# Sintex Industries

*Spinning growth*

**OUTPERFORMER**

**1 September 2014**

**BSE Sensex: 26638**

**Sector: Others**

**Stock data**

| | |
|---|---|
| CMP (Rs) | 73 |
| Mkt Cap (Rsbn/USDm) | 26.0 / 429.6 |
| **Target Price (Rs)** | **134** |
| **Potential from CMP (%)** | **+84** |
| **Earnings change (%)** | |
| FY15E | **-29** |
| FY16E | **-25** |
| Bloomberg code | SINT IN |
| 1-yr high/low (Rs) | 107/17 |
| 6-mth avg. daily volumes (m) | 5.35 |
| 6-mth avg. daily traded value (Rsm/USDm) | 368.5 / 6.09 |
| Shares outstanding (m) | 882 |
| Free float (%) | 56.2 |
| Promoter holding (%) | 43.8 |

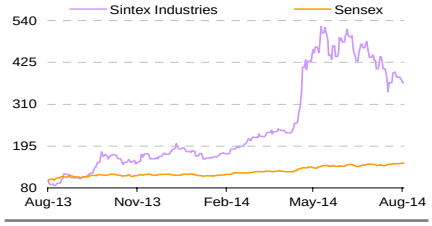
*Stock price as on 28 August 2014*

**We recently interacted with the management of Sintex Industries. Key takeaways:**

- The management expects revenue CAGR of 18% over FY14-17E with increasing government focus on social spending driving growth in the prefab segment. In custom molding, recent acquisitions in overseas subsidiaries and newer product offerings in India would be the key growth drivers.
- The greenfield spinning project in Gujarat is set for commissioning in H1FY16 and would drive the next leg of growth for Sintex. The company expects to earn an IRR of ~18% on the back of proximity of raw material sourcing, locational advantage, and several tax sops and interest rebates including subsidy on power.
- Sintex expects a further 150-200bp margin expansion over the next two years (130bp in the last one year), led by (a) easing working capital cycle (attributable to calibrated pace of execution for monolithic business), (b) increasing share of pre-fab business (EBITDA margin of ~25%), (c) higher revenue growth, and (d) niche product offerings in custom molding business.
- With higher operating cash flows and significant lower capex intensity, there would be significant free cash flow (FCF) generation starting FY16. Also, conversion of FCCBs (US$140m) will aid the overall deleveraging process, though it will also lead to a 36% equity dilution.

**A macroeconomic turnaround, improving trajectory of businesses linked to government spending and easing working capital cycle would drive a 32% PAT CAGR over FY14-17E. Also, FCCB conversion and improving FCF profile should aid balance sheet deleveraging starting FY16. With better growth prospects and high visibility on RoE expansion ahead, we expect a further re-rating in the stock. We reiterate Outperformer with a revised price target of Rs134.**

Price performance – relative and absolute




| (%) | 3-mth | 6-mth | 1-yr |
|---|---|---|---|
| Sintex Industries | (18.2) | 112.7 | 294.3 |
| Sensex | 9.9 | 26.1 | 44.8 |

Key financials

| As on 31 March | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Net sales (Rs m) | 51,076 | 58,645 | 68,256 | 77,567 | 95,033 |
| Adj. net profit (Rs m) | 4,138 | 3,831 | 4,427 | 6,176 | 8,871 |
| Shares in issue (m) | 311 | 311 | 447 | 447 | 447 |
| Adj. EPS (Rs) | 13.3 | 12.3 | 9.9 | 13.8 | 19.9 |
| *% change* | *23.1* | *(7.4)* | *(19.5)* | *39.5* | *43.6* |
| PE (x) | 5.5 | 5.9 | 7.4 | 5.3 | 3.7 |
| Price/ Book (x) | 0.7 | 0.6 | 0.7 | 0.6 | 0.5 |
| EV/ EBITDA (x) | 6.2 | 6.0 | 5.8 | 4.7 | 3.2 |
| RoE (%) | 14.3 | 11.5 | 10.6 | 12.1 | 15.2 |
| RoCE (%) | 8.7 | 9.6 | 9.5 | 10.6 | 13.9 |

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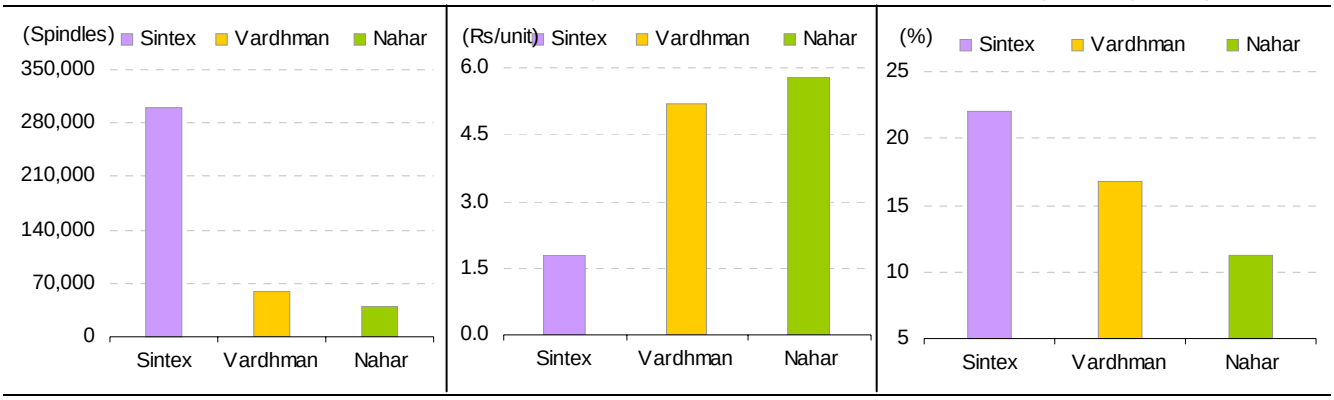
SEBI Registration Nos.: INB23 12914 37, INF23 12914 37, INB01 12914 33, INF01 12914 33.

## ❑ Greenfield spinning project – the next leg of growth

Sintex is actively pursuing the first phase of its 1m spindle project in Gujarat and expects to commence commercial production by H1FY16. Total capex for phase 1 stands at Rs18bn (300,000 spindles) and the project is likely to get commissioned in early-FY16 (we conservatively estimate a 3-6 month delay). The company expects an IRR of ~18% in the business, which is significantly higher than that of listed peers in the space. Sintex's optimism on the project stems from (a) substantial economies of scale, given its spindle size of 300,000 against an average size of 40,000 for larger players, (b) proximity to raw material sourcing, and (c) proximity to the port (60km from Pipavav, Gujarat).

Exhibit 1: Economies of scale... ... and lower power tariffs... ... to lead to higher margins vs peers




*Source: Company, IDFC Securities Research*

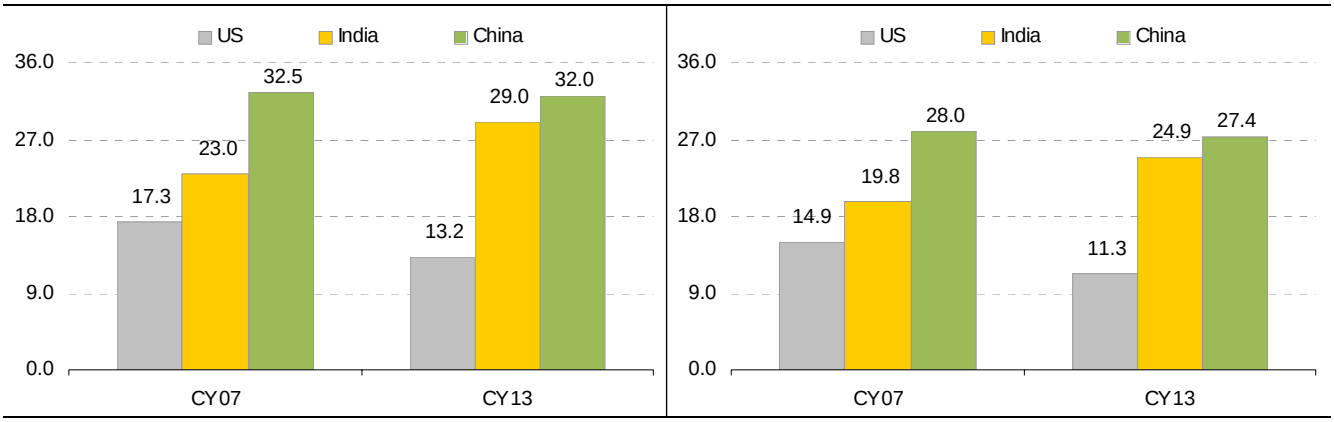
### *Attractive IRR of 18% led by various financial and operational subsidies*

Several tax sops and interest rebates which the project expects to receive from the state government should aid margin expansion. The said benefits include: (a) interest subsidy of 5% without a ceiling for the period of five years on new plant & machinery for ginning and processing, (b) interest subsidy of 7% on new plant & machinery for cotton and spinning, and (c) power tariff concession on new investment for cotton spinning at the rate of Rs1.8 per unit for five years.

### *While China's cotton cultivation is declining; India is gaining market share in global cotton production*

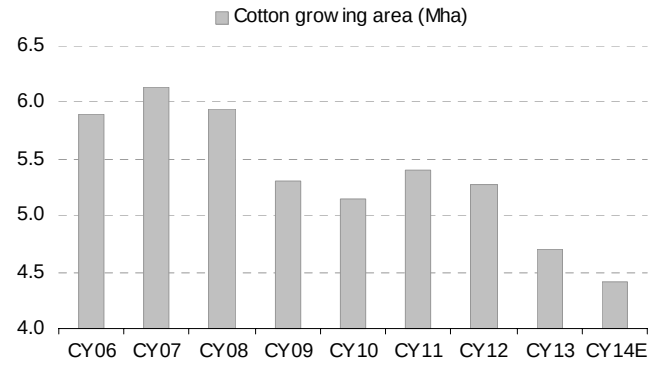
Cyclical and fragmented nature of the spinning business and intense competitive intensity, both in local and export markets, are key investor concerns pertaining to the new greenfield spinning project. Our analysis suggests that pricing risks led by China are extrapolated. In fact, over the last decade, declining acreage of cotton cultivation, increasing labour costs and appreciating currency have made spinning in China a less profitable business. Cotton production in China has been on a decline, while India's share in overall world cotton production has been on an uptrend. Hence, we are positive on Sintex's spinning venture.

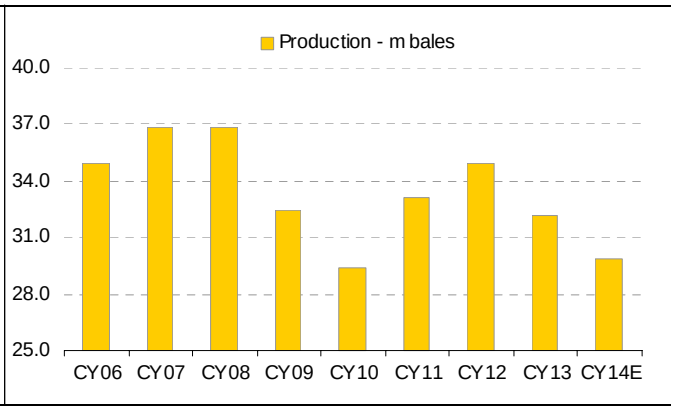
Exhibit 2: While India's cotton production and share in global markets have gone up ...




*Source: US Department of Agriculture*

Exhibit 3: ...China's cotton growing acreage and production have been on a decline

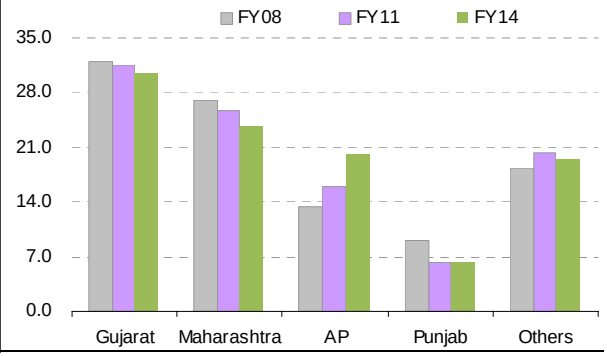



*Source: US Department of Agriculture*

Exhibit 4: Gujarat has been the highest cotton growing state in India

| | FY07 | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 |
|---|---|---|---|---|---|---|---|---|
| Gujarat | 8.8 | 8.3 | 7.0 | 8.0 | 10.4 | 12.0 | 8.7 | 10.9 |
| Maharashtra | 4.6 | 7.0 | 4.8 | 5.9 | 8.5 | 7.2 | 7.9 | 8.5 |
| AP | 2.2 | 3.5 | 3.6 | 3.2 | 5.3 | 4.9 | 6.8 | 7.1 |
| Punjab | 2.7 | 2.4 | 2.3 | 2.0 | 2.1 | 2.3 | 2.2 | 2.3 |
| Others | 4.4 | 4.7 | 4.7 | 4.9 | 6.7 | 8.8 | 8.7 | 6.9 |
| **Total** | **22.6** | **25.9** | **22.3** | **24.0** | **33.0** | **35.2** | **34.2** | **35.6** |

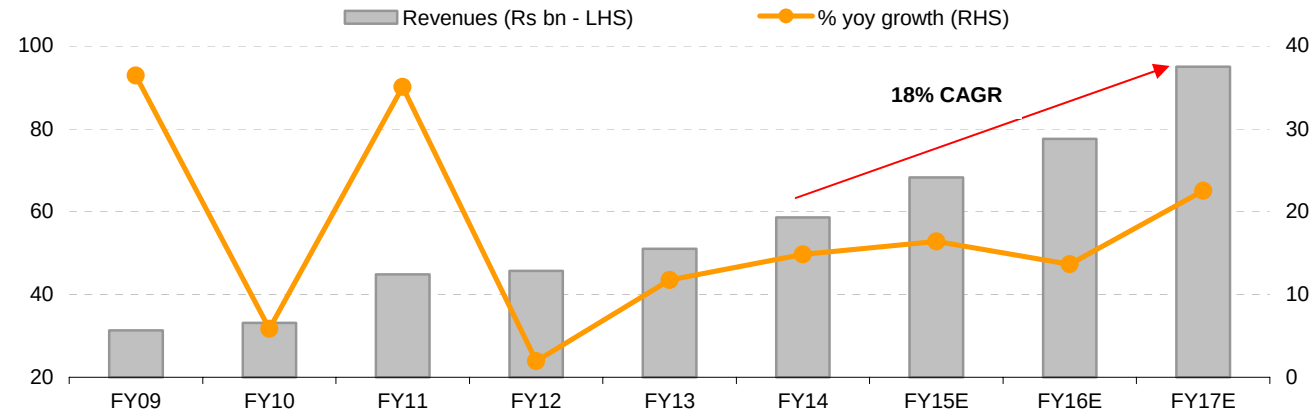



*Source: Company, India Agricultural Department*

## ❑ Revenue CAGR of 18% over FY14-17E; prefab and overseas business to be the key drivers

Sintex expects revenue CAGR of 20%+ over the next 2-3 years against our estimate of 18%. Growth would primarily be led by the prefabs business given increasing government focus on social spending. In custom moulding business, a larger footprint in overseas markets through the inorganic route (led by acquisition of Poschmann, Germany & Simonin, Poland) should help Sintex broaden the customer base, exploit synergies and make faster headway into new markets. Notably, the spinning project will account for 13% (Rs12bn) of the total FY17 revenues and drive revenue growth in the medium term. The management expects revenue growth of 18-20% in FY15 vs our estimate of 16%.

Exhibit 5: We expect revenue CAGR of 18% over FY14-17E

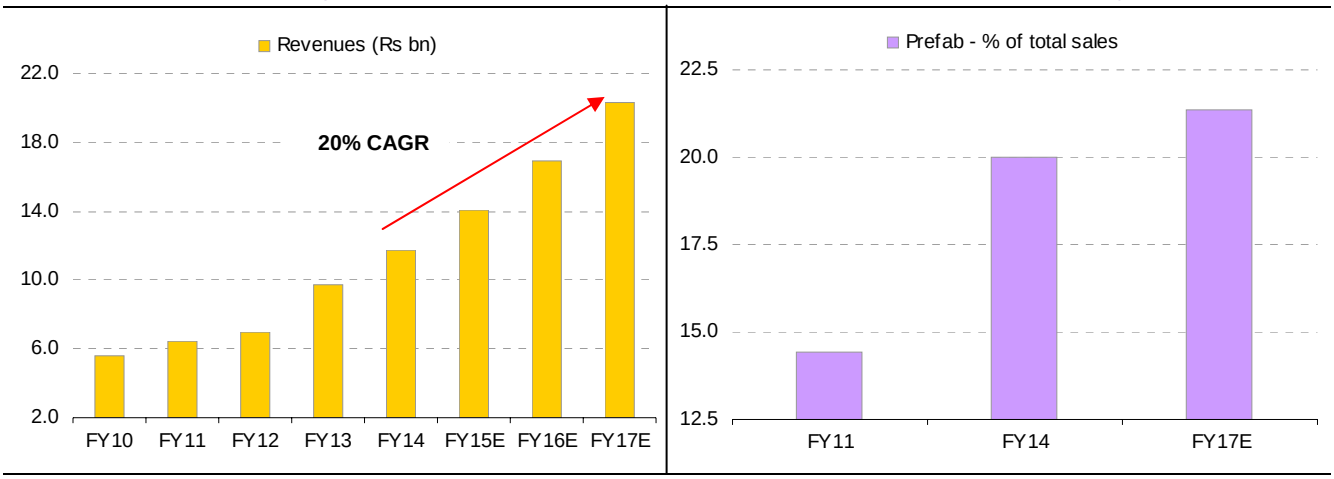



*Source: Company, IDFC Securities Research*

### *Improving social spending to aid prefab revenue growth*

Prefab revenues are mainly a function of government orders from schemes such as Sarva Siksha Abhiyan (SSA) and National Rural Health Mission (NRHM), where a substantial budget allocation happens towards infrastructure set-up of classroom, kitchens for mid day meals, toilet blocks and other healthcare centres. Sintex has secured approval from 20 states, and currently operates in 15 states with plans to increase presence to 18 states by Mar-15. After the ramp-up, we expect Sintex to execute an annual installation of ~80,000 sites, up from ~65,000 in FY14. We estimate 20% CAGR in revenues from the segment over FY14-17 with its contribution rising to ~22% (US $330m) in total revenues by FY17E from ~20% in FY14. Notably, Sintex does ~65,000 installations in a year and, given the small ticket size (average site billing of Rs1.5m), the business has little risk of payment delays.

Exhibit 6: Prefab revenues to register CAGR of 20% FY14-17E ... ... and account for 22%+ of total revenues by FY17E

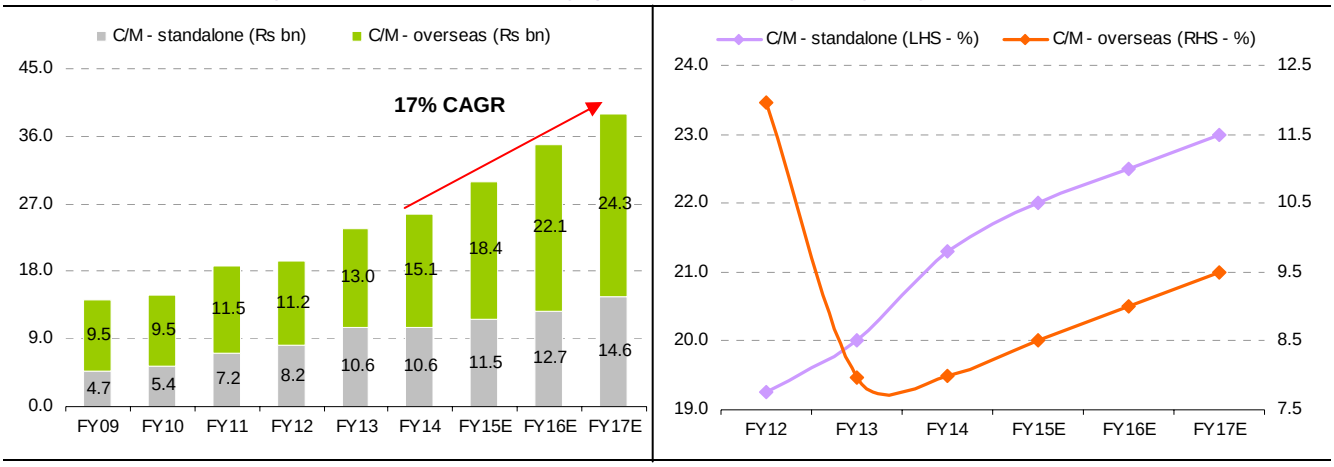



*Source: Company, IDFC Securities Research*

### *Inorganic route in overseas markets and product diffrentiation to support custom molding*

Sintex's custom molding business comprises (i) standalone operations (including a subsidiary – BRIGHT Autoplast) catering to auto markets, and (ii) overseas operations catering to electrical & power (including wind turbine, automotive, aerospace, defence, medical, transportation and other industries). The international business has grown through a series of acquisitions aimed at acquiring technology, a customer base, foray into new verticals, synergies and quicker entry into new markets. We expect overseas custom moulding revenues to grow to US$400m by FY17 from US$250m in FY14, implying a CAGR of 17%.

Exhibit 7: Custom mouldings business revenues trending up... ...as also operating margins




*Source: Company, IDFC Securities Research*

## ❑ Operating margins expected to improve by 150-200bp by FY16E

An inordinate increase in working capital cycle at monolithic business, from 110 days in FY11 to 152 days in FY13, was the key reason for margin deterioration at Sintex. This was largely on the back of delays in government processes and a longer working capital cycle (attributable to increasing interest rates and large ticket size of orders). Over the last few quarters, the company's strategy of (a) calibrated pace of execution at monolithic business, (b) moving into various applications and markets at overseas custom moulding business through acquisitions, and (iii) moving to high-end structured dyed yarn fabric in textile business have paid off. After a 130bp expansion in EBITDA margin in the last one year, Sintex expects a further increase of 150-200bp over the next two years.

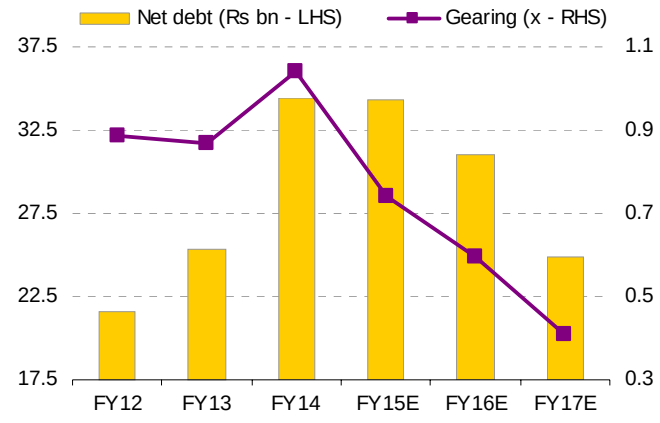
Exhibit 8: Easing of working capital cycle and lower collection days to improve operating margins

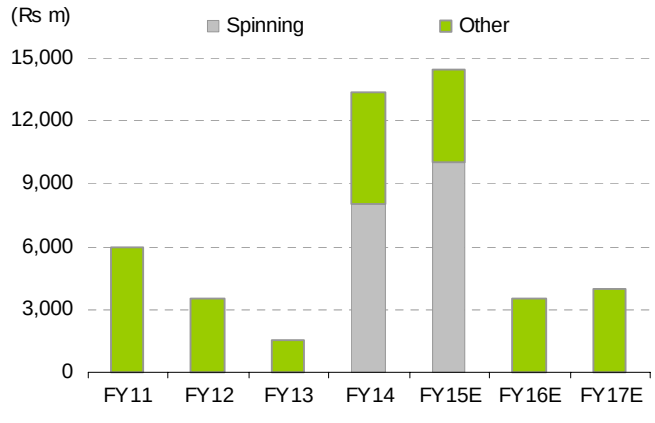

*Source: Company, IDFC Securities Research*

## ❑ Capex intensity to abate and gearing to taper sharply in FY16E

With most of the businesses not requiring substantial capex spend and given the focus on improving balance sheet health, we believe capex intensity for existing businesses will reduce in FY16E. Notably, total planned capex for FY15/16E stands at Rs14bn/3.5bn, including total maintenance capex of Rs2bn in the period. Of the total earmarked capex of Rs14bn in FY15, ~Rs10bn would be spent on the spinning project, ~Rs2bn for acquisitions and the remaining as ongoing capex. However, with phase 1 capex of spinning likely to be over in FY15, total capex in FY16 will be curtailed to ~Rs2bn.

Exhibit 9: Gearing to come off sharply in FY16E... ... as capex intensity reduces




*Source: Company, IDFC Securities Research*

Over the last few years, there has been skepticism around Sintex's higher capex intensity and overseas acquisitions. Our analysis suggests that incremental RoCE over the last two years (FY12-14) has been 19% and, even after excluding working capital release (led by lower execution at Monolithic), RoCE works out to 11%. Thus, we believe capex has been productive and this imparts comfort on capital allocation for other capex initiatives of the company.

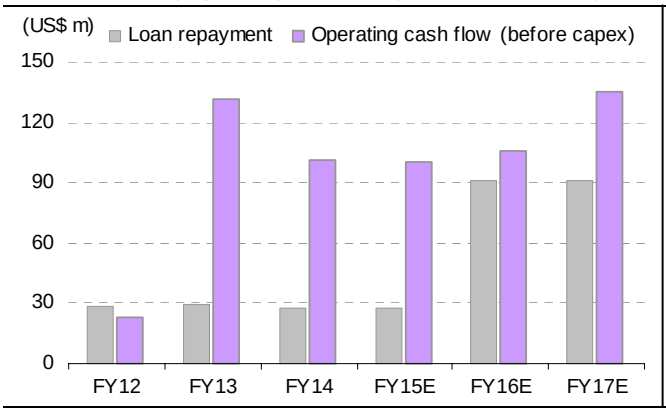
Exhibit 10: Incremental RoCE over last two years has been at 19%

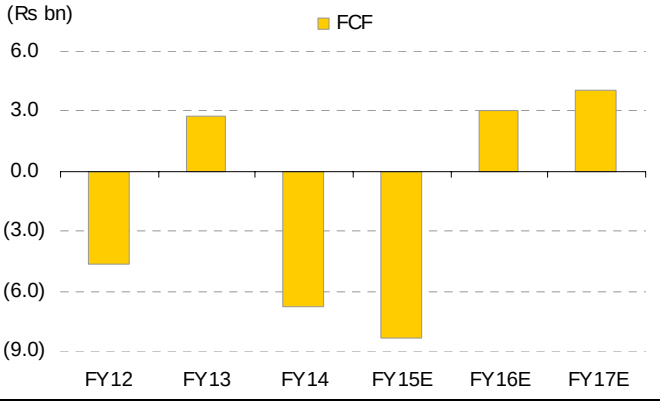
| Details | (Rs m) |
|---|---|
| Increase in gross block (a) | 14,887 |
| Increase in w/cap (b) | (6,496) |
| **Increase in total cap employed (a+b)** | **8,391** |
| Increase in sales | 12,928 |
| Increase in EBITDA | 2,475 |
| Increase in depreciation | 869 |
| **Increase in EBIT** | **1,606** |
| **RoCE on incremental cap (%)** | **19** |

## ❑ No major loan repayment due till FY15E; expect strong FCF generation starting FY16E

Post the repayment of FCCBs in March 2013, there has been no major loan repayment due in FY14 and FY15. Significant loan repayment would start in FY16, with Rs3.5bn of NCD repayments due in June 2015 to LIC. With higher operating cash flows along with lower capex intensity, we estimate free cash flow of Rs1.4bn (before Rs10bn of spinning capex) in FY15E, which should increase to Rs4.8bn in FY16E. We expect FCCB conversion of US$140m to materialize in FY15, resulting in a net debt reduction though accompanied by 36% equity dilution. We expect net gearing to come off from 1.1x in FY14 to ~0.6x by FY16E and further reduce to 0.4x in FY17E.

Exhibit 11: Strong operating cash flow generation over two years to aid FCF generation in FY16E



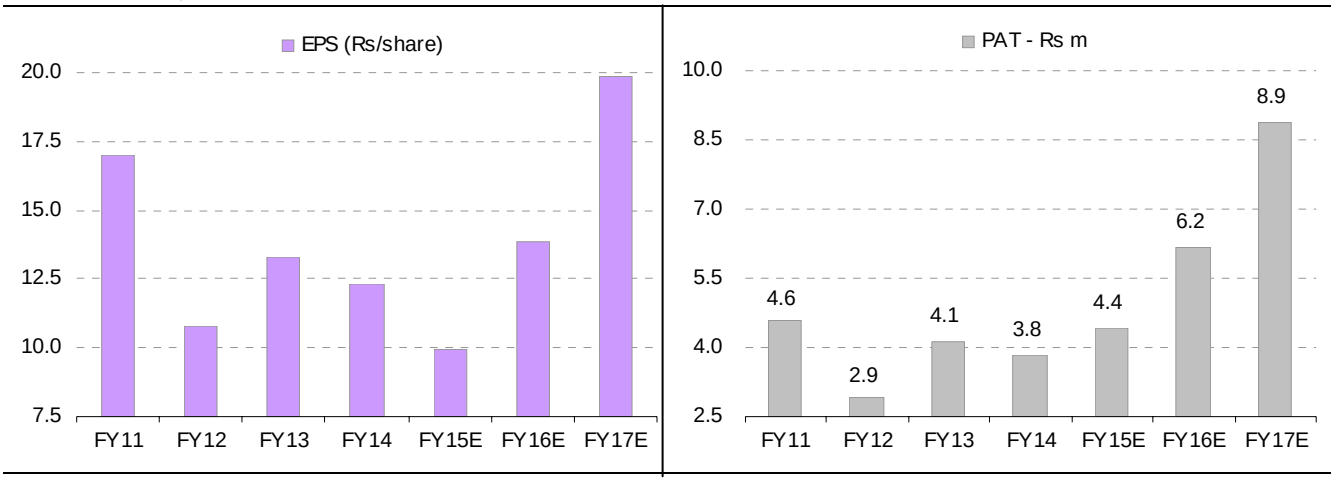




*Source: Company, IDFC Securities Research*

## ❑ PAT CAGR of 32% over FY14-17E; reiterate Outperformer with a revised price target of Rs134

With a general macroeconomic turnaround, improving trajectory of businesses linked to government spending and easing working capital cycle, we expect earnings growth acceleration for Sintex over the next two years. Also, FCCB conversion and improving FCF profile would aid balance sheet deleveraging starting FY16. However, a 36% equity dilution on account of the FCCB conversion implies EPS CAGR of 17% over FY14-17E (vs 32% PAT CAGR). With better growth prospects and high visibility on RoE expansion, we expect a further re-rating in the stock. Reiterate Outperformer with a revised price target of Rs134 (8x FY16E EPS and 0.6x capital employed in spinning project).

Exhibit 12: We expect 17% EPS CAGR and 32% PAT CAGR over FY14-17E




*Source: Company, IDFC Securities Research*

## Income statement

| Year to 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| **Net sales** | **51,076** | **58,645** | **68,256** | **77,567** | **95,033** |
| *% growth* | *11.7* | *14.8* | *16.4* | *13.6* | *22.5* |
| Operating expenses | 43,384 | 49,003 | 56,796 | 64,093 | 77,138 |
| **EBITDA** | **7,692** | **9,642** | **11,460** | **13,474** | **17,896** |
| *% change* | *7.3* | *25.4* | *18.9* | *17.6* | *32.8* |
| Other income | 599 | 774 | 500 | 500 | 500 |
| Net interest | (1,465) | (2,894) | (2,732) | (2,272) | (2,423) |
| Depreciation | 2,054 | 2,548 | 3,374 | 3,515 | 4,192 |
| Pre-tax profit | 4,771 | 4,975 | 5,855 | 8,187 | 11,780 |
| Current tax | 669 | 1,180 | 1,464 | 2,047 | 2,945 |
| Profit after tax | 4,102 | 3,795 | 4,391 | 6,140 | 8,835 |
| Minorities | 36 | 36 | 36 | 36 | 36 |
| **Net profit after non-recurring items** | **4,138** | **3,831** | **4,427** | **6,176** | **8,871** |
| *% change* | *41.3* | *(7.4)* | *15.6* | *39.5* | *43.6* |

## Balance sheet

| As on 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Paid-up capital | 311 | 311 | 447 | 447 | 447 |
| Reserves & surplus | 30,939 | 35,127 | 47,846 | 53,666 | 62,181 |
| Total shareholders' equity | 31,250 | 35,438 | 48,293 | 54,112 | 62,627 |
| Total current liabilities | 10,505 | 13,191 | 15,117 | 15,270 | 18,158 |
| Total debt | 34,802 | 38,193 | 39,870 | 35,870 | 33,370 |
| Deferred tax liabilities | 2,906 | 3,358 | 3,858 | 4,358 | 4,858 |
| Other non-current liabilities | 1,620 | 774 | 774 | 774 | 774 |
| Total liabilities | 49,832 | 55,517 | 59,620 | 56,273 | 57,161 |
| **Total equity & liabilities** | **81,082** | **90,955** | **107,912** | **110,385** | **119,788** |
| Net fixed assets | 32,591 | 37,403 | 48,630 | 48,615 | 48,423 |
| Investments | 705 | 2,487 | 2,487 | 2,487 | 500 |
| Total current assets | 35,205 | 31,745 | 37,475 | 39,963 | 51,545 |
| Deferred tax assets | 27 | 70 | 70 | 70 | 70 |
| Other non-current assets | 12,554 | 19,251 | 19,251 | 19,251 | 19,251 |
| Working capital | 24,700 | 18,554 | 22,358 | 24,693 | 33,386 |
| **Total assets** | **81,082** | **90,955** | **107,912** | **110,385** | **119,788** |

## Cash flow statement

| Year to 31 Mar (Rs m) | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Pre-tax profit | 4,771 | 4,975 | 5,855 | 8,187 | 11,780 |
| Depreciation | 2,054 | 2,548 | 3,374 | 3,515 | 4,192 |
| Chg in Working capital | (6,612) | (7,052) | (1,554) | (3,177) | (4,898) |
| Total tax paid | (669) | (1,180) | (1,464) | (2,047) | (2,945) |
| Ext ord. Items & others | 1,304 | (846) | - | - | - |
| Operating cash Inflow | 848 | (1,555) | 6,210 | 6,478 | 8,129 |
| Capital expenditure | (5,690) | (7,067) | (14,600) | (3,500) | (4,000) |
| Free cash flow (a+b) | (4,842) | (8,623) | (8,390) | 2,978 | 4,129 |
| Chg in investments | (36) | (1,782) | - | - | 1,987 |
| Debt raised/(repaid) | 5,255 | 3,392 | 1,677 | (4,000) | (2,500) |
| Capital raised/(repaid) | 40 | - | 135 | - | - |
| Dividend (incl. tax) | (248) | (248) | (356) | (356) | (356) |
| Misc | 1,371 | 1,052 | 9,184 | 536 | 536 |
| Net chg in cash | 1,541 | (6,209) | 2,250 | (842) | 3,795 |

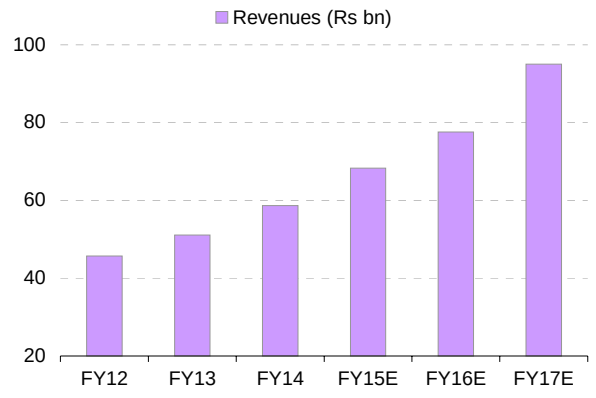
## Key ratios

| Year to 31 Mar | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| EBITDA margin (%) | 15.1 | 16.4 | 16.8 | 17.4 | 18.8 |
| EBIT margin (%) | 11.0 | 12.1 | 11.8 | 12.8 | 14.4 |
| PAT margin (%) | 8.1 | 6.5 | 6.5 | 8.0 | 9.3 |
| RoE (%) | 14.3 | 11.5 | 10.6 | 12.1 | 15.2 |
| RoCE (%) | 8.7 | 9.6 | 9.5 | 10.6 | 13.9 |
| Gearing (x) | 0.8 | 1.0 | 0.7 | 0.6 | 0.4 |

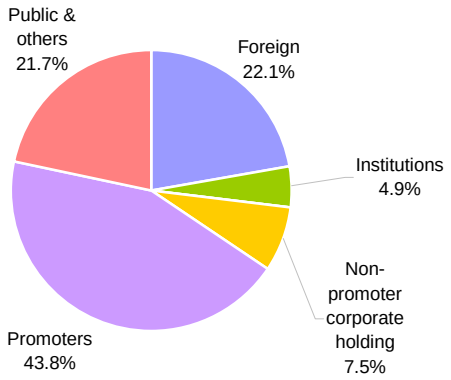
## Valuations

| Year to 31 Mar | FY13 | FY14 | FY15E | FY16E | FY17E |
|---|---|---|---|---|---|
| Reported EPS (Rs) | 13.3 | 12.3 | 9.9 | 13.8 | 19.9 |
| Adj. EPS (Rs) | 13.3 | 12.3 | 9.9 | 13.8 | 19.9 |
| PE (x) | 5.5 | 5.9 | 7.4 | 5.3 | 3.7 |
| Price/ Book (x) | 0.7 | 0.6 | 0.7 | 0.6 | 0.5 |
| EV/ Net sales (x) | 0.9 | 1.0 | 1.0 | 0.8 | 0.6 |
| EV/ EBITDA (x) | 6.2 | 6.0 | 5.8 | 4.7 | 3.2 |
| EV/ CE (x) | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 |

## We expect revenue CAGR of 18% over FY14-17E




## Shareholding pattern




*As of June 2014*

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