

Kitex Garments

BSE SENSEX	S&P CNX
24,884	7,603
Bloomberg	KTG IN
Equity Shares (m)	47.5
M.Cap.(INRb)/(USDb)	21.3 / 0.3
52-Week Range (INR)	1,070/340
1, 6, 12 Rel. Per (%)	8/-38/-6
Avg Val, (INR m)	132
Free float (%)	45.8

Financials & Valuations (INR b)

Y/E Mar	2016	2017E	2018E
Net Sales	5.5	6.6	7.9
EBITDA	1.9	2.4	3.0
PAT	1.1	1.5	2.0
EPS (INR)	23.6	31.5	41.1
Gr. (%)	13.8	33.6	30.2
BV/Sh (INR)	77.3	101.9	134.7
RoE (%)	35.5	35.2	34.7
RoCE (%)	41.8	47.6	50.2
P/E (x)	19.0	14.2	10.9
P/BV (x)	5.8	4.4	3.3

Estimate change	↔
TP change	↔
Rating change	↔

CMP: INR449 TP: INR820 (+83%)
Buy

Revenues meet expectations; growth momentum to continue

- **Revenues meet estimates; margins miss:** KTG's 4QFY16 revenue grew 16.7% to INR1.8b (est. of INR1.7b) led by garments which grew 13.6% and net fabric revenues which grew 46.5%. EBITDA margins contracted 510bp YoY to 37.6% (est. of 42%) due to decrease in gross margins of 150bp and increase in other expenses of 340bp. EBITDA stood at INR693m (est. of INR711m). Led by lower interest cost at INR4m (v/s INR49m in 4QFY15), PAT grew 8% to INR449m (est. of INR416m). Interest was lower on account of a one off subvention credit pertaining to 2QFY16 and 2HFY16, entirely credited in 4QFY16.
- **Management confident of 20% CAGR over FY16-FY19 aided by newer clients and products:** FY17 growth is to be led by increased capacity in FY16 done through automation and added labour. FY18 and FY19 capex will drive further automation that shall see capacity expanding without need for significant addition of manpower. Management is confident of 20% revenue growth in each of the years, with margins maintained at minimum 35%. It also plans to add newer clients and has signed agreements with Target, few other retailers and wholesale channels. Shift towards high value and innovative products like 100% organic clothes range shall contribute to growth and further aid margins. KTG highlighted capex plans spending close to INR1.6b with ~INR550-600m in FY17, ~INR600m in FY18 and ~INR500-550m in FY19. FY17 capex is directed towards a greener production through new generation boiler, effluent and sewage treatment plans that will result in carbon credits and increased efficiency.
- **Branded segment progressing well:** Management is confident of clocking INR400m of revenues from Lamaze and Little Stars, while additional costs pertaining to marketing, salaries, etc is expected to be INR130m (USD2m). It expects shipments to begin from July end or August.
- **INR2.5b cash with INR0.9b of debt as at FY16:** KTG had a cash balance of INR2.5b (INR2b in March 2015) and a gross debt of INR0.9b (INR1.4b in March 2015). Out of the ~USD40m cash deposits, close to USD18m are booked in forward market with rates ranging 68-71.
- **Valuation and view:** We expect 20% revenue CAGR along with 32% PAT CAGR over FY16-18. Given the huge scalability, strong return ratios and free cash generation, we maintain **Buy** with a TP of INR820—valuing it at 20x FY18E EPS

Quarterly performance

Y/E March	FY15				FY16				FY15	FY16	FY16	Var
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE	%
Net Sales	1,028	1,282	1,221	1,580	1,091	1,343	1,181	1,844	5,111	5,458	1,691	9
YoY Change (%)	2.3	28.1	22.8	11.1	6.2	4.7	-3.2	16.7	15.6	6.8	7.0	
Total Expenditure	756	946	802	921	789	891	765	1,150	3,424	3,596	980	
EBITDA	272	337	419	660	301	451	417	693	1,687	1,863	711	-2
Margins (%)	26.5	26.2	34.3	41.7	27.6	33.6	35.3	37.6	33.0	34.1	42.0	
Depreciation	50	52	53	58	55	55	55	48	213	213	58	
Interest	36	41	66	49	48	44	42	4	192	138	42	
Other Income	24	53	51	6	59	68	54	17	134	198	20	
PBT	210	296	352	558	258	421	373	659	1,417	1,711	631	5
Tax	66	103	121	142	98	149	132	210	432	590	214	
Rate (%)	31.4	34.8	34.3	25.4	38.1	35.4	35.4	31.9	30.5	34.5	34.0	
Reported PAT	144	193	231	416	160	272	241	449	985	1,121	416	8
Adj PAT	144	193	231	416	160	272	241	449	985	1,121	416	8
YoY Change (%)	11.3	61.4	104.0	97.4	10.7	40.6	4.0	7.9	71.7	13.8	0.0	
Margins (%)	14.0	15.1	18.9	26.3	14.6	20.2	20.4	24.4	19.3	20.5	24.6	

E: MOSL Estimates

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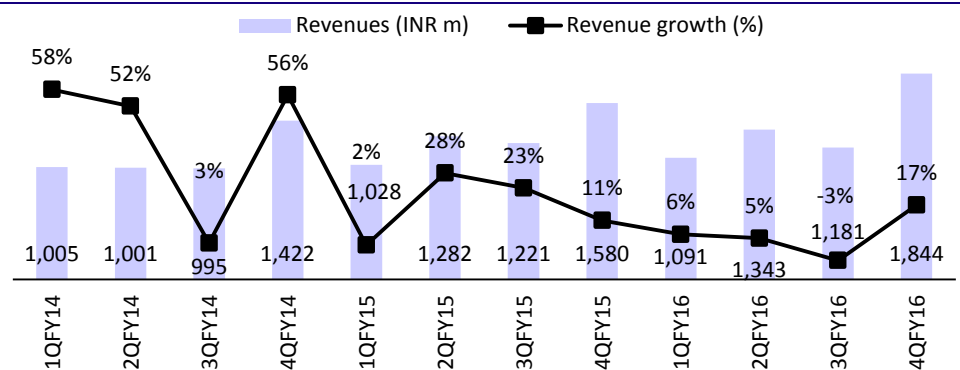
Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Revenues meet expectations

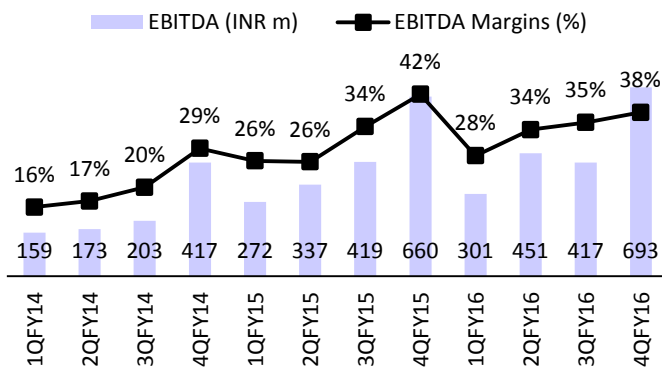
- KTG's 4QFY16 revenue grew 16.7% to INR1.8b (est. of INR1.7b) led by garments which grew 13.6% and net fabric revenues which grew 46.5%.
- EBITDA margins contracted 510bp YoY to 37.6% (est. of 42%) due to decrease in gross margins of 150bp and increase in other expenses of 340bp. EBITDA stood at INR693m (est. of INR711m). Led by lower interest cost at INR4m (v/s INR49m in 4QFY15), PAT grew 8% to INR449m (est. of INR416m).
- Interest was lower on account of a one off subvention credit pertaining to 2QFY16 and 2HFY16, entirely credited in 4QFY16. 3% interest subvention was withdrawn by government in end of 2Q, reinstated in 4Q. So there was a subvention credit for 2Q, 3Q and 4Q credited in 4Q only.

Exhibit 1: Revenue growth trend



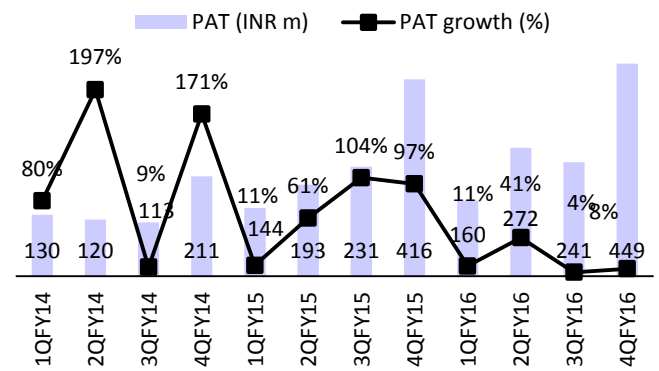
Source: MOSL, Company

Exhibit 2: EBITD and margins trend



Source: MOSL, Company

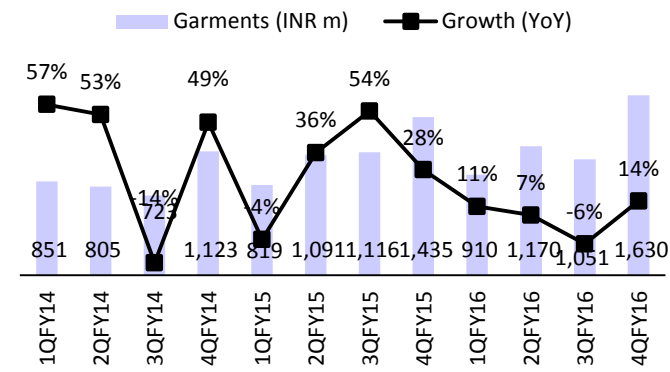
Exhibit 3: PAT growth trend



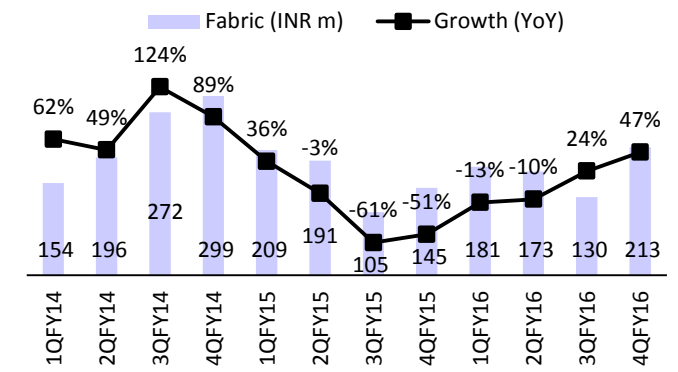
Source: MOSL, Company

Garments segment reports 14% growth, fabrics grow 47%

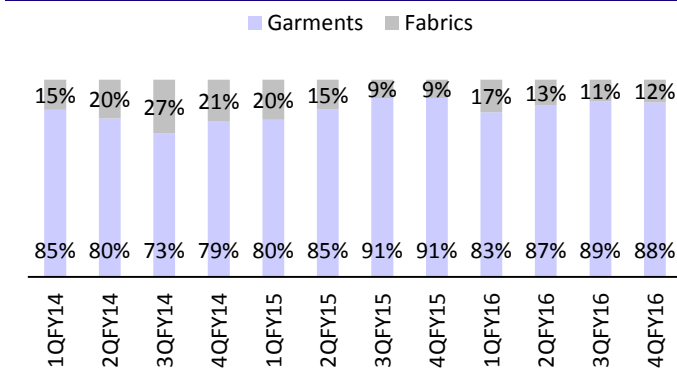
- During 4QFY16, garments segment grew 13.6% to INR1,630m while net fabric revenues grew 46.6% to INR213m.
- Garment business contribution to total revenue stood at 88% as against 91% in 4QFY15.
- Garment margins contracted by 270bp YoY to 43.5% while fabric margins decreased from 6.7% in 4QFY15 to 5% in 3QFY16.

Exhibit 4: Garments revenues and growth

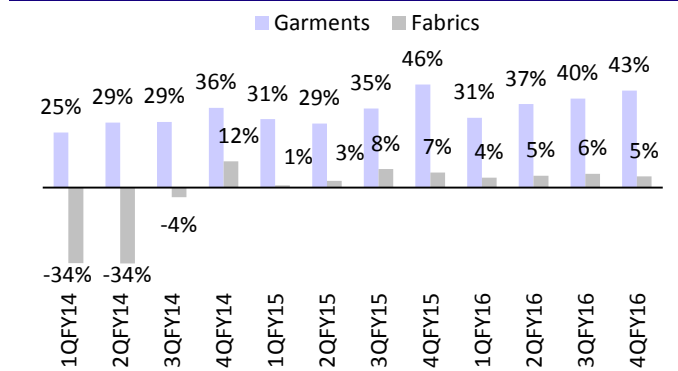
Source: MOSL, Company

Exhibit 5: Fabric revenue and growth

Source: MOSL, Company

Exhibit 6: Segment revenue mix (%)

Source: MOSL, Company

Exhibit 7: Segment margins

Source: MOSL, Company

Management confident of 20% CAGR over FY16-FY19 aided by newer clients and products

- FY17 growth is to be led by increased capacity in FY16 done through automation and added labour.
- FY18 and FY19 capex will drive further automation that shall see capacity expanding without need for significant addition of manpower.
- Management is confident of 20% revenue growth in each of the years, with margins maintained at minimum 35%.
- It also plans to add newer clients and has signed agreements with Target, few other retailers and wholesale channels. Shift towards high value and innovative products like 100% organic clothes range shall contribute to growth and further aid margins.
- KTG highlighted capex plans spending close to INR1.6b with ~INR550-600m in FY17, ~INR600m in FY18 and ~INR500-550m in FY19. FY17 capex is directed towards a greener production through new generation boiler, effluent and sewage treatment plans that will result in carbon credits and increased efficiency.

Cash of INR2.5b and Debt of INR0.9b as at FY16

- Cash and Cash Equivalents as at March 2016 stood at INR2.5b (v/s INR2b in March 2015) and Gross Debt (Long Term Borrowings + Short Term Borrowings) stood at INR0.9b at March 2016 (v/s INR1.4b in March 2015).
- Out of the ~USD40m cash deposits, close to USD18m are booked in forward market with rates ranging 68-71.

Branded segment progressing well

- Management is confident of clocking INR400m of revenues from Lamaze and Little Stars, while additional costs pertaining to marketing, salaries, etc is expected to be INR130m (USD2m).
- It expects shipments to begin from July end or August.

Kitex Childrenswear Limited (KCL) listing and merger

- Internally, the company is working on the same. Company plans to list KCL first separately, followed by a merger, as highlighted by management earlier.
- It expects the independent listing to happen in 2018, followed by merger in 2019.

Other conference call highlights

- KCL has seen growth of close to 6-7% in FY16 along with PBT margins of 25-27%.
- Outlook – expect FY17 and FY18 to see 20% growth each. Targeting INR6.8b sales including other income in FY17. PBT margins of 30%+ are sustainable.
- Jockey sales for FY16 down by 12%; expect FY17 to be even lower and close to nil in FY18. However, KTG already has arrangements with other clients which will not lead to loss of revenues. Cost wise Jockey's synthetic proposal is not workable; hence KTG did not accept the same. Jockey margins higher by 100-200bp due to standard product. However, management does not expect Jockey withdrawal to impact margins or profitability.
- Price arrangements with clients – For every 5% increase/decrease in raw material cost, a 1% adjustment is done to FOB price.
- Future investments will be made under the TUF scheme.
- Management might consider increasing dividend payout ratio in future.

Exhibit 8: Quarterly metrics (%)

	FY13				FY14				FY15				FY16			
	1Q	2Q	3Q3	4Q	1Q	2Q	3Q3	4Q	1Q	2Q	3Q3	4Q	1Q	2Q	3Q3	4Q
Sales Growth																
Garments	-5	18	27	17	57	53	-14	49	-4	36	54	28	11	7	-6	14
Fabrics	-60	-43	-26	-3	62	49	124	89	36	-3	-61	-51	-13	-10	24	47
Sales Mix																
Garments	85	80	87	83	85	80	73	79	80	85	91	91	83	87	89	88
Fabrics	15	20	13	17	15	20	27	21	20	15	9	9	17	13	11	12
EBIT Margin																
Garments	22	28	23	25	25	29	29	36	31	29	35	46	31	37	42	43
Fabrics	-10	-8	-6	-5	-34	-34	-4	12	1	3	8	7	4	5	7	5
EBIT Contribution																
Garments	109	108	104	104	133	140	106	92	99	98	98	99	97	98	98	99
Fabrics	-9	-8	-4	-4	-33	-40	-6	8	1	2	2	1	3	2	2	1

Source: Company, MOSL

Valuation and view

We value KTG at 20x FY18E EPS, higher than its 5-year average of 12.2x, which we believe is justified considering:

Large opportunity: Kitex has presence in the highly niche USD20b global infant-wear clothing market and is the 3rd largest vendor globally. With India's market share being low single-digit, and with India's growing competitiveness against erstwhile low-cost countries like China (~52% market share), we believe the long term opportunity for KTG is large.

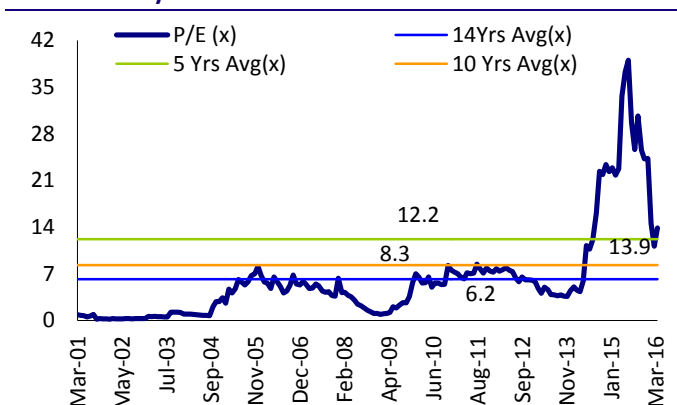
High entry barriers: KTG is the largest exporter of infant-wear clothing out of India and commands a 70% market share for all infant-wear clothing exports out of India. Adhering to stringent safety measures, maintaining high quality standards, higher degree of complexity (than adult garments) due to involvement of small sizes, need for greater variety, smaller batch size orders and high labor requirements are some of the key entry barriers that support superior profitability for the company.

Industry leading return ratios: KTG commands strong, industry leading return ratios (41.8% RoCE and 35.5% RoE), with its business model generating robust free cash generation (INR4.6b over FY16-18). We believe KTG stands out amongst listed textile exporters (with most of them present in capital intensive, low RoCE businesses of yarn and fabric manufacturing (averaging ~10% RoCE)).

Opportunity to enter the brands business: We expect KTG to capture a larger pie of the infant-wear value chain through its forward integration with its launch of own brand in the US market (Little Stars) as well as licensing of private labels (Lamaze) in the US market. Forward integration holds high significance for the company as margins in its own brand will be double of the current business (~60% versus current margins of ~30%), along with higher realizations.

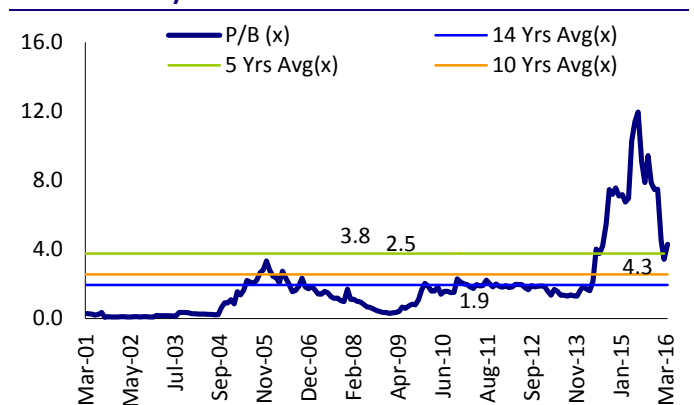
We value the stock at 20x FY18E EPS of INR41.1, arriving at price target of INR820. Maintain **Buy**.

Exhibit 9: 15 year PE band



Source: MOSL, Company

Exhibit 10: 15 year PB band



Source: MOSL, Company

Operating metrics

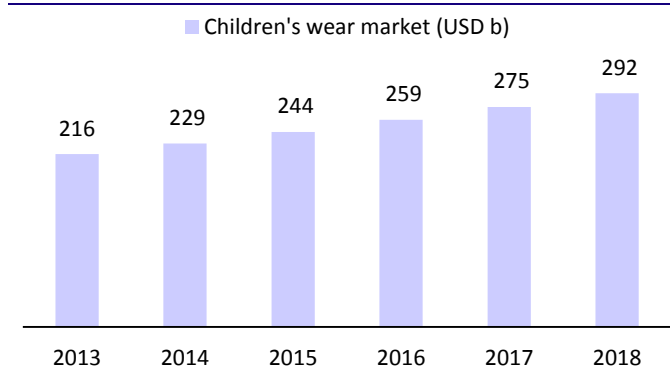
Exhibit 11: Operating metrics and key assumptions

Y/E March (INR m)	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E
Growth (%)							
Garments		15	31	27	7	19	19
Fabric		-36	82	-29	7	-5	0
Net Revenues		2	40	16	7	21	20
Contribution (%)							
Garments	75	84	79	87	87	90	91
Fabric	25	16	21	13	13	10	9
Net Revenues	100	100	100	100	100	100	100
EBIT Margins (%)							
Garments	19	21	27	36	39	37	37
Fabric	9	-7	-10	4	5	12	12
Segment EBIT	16.5	16.2	19.3	32.3	34.5	33.0	32.5
EBIT Contribution (%)							
Garments	86	107	111	98	98	96	97
Fabric	14	-7	-11	2	2	4	3
Segment EBIT	100	100	100	100	100	100	100

Source: Company, MOSL

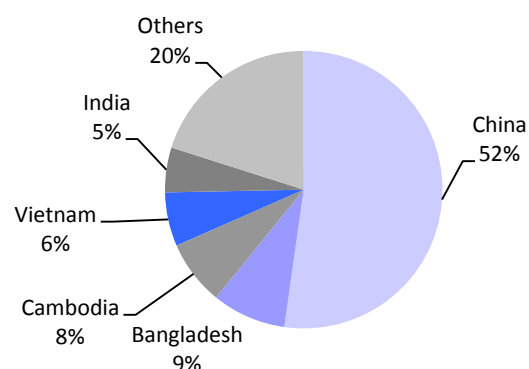
Story in charts

Exhibit 12: Global children's wear market is huge



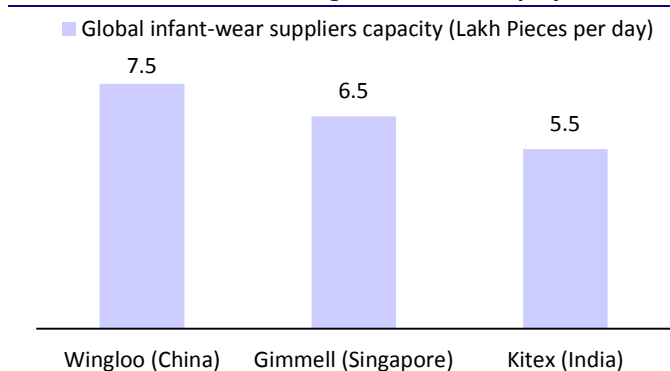
Source: MOSL, Company

Exhibit 13: India has high potential for infant-wear sourcing



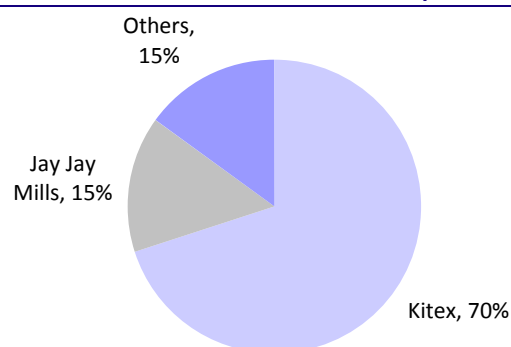
Source: MOSL, Company

Exhibit 14: Kitex is the 3rd largest infant-wear player



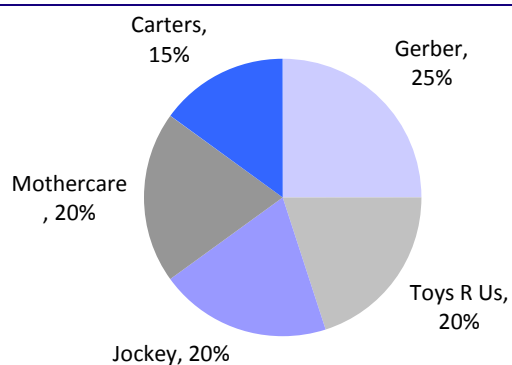
Source: MOSL, Company

Exhibit 15: Kitex dominated infant-wear exports from India



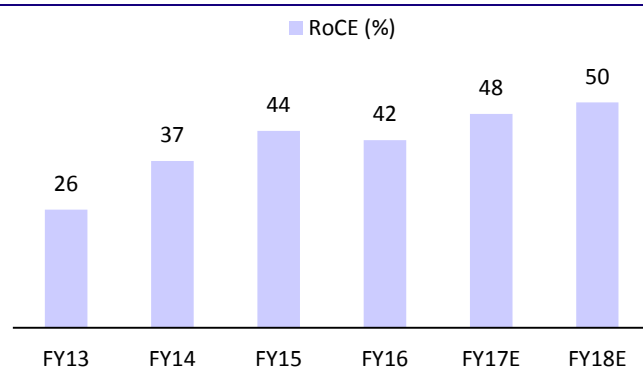
Source: MOSL, Company

Exhibit 16: Diversified client mix augurs well for margins



Source: MOSL, Company

Exhibit 17: Kitex reports strong capital efficiency



Source: MOSL, Company

Financials and Valuations

Income Statement							(INR Million)	
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Net Sales	2,561	3,120	3,170	4,422	5,111	5,458	6,578	7,904
Change (%)	-4.3	21.9	1.6	39.5	15.6	6.8	20.5	20.2
EBITDA	453	582	601	951	1,687	1,863	2,368	3,004
EBITDA Margin (%)	17.7	18.7	19.0	21.5	33.0	34.1	36.0	38.0
Depreciation	69	69	86	97	213	213	248	299
EBIT	384	514	515	855	1,474	1,650	2,120	2,704
Interest	125	176	115	106	192	138	78	44
Other Income	53	64	40	133	134	198	248	322
Extraordinary items	0	0	0	0	0	0	0	0
PBT	312	401	440	882	1,417	1,711	2,290	2,982
Tax	106	130	147	308	432	590	792	1,032
Tax Rate (%)	34.0	32.4	33.3	34.9	30.5	34.5	34.6	34.6
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
Reported PAT	206	271	294	574	985	1,121	1,498	1,950
Adjusted PAT	206	271	294	574	985	1,121	1,498	1,950
Change (%)	11.5	31.5	8.3	95.3	71.7	13.8	33.6	30.2

Balance Sheet							(INR Million)	
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Share Capital	48	48	48	48	48	48	48	48
Reserves	689	927	1,176	1,694	2,591	3,626	4,791	6,352
Net Worth	736	974	1,224	1,742	2,639	3,674	4,838	6,400
Debt	1,084	1,015	1,012	1,342	1,612	918	510	306
Deferred Tax	157	163	162	216	226	206	206	206
Total Capital Employed	1,977	2,153	2,397	3,299	4,477	4,798	5,555	6,912
Gross Fixed Assets	1,540	1,613	1,638	2,374	2,625	2,698	3,348	3,948
Less: Acc Depreciation	317	385	465	562	743	956	1,204	1,503
Net Fixed Assets	1,223	1,228	1,172	1,812	1,882	1,742	2,144	2,445
Capital WIP	9	4	23	7	0	0	0	0
Investments	0	0	0	0	0	46	46	46
Current Assets	1,267	1,443	1,755	2,219	3,681	4,401	4,769	6,140
Inventory	566	520	459	108	112	130	135	157
Debtors	393	318	506	531	627	960	956	1,149
Cash & Bank	64	365	412	1,036	2,033	2,499	2,960	3,972
Loans & Adv, Others	244	240	378	544	909	811	718	862
Curr Liabs & Provns	522	522	553	738	876	1,391	1,619	1,932
Curr. Liabilities	393	348	333	402	343	688	621	747
Provisions	129	174	221	337	532	703	997	1,186
Net Current Assets	745	921	1,202	1,480	2,805	3,010	3,151	4,207
Total Assets	1,977	2,153	2,397	3,299	4,687	4,798	5,342	6,699

Financials and Valuations

Ratios

Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Basic (INR)								
EPS	4.3	5.7	6.2	12.1	20.7	23.6	31.5	41.1
Cash EPS	5.8	7.2	8.0	14.1	25.2	28.1	36.8	47.4
Book Value	15.5	20.5	25.8	36.7	55.6	77.3	101.9	134.7
DPS	0.4	0.6	0.8	1.0	1.3	3.0	6.0	7.0
Payout (incl. Div. Tax.)	10.8	12.2	15.1	9.7	7.3	14.9	22.3	19.9
Valuation(x)								
P/E					21.6	19.0	14.2	10.9
Cash P/E					17.8	16.0	12.2	9.5
Price / Book Value					8.1	5.8	4.4	3.3
EV/Sales					4.1	3.6	2.9	2.2
EV/EBITDA					12.4	10.6	8.0	5.9
Dividend Yield (%)					0.3	0.7	1.3	1.6
Profitability Ratios (%)								
RoE	32.0	31.7	26.7	38.7	45.0	35.5	35.2	34.7
RoCE	28.5	30.3	26.3	37.2	43.9	41.8	47.6	50.2
Turnover Ratios (%)								
Asset Turnover (x)	1.3	1.4	1.3	1.3	1.1	1.1	1.2	1.1
Debtors (No. of Days)	56	37	58	44	45	64	53	53
Inventory (No. of Days)	81	61	53	9	8	9	8	7
Creditors (No. of Days)	56	41	38	33	25	46	34	34
Leverage Ratios (%)								
Net Debt/Equity (x)	1.4	0.7	0.5	0.2	-0.2	-0.4	-0.5	-0.6

Cash Flow Statement

(INR Million)

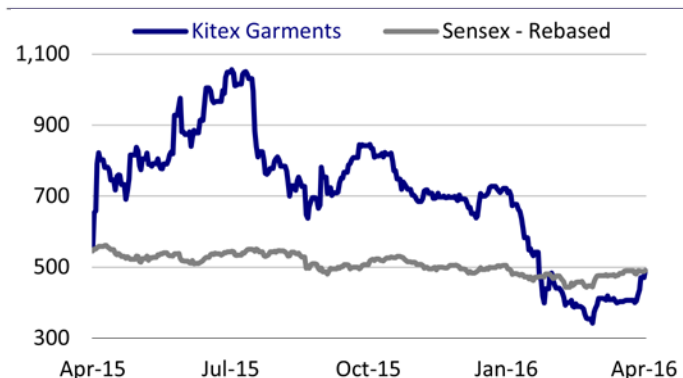
Y/E Mar	2011	2012	2013	2014	2015	2016	2017E	2018E
Adjusted EBITDA	453	582	601	951	1,687	1,863	2,368	3,004
Non cash opr. exp (inc)	58	64	38	129	136	198	248	322
(Inc)/Dec in Wkg. Cap.	-582	114	-256	315	-176	261	107	-45
Tax Paid	-86	-134	-139	-242	-364	-590	-792	-1,032
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	-156	626	244	1,154	1,284	1,733	1,930	2,249
(Inc)/Dec in FA & CWIP	-107	-68	-48	-720	-302	-70	-650	-600
Free cash flows	-263	558	196	433	981	1,663	1,280	1,649
(Pur)/Sale of Invt	0	0	0	0	0	-46	0	0
Others	3	11	4	8	-9	0	0	0
CF from Inv. Activity	-104	-57	-44	-712	-311	-116	-650	-600
Inc/(Dec) in Net Worth	0	0	0	0	0	0	0	0
Inc / (Dec) in Debt	390	-69	-5	334	271	-694	-408	-204
Interest Paid	-130	-176	-115	-106	-192	-138	-78	-44
Divd Paid (incl Tax) & Others	-18	-22	-33	-45	-56	-319	-333	-389
CF from Fin. Activity	242	-267	-153	183	24	-1,150	-819	-637
Inc/(Dec) in Cash	-18	302	47	624	996	466	461	1,012
Add: Opening Balance	81	64	365	412	1,036	2,033	2,499	2,960
Closing Balance	64	365	412	1,036	2,033	2,499	2,960	3,972

Corporate profile

Company description

Kitex Garments Ltd (KTG) is based in Kochi, India. Incorporated in 1992, its first public issue was in 1995. Its promoters are Mr MC Jacob, Mr Bobby Jacob and Mr Sabu Jacob. KTG is in the business of manufacturing and exporting infant garments. Company derives 80% of its revenue from the sale of infant garments and the balance 20% from the sale of fabric to Kitex Childrenwear.

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Dec-15	Sep-15	Dec-14
Promoter	54.2	54.2	54.2
DII	2.4	0.7	0.1
FII	0.7	2.3	2.4
Others	42.7	42.8	43.3

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
CKG Super Market Limited	6.4
Gopinathan C K	5.4
Acumen Capital Market (India) Ltd	2.7
Jinsha Nath C K	2.2
Sethuparvathy	1.4

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Sabu M Jacob	Chairman & Managing Director
A Babu	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Sabu M Jacob	C Mohan
Benni Joseph*	Sindhu Chandrasekhar
K L V Narayanan*	C P Philipose
Erumala Mathew Paulose*	

*Independent

Exhibit 6: Auditors

Name	Type
Ernst & Young LLP	Internal
Kolath & Co	Statutory
Rajendran, Mani & Varier	Cost Auditor
SVJS & Associates	Secretarial Audit

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY16	23.6	25.2	-6.4
FY17	31.5	31.7	-0.6
FY18	41.1	39.9	3.1

Source: Bloomberg

NOTES

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