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Lakshmi Machine Works Ltd. (LMW)

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Established in 1962, Lakshmi Machine Works (LMW) is one of India's largest textile machinery manufacturers. The company is primarily engaged into manufacturing Machine tools. LMW has 60% market share in the domestic Textile Spinning Machinery Industry. It manufactures spindles, rings, top rollers, flyers, cots & aprons and gears. The company caters to both domestic and international markets.

Investment Rationale

LMW enjoys competitive advantage as a market leader: LMW enjoys 70% volume market share and 60% value market share in India. It has several benefits over competition such as cost competitiveness, strong after sales network, a huge customer base and world class technology to manufacture products. On an average, LMW's machinery is 10-15% cheaper compared to European competitors who have set up base in India. It also has an after sales office in every textile hub of the country. These factors play an important role in fortifying its position as the market leader.

Growth in textile export bodes well for the company: India currently accounts for a 4% share in the global textile industry and has 22% of the world's total installed capacity. The government is pushing to increase its market share to 8% by 2020. Indian textile industry one of the largest contributors to India's exports contributing about 30% to the country's total exports basket. The government is aiming to increase exports via Merchandise Exports from India Scheme (MEIS), which has recently been modified to include the markets of Bangladesh and Sri Lanka. This increase is expected to push up the derived demand for spinning machinery thereby catalysing growth for the company.

Judicious working capital management: LMW effectively controls its working capital requirements which is the biggest strength for the company. The company has been a huge cash balance of Rs. 975.2 Crores amounting to a cash/share of Rs. 886. Net working capital has remained negative since FY06. The company follows the practice of taking advance payment of at least 10% (non-refundable) on new orders, which bodes well the working capital management.

Order book to pick up FY17E onwards: Due to lower planned capex in the textile industry in India, the company's order inflow in FY16E is expected to decline to Rs. 1,300 Crores from Rs. 2,090 Crores, thus resulting in an order book of Rs. 4,350.2 in FY16E as against Rs. 5,594.1 Crores in FY15. However, with the anticipated start of higher investment cycle in FY17E due improving macro sentiments and government's push to the textile sector, the order inflow is expected to increase to Rs. 2,000.0 Crores in FY17E. We expect the top-line to moderate and stand at Rs. 2,392.6 Crores in FY16E, while it is expected to rise to Rs. 2,572.4 Crores by FY17E.

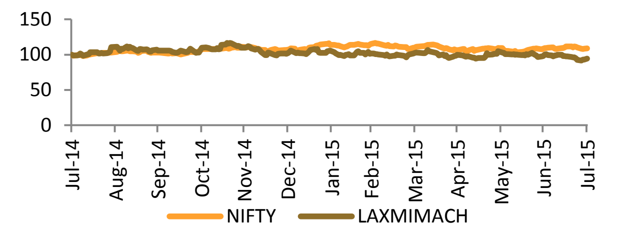
Market Data

Rating	**BUY**
CMP (Rs.)	3,577.0
Target (Rs.)	**4,289**
Potential Upside	20%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	4,499/3,451
Adj. all time High (Rs.)	4,499
Decline from 52WH (%)	20.5
Rise from 52WL (%)	3.7
Beta	0.4
Mkt. Cap (Rs.Cr)	4,030.2

Fiscal Year Ended

Y/E	FY14A	FY15E	FY16E	FY17E
Revenue (Rs.Cr)	2,337.8	2,488.2	2,392.6	2,572.4
Net profit (Rs.Cr)	189.0	219.6	190.4	237.3
EPS (Rs.)	167.8	194.9	169.0	210.6
P/E (x)	18.1	18.3	21.2	17.0
P/BV (x)	3.1	3.1	2.8	2.4
ROE (%)	18.3	18.4	13.9	15.1

One year Price Chart



Shareholding Pattern	Jun-15	Mar-15	Chg.
Promoters	28.4	28.4	0.0
FII	1.8	2.6	(0.8)
DII	26.6	25.3	1.3
Others	43.2	43.7	(0.5)

Lakshmi Machine Works Ltd.

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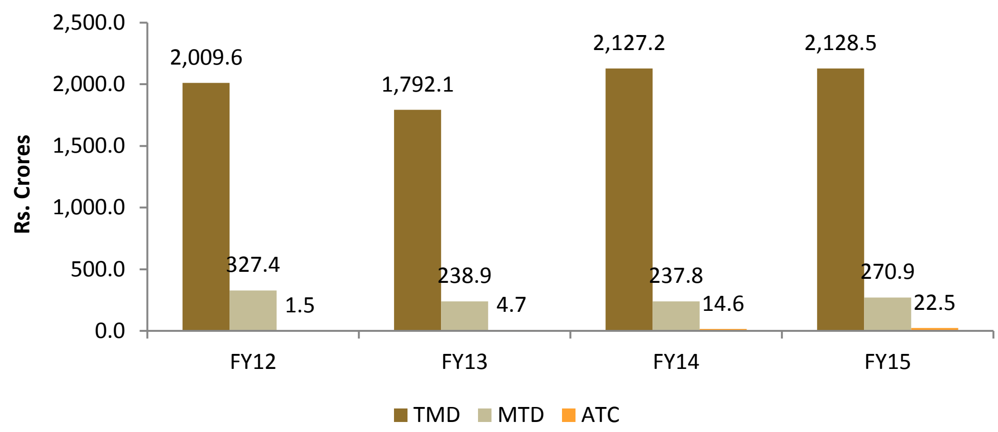
Manufacturing units or installation of all these divisions is located in Coimbatore, Tamil Nadu and India. 92% of its order inflows arise from TMD. Its domestic business generates 80% of its revenues while the rest are accounted for by exports. It specializes in ring frame based spinning machines and commands 10% market share globally for this division. Its biggest customers include Trident, Vardhman and Welspun. The company has tie-ups with Voltas and Super Sales for selling its components.

Segmental revenue contribution



Improved EBITDA despite falling revenue

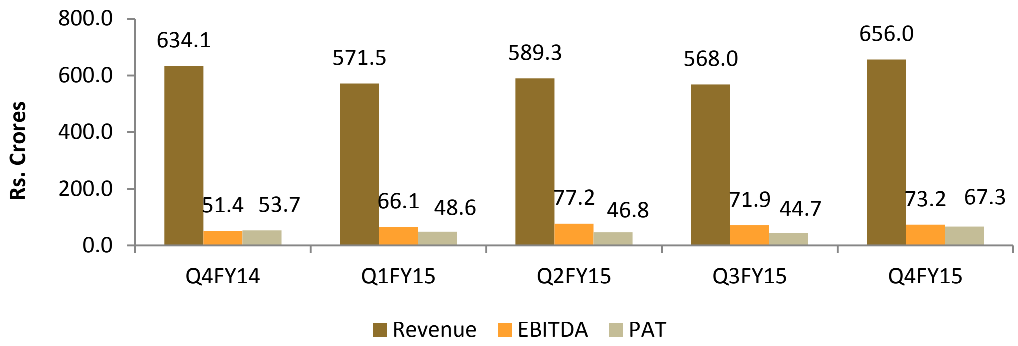
Net revenue for Lakshmi Machine works increased marginally by 3% YoY and stood at Rs. 638.6 Crores during Q4FY15. EBITDA registered a 42% YoY growth due to constant operating cost.

Net revenue for Lakshmi Machine works increased marginally by 3% YoY and stood at Rs. 638.6 Crores during Q4FY15. Revenues for the MTD increased by 12% YoY reported at Rs. 83.7 Crores led by a pick-up in automotive demand. The revenue from its largest business segment TMD remained largely flat at Rs. 568.14 Crores declining by 1.4% due to financing issues within the industry. LMW's order book at Q4FY15-end stood at Rs 3,050.0 Crores declining by 13.1% YoY primarily due to industry headwinds. Order book for domestic textile machinery was at Rs 2,890.0 Crores. Order inflows have increased by 10% to Rs 2,090.0 Crores, out of which 8% were export orders and are likely to remain at similar levels in FY16.

EBITDA registered a 42% YoY growth due to operating costs remaining unchanged at Rs. 582 Crores same as Q4FY14. EBITDA Margins increased by 307.2 bps reported at 11.5%.

PAT for the period under review increased by 25.2% YoY to Rs. 67.1 Crores. PAT margins were reported at 10.8% growing by 200 bps YoY. The growth in the bottom-line can be attributed to lower tax outgo and lesser depreciation charges that declined by 11.1% and 43.2% YoY respectively.

Quarterly performance



FY15 performance

Lakshmi Machine Works Ltd. reported a top-line of Rs. 2,488.2 Crores a marginal increase of 6% over previous year. The marginal increase is a result of 1% decline in the revenue from the TMD segment of the company.

Lakshmi Machine Works Ltd. reported a top-line of Rs. 2,488.2 Crores a marginal increase of 6% over previous year. This was mainly due to 1% decline in the revenue from the TMD segment of the company. However, machine tool divisions as well as advanced machining sales were strong. Exports were flat YoY but are expected to move up sharply in FY16 on account of a Rs. 175 Crores order. LMW's order book was Rs. 3,050.0 Crores at end of FY15. Machine tool divisions' order backlog in this is Rs. 85 Crores, with the rest being orders for Textile machinery. EBITDA was reported at 301.2 Crores a rise of 14.5% from the previous year. EBITDA margin increased to 12.1% from 11.2% in FY14 due to better control of expenses. PAT grew 16.1% on lower interest, depreciation and tax. Tax was lower on account of deferred tax asset creation. PAT margin was reported at 9% as against 8% in FY14.

Improving macro dynamics for textile augur well for the company

The government is aiming to increase textile exports via Merchandise Exports from India Scheme (MEIS), which has recently been modified to include the markets of Bangladesh and Sri Lanka.

Textile industry in India is a strategically important industry as it accounts for ~5% of the Indian GDP and contributes close to 14% to the Index of Industrial Production. India currently accounts for a 4% share in the global textile industry and has 22% of the world’s total installed capacity. The government is pushing to increase its market share to 8% by 2020. Textile industry is also one of the largest contributors to India’s exports contributing about 30% to the country’s total exports basket. Textile exports from India posted a 5.3% growth in FY15. The current size of global textile trade is around USD 800 bn, which is likely to grow to USD 1,300 bn by 2023. Indian textile market size is currently pegged at USD 108 bn and is expected to expand to USD 233bn by 2023. India is the second largest player after China. The textile ministry intends to increase the export of textiles for FY16 by 14% at USD 47.5 bn from actual exports of USD 41.6 bn in 2014-15. On the domestic front, textile consumption in India is at USD 66 bn and has the lowest domestic per capita spend on garments at USD 37. However, it is expected that that by 2025 India’s domestic per capita expenditure on garments will rise to USD 129 as a result of economic growth.

LMWs top two customers viz; Vardhman and Welspun export 38.5% and 68.0% of its total production. Welspun is one of the largest textile manufacturers that account for ~40% exports from India. The government is aiming to increase textile exports via Merchandise Exports from India Scheme (MEIS), which has recently been modified to include the markets of Bangladesh and Sri Lanka. On technology upgradation in the sector, there is a budget provision of Rs. 1,520.8 Crores under Technology Upgradation Fund Scheme for 2015-16, out of which Rs. 437.6 Crores have been released till date. Any export growth will augment demand from these players hence, impacting the company positively.

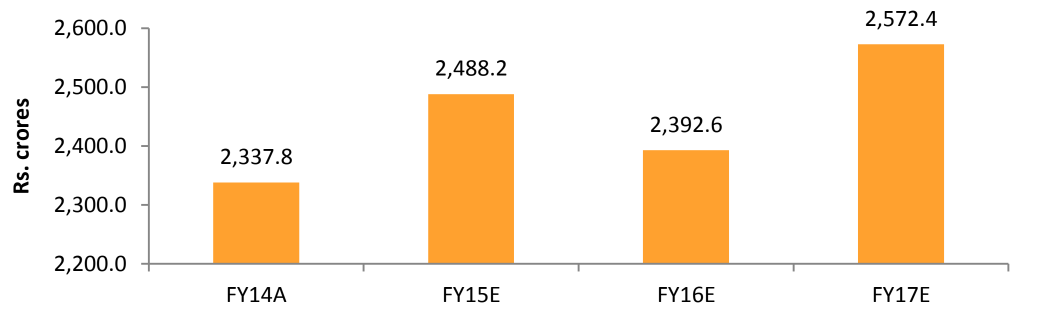
Revenue growth to pick up FY17E onwards

With the capex picking up in FY17E the revenue growth is expected to pick up to Rs. 2,572.4 Crores.

TMD accounts for the largest chunk (~92%) in the revenue pie of the company. It has a current order book of Rs. 2,970.0 Crores. However, capex in the spinning segment has remained low in the past few years due to lower raw material prices thereby affecting order book growth as almost 50% of the order book for TMD segment remains slow moving. Moreover, two of its major clients, Trident and Vardhman have not planned any capex for FY16; hence capping any expected growth in the revenue. Its largest customer Welspun however has a planned capex of Rs. 1,300.0 Crores, thereby providing an order visibility. We estimate the company's order inflow for FY16E at Rs. 1,300 Crores and Rs. 2,000 Crores in FY17E.

We expect the company to execute 55% of this order book hence project the revenue at Rs. 2,392.6 Crores for FY16E. However, with the capex picking up in FY17E the revenue growth is expected to pick up to Rs. 2,572.4 Crores.

Revenue growth to pick up FY17E onwards



Greater market share provides a competitive edge

LMW enjoys cost competitiveness in the market due to its higher market share and lower historical costs of capacity establishment.

LMW is one of the global trios that manufacture the entire range of spinning machinery. It enjoys 70% volume market share and 60% value market share in India and has been able to retain the same despite the entry of many global players like Rieter (15%), Truzler (13%) and other Chinese companies. LMW has a better positioning over the market due to cost competitiveness, strong after sales network, a huge customer base and world class technology to manufacture products. LMW's machinery costs 10-15% lower as compared to its competitors. It also enjoys the advantage of capacities set up at historical low costs, while MNCs currently penetrating Indian markets have to bear heavy costs of capital investment that is translated into their machinery cost. It also has an efficient and well spread after-sales network with service centers spread in each textile hub of the country, while its peers have only three to four centers altogether.

Increasing capacity utilisation to aid growth

At the current order book of Rs. 3,050 Crores, LMW currently operates at 50% capacity utilization and works only two shifts, against the normal practice of working on three shifts. Going forward, the company seeks to enhance the capacity utilisation in order to cater to any increase in demand. We estimate the order book to grow by 29.8% by FY17E hence, we expect capacity utilization to be ramped up over the next two years, thus providing enough avenues for growth. This also limits the capex requirement of the company.

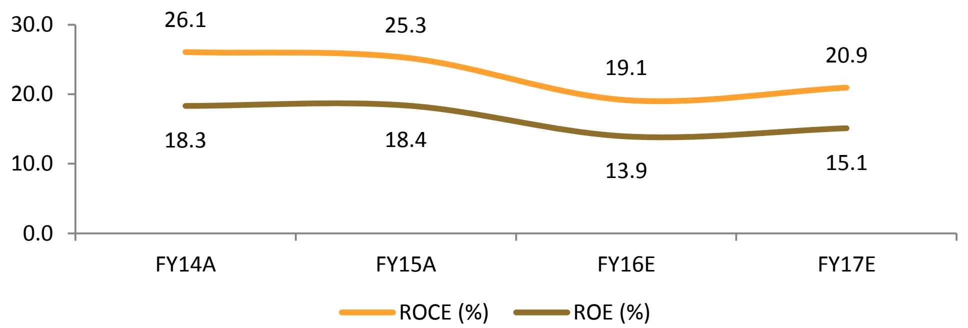
Prudent liquidity management augurs well for the company

LMW effectively controls their working capital requirement which is the biggest strength for the company. Due to this the company has become cash rich and owns a cash balance of Rs. 975.2 Crores which is around 68% of the entire balance sheet size of the company resulting in

LMW's cash conversion cycle for FY15 was (15) days and has been negative in last six years. This showcases judicious liquidity management by the company.

cash /share of Rs. 886. Networking capital has remained negative since FY06. The company follows the practice of taking advance payment of at least 10% (non-refundable) on new orders, which bodes well the working capital management. Its cash conversion cycle for FY15 was (15) days. This showcases judicious liquidity management by the company. The company is in the state of financing any forthcoming capex internally. We expect the trend to continue and the cash conversion cycle to average at 10 days over FY15E-FY17E.

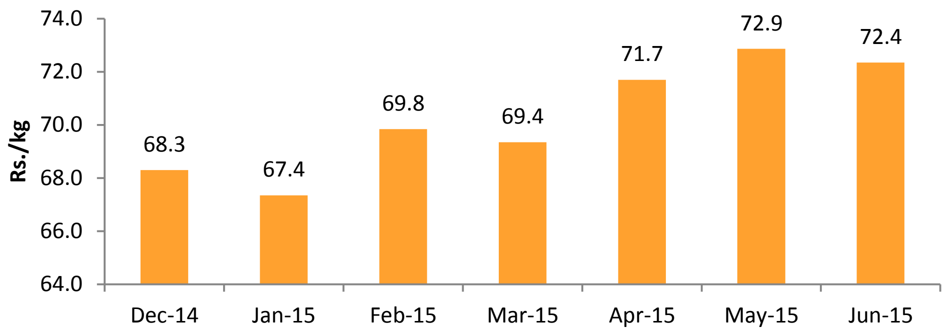
Return ratios to remain favorable going forward



Stable cotton prices to aid margins

Cotton and cotton yarn prices are expected to grow given the declining production in the in India. As Indian rupee has depreciated by over 40% against the US Dollar over the last five years, the depreciation against Chinese Yuan has been even greater at 43%. This resulted in competiveness shifting in favor of India, against Chinese players. Moreover, numerous estimates show that the area under cotton cultivation in India is likely to decline by 5%-15% in FY16. Production of cotton in India is likely to go down by 5%-7% in FY16, while consumption is expected to either remain flat or marginally rise by 1%-3% year-on-year. However, on a global level, cotton stock is likely to remain in surplus due to lower demand. Therefore, we are of the view that on an average, cotton prices will hover around current levels. This augurs well for expanding the margins of spinning companies, hence is favourable for LMW.

Cotton-price trend



Key risks:

- LMW faces cyclicality risk. Any unexpected downside in the textile industry may hamper spinning players' plans to expand capacity.
- Any change in TUFS policy may impact textile sector capex and in turn LMW's growth prospects.
- LMW faces the risk of competition with cheaper Chinese players.

Balance Sheet (Consolidated)

Y/E (Rs.Cr)	FY14A	FY15A	FY16E	FY17E
Share Capital	11.3	11.3	11.3	11.3
Reserve and surplus	1,096.9	1,270.6	1,441.2	1,678.6
Net Worth	**1,108.1**	**1,281.8**	**1,452.4**	**1,689.9**
Total Debt	0.0	0.0	0.00	0.0
Other non-current liabilities	225.8	134.5	124.7	124.7
Capital Employed	**1,334.0**	**1,416.3**	**1,577.2**	**1,814.6**
Fixed Assets	428.2	445.0	347.1	242.9
Investments	86.9	87.5	87.5	87.5
Net Current Assets	818.9	874.1	1,142.6	1,484.3
Deferred tax assets	0.0	9.7	0.0	0.0
Capital Deployed	**1,334.0**	**1,416.3**	**1,577.2**	**1,814.6**

Profit & Loss Account (Consolidated)

Y/E (Rs.Cr)	FY14A	FY15A	FY16E	FY17E
Net Sales	2,337.8	2,488.2	2,392.6	2,572.4
Expenses	2,074.9	2,187.0	2,127.0	2,232.9
EBITDA	**262.9**	**301.2**	**265.6**	**339.6**
Other Income	110.6	100.3	100.3	100.3
Depreciation	104.5	99.7	103.8	110.2
EBIT	269.0	301.8	262.1	329.6
Net Interest cost	0.6	0.6	1.0	0.0
Profit Before Tax	268.4	301.1	261.1	329.6
Tax	79.4	81.5	70.6	92.3
Net Profit	**189.0**	**219.6**	**190.4**	**237.3**

Key Ratios (Consolidated)

Y/E	FY14A	FY15A	FY16E	FY17E
EBITDA Margin (%)	11.2	12.1	11.1	13.2
EBIT Margin (%)	11.5	12.1	11.0	12.8
NPM (%)	8.1	8.8	8.0	9.2
ROCE (%)	26.1	25.3	19.1	20.9
ROE (%)	18.3	18.4	13.9	15.1
EPS (Rs.)	167.8	194.9	169.0	210.6
P/E (x)	18.1	18.3	21.2	17.0
P/BVPS (x)	3.1	3.1	2.8	2.4
EV/EBITDA (x)	9.6	10.1	10.6	7.3

Valuation and view

LMW is the largest player in the textile industry enjoying benefits of big clients, cost competitiveness and a high cash balance on its books. Going forward we expect the company gain from the government thrust on the textile sector and increasing competitiveness of its existing clients.

We expect LMW's net profit to grow by 8% during FY15-FY17E and the RoE and RoCE to stay at 15.1% and 20.9% respectively. At the current market price (CMP) of Rs. 3,577.0, the stock trades at a P/E multiple of 21.2x FY16E and 17.0x FY17E. We recommend 'BUY' with a target price of Rs. 4,289, assigning a forward P/E multiple of 22.0x, which implies a potential upside of ~20% to the CMP from 12 months perspective.

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