December 8, 2014

Sarla Performance Fibers

"On the cusp of an earnings break-out"

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

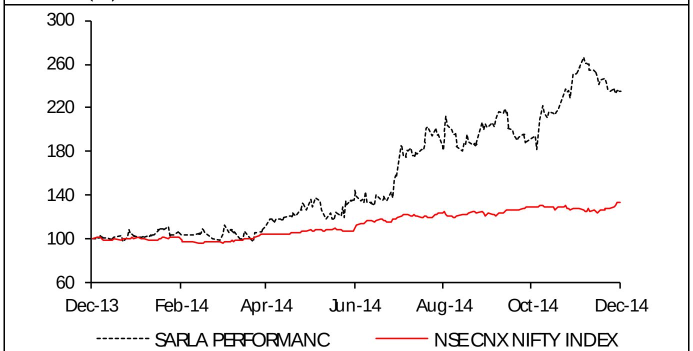
Initiating Coverage | Sarla Performance Fibers Limited

Recommendation	BUY
CMP (Rs.)	Rs. 395
Target Price (Rs.)	Rs. 520(Upside 32%)

Stock Details

BSE Code	526885
Bloomberg Code	SRPL IN
Market Cap (Rs. cr)	330
Free Float (%)	34
52- wk HI/Lo (Rs)	469/161
Avg. Volume	7723
Face Value (Rs)	10.0
Dividend(%) (FY 14)	75
Shares o/s (Crs)	0.83

Relative Performance	1Mth	6Mth	1Yr
SRPL IN(%)	(8.4)	68.8	135.3
NIFTY(%)	2.4	12.6	36.4



Shareholding Pattern as on 30 September 2014	
Promoters Holding	66.4%
Institutional (Incl. FII)	2.2%
Corporate Bodies	6.2%
Public & others	25.2%

Vishal Jajoo - Sr. Research Analyst
(+91 22 3926-8136)
Email id: vishal.jajoo@nirmalbang.com

Snapshot

Sarla Performance Fibers (Sarla Performance) commenced operations as a manufacturer of commodity yarns and gradually progressed to specialized and high value-added yarns.

Investment Rationale

- **70 per cent of incremental profits to come from US business:** Sarla Performance is the first Indian textile company to set up a manufacturing unit in the USA. With this facility, the wholly-owned subsidiary of the company, Sarlaflex Inc. would be able to cater to large textile companies based out of the US, taking benefit of the NAFTA/CAFTA rules. This should add to the competitiveness of the company on account of taxes to the tune of 32 per cent.

- **Set up the US facility at one of the lowest possible investment:** The facility (spread over an area of 42 acres, 3.3 lakh square feet construction area) in South Carolina was acquired for ~Rs.4 crore. The replacement cost of this facility could easily be around Rs.100 crore. In fact, as per an estimate the yearly cost of upkeep should be equal to the cost which Sarla Performance paid for the acquisition.

- **Pro-active approach; unlike other commoditized textile players:** The promoters have been pro-active in changing the business model at the opportune time. Sarla Performance tweaked the business model to shift from a commodity player and entered value-added segment (year 2006). Similarly, the company entered the US market at the opportune time when it appeared that the Indian business would offer a stable growth model.

- **Clean Balance Sheet:** The repayment of the acquisition cost is to be done over a period of seven years. The net debt in the books of the company stands at Rs.120 crore while the networth is approximately Rs.170 crore.

- **Consistent track record in the past:** The net sales, EBITDA and PAT of the company registered a CAGR of 17 per cent, 18 per cent, 16 per cent respectively over the last 10 years.

Valuation & Recommendation

On the back of stabilization of the US facility, we expect FY'15E to be a year of consolidation with decent growth in the topline but very marginal growth in the bottomline.

We expect the company to post a PAT of Rs.39.5 crore on a topline of Rs.380 crore in FY'16E, translating into an EPS of Rs.47.3. We value the business at 11x FY'16E earnings to arrive at a price target of Rs.520 by September 2015.

Particulars (Rs Cr)	Net Sales	*Growth (%)*	EBITDA	PAT	EPS (Rs)	P/E (x)
FY'13	258.7	*17.2%*	45.6	27.9	33.4	11.8
FY'14	261.8	*1.2%*	64.9	31.7	38.0	10.4
FY'15E	340.0	*29.9%*	69.4	33.9	40.6	9.7
FY'16E	380.0	*11.8%*	81.5	39.5	47.3	8.4

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

INVESTMENT RATIONALE

The US business should be the key contributor

Sarla Performance is the first Indian textile company to set up a facility in the US. The facility operating at 20 per cent of the capacity utilization (at present) offers immense potential to the earnings going forward. As per our estimates, the US facility (operating through a 100 per cent subsidiary of the company) – Sarlaflex Inc. should be contributing more than 70 per cent of the incremental profits of the company going forward.

Set up a plant in South Carolina at one of the lowest possible cost structure…

The company has set up the plant in South Carolina at one of the lowest possible cost structure.

Dimensions	Particulars	Remarks
Area	Spread over an area of 42 acres of land	The replacement cost of the facility would be around Rs.100 crore
Built-up specifications	Constructed area of 3.3 lakh square feet	The acquisition cost could be the charges required for the upkeep of the building and allied premises
Payment terms	Spread over a span of 7 years	The County cannot keep a profit margin

(Source: Nirmal Bang Research)

Since the company acquired this huge property from the County and as per the prevalent laws, the County cannot sell any property with a profit margin, the cost of acquisition of this property is just Rs.4 crore and that too spread over a 7-year period.

The replacement cost itself of the facility could be around Rs.100 crore (equal to more than 20 per cent of the present enterprise value).

To summarize, the cost of manufacturing in the US is very competitive compared to that in India except in terms of labour. However, a significant portion of the same was offset by cheap cost of power and capital. Additionally, this puts the company in proximity to world's largest textile companies for growth.

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Deriving full benefits of the NAFTA and CAFTA rules

Under the NAFTA and CAFTA agreement, there is a growing preference of procuring readymade garments as well as yarn manufactured in the US itself. Import of the same outside the US territories invokes duty as high as 32 per cent.

Sarla Performance being the first Indian textile company to set up a facility in the US is strategically placed to reap the benefits of the same. It was the first new plant to start in POY (Partially Oriented Yarn) manufacturing in the USA in the past 25 years.

At present, a single local supplier meets 50 per cent of the demand thereby offering huge potential market for Sarla Performance.

While the overseas business will provide scalability, domestic business will provide stability

With infrastructure already in place and facilities being set up, the US business which commenced operations in January 2014 is operating at 20 per cent capacity utilization. This business has the potential to achieve break-even levels at just 30 per cent utilization levels. Sarla Performance has supplied trial quantities to atleast 20 customers. The company has started attaining the right quality across spinning, texturizing and twisting processes. Sarlaflex has already started hiring senior managers to set right the quality standards demanded by large US textile companies. The impact of these initiatives should be visible over the next 2-3 years, as the company moves towards full utilization of the plant in the USA.

Once a sizeable level is reached with regard to utilisation, the company is contemplating phase II as well.

However, for our own projections, we have considered contribution only from phase I of the facility.

The domestic business is expected to grow at a CAGR of ~4 per cent and realizations are expected to increase by 3 per cent over the next couple of years.

One of the strongest Balance Sheets in the sector

The consolidated net debt in the books of the company stands at Rs.150 crore. Out of this, a sum of Rs.22.5 crore is due to a new market tax credit transaction that the company has availed in the US, which allows fiscal incentives. Therefore, the net debt is Rs.127 crore against networth of Rs.170 crore. The average cost of debt is around 4 per cent per annum and interest coverage is 12-13x.

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Proven track record

Operating in the niche segment of textiles, the company has a proven track record. While the revenues of the company have registered a continuous growth, EBITDA margins over the last three years have improved from 14.5 per cent to 19.3 per cent.

Sarla Performance has begun production of Nylon 66 high tenacity yarn. Nylon 66 high tenacity and low shrinkage yarn is a niche and specialized offering. The products finds its applications in high-end segments like parachutes, car air bags, specialized sewing applications in automotive, shoes, leather, industrial filters, hoses, among others.

Nylon 66 is a high-margin product in the overall portfolio and at present, the focus of the company in the domestic markets is the air bags segment.

Due to the lengthy time taken for approvals by the systems suppliers, the current supplies for air bag end-application is miniscule but over the next two years, the management expects this segment to contribute 10-15 per cent to the consolidated revenues.

Diversified portfolio with a marquee client base

The company’s product portfolio finds application in high value-added applications like:

- Innerwear, hosiery and sportswear
- Threads
- Industrial yarn &
- Commodity yarns

The company has a marquee list of clients which include multi-national names like Gildon. The company has also set up exclusive warehouses in Vietnam for renowned international innerwear player - Hanes.

Through Sarlaflex Inc., the company as a manufacturer of compliant yarn, has an edge over the exporters from around the world and has started dispatching small quantities to a wide range of clients in sewing threads, hosiery, lingerie and furnishing-related applications.

Consistent performance backed by conservative approach

Being a niche player in the segment, Sarla Performance has been consistently performing over the past several years. The company has maintained strict discipline with regard to the debt levels in the Balance Sheet and has never over-shot the same irrespective of the availability of subsidized loans under the TUFS (Textile Upgradation Fund Scheme).

The conservative nature of the management can be gauged from the fact that before commencement of the US facility, the management preferred to enter the windmill segment (7.25 MW capacity, 17-18 per cent returns per annum) since the Indian textile operations were expected to grow at a moderate pace.

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Changing the business model at the right time

The company began operations in the year 1993 in polyester segment. Over a period of time, the management realized that going forward, the growth should come from value-added products. Therefore, the company was renamed as Sarla Performance Fibers, in-line with the change in business model.

Sarla Performance entered the niche Nylon 66 segment for the domestic markets on one hand while sensing the growth opportunity in the US market, set up a facility through Sarlaflex Inc. in the US markets.

Year	Particulars
2002	Expanded product portfolio to sewing thread from commodity polyester yarns
2004	Established second manufacturing unit in Silvassa
2006	A change in the company's name from Sarla Polyester
	Set up a spinning plant for conversion of nylon chps into high tenacity nylon 6 and nylon 66 industrial yarns
2007	Expanded production capacities in Silvassa
2009	Established a JV in Portugal, Sarla Europe LDA
2010	Installed first windmill in Gujarat of 1.25 MW
2011	Installed windmill of 2 MW in Satara, Maharashtra
2012	Set up two more windmills in Sangli, Maharashtra
2013	Directly entered American POY Market through setting up wholly-owned subsidiary Sarlaflex Inc, at South Carolina
2014	Started commercial production at POY from a green field plant at South Carolina, USA in January 2014

Recently concluded QIP to fund the capex requirement

Sarla Performance recently concluded a QIP for a sum of Rs.47 crore. Eminent names in mutual fund industry like HDFC, DSP Blackrock and Tata Mutual Fund have subscribed for the same. These funds should help the company fund capex going forward.

RISKS & CONCERNS

Any delay in ramping up the US project

The growth driver for the company going forward is Sarlaflex Inc. Any significant delay in ramping up the facility and failure to derive the desired output can put stress on the financial performance of the company.

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

COMPANY BACKGROUND

Promoted by Mr. Madhusudan Jhunjhunwala and Mr. Krishnakumar Jhunjhunwala, Sarla Performance Fibers was incorporated as Sarla Polyester Limited in the year 1993. The company was a 100 per cent EOU (Export Oriented Undertaking). The company has four manufacturing facilities – three in Silvasa and one in Vapi. Sarla Performance has a strong global presence and reach with exports to over 50 countries.

INDUSTRY BACKGROUND

With the overall changing macros across the globe with China, the leader, losing its labour advantage over a period of time, we feel that Indian textile companies are strategically placed.

With developed economies, particularly the US showing significant signs of improvement, a number of policies are supportive of setting up manufacturing facilities in that particular geography.

VALUATION AND RECOMMENDATION

On the back of stabilization of the US facility, we expect FY'15E to be a year of consolidation with decent growth in the topline but very marginal growth in the bottomline.

We expect the company to post a PAT of Rs.39.5 crore on a topline of Rs.380 crore in FY'16E, translating into an EPS of Rs.47.3. We value the business at 11x FY'16E earnings to arrive at a price target of Rs.520 by September 2015.

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Financials

Profit & Loss Account	FY'13	FY'14	FY'15E	FY'16E
Net Revenues	258.7	261.8	340.0	380.0
Other Income	2.1	13.2	14.4	16.5
Total Income	**260.8**	**275.0**	**354.4**	**396.5**
Raw material	140.6	143.7	175.0	195.0
Operating cost	44.1	31.9	55.0	60.0
Other expenses	30.5	34.5	55.0	60.0
Total Expenses	215.2	210.1	285.0	315.0
PBIDT	45.6	64.9	69.4	81.5
Depreciation	8.2	11.1	16.0	18.0
Interest	5.7	6.8	5.5	6.0
Profit before tax	35.1	42.1	47.9	57.5
Taxes	6.7	9.9	14.0	18.0
Extra-ordinary item	0.0	0.5	0.0	0.0
Net Profit	**27.9**	**31.7**	**33.9**	**39.5**

Quarterly results	Dec.13	Mar.14	Jun.14	Sep.14
Net Sales	63.0	70.7	82.1	80.1
Other Income	0.6	4.8	3.6	5.2
Total Income	63.6	75.5	85.7	85.3
Total Expenses	49.1	62.3	71.8	67.2
PBIDT	14.5	13.2	13.9	18.1
Interest	1.1	1.2	1.0	1.1
Depreciation	2.4	4.0	3.9	4.1
Taxes	3.0	1.7	2.6	3.2
Minority Interest	0.0	0.0	0.0	0.0
PAT	8.0	6.3	6.4	9.7

Profitability Ratios	FY'13	FY'14	FY'15E	FY'16E
EBITDA margin	17.6%	24.8%	20.4%	21.4%
PAT margin	10.8%	12.1%	10.0%	10.4%

Growth Ratios	FY'13	FY'14	FY'15E	FY'16E
Net Sales growth	17.2%	1.2%	29.9%	11.8%
EBITDA growth	32.2%	42.3%	6.9%	17.4%
PAT growth	47.6%	13.6%	6.9%	16.5%

Balance Sheet (Rs. Cr.)	FY'13	FY'14	FY'15E	FY'16E
Equity Capital	7.0	7.0	8.4	8.4
Reserves & Surplus	135.1	162.2	185.0	205.0
Networth	142.1	169.2	193.4	213.4
Secured loans	102.4	197.7	195.0	191.0
Unsecured loans	11.8	35.5	20.0	25.0
Total loan funds	114.2	233.2	215.0	216.0
Total Liabilities	**260.4**	**405.8**	**455.8**	**490.8**
Net Block	102.1	196.1	205.0	216.0
Investments	2.8	54.8	54.8	54.8
Current Investments				
Current Assets	167.6	202.1	250.0	280.0
Current Liabilities	36.5	42.5	45.0	60.0
Total Assets	**260.4**	**405.8**	**455.8**	**490.8**

Cash flow (Rs. Cr.)	FY'13	FY'14	FY'15E	FY'16E
Profit before tax	35.1	42.1	47.9	57.5
Net cash from operations	27.3	34.8	36.0	42.0
Net cash from investments	(54.5)	(123.8)	(60.6)	(59.4)
Net cash from financing activities	36.5	103.9	104.0	106.0
Net change in cash	9.3	14.9	79.4	88.6

Valuation Ratios	FY'13	FY'14	FY'15E	FY'16E
Marketcap/Sales	1.3	1.3	1.0	0.9
Fully diluted EPS	33.4	38.0	40.6	47.3
P/E	11.8	10.4	9.7	8.4

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com