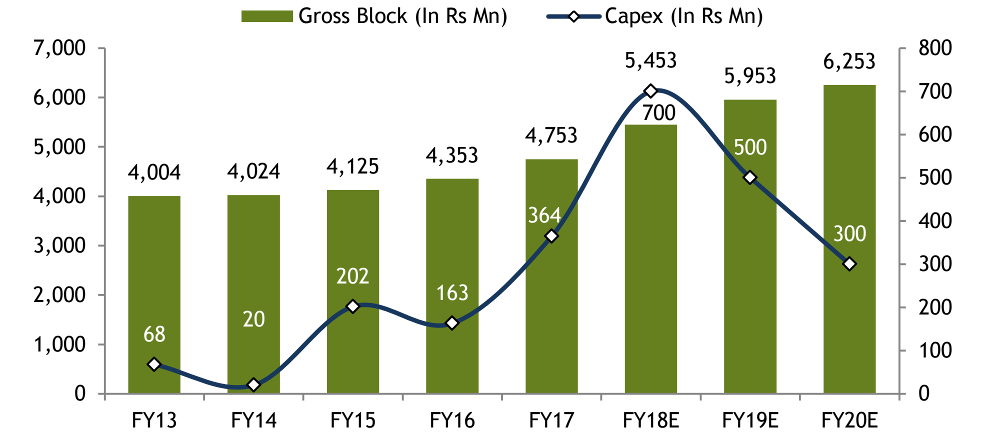
Garment margins jumped by 380bps in FY17 led by increased efficiencies, mainly due to expansion and modernization activities carried out by the company. While operating efficiencies would continue to accrue as full benefits of expansion are yet to be realized, FY18 is likely to see a marginal decline in garment margins due to unfavorable currency, the Brexit impact and a change in the duty drawback structure.

We however expect garment margins to expand ~400bps to 22% over FY18-FY20 led by strong operating and processing efficiencies. The retail segment, which incurred losses in FY16 and FY17, attained breakeven in 2QFY18 led by lower per unit costs and strong growth in LFS sales. We expect retail margins to touch 3% in FY20, a ~300bps expansion over FY18-FY20E, on rigorous outlets expansion plans and strong revenue growth.

Expect to generate ~Rs 1.4bn FCFF generation over next 3 years

In Dec'07, SPAL acquired Sri Balaji Bakiam Spinning Mill at Valapady, which had a capacity of 12,672 spindles, for a consideration of Rs 260mn funded by a mix of internal accruals and debt. Post the acquisition, the company has added only ~4,300 spindles over the last 10 years. Historically, SPAL's capex for capacity addition has been quite low constrained by heavy debt and shortage of free cash flows. However, the IPO funds (~Rs 2.15bn) enabled the company to pay off its long-term debt (~Rs 630mn) and accumulated funds for its much needed expansion & modernization (~Rs 750mn) and retail outlet expansion (~Rs 280mn).

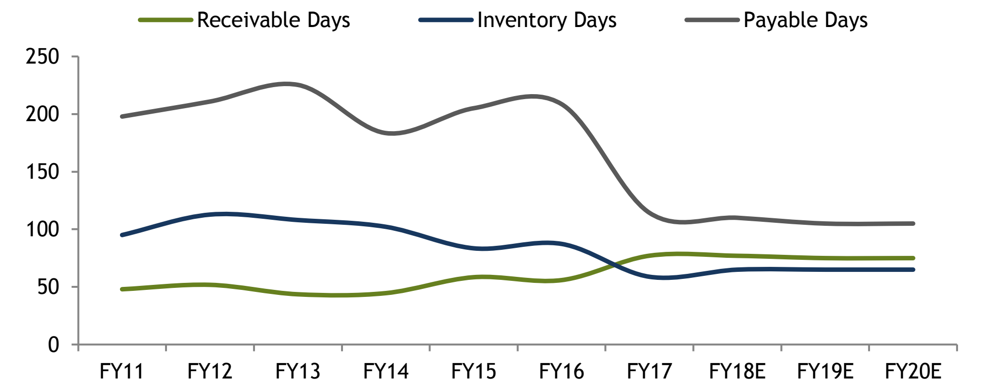
Exhibit 34: Minimal increase in gross block over FY13-FY16, but things looking up post the 2016 IPO



Source: Equirus Securities, Company

Backward integration would reduce dependence on third parties in terms of raw material procurement and yarn processing, resulting in tight control over working capital. In-house manufacturing would lead to a sharp reduction in payable days and increase inventory days. Receivable days could increase marginally due to a higher share of retail in the total sales mix. While WC days could inch up because of this, things should stabilize once the backward integration exercise is complete.

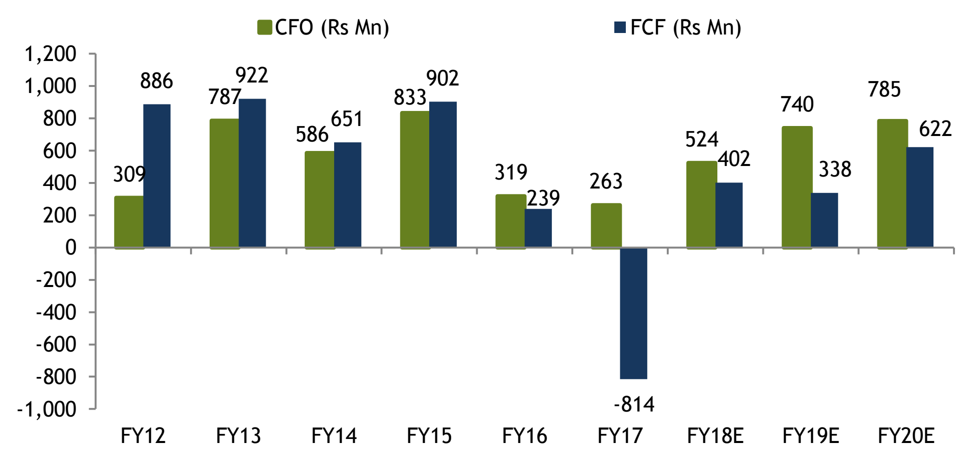
Exhibit 35: Payable days to decline on increase in in-house manufacturing; receivable days to increase on a higher retail share in the total mix



Source: Company, Equirus Securities

The entire backward process will generate strong cash flows from savings in interest costs, topline growth and margin expansion. Between FY15-FY17, SPAL generated OCF of ~Rs 1.4bn, which is expected to touch ~Rs 2bn over FY18-20E. While cash outflow in terms of capacity expansion and new retail outlet addition will continue in the future, IPO funded capex, a 10% revenue CAGR and a ~260bps margin expansion over FY17-20E would help SPAL generate ~Rs 1.4bn of FCF over the next three years.

Exhibit 36: OCF to rise, leading to FCF generation of ~Rs 1.4bn over next 3 years



Source: Equirus Securities

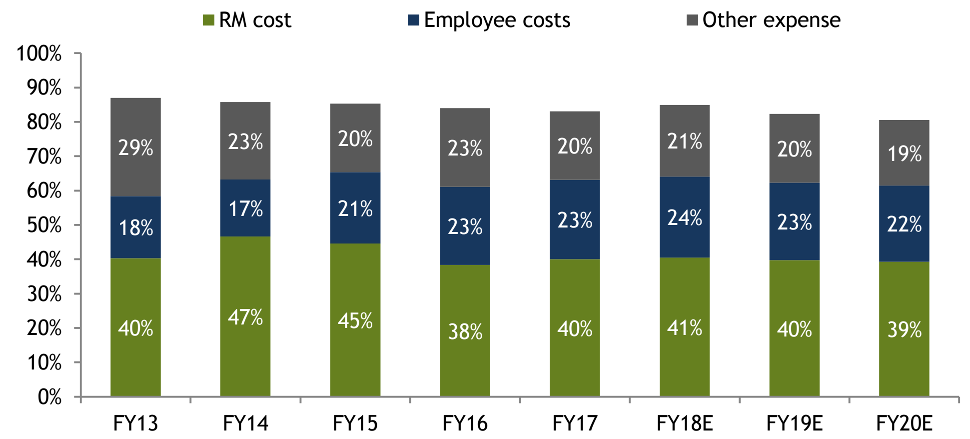
RM costs, overheads to decline; profitability, margins to improve

Proximity of sewing capacities to laborers ensures low attrition rate

Garment manufacturing is a labor-intensive industry. Give the high proportion of women laborers, the attrition rate is also very high. SPAL currently has 23 manufacturing facilities located within ~125kms radius of its main office. The company has arranged sewing capacities closer to the homes of laborers as majority of them are housewives. This gives them flexibility to manage full-time responsibilities at work and home. Consequently, the company's attrition rate is very low, thus lowering the T&D expenses and retention of highly efficient laborers.

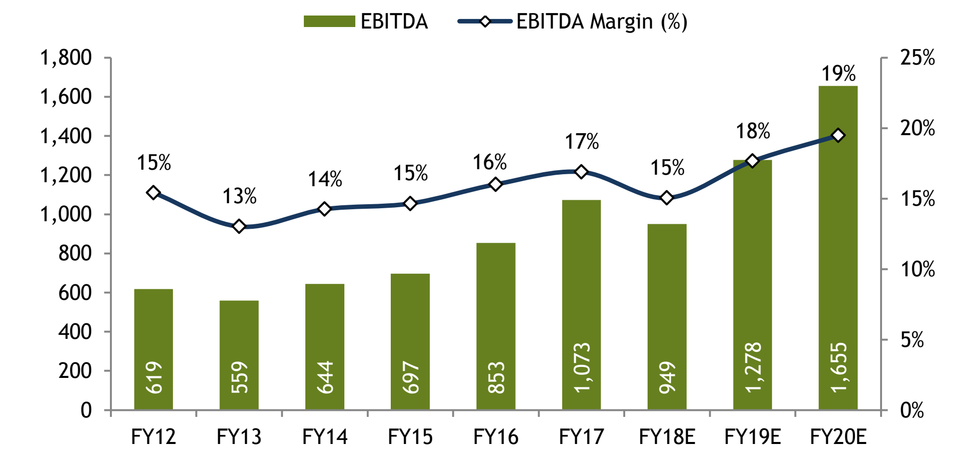
However, other machines for spinning, printing and dyeing are placed at a single location, resulting in significant savings in production, labor and transportation costs. While RM costs will decline on backward integration benefits; employee costs and other expenses (as a percentage of sales) would dip on scaling benefits.

Exhibit 37: RM costs, employee costs and other expenses to dip on scaling benefits



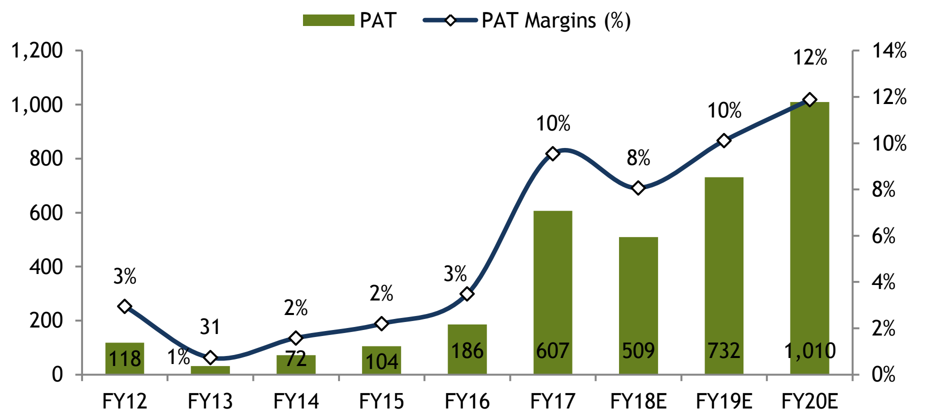
Source: Company, Equirus Securities

Exhibit 38:EBITDA to grow at 16% CAGR with ~260bps margin expansion over FY17-20E



Source: Equirus Securities

Exhibit 39: PAT to grow at 18% CAGR with ~200bps margin expansion over FY17-20E



Source: Equirus Securities

Lower rebates offset backward integration gains in FY18; FY19 to be better

In the pre-GST regime, SPAL received a total of 10.5-11% rebate on garment exports, which included a ~7.7% duty drawback and 3.05% Rebate On State Levies (ROSL). Post GST, the duty drawback rate has been reduced to 2% while ROSL to 0.39% (final notification pending). Against this, the company will be able to take an input tax credit of ~5% on procured raw materials, effectively leading to a ~3% impact on margins. We expect this margin impact to be offset by backward integration benefits gradually flowing in, leading to flat margins in FY18. SPAL would fully pass-on the impact of duty drawback to customers in a few months as they are already struggling due to currency depreciation.

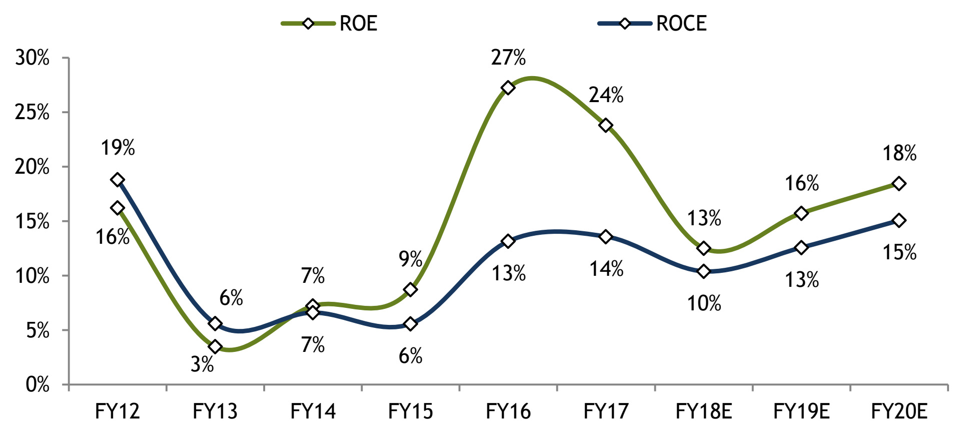
FY19 margins are expected to be much better as (b) backward integration benefits will fully accrue to the company, and (b) new orders will be based on adjusted drawback rates and desired margin levels.

ROE/ROCE to expand by ~300bps in FY19 after declining in FY18

Over FY13-FY15, SPAL's return ratios remained in single digits due to low margins and high interest expenses. In the last two years, return ratios have improved significantly due to strong operating profit growth and falling interest costs. SPAL's ROE/ROCE is expected to decline in FY18 due to challenging demand conditions (affected by Brexit).

However, return ratios should pick up again from FY19 on the back of strong operating efficiencies due to backward integration, new orders taken in line with the new duty drawback structure, strong retail sales growth and no long-term debt on books. We expect SPAL's ROE/ROCE to reach 18%/15% in FY20E.

Exhibit 40:Return ratios to improve by ~300bps in FY19 post declining in FY18



Source: Equirus Securities

Forecast & key assumptions

- Garment revenues to grow at 8% CAGR over FY17-FY20E with margins expanding to ~22% in FY20. FY18 to see a marginal dip in margins on forex losses and Brexit impact.
- Retail revenues to grow strongly at ~25% CAGR over FY17-FY20E with expected breakeven in FY18E and margins expanding to ~2% in FY20.
- SPUK revenues to see strong growth off a smaller base, but significant contribution to SPAL's topline and bottom-line still a while away.
- Entire backward integration process is expected to complete in FY18, with benefits likely to flow in from FY19 onwards. Expansion activities to continue in FY19 and FY20 as well.
- Debt reduction and backward integration will boost margins. Expect EBITDA/PAT to grow at CAGR of 16%/18% over FY17-20E.

Exhibit 41:Key Assumptions

Particulars	FY17	FY18E	FY19E	FY20E
Garment Revenues (In Rs Mn)	5,955	5,754	6,507	7,594
YoY Growth	19%	-3%	13%	17%
Retail Revenues (In Rs Mn)	568	717	913	1,119
YoY Growth	64%	26%	30%	20%
Number of pieces exported	47.9	49.1	59.0	70.8
Export Realization per piece (Rs)	100	99	94	92
No of retail outlets				
COCO	38	43	50	57
FOFO	16	25	40	55
LFS	85	130	194	266
MBO outlets	4,000	4,200	4,500	4,800

Source: Equirus Securities

Investment risk & concerns

Forex volatility: SPAL's revenues are generated in USD/Pound/Euro, which constitute ~50%/28%/22% of the revenue mix. The company hedges ~60% of the order value at the time of receiving the order, 20% at the time of shipment while the balance 20% is kept open. While sharp currency movements can lead to renegotiation in the terms of the contract, small movements have to be borne by the company itself. Hence, high currency volatility will hit revenues and margins.

Customer concentration: Till FY17, SPAL had only five major customers that contributed ~98% of its garment revenues. A slowdown in any major customer significantly affects SPAL's garment revenues. Such high concentration stems from the company's strategy to focus on the top-few, most-profitable customers due to capacity constraints. However, post IPO and subsequent capacity addition, SPAL is adding more customers to diversify its revenues and limit exposure to a single currency. The company has added three more customers in FY17 while two more customers are in the pipeline. However, since new customers would take some time to scale up, the customer concentration risk will persist for some time.

Slowdown in UK market: Demand from the UK and other related markets spiraled down due to Brexit impact in FY17, significantly impacting the company's performance in H1FY18. We expect this slowdown to hurt SPAL's H2FY18 also. However, continued slowdown in FY19 can severely affect the company's growth trajectory.

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.

Corporate Governance

Key highlights on corporate governance based on SPAL's recent Annual Reports:

- Company accounts were audited by M/s. Deloitte Haskins & Sells, CA, for a period of five years ending FY17. From FY18, SPAL has appointed M/s. ASA & Associates LLP, CA for a period of five years. The reports and findings of the Internal Auditor and the internal control system are periodically reviewed.

- SPALs Board of Directors has an optimum combination of Executive, Non-Executive and Independent Directors, including women directors. The Board comprises three whole-time directors (the Managing Director and two Executive Directors), one Non-Executive Director and four Independent Directors. Except for the Non-executive Director, all other directors (including MD) are liable to retire by rotation.

- SPAL has not paid any dividend till FY16 due to heavy debt and expansion plans. It paid a dividend of 30 paise for full year FY17 with a dividend payout ratio of 5%.

Competitor Analysis

Kitex Garments - The closest rival

Profile: Kochi-based Kitex Garments manufactures and sells infantwear and childrenswear garments, which includes sleep suits, t-shirts, pants, hosiery, innerwear and outerwear for infants. Kitex is the largest childrenswear exporter of India with a production capacity of 165mn pieces per annum, followed by SPAL with a production capacity of 51mn pieces. Some other private players that compete with SPAL are Jay Mills Pvt. Ltd. and Eastman Exports Pvt. Ltd.

Kitex Garments mainly sells basic garments and operates in bulk quantities only (>100,000 pieces). Against this, SPAL is mainly present in fashion garments where the production time is much higher and batch sizes are smaller (20,000-50,000 pieces). Per unit realization of Kitex Garments stands at ~Rs 80-90 while that for SPAL at ~Rs 100-110. SPAL is moving towards increasing the share of basic garments (at par with fashion garments) in the total mix to improve utilization levels by achieving operating efficiencies with realization per piece not falling below ~Rs 85-90.

Kitex operates in a single plant where all processing activities are carried out at one place and laborers also stay with their families in quarters. In contrast to this, SPAL operates through 23 manufacturing facilities which are located within a radius of ~125kms near Tirupur, India's leading textile hub, and close to families of laborers. This not only results in significant savings in production, labor and transportation costs but also reduces the attrition rate - a key industry concern.

Exhibit 42: SPAL & Kitex Garments - Financial comparison

	SP Apparels			Kitex Garments		
Rs Mn	FY15	FY16	FY17	FY15	FY16	FY17
Revenue	4,758	5,328	6,357	5,111	5,458	5,459
Growth	5%	12%	19%	16%	7%	0%
Exports (In Mn Pieces)*	29	36	48	-	-	-
Realization per piece*	127	118	100	-	-	-
EBITDA	697	853	1,073	1,688	1,863	1,703
EBITDAM	14.6%	16.0%	16.9%	33.0%	34.1%	31.2%
Depreciation	197	201	208	213	213	204
EBIT	500	652	866	1,474	1,650	1,500
PAT	104	354	607	985	1121	925
PATM	2%	7%	10%	19%	21%	17%
Net Working Capital	852	1,061	1,873	536	653	1,551
NWC Turns	5.6	5.0	3.4	9.5	8.4	3.5
Fixed Assets	2,685	2,711	2,912	1,882	1,730	1,615
FA Turns	1.7	2.0	2.3	2.7	3.2	3.4
Capital Employed	4,158	4,272	5,949	4,509	5,027	4,890
Capital Employed Turns	1.14	1.25	1.07	1.13	1.09	1.12
Pre-tax RoCE	12%	15%	15%	33%	33%	31%

Source: Equirus Securities, (*): Kitex has stopped giving their volume figures

Exhibit 43:Peer set - comparative analysis

Company	Production Capacity (In mn pieces)	FY17 Revenue (In Rs mn)	Key Markets	Key Clients
SP Apparels	51	6,357	Europe & Unites States	TESCO, ASDA, Primark, Mothercare, Dunnes Outlets
Kitex Garments	165	5,459	Unites States	Gerber, Walmart, Amazon, Buy-Buy Baby, Children's Place, Kohl's, Toys R Us, Carter's, Mothercare, Target.
Jay Mills (Pvt) Ltd.	NA	4,971 (FY16)	UK, US, Brazil, France, Sweden	Kappahl Outlets-Sweden, Dunnes Outlets-Ireland, Gerber Childrenswear-US, Mother Care-UK
Eastman Exports (Pvt) Ltd.	NA	12,286 (FY16)	US, Europe, Mexico, Brazil, Hong Kong, Korea, Japan, South Africa, Australia	Guru, Esprit, Fila, Timberland, Mexx, Base London, Nike, Calvin Klein, sOliver, Tom Tailor, Vetir. U.S. – Tommy Hilfiger, Caribbean Joe, Abercrombie & Fitch, Kappa, Coogi

Source: Equirus Securities

Topline trends: While SPAL has emerged strong with revenues growing at 16% CAGR over FY15-17 backed by business expansion from existing customers, Kitex struggled to expand its revenues which grew by a meager 3% CAGR over FY15-FY17 due to delayed dispatches, forex fluctuations, exit of a major customer, and a delay in pickup of its brands.

Margin profile: SPAL's margins profile has been quite weak vis-à-vis Kitex Garments due to lack of fully integrated production activities (leading to high dependence on third parties) and capacity constraints which restricted them to expand revenues and thus reduce per unit costs. Moreover, SPAL's production costs were higher due to presence in the fashion segment (leading to low machine utilization) and hiring of specialized employees. Along with this, high interest payments resulted in low profit margins. In contrast to this, Kitex operates in the basic segment with high level of automation; this along with a debt-free B/S enabled the company to maintain high margin levels. SPAL, with its IPO proceeds, has not only paid off its debt but also has invested heavily in fully integrating its production chain and expanding capacities. This should push down its production costs and improve its margins.

Working capital: SPAL's working capital turns have historically been quite low as compared to Kitex, mainly due to high production time required for fashion garments vis-à-vis basic garments for Kitex which consequently has lower working capital turns. Moreover, outsourcing to third parties also added to the production time. With an increase in the revenue share of basic garments along with fully integrated production, net working capital turns are set to rise in future.

Return ratios: Despite strong customer demand, SPAL could not scale up volumes mainly due to bottlenecks with existing machines and capacity and serviceability constraints. This did not allow effective utilization of the installed capacity. But post payment of long term debt and expansion and modernization carried, SPAL's return ratios are set to improve.

Valuation

Initiate with a Jun'19 TP of Rs 541 based on 17x Jun'19 EPS of Rs 32

- We expect SPAL's future to be significantly different from its past which was marred by high debt, capacity constraints and a concentrated customer base.

- We initiate coverage on the stock with a P/E based Jun'19 TP of Rs 541 based on 17x Jun'19 EPS of Rs 32/share. We believe valuations are justified as (1) the full benefits of backward integration are yet to flow to the bottom-line, (2) capacity expansion will allow existing customers to grow their business with SPAL, (3) new customer additions and their gradual scale-up will ensure effective capacity utilization, (4) retail revenue growth fuelled by retail outlet expansion and a rise in profitability.

Exhibit 44: Peer Valuation

Particulars		SP Apparels	Kitex Garments
P/E	FY17	17	23
	FY18E	20	21
	FY19E	14	18
P/B	FY17	2.7	4.7
	FY18E	2.4	4.0
	FY19E	2.1	3.3
EV/EBITDA	FY17	10.7	11.9
	FY18E	11.8	10.9
	FY19E	8.6	9.0
ROE (%)	FY17	24%	22%
	FY18E	13%	20%
	FY19E	16%	21%

Source: Equirus Securities

- With 12% revenue CAGR over FY12-FY17, a strong margin profile (EBITDAM at 30-32% and PATM at 17-20%), robust return ratios with ROEs/ROCEs at 22%/32% in FY17, Kitex currently trades at 18x FY19E EPS. SPAL, on the other hand, is yet to see strong revenue growth which in turn will improve its margin profile (EBITDAM expansion of ~260bps over FY17-FY20 next 3 years) and boost in return ratios (~300bps core ROIC expansion over next 3 years). At a CMP of Rs 410, SPAL currently trades at 14x FY19E EPS.

Exhibit 45:TTM P/E vs. 2 year forward EPS Growth

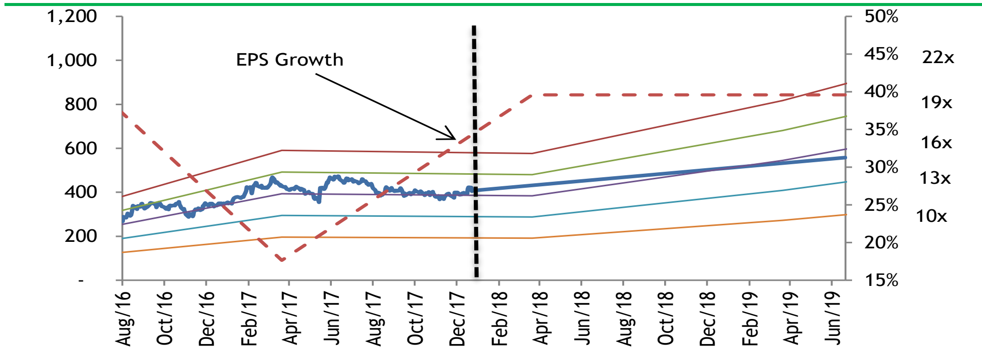


Exhibit 46:TTM EV/EBITDA vs. 2 year forward EBITDA Growth

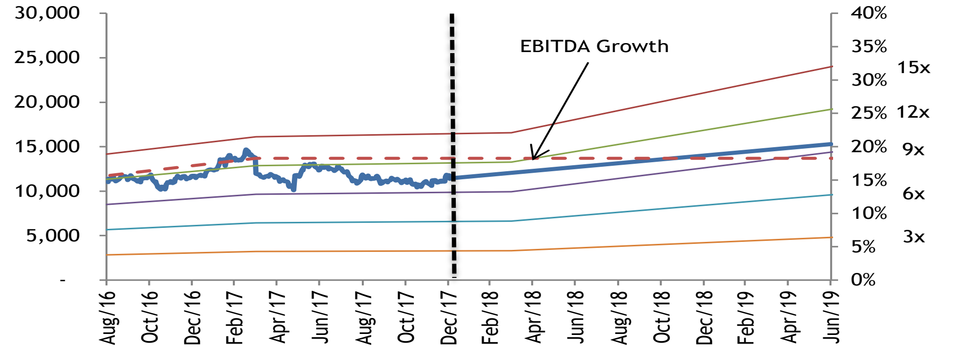
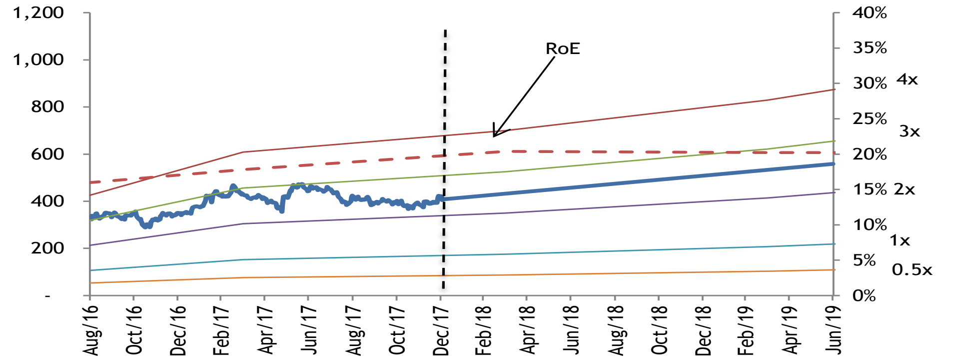


Exhibit 47:TTM P/B vs. 2 year forward RoE



Source: Equirus Securities

Annexure 1: Company Overview

SPAL is one of India's leading manufacturers and exporters of knitted garments for infants and children. It provides end-to-end garment manufacturing from greige fabric to finished products, including body suits, sleep-suits, tops and bottoms. It is also the sub-licensee to manufacture, distribute and market adult menswear products in India under the *Crocodile* brand. Its business majorly comes from five big customers namely TESCO, ASDA, Primark, Mother Care, Dunes outlets. It recently added three customers to its client portfolio - Garan Inc., K-Mart and Kiabi.

SPAL utilized its IPO proceeds to pay off its debt and carry out its expansion and modernization activities, a key constraining factor in its revenues growth. With minimal debt, expanded capacity and fully integrated production process, SPAL will receive a significant boost to its topline as well as bottom-line.

S.P. Apparels has two subsidiaries, viz. Crocodile Products Pvt Ltd. (CPPL) and S.P. Apparels (UK) (P) Ltd. (SPUK). CPPL is engaged in the business of establishing and managing units to manufacture, trade, deal, import and export garments and to enter into JV agreements with CIPL for manufacturing and marketing products under the trade mark *Crocodile*. About 70% of CPPL is owned by SPAL while the remaining 30% by Crocodile International Pte. Ltd.

SPUK is a 100% subsidiary of SPAL and engaged in trading activities with new customers in 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 customers for any technical and other grievance.

Exhibit 48:SPAL's journey over various phases

1989-2003 Bootstrap Phase

- 1989: Starts operations as a partnership firm
- 1998: Sets up manufacturing facility at Neelambur
- 2003: Sets up first house embroidery facility at Thekkalur

2004-2008 Expansion Phase

- 2004: Sets up flagship factory at Avinashi
- 2005: Commissions dyeing plant at Perundarai
- 2006: Invests in JV company for manufacturing of *Crocodile* brand
- 2007-08: Ammalgamation with Sri Balaji Bakkiam Spinning Mills

2008-2015 Consolidation Phase

- 2008-13: Streamlines operations to integrate factories, increase efficiencies and increase backward integration
- 2014: Incorporates SPUK to cater to increasing integration, get a closer-to-client presence, and develop new relationships

2016-2018 Growth Phase

- 2016: Lists on BSE/NSE; repayment of loans to reduce leverage
- 2017-18: Undertakes (a) integration/expansion of manufacturing facilities to increase operational efficiency, and (b) expansion of *Crocodile* brand by setting up COCO and LFS outlets in new states and cities

Source: RHP, Equirus Securities

Key Management profile

Mr. P Sundararajan (Chairman and MD)

Mr. P. Sundararajan is SPAL's Chairman and Managing Director. He holds a Bachelor of Science degree from the Bangalore University and has ~31 years of experience in the textile and apparel industry. He is currently the managing director of Crocodile Products Private Limited and a Director of Poornam Enterprises Private Limited. He is also the managing partner of S.P. Lifestyles. He was a partner in some other partnership firms carrying on business in the purchase and sale of cloth, since 1983.

Mrs. S Latha (Executive Director)

Mrs. S. Latha is SPAL's Executive Director, and was appointed as a Non-Executive Director on 18 Nov'05. She has completed education up to higher secondary, and has ~24 years of experience in the textile and apparel industry. She is currently a Director of Crocodile Products Private Limited, and a partner in the partnership firm, S.P. Lifestyles. She was also a partner in a partnership firm carrying on business in the purchase and sale of cloth since 1991.

Mrs. P.V. Jeeva (Chief Executive Officer)

Mrs. P.V Jeeva, aged 48 years, is SPAL's Chief Executive Officer, and has been associated with the company since 1 July'86. She holds a diploma in textile processing from GRG Polytechnic College, Coimbatore, and has approximately 30 years of experience in the textile and apparel industry.

Mr. V. Shankar Ram (Chief Operating Officer)

Mr. V. Shankar Ram, aged 48 years, is SPAL's Chief Operating Officer and has been associated with the company since July 1, 2015. Mr. Shankar Ram holds a Bachelor of Commerce degree from CBM College, Bharatiyar University.

Mr. V. Balaji (Chief Financial Officer)

Mr. V. Balaji, aged 46 years, is SPAL's Chief Financial Officer, and has been associated with the company since 2 May'12. Mr. Balaji is a qualified Chartered Accountant and has 16 years of experience in the field of finance and accounts.

Consolidated Quarterly Earnings Forecast and Key Drivers

Rs in Mn	1Q17A	2Q17A	3Q17A	4Q17A	1Q18A	2Q18A	3Q18E	4Q18E	1Q19E	2Q19E	3Q19E	4Q19E	FY17A	FY18E	FY19E	FY20E
Revenue	1,622	1,670	1,482	1,581	1,506	1,661	1,577	1,565	1,809	1,809	1,809	1,809	6,357	6,310	7,238	8,500
Raw Materials Consumed	610	706	577	648	595	678	664	619	720	720	720	720	2,542	2,555	2,881	3,341
Employee Costs	369	380	347	366	384	382	357	366	407	407	407	407	1,473	1,489	1,629	1,887
Other Expenses	318	328	320	307	340	367	303	307	363	363	363	363	1,268	1,316	1,451	1,618
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
EBITDA	326	255	238	260	188	235	253	274	320	320	320	320	1,073	949	1,278	1,655
Depreciation	44	42	54	54	54	53	59	62	64	64	64	64	208	228	257	274
EBIT	281	213	184	206	134	182	194	212	255	255	255	255	866	721	1,022	1,381
Interest	67	42	31	0	67	77	21	30	37	37	37	37	135	195	147	129
Other Income	20	58	77	56	105	45	47	47	54	54	54	54	210	244	217	255
PBT	234	229	230	262	171	150	220	229	273	273	273	273	941	771	1,092	1,507
Tax	71	67	88	101	61	53	72	76	90	90	90	90	334	262	360	497
PAT bef. MI & Assoc.	163	162	142	161	110	98	147	154	183	183	183	183	607	509	732	1,010
Minority Interest	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Profit from Assoc.	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Recurring PAT	163	162	142	161	110	98	147	154	183	183	183	183	607	509	732	1,010
Extraordinaries	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Reported PAT	163	162	142	161	110	98	147	154	183	183	183	183	607	509	732	1,010
EPS (Rs)	6.49	6.43	5.63	6.40	4.39	3.88	5.85	6.11	7.27	7.27	7.27	7.27	24.60	20.22	29.07	40.12
Key Drivers																
Garment Revenues	-	-	-	-	-	-	-	-	-	-	-	-	5,754	6,507	7,594	8,515
Retail Revenues	-	-	-	-	-	-	-	-	-	-	-	-	717	913	1,119	1,343
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sequential Growth (%)																
Revenue	8 %	3 %	-11 %	7 %	-5 %	10 %	-5 %	-1 %	16 %	0 %	0 %	0 %	-	-	-	-
Raw Materials Consumed	2 %	16 %	-18 %	12 %	-8 %	14 %	-2 %	-7 %	16 %	0 %	0 %	0 %	-	-	-	-
EBITDA	75 %	-22 %	-7 %	9 %	-28 %	25 %	8 %	8 %	17 %	0 %	0 %	0 %	-	-	-	-
EBIT	110 %	-24 %	-14 %	12 %	-35 %	36 %	7 %	10 %	20 %	0 %	0 %	0 %	-	-	-	-
Recurring PAT	80 %	-1 %	-12 %	14 %	-31 %	-12 %	51 %	5 %	19 %	0 %	0 %	0 %	-	-	-	-
EPS	-4 %	-1 %	-12 %	14 %	-31 %	-12 %	51 %	5 %	19 %	0 %	0 %	0 %	-	-	-	-
Yearly Growth (%)																
Revenue	33 %	33 %	9 %	6 %	-7 %	-1 %	6 %	-1 %	20 %	9 %	15 %	16 %	19 %	-1 %	15 %	17 %
EBITDA	80 %	32 %	-18 %	40 %	-42 %	-8 %	6 %	5 %	70 %	36 %	26 %	17 %	26 %	-12 %	35 %	29 %
EBIT	114 %	50 %	-23 %	54 %	-52 %	-15 %	5 %	3 %	91 %	40 %	32 %	20 %	33 %	-17 %	42 %	35 %
Recurring PAT	315 %	263 %	13 %	78 %	-32 %	-40 %	4 %	-5 %	66 %	87 %	24 %	19 %	101 %	-18 %	44 %	38 %
EPS	66 %	143 %	-24 %	-6 %	-32 %	-40 %	4 %	-5 %	66 %	87 %	24 %	19 %	19 %	-18 %	44 %	38 %
Margin (%)																
EBITDA	20 %	15 %	16 %	16 %	12 %	14 %	16 %	17 %	18 %	18 %	18 %	18 %	17 %	15 %	18 %	19 %
EBIT	17 %	13 %	12 %	13 %	9 %	11 %	12 %	14 %	14 %	14 %	14 %	14 %	14 %	11 %	14 %	16 %
PBT	14 %	14 %	15 %	17 %	11 %	9 %	14 %	15 %	15 %	15 %	15 %	15 %	15 %	12 %	15 %	18 %
PAT	10 %	10 %	10 %	10 %	7 %	6 %	9 %	10 %	10 %	10 %	10 %	10 %	10 %	8 %	10 %	12 %

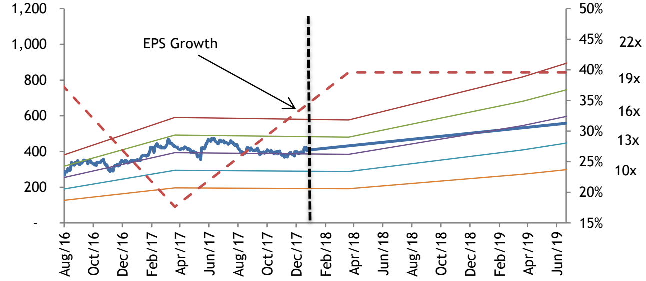
Consolidated Financials

P&L (Rs Mn)	FY17A	FY18E	FY19E	FY20E
Revenue	6,357	6,310	7,238	8,500
Op. Expenditure	5,283	5,360	5,960	6,845
EBITDA	1,073	949	1,278	1,655
Depreciation	208	228	257	274
EBIT	866	721	1,022	1,381
Interest Expense	135	195	147	129
Other Income	210	244	217	255
PBT	941	771	1,092	1,507
Tax	334	262	360	497
PAT bef. MI & Assoc.	607	509	732	1,010
Minority Interest	-13	0	0	0
Profit from Assoc.	0	0	0	0
Recurring PAT	619	509	732	1,010
Extraordinaires	0	0	0	0
Reported PAT	619	509	732	1,010
FDEPS (Rs)	24.6	20.2	29.1	40.1
DPS (Rs)	0.5	1.0	1.5	2.0
CEPS (Rs)	35.7	29.3	39.3	51.0
FCFPS (Rs)	-35.2	16.0	13.4	24.7
BVPS (Rs)	152.2	171.2	198.5	236.2
EBITDAM (%)	17 %	15 %	18 %	19 %
PATM (%)	10 %	8 %	10 %	12 %
Tax Rate (%)	36 %	34 %	33 %	33 %
Sales Growth (%)	19 %	-1 %	15 %	17 %
FDEPS Growth (%)	19 %	-18 %	44 %	38 %

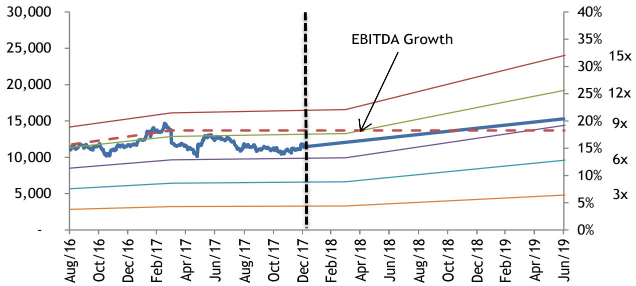
Balance Sheet (Rs Mn)	FY17A	FY18E	FY19E	FY20E
Equity Capital	252	252	252	252
Reserve	3,579	4,058	4,744	5,694
Networth	3,831	4,310	4,996	5,945
Long Term Debt	1,660	1,620	1,580	1,540
Def Tax Liability	458	400	300	200
Minority Interest	0	0	0	0
Account Payables	796	770	829	961
Other Curr Liabi	89	90	103	121
Total Liabilities & Equity	6,835	7,190	7,808	8,768
Net Fixed Assets	2,912	2,934	3,178	3,154
Capital WIP	0	0	0	0
Others	230	230	230	230
Inventory	1,024	1,124	1,289	1,514
Account Receivables	1,343	1,331	1,487	1,747
Other Current Assets	392	492	491	655
Cash	934	1,079	1,134	1,469
Total Assets	6,835	7,190	7,808	8,768
Non-cash Working Capital	1,873	2,087	2,335	2,833
Cash Conv Cycle	107.6	120.7	117.7	121.7
WC Turnover	3.4	3.0	3.1	3.0
FA Turnover	2.2	2.2	2.3	2.7
Net D/E	0.2	0.1	0.1	0.0
Revenue/Capital Employed	1.2	1.0	1.1	1.2
Capital Employed/Equity	2.0	1.5	1.4	1.3

Cash Flow (Rs Mn)	FY17A	FY18E	FY19E	FY20E
PBT	941	771	1,092	1,507
Depreciation	208	228	257	274
Others	59	0	0	0
Taxes Paid	185	262	360	497
Change in WC	-760	-213	-248	-499
Operating C/F	263	524	740	785
Capex	-373	-309	-500	-250
Change in Invest	-580	0	0	0
Others	-212	59	0	0
Investing C/F	-1,165	-250	-500	-250
Change in Debt	-894	-40	-40	-40
Change in Equity	2,003	0	0	0
Others	-190	-88	-145	-160
Financing C/F	918	-128	-185	-200
Net change in cash	17	146	55	335
RoE (%)	24 %	13 %	16 %	18 %
RoIC (%)	14 %	10 %	13 %	15 %
Core RoIC (%)	12 %	9 %	12 %	15 %
Div Payout (%)	0 %	6 %	6 %	6 %
P/E	16.6	20.2	14.0	10.2
P/B	2.7	2.4	2.1	1.7
P/FCFF	-11.6	25.5	30.4	16.5
EV/EBITDA	10.7	11.8	8.6	6.4
EV/Sales	1.8	1.8	1.5	1.2
Dividend Yield (%)	0.1 %	0.2 %	0.4 %	0.5 %

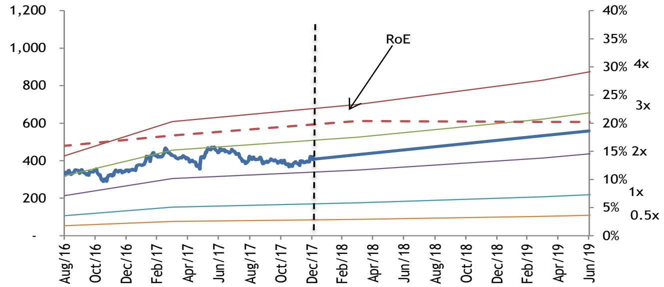
TTM P/E vs. 2 yr forward EPS growth



TTM EV/EBITDA vs. 2 yr forward EBITDA growth



TTM P/B vs. 2 yr forward RoE



Historical Consolidated Financials

P&L (Rs Mn)	FY14A	FY15A	FY16A	FY17A
Revenue	4,521	4,758	5,328	6,357
Op. Expenditure	3,877	4,061	4,475	5,283
EBITDA	644	697	853	1,073
Depreciation	175	197	201	208
EBIT	469	500	652	866
Interest Expense	356	312	253	135
Other Income	12	67	48	210
PBT	126	255	448	941
Tax	54	150	93	334
PAT bef. MI & Assoc.	72	104	354	607
Minority Interest	0	0	-2	-13
Profit from Assoc.	0	0	0	0
Recurring PAT	72	72	72	72
Extraordinaires	0	0	169	0
Reported PAT	72	72	72	72
EPS (Rs)	4.3	6.2	20.8	24.6
DPS (Rs)	0.0	0.0	0.0	0.5
CEPS (Rs)	14.7	18.0	32.6	35.7
FCFPS (Rs)	38.8	53.7	14.0	-35.2
BVPS (Rs)	63.4	79.3	74.0	152.2
EBITDAM (%)	14 %	15 %	16 %	17 %
PATM (%)	2 %	2 %	7 %	10 %
Tax Rate (%)	43 %	59 %	21 %	36 %
Sales growth (%)	5 %	5 %	12 %	19 %
FDEPS growth (%)	128 %	46 %	234 %	19 %

Balance Sheet (Rs Mn)	FY14A	FY15A	FY16A	FY17A
Equity Capital	168	168	171	252
Reserve	897	1,165	1,097	3,579
Networth	1,065	1,333	1,268	3,831
Long Term Debt	2,944	2,493	2,592	1,660
Def Tax Liability	172	332	413	458
Minority Interest	0	0	0	0
Account Payables	1,060	1,192	1,168	796
Other Curr Liabi	129	123	172	89
Total Liabilities & Equity	5,370	5,473	5,612	6,835
Net Fixed Assets	2,775	2,685	2,711	2,912
Capital WIP	0	100	36	0
Others	213	451	353	230
Inventory	1,266	1,089	1,275	1,024
Account Receivables	553	762	816	1,343
Other Current Assets	413	317	309	392
Cash	151	70	113	934
Total Assets	5,370	5,473	5,612	6,835
Non-cash Working Capital	1,042	852	1,061	1,873
Cash Conv Cycle	84.1	65.3	72.6	107.6
WC Turnover	4.3	5.6	5.0	3.4
FA Turnover	1.6	1.7	1.9	2.2
Net D/E	2.6	1.8	2.0	0.2
Revenue/Capital Employed	1.0	1.1	1.3	1.5
Capital Employed/Equity	5.9	4.7	4.2	3.5

Cash Flow (Rs Mn)	FY14A	FY15A	FY16A	FY17A
PBT	126	255	280	941
Depreciation	175	197	201	208
Others	363	287	257	59
Taxes Paid	15	29	60	185
Change in WC	-62	123	-358	-760
Operating C/F	586	833	319	263
Capex	-65	-148	-254	-373
Change in Invest	3	-2	2	-580
Others	-75	91	-28	-212
Investing C/F	-137	-59	-280	-1,165
Change in Debt	-340	-447	61	-894
Change in Equity	72	0	0	2,003
Others	-376	-323	-260	-190
Financing C/F	-643	-770	-198	918
Net change in cash	-194	4	-159	17
RoE (%)	7 %	9 %	27 %	24 %
RoIC (%)	7 %	6 %	13 %	14 %
Core RoIC (%)	7 %	5 %	13 %	12 %
Div Payout (%)	0 %	0 %	0 %	0 %
P/E	95.9	65.6	19.7	16.6
P/B	6.4	5.1	5.5	2.7
P/FCFF	10.5	7.6	29.1	-11.6
EV/EBITDA	20.8	19.2	15.9	10.7
EV/Sales	3.0	2.8	2.5	1.8
Dividend Yield (%)	0.0 %	0.0 %	0.0 %	0.1 %

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