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The Trick Is To Spot Them At The Larval Stage

TINY TREASURE

April 2016

BSE Code	:	**532641**
Time Duration	:	**1 year**
CMP	:	**₹136 (as on 27 April, 2016)**
Target Price	:	**₹168**

Nandan Denim

A LEADER IN THE MAKING

From the treasure chest of Small-caps, we would like to pick Nandan Denim. The company will eventually be the largest denim fabric facility in India and fourth largest in the world. It enjoys 10% of the domestic fabric market share.

We believe Nandan Denim has potential upside due to its capacity expansion, higher margins, product diversification, backward integration and tax incentives bailed out by the government. We also reassert confidence in management's ability to deliver good performance, as it is part of the Chirpal group and stands in an advantageous position due to established customer relationships.

Industry growth: Company believes the Indian domestic denim market is historically growing at the rate of 15-18% CAGR and will continue to grow at this rate. International markets are growing at 3-4%. As of now 3/4th of the exports of domestic denim industry are to Bangladesh and residual 25% are for the rest of the markets, prominent amongst them being Southeast Asia and African countries.

Capacity expansion: To take advantage of the growth in domestic market, company is expanding the spinning capacity to 124 tons per day and 110 mm per annum for Denim. It currently has Shirting facility of 10 million meters and Denim of 99 million meter per annum. The spinning capacity is 70 tonnes a day which company plans to expand to 124 tonnes a day. The capex outlay for this is Rs 612 crores to be funded 70% by debt.

With this, the company will become the player with the largest capacity domestically to be followed by Arvind Mills. We believe the capacity addition is going to incrementally add to revenues as it can further take advantage of industry growth and also will improve margins due to backward integration to the tune of 4-5% above the competition. Company is currently outsourcing 50% of its requirement which will henceforth be done in-house. The processing unit is under construction and will be completed by second half of FY17. This will help company to sell shirting fabric and not Grey Fabric which has lower margins. Company also aims to maintain its capacity utilisation of 80-85% going forward.

Product diversification: The Company manufactures denim and shirting fabric and has seen a CAGR growth of 21.2% in revenue over FY11-15. In FY15, the company saw 41.6% increase in the revenue from denim. It contributes 77% to the revenue (from 67% in FY14) and 94-95% in 9months ending Dec15. A new product, 'Shirting fabric' was introduced during FY15 and it contributed 11% to the revenue in FY15. Denim business has better margins and we believe the further incremental revenue will come from this area.

Company is inclined towards shifting its focus on premium products and would like to contribute to substantial portion of the revenue through sale of these. We see that the price mix is benefiting the company, and is also adding to the topline along with improving EBITDA margins which expanded by 105 basis points in 9mths ended Dec15. Revenues from exports are growing continuously, constituting 12.3% from exports in FY15 and 13% in 9mDec15. Margins are similar to that of the domestic market. However, the company believes there is scope to increase the exposure to international markets.

Government Subsidy: Company will benefit from Gujarat textile policy which will provide 5% (7% - spinning facility) interest subsidy and power subsidy @ Rs1/unit for 5 years. Also, the company will be able to claim benefit under VAT/Entry Tax reimbursement for 8 years and 100% stamp duty reimbursement. Also, under TUFS (Central textile policy), it will be getting 5% interest subsidy and 10% capital subsidy for a period of 7 years. This will be applicable once the new capacity expansion plan is completed in second half of FY17. The new debt of Rs 428.4 crores for capacity expansion raised will be having interest rate of 1-2% vs 6% for the old loans and 12% for the working capital. This will provide benefits of operating leverage to the company and will improve margins disproportionally

Raw material proximity: Company sources 50% of the yarn from other players and rest is made in-house. Nandan Denim imports 10% of the raw material and rest is procured indigenously. Due to its strategic location in Gujarat, company needs to keep low inventory levels of 1 -1.5 a month for cotton as it is in the proximity of cotton producing areas.

Valuations metrics: The current P/E ratio of 9.97 is at lower end compared to its peer Arvind at 23.8. We believe stock will see growth in revenue of 20% and bottom line of 15%, and will see an upside of ~24% on the share price, touching levels of 168.