

On the cusp of a recovery

The textile sector faced the perfect storm in 2022 given: i) the demand slowdown in export markets due to high inflation, ii) the supply chain disruptions during the COVID-led lockdowns which affected inventory levels, and iii) the record high commodity costs which severely hit margin. After navigating these unpleasant events, the sector is seeing signs of a revival. The commentary from textile companies have been positive as they expect: i) a sequential improvement in demand due to normalised inventory levels at the retailers' end, ii) correction in cotton prices and freight costs (amid the cool off in inflation) and better utilisation to boost EBITDA margin, and iii) healthy return ratios on lower debt levels and minimal capex requirements (as most players have expanded capacities over the last two years).

The commentary from players across the textile value chain indicates a sequential improvement in demand and better capacity utilisation from Q3FY23.

Exhibit 1: Commentary from players across the textile sector

Gokaldas Exports	<ul style="list-style-type: none"> • Revenues have been on a downward trend over last three quarters. The management feels slide in revenues have bottomed out, with trends reversing from Q4FY23. It intends to boost its market share and ride the growth curve in the aftermath of the downturn • The long-term macroeconomic factors are favourable to the growth of the business. As far as revenue is concerned, it expects to start growing sequentially in FY24
KPR Mill	<ul style="list-style-type: none"> • Demand is comparatively better sequentially. Demand for yarn and garments is strong • KPR has an order book of ~ INR1,000cr. It maintains an order book of five-to-six months and is not seeing any drop in orders
Nitin Spinners	<ul style="list-style-type: none"> • Domestic cotton prices have corrected by ~40% from its peak to INR63,000 a candy. The disparity between domestic and international cotton prices has reduced substantially. As a result, utilisation in the spinning industry is returning to near normalcy levels • Demand has started to improve due to higher retail consumption and lower inventory in downstream channels. Exports have started to pick up
Vardhman Textiles	<ul style="list-style-type: none"> • There is an improvement in demand as brands have liquidated stocks and started buying • The company is running at optimum capacity utilisation from the last few months
Indo Count Industries	<ul style="list-style-type: none"> • Retailers appeared enthusiastic during its last home textile show in Jan'23 and during the market week in the US in Sep'22 • Inventory in the supply chain has fallen to 28 weeks from 40 weeks at peak levels. As normalised inventory levels is 24 weeks, there is scope for an improvement. The management expects it to play out in FY24 • It expects to reach normalised volume rates (pre-COVID levels) by FY24-end. Currently, it has demand visibility of four-to-six months
Himatsingka Seide	<ul style="list-style-type: none"> • HSS is seeing encouraging signs as far as demand is concerned. It expects an incremental improvement in utilisation going forward • There is an uptick in its order book. It is seeing relative stability and signs of an improvement in its order book for Q4FY23 • Capacity utilisation has improved across all divisions, with further improvement expected in the coming quarters

Source: Nuvama Wealth Research

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Exhibit 2: Textile sector trends and outlook

Company	Revenue trend (INR cr)	Operating margin trend (%)	Outlook
GEXP			Revenue bottomed out in Q3FY23. Sequentially, revenue growth will be robust. The company will maintain current margin levels
KPR			KPR is maintaining an order book of five-to-six months. Margin in the garment segment stands at 22-23%
Nitin Spinners			Utilisation in the spinning industry has returned to near normalcy. Margin will improve as the situation normalises
Vardhman Textiles			Improvement in demand and hence higher capacity utilisation to be seen ahead. We see an uptick in margin ahead as cotton prices have corrected
ICIL			ICNT aims to achieve pre-COVID volumes in FY24 and maintain margin at 15-17%
HSS			Capacity utilisation to increase going ahead. With demand returning, margin will improve

Source: Company, Nuvama Wealth Research

Correction in cotton prices to improve the cotton-yarn spread and aid margin

CAI pegs cotton production at 333lk bales in the 2022-23 season, up from 312lk bales in the 2021-22 season. Consumption is expected at 319lk bales versus 318lk bales in the last season. The committee expects exports of 32lk bales as against 46lk bales in the last season. Imports are estimated at 13lk bales versus 15lk bales in the last season. All this bodes well for the supply of cotton, with prices correcting to ~INR65,000 per candy in Mar'23 from ~INR102,000 per candy (average price) in Aug'22. We expect a sequential improvement in margin on account of a correction in cotton prices for players across the textile sector.

Exhibit 3: Cotton prices (INR per candy)

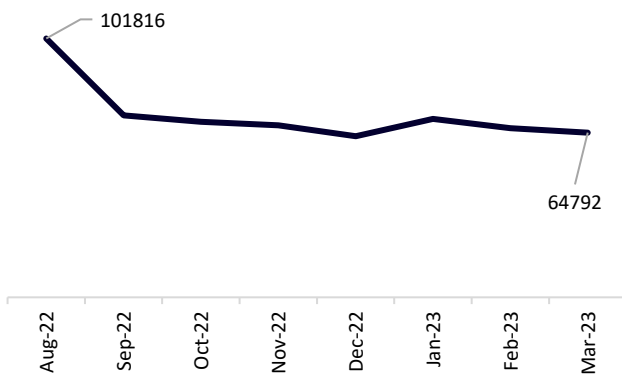
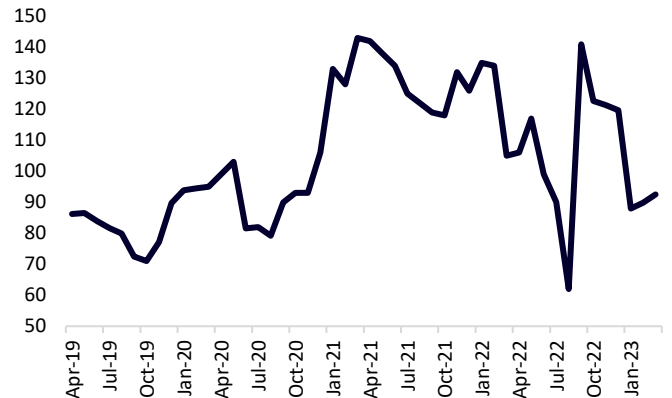


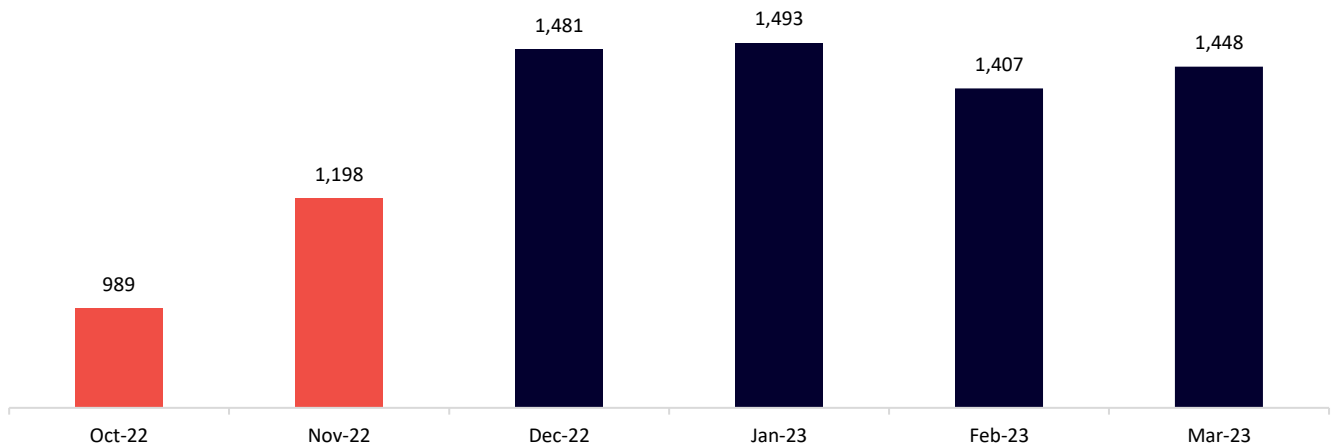
Exhibit 4: Cotton-Yarn Spread (INR/kg)



Source: Bloomberg

Before the COVID-19 pandemic, average cotton yarn spreads were INR70-80/kg. During the pandemic, yarn players received a huge boost as spreads shot up to ~INR140/kg as exports surged due to a ban on cotton from China's Xinjiang province and pent-up demand. Spreads are currently trailing ~INR90/kg, which is above the usual average. It is expected to stay elevated on replenishment of the order book.

Exhibit 5: India's RMG exports (USD mn)



Source: Apparel Export Promotion Council

India's RMG exports hit a low of USD989mn in Oct'22 on higher inventory levels at retailers' end and a slowdown in demand due to rising inflation. Improvement in inventory levels and the cool off in inflation resulted in RMG exports of USD1,448mn in Mar'23 (up 3% MoM). Exports improved by 19% QoQ to USD4,348mn in Q4FY23. This is in line with the commentary given by garment manufacturers such as GEXP and KPR (refer Exhibit 1). We expect this trend to continue going forward.

India's home textile exports to the US

The home textile market in the US was hit by a cut in discretionary spends amid rising inflation and a build-up in inventory at the retailer's end. There is a clear uptick in exports from India from the lows of Aug-22. Sequentially, India's exports have improved. The commentary from home textile players indicates an uptick in demand and better capacity utilisation.

Exhibit 6: Bedsheet exports to the US (USD mn)

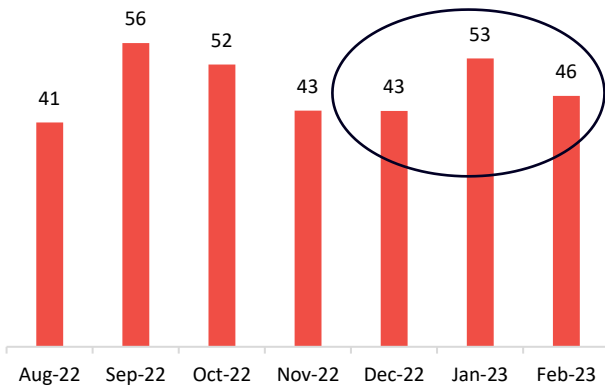
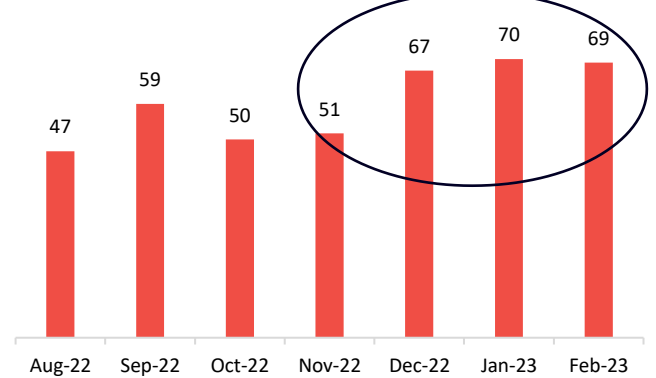


Exhibit 7: Terry towel imports by the US (USD mn)



Source: OTEXA

India's market share in US home textile imports

India's market share in cotton sheet imports by the US has been inching up and stood at 58% in Feb'23. In terry towels, its share stood at 47%. The country has been consistently gaining market share in the last five months. The ban on cotton products from Xinjiang has been effective as US customs have been quite stringent on enforcing the ban. This has boosted India's market share.

Exhibit 8: India's market share in bedsheet imports

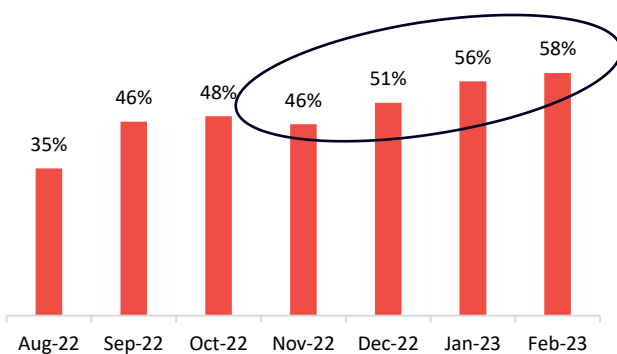
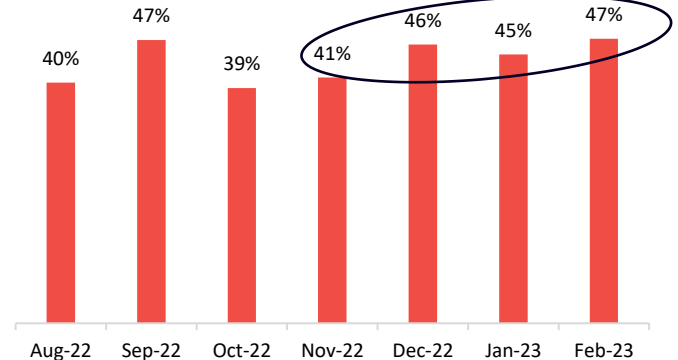


Exhibit 9: India's market share in terry towel imports



Source: OTEXA

Valuation and view

The garment and yarn sector will be the first to benefit from an uptick in demand and a reversal in commodity prices.

- i) In the listed garments space, we prefer KPR and GEXP as they are the largest and most efficient companies. Over the last few years, both entities have gained share from unorganised players. Further consolidation in the sector will result in market share gains for both players.
- ii) In the yarn segment, we prefer large companies (Vardhman Textiles, Nitin Spinners and Ambika Cotton Mills mainly on account of improvement in cotton yarn spread.
- iii) The home textiles sector will benefit from a revival in exports around the US holiday season at the end of the year. We prefer ICIL and HSS in the home textile segment.

Valuations at a glance

Company	CMP (INR)	M-cap	TP (INR)	Upside	Revenue (INR cr)			EBITDA (INR cr)			EBITDA margin			P/E ratio (x)		
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
KPR	618	21,107	756	22%	5,684	6,293	6,957	1,245	1,460	1,684	22%	23%	24%	26.9	22.5	19.1
GEXP	366	2,218	Not rated	NA	2,264	2,567	3,037	263	303	381	12%	12%	13%	14.8	14.2	10.9
Vardhman	314	9,069	Not rated	NA	10,124	10,185	10,730	1,334	1,682	1,873	13%	17%	17%	11.0	8.5	7.5
Nitin	253	1,425	Not rated	NA	2,264	2,712	3,145	335	433	529	15%	16%	17%	8.4	6.7	4.6
ICIL	134	2,663	189	41%	2,987	3,494	4,016	433	528	655	15%	15%	16%	11.3	8.7	6.6
HSS	79	775	Not rated	NA	2,697	3,136	3,633	246	439	NA	9%	14%	NA	NA	8.8	5.5

*Estimates for GEXP, Vardhman Textile, Nitin Spinners and HSS are Bloomberg consensus.

*No Bloomberg estimates are available for Ambika Cotton Mills

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