Textiles & Apparel

Rating Change

Equity | India | Textiles & Apparel
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Sailing through the storm

Manish Sarawagi >> +91 22 6632 8688
Research Analyst
DSP Merrill Lynch (India)
manish_sarawagi@ml.com

Earnings, POs cut sharply; Welspun cut to U/P; Buy BRFL

We cut operating earnings of our textile universe by avg. 15% and EPS by avg. 49% for FY10E to reflect the economic downturn in key markets (US/EU). As a result of this and lower target multiples (to reflect moderated growth) our POs are down 40-70%. We retain our Buy rating on Bombay Rayon (BRFL), seeing it as best positioned to weather the storm given its relatively de-risked biz model, on strong earnings growth outlook despite the cut and attractive valuations (5x '10E PE with 44% EPS CAGR and 22% RoE). Welspun, having highest exposure to US (>60% of sales) in our universe, is cut to Underperform, on added concern on deteriorating balance sheet.

Outlook deteriorates led by economic downturn…

The economic scenario has worsened sharply in the key markets of US and EU over last couple of months resulting in retailers beginning to cut their sales budgets. This puts at risk sales volume growth and realizations/margin assumptions for textile companies, in our view. However, large integrated players appear relatively better placed than smaller players, as buyers are forced to do cost cutting and undertake vendor consolidation.

…despite improving cost competitiveness

We see three key positives emerging for the sector – 1) Sharp depreciation in Re, 2) Rise in Chinese costs (labor, power, currency, lower export subsidies) by nearly 20% yoy resulting in increasing competitiveness for India and 3) fall in input costs, especially cotton, which has come off its peak, but still remains significantly high on a yoy basis. We believe the companies might be forced to pass on these benefits to the buyers in a bid to keep their capacities running full.

Earnings cut led by lower sales, higher funding costs

We have trimmed our sales forecast by 3-15% for most companies over FY09-11. The companies should also get impacted by higher interest costs as debt levels go up (due to non-conversion of warrants). Balance sheet quality, too, is a cause of concern for us, particularly for Arvind and Welspun. Overall, we expect earnings to remain depressed for all companies in this space, with the exception of Bombay Rayon, where we still expect robust earnings growth of 44%p.a., despite our estimates cut.

What could turn the tide?

If the weakness in the Re sustains not only vs USD but also vs currencies of neighboring countries, it would improve India's competitiveness and lead to substantial flow of orders. Besides, there are certain non-fundamental company specific factors which could trigger a stock performance – any +ve newsflow on denim restructuring or Thane realty value unlocking in Raymond and potential reduction in liabilities on account of derivative exposure in Himatsingka.

Table 1: Ratings & POs (Rs)

	Q-R-Q	Price	New PO	Old PO	PO Change
Bombay Rayon	C-1-7	170	270	450	-40%
Raymond	C-3-7	81	75	200	-63%
Arvind	C-3-7	16	13	42	-69%
Gokaldas	C-3-7	107	116	200	-42%
Welspun India	C-3-9	21	21	71	-70%
Himatsingka	C-2-7	28	29	55	-47%

Source: Merrill Lynch

Table 2: Estimates cut

(FY10E)	Sales	EBIDTA	EPS
Bombay Rayon	-14%	-13%	-18%
Raymond	-6%	-6%	-37%
Arvind	-8%	-2%	-57%
Gokaldas	-14%	-20%	-29%
Welspun India	-7%	-13%	-92%
Himatsingka	-28%	-34%	-61%

Source: Merrill Lynch

Table 3: Valuation summary

	EPS CAGR FY09E-11E	PE (x) FY10E	EV/E (x) FY10E	RoE FY09E
Bombay Rayon	44%	5	6	22%
Raymond	5%	9	5	4%
Arvind	NM	17	6	1%
Gokaldas	-4%	7	5	13%
Welspun India	-10%	23	7	2%
Himatsingka	8%	8	6	5%

Source: Merrill Lynch

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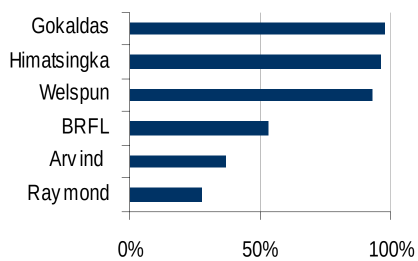
Earnings, POs cut on worsening outlook

We are cutting operating earnings of our textile coverage universe by average 15% and EPS by average 49% for FY10E (see Table 2) to reflect the economic downturn in key markets (US/EU). As a result of this and lower target multiples (to reflect higher risk to growth) our POs are down 40-70%. We maintain our Buy rating on Bombay Rayon (BRFL), which we see as best positioned to weather the storm, given its relatively de-risked business model, strong earnings growth outlook despite the earnings cut and attractive valuations (6x FY10E PE vs sector avg. at 12x despite far stronger growth and higher RoE). Welspun, having highest exposure to US (>60% of sales) in our universe, is cut to Underperform, on our added concern on deteriorating Balance sheet.

Chart 1: Prop of export sales (mainly to US/EU)



Source: Merrill Lynch

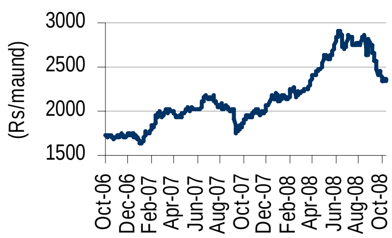
Slowdown in key markets worsens sector outlook…

The economic scenario has worsened sharply in the key markets of US and EU over last couple of months resulting in retailers beginning to cut their sales budgets. This clearly puts at risk sales volume growth and realizations/ margin assumptions for textile companies, in our view. However, large integrated players should be relatively better placed than smaller players, as buyers would be forced to do cost cutting and undertake vendor consolidation.

…despite improving cost competitiveness

- Rise in Chinese costs (labor, power, currency, lower export subsidies) by nearly 20% yoy resulting in increasing competitiveness for India
- Sharp depreciation in Re
- Fall in input costs, especially cotton, which has come off its peak, but still remains significantly high on a yoy basis.

Chart 2: Cotton* price trend



Source: MCX, Merrill Lynch *Medium staple

We note that Arvind's earnings are most sensitive to changes in INR and cotton prices due to very high operating leverage. Earnings of Himatsingka, Gokaldas and Welspun (predominantly exporters) are also very sensitive to INR. Although Bombay Rayon's earnings are quite sensitive to INR we believe it is relatively insulated from cotton price fluctuation as it buys yarn, whose prices remain relatively more stable.

Table 4: Earnings sensitivity of a 1% chg

	INR/US$	Cotton prices
Bombay Rayon	4%	NM
Raymond	1%	2%
Arvind Mills	8%	10%
Welspun India	9%	4%
Himatsingka	7%	NM
Gokaldas	8%	NM

Source: Merrill Lynch

We believe these companies might be forced to pass on these benefits to the buyers in a bid to keep their capacities running full.

…resulting in sharp earnings estimates cut

We have cut our earnings estimates sharply for most companies driven by lower sales forecast and higher estimates for funding costs.

Table 5: Snapshot of earnings cut

	Sales		EBIDTA		EPS	
	FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Bombay Rayon	-9%	-14%	-6%	-13%	-9%	-18%
Raymond	-2%	-6%	7%	-6%	-6%	-37%
Arvind	-3%	-8%	-15%	-2%	NM	-57%
Gokaldas	-5%	-14%	-8%	-20%	-11%	-29%
Welspun India	-5%	-7%	-21%	-13%	-88%	-92%
Himatsingka	-25%	-28%	-42%	-34%	-51%	-61%

Source: Merrill Lynch

- We have trimmed our sales forecast by 3-15% for most companies over FY09-11 to factor-in the impact of the downturn.
- We have assumed that the companies would pass on the benefits relating to lower costs and hence have not changed our margin assumptions significantly.
- The companies would also get impacted by higher interest costs as – 1) debt levels go up due to non-conversion of warrants, as in case of Raymond and Arvind and 2) overseas funding for working capital becomes scarce and gets converted to higher interest bearing Re loans, which probably might turn out to be cheaper vs foreign loan due to Re depreciation. But nonetheless the cost for working capital funding would go up.

Overall, we expect earnings to remain subdued for all companies in this space, with the exception of BRFL where we expect robust growth of 44% CAGR over FY09-11.

Valuations – BRFL most attractive in our view

Table 5 below shows the relative valuation of textile companies under our coverage. BRFL's valuations clearly look most attractive to us at 5x FY10E PE, lowest in the peer-group despite significantly higher RoE (22% for BRFL versus in single digit for most) and stronger earnings visibility (44% EPS CAGR over FY09E-11E). On EV/E it is trading at 6.5x FY10E (with 43% CAGR over FY09-11E), which appears reasonable considering that full benefits of its new capacities should get reflected only in FY11, when its trading at only 5x. Most other companies look expensive considering the growth outlook and RoE.

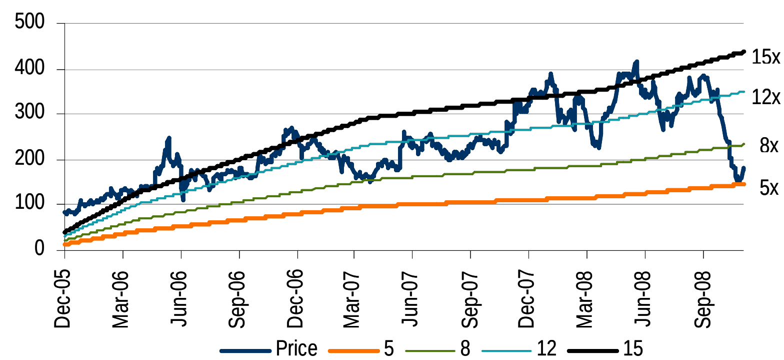
Table 6: Relative valuation for India textile universe (Rs)

		Stock		Upside /	EPS		EPS CAGR	PER (x)		EV/E (x)		RoE	P/BV
Yr endin March	Rating	price	PO	(downside)	FY09E	FY10E	FY09-11E	FY09E	FY10E	FY09E	FY10E	FY09E	FY09E
Bombay Rayon	Buy	170	270	59%	23.6	33.0	44%	7.2	5.2	9.8	6.5	22%	1.4
Raymond	Underperform	81	75	-7%	8.9	9.3	5%	9.1	8.7	5.8	4.9	4%	0.4
Arvind	Underperform	16	13	-19%	(1.6)	0.9	NM	NM	17.4	8.1	6.4	1%	0.3
Gokaldas	Underperform	107	116	8%	17.6	15.6	-4%	6.1	6.9	5.6	5.4	13%	0.8
Welspun India	Underperform	21	21	0%	1.2	0.9	-10%	17.9	22.6	9.2	6.7	2%	0.3
Himatsingka	Neutral	28	29	4%	3.1	3.4	8%	9.0	8.3	9.5	6.5	5%	0.4

Source: Merrill Lynch

Relative to trading history (unfortunately not very long as the company got listed in 2005 only), BRFL, not surprisingly, is trading at by far the lowest end of its 1-yr fwd rolling PE band. With a 45% stock price correction in the last 3 month (among the steepest across the textile universe) we believe the risks are more than captured in the price.

Chart 3: BRFL – 1-yr fwd rolling PE band



Source: Bloomberg, Merrill Lynch

POs cut 40-70%

The PO cut has been largely driven by the earnings cut. We have also lowered the target multiple in most cases (as tabulated below) to reflect the weaker growth outlook and higher risks. We continue to prefer valuing the textile business on EV/EBIDTA multiple as we believe this appropriately captures the true business valuation and not the PE which gets distorted by fluctuating other income.

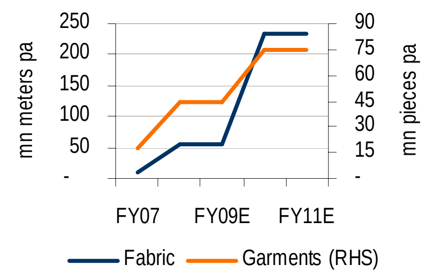
- We have assigned a higher target EV/E for FY10 to BRFL due to 43% CAGR in EBIDTA over FY09E-11E. At our PO, BRFL would trade at only 5.7x EV/E in FY11E, when full benefits of the new capacities should start to flow in.
- We have valued Raymond's textile business at a premium to others due to its strong domestic brand franchise.
- Rest all have been valued at 5.5x EV/E (with the exception of Arvind whose denim business is in a structural downturn and hence should see a decline)
- Retail businesses have been valued on EV/sales at par with other retailers – Himatsingka's retail business has been given a premium due to its higher profitability.

Table 7: Snapshot of PO cut (Rs)

	Old PO	Basis	New PO	Basis
Bombay Rayon	450	8.5x FY10E EV/E	270	7.5x FY10E EV/E
Raymond	200	SoTP - 7.5x EV/E for textiles, 1x EV/sales for retail	75	SoTP - 6x EV/E for textiles, 0.8x EV/sales for retail
Arvind	42	SoTP - 5.5x EV/E for textiles, 0.7x EV/sales for retail	13	SoTP - 5x EV/E for textiles, 0.7x EV/sales for retail
Gokaldas	200	6.5x FY10E EV/E	116	5.5x FY10E EV/E
Welspun India	71	5x FY10E EV/E	21	5.5x FY10E EV/E
Himatsingka	55	5.5x EV/E for textiles, 1.1x EV/sales for retail	29	5.5x EV/E for textiles, 1.1x EV/sales for retail

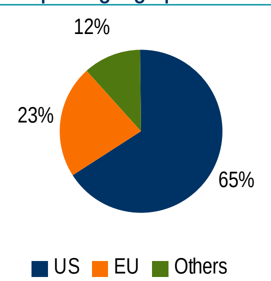
Source: Merrill Lynch

Chart 4: Capacity ramp-up in BRFL



Source: Merrill Lynch

Chart 5: Welspun – geographic sales mix*



Source: Merrill Lynch *FY09E

BRFL stands out, top Buy

We have a Buy on Bombay Rayon as we believe it clearly stands out in terms of its performance so far as well as its ability to weather the storm due to the following: –

- Relatively de-risked business model with focus on both domestic and exports opportunities. Domestic fabric sales accounting for about 40% of sales currently. In exports, the company focuses on apparel (shirts) exports, where India has limited capacities.
- Cost competitiveness helped by loads of fiscal benefits for its new manufacturing facilities coming up in Maharashtra. This should help the company gain market share.
- Despite the earnings estimates being cut by 9-18% to reflect the higher risk poised by the current environment, we still expect the company to deliver strong earnings growth of 44% CAGR over FY09E-11E helped by new capacities coming on stream.
- Valuations appear to be attractive at 6x FY10E PER with 44% CAGR earnings growth and RoE of 22%.

Downgrade Welspun to Underperform

We downgrade Welspun to Underperform led by:

- Concerns on its high US exposure (>60% of sales) and performance of its EU based brands & distribution companies – Christy and Sorema. Welspun accounts for roughly 10% of total US import of towels and a slowdown there should impact Welspun negatively.
- Concerns about its deteriorating consolidated balance sheet with debt-equity at >3x currently versus 2.4x earlier. In the current environment, refinancing could become an issue, given the very high leverage.
- Earnings estimates cut sharply – EBIDTA cut by 13-21% led by lower sales and margin assumptions.

We have cut its PO to Rs21 from Rs71 to reflect lower earnings and worse than expected Balance Sheet. We believe there is a downside risk to our earnings given the deteriorating economic outlook in its key markets – US and EU.

We continue to maintain Underperform rating on Raymond, Arvind and Gokaldas led by subdued earnings outlook and rich valuations.

Bombay Rayon (Buy)

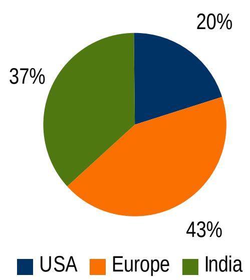
PO cut to Rs270

We have cut BRFL's earnings by 9-18% over FY09E-11E to factor-in lower sales growth due slowdown in US / EU which account for more than 60% of its total business. We have reduced PO to Rs270 (from Rs450 earlier) to factor in market de-rating and lower earnings.

2Q results in-line

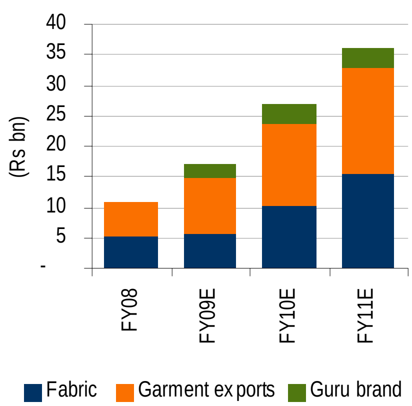
BRFL reported 2Q PAT at Rs367mn, a growth of 20% yoy, which was exactly in line with our estimates. Margins expanded 200bp which was a surprise to us. This was led by margin expansion on the back of increasing share of higher margin garments. However, interest cost was up 62% yoy. This was due to conversion of some of the foreign working capital loan into Re loan (higher interest cost), due to the non-availability of foreign loan. BRFL completed the acquisition of Guru (UK apparel brand & retailer) during the quarter.

Chart 6: Sales mix (FY10E)



Source: Merrill Lynch

Chart 7: Bombay Rayon – sales growth trend



Source: Merrill Lynch

Cut our sales forecast despite mgmt confidence

We have cut sales forecast by 9-14% for FY09-11 to build in a more severe downturn than expected earlier. Particularly, we have trimmed our sales forecast for Guru. We note that our estimates are significantly below management guidance. As per the management, order book is full till March'09 and the flow of orders remains as strong as ever helped by rising Chinese costs and lack of garment capacities in India.

Table 8: What has changed?

	FY09E	FY10E	FY11E
Sales	-9%	-14%	-9%
EBIDTA	-6%	-13%	-8%
PAT	-9%	-18%	-11%

Source: Merrill Lynch

Conservative margin forecasts

We have build in margin dilution of 70bp each in FY10E and FY11E to factor-in potential pressures from overseas buyers. This is despite a weaker Re and fall in input costs. Further, the new Maharashtra facility has a lower cost structure given the fiscal incentives given by the State Govt like reimbursement of employers contribution to provident fund, exemption from various duties and interest subsidy of 4% over and above the 5% from Central Govt.

Table 9: Key assumptions

	FY07	FY08	FY09E	FY10E	FY11E
Fabrics					
Volume Sold (mn meters)	27	49	52	94	142
Chg	41%	84%	8%	80%	50%
Sales value (Rsmn)	2,942	5,320	5,719	10,294	15,441
Chg	91%	81%	8%	80%	50%
Realization (Rs/mtr)	111	109	109	109	109
Chg		-2%	0%	0%	0%
Garments					
Volume Sold (mn pieces)	7.0	20.8	31.5	49.0	63.0
Chg	293%	195%	52%	56%	29%
Sales value (Rsmn)	1,954	5,648	8,940	13,274	17,202
Chg	307%	189%	58%	48%	30%
Realization (Rs/piece)	278	272	284	271	273
Chg		-2%	4.3%	-5%	1%

Source: Merrill Lynch

iQprofile SM Bombay Rayon Fashions Ltd

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	4,894	10,891	17,092	26,784	36,020
Gross Profit	1,885	4,838	8,883	13,586	17,740
Sell General & Admin Expense	(965)	(2,521)	(5,350)	(8,105)	(10,472)
Operating Profit	815	1,964	3,050	4,408	6,122
Net Interest & Other Income	(59)	(177)	(617)	(1,007)	(1,047)
Associates	NA	NA	NA	NA	NA
Pretax Income	756	1,787	2,433	3,401	5,075
Tax (expense) / Benefit	(212)	(551)	(803)	(1,122)	(1,675)
Net Income (Adjusted)	544	1,227	1,630	2,279	3,400
Average Fully Diluted Shares Outstanding	63	63	69	69	69
Key Cash Flow Statement Data					
Net Income (Reported)	544	1,227	1,630	2,279	3,400
Depreciation & Amortization	104	352	483	1,073	1,146
Change in Working Capital	(1,676)	(3,696)	(3,611)	(4,089)	(4,181)
Deferred Taxation Charge	124	112	0	0	0
Other Adjustments, Net	(124)	(112)	0	0	0
Cash Flow from Operations	(1,028)	(2,118)	(1,498)	(737)	366
Capital Expenditure	(2,438)	(5,136)	(13,878)	(100)	(150)
(Acquisition) / Disposal of Investments	(1,258)	1,177	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(3,695)	(3,959)	(13,878)	(100)	(150)
Shares Issue / (Repurchase)	2,844	126	1,136	0	0
Cost of Dividends Paid	(92)	(109)	(159)	(179)	(199)
Cash Flow from Financing	5,137	5,882	15,378	836	(214)
Free Cash Flow	(3,466)	(7,254)	(15,376)	(837)	216
Net Debt	2,562	8,606	23,007	24,022	24,007
Change in Net Debt	1,971	6,059	14,399	1,016	(17)
Key Balance Sheet Data					
Property, Plant & Equipment	3,540	8,327	21,722	20,749	19,752
Other Non-Current Assets	1,358	181	181	181	181
Trade Receivables	1,020	2,342	3,994	5,734	8,360
Cash & Equivalents	773	593	593	593	593
Other Current Assets	2,486	5,324	7,698	11,063	13,669
Total Assets	9,176	16,767	34,188	38,319	42,555
Long-Term Debt	3,335	9,199	23,600	24,615	24,600
Other Non-Current Liabilities	134	246	246	246	246
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	751	1,216	1,630	2,646	3,697
Total Liabilities	4,220	10,661	25,476	27,506	28,543
Total Equity	4,956	6,106	8,714	10,814	14,016
Total Equity & Liabilities	9,176	16,767	34,190	38,320	42,558
iQmethod **SM - Bus Performance***					
Return On Capital Employed	10.7%	11.3%	8.5%	8.7%	11.0%
Return On Equity	16.8%	22.2%	22.0%	23.3%	27.4%
Operating Margin	16.7%	18.0%	17.8%	16.5%	17.0%
EBITDA Margin	18.8%	21.3%	20.7%	20.5%	20.2%
iQmethod **SM - Quality of Earnings***					
Cash Realization Ratio	-1.9x	-1.7x	-0.9x	-0.3x	0.1x
Asset Replacement Ratio	23.3x	14.6x	28.7x	0.1x	0.1x
Tax Rate (Reported)	28.0%	30.8%	33.0%	33.0%	33.0%
Net Debt-to-Equity Ratio	51.7%	140.9%	264.0%	222.1%	171.3%
Interest Cover	6.3x	5.2x	3.7x	3.7x	4.9x
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page X.

Company Description

After a modest beginning as a small fabric supplier, Bombay Rayon has grown multi-folds to emerge as India's leading integrated textiles company in a very short span of time. The recent acquisition of Guru, marks its foray into international branding and retailing. In FY08, garments contributed about half of sales - all exports, the rest being accounted for by fabric, sold mainly in the domestic market.

Investment Thesis

Our Buy rating on Bombay Rayon is premised on strong earnings growth of 44% pa over FY09-11E and inexpensive valuations. We expect strong volume growth in both fabric and garments driven by new capacities coming on stream. Global economic downturn is a concern but is priced in, in our view. Management has ambitious plans for Guru rollout across the globe, which should be an additional growth driver.

Stock Data

Price to Book Value	1.4x

Raymond (Underperform)

Core worsted fabric performance revives…

Worsted fabric performance was back on track in 2Q with sales growth of 22% yoy on a low base (ERP implementation problems last yr). This was led by 8% realization growth on better mix and 13% volume growth. EBIT margins expanded to 22% from 18% last yr led by higher realizations and lower input costs. We expect the performance of this business to remain strong over the next few quarters helped by softer wool prices and an elongated marriage season.

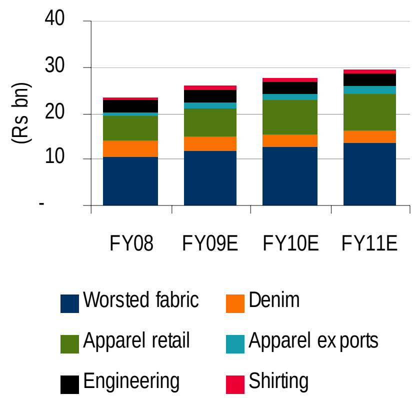
…but denim continues to be a drag

Denim JV reported loss of Rs400mn at PBT level for 2Q (Raymond's share is 50%). Management, in the earnings conference call, has indicated that they plan to close down the US and the Belgium operations by January'09. This should bring down the losses incurred by the JV and will be a positive, when it happens.

EPS est. lowered on lower sales, higher interest; PO cut

We have cut EPS 6-37% over FY09-10E mainly due to higher interest costs – we have assumed higher debt due to non-conversion of promoter warrants at Rs340/share (given current stock price is significantly lower). Further, we have also assumed slower sales growth given economic downturn. We have cut our SoTP based PO to Rs75 to factor-in lower earnings and market de-rating. This does not include the potential value unlocking from Thane real estate from where they currently operate part of their worsted facility.

Chart 8: Raymond – sales mix



Source: Merrill Lynch

Table 10: What has changed?

	FY09E	FY10E
Net sales	-2%	-6%
EBIDTA	7%	-6%
EPS	-6%	-37%

Source: Merrill Lynch

Table 12: SoTP valuation (Rs mn)

	Basis	Target (x)	EV
Textiles	EV/E	6.0	11,540
Engineering	EV/E	4.0	1,483
Retail	EV/sales	0.8	5,848
Total EV			18,870
less: net debt			14,253
Equity value			4,618
# of shares			61
Fair value per share			75

Source: Merrill Lynch

Table 11: Key assumptions

(Rs mn)	FY07	FY08	FY09E	FY10E	FY11E
Worsted Fabric					
Volumes (mn meters)	29.5	32.8	37.2	40.9	44.5
change	12%	11%	14%	10%	9%
Realisations (Rs/meter)	326	325	338	338	338
change	5%	0%	4%	0%	0%
Sales value	9,627	10,644	12,580	13,810	15,028
change	17%	11%	18%	10%	9%
Denim					
Sales value	3,670	3,871	3,703	3,418	3,304
change		5%	-4%	-8%	-3%
Garment exports					
Sales value	779	971	1,214	1,335	1,469
change		25%	25%	10%	10%
Retailing					
Raymond Apparel	2,376	3,507	4,454	5,344	5,879
ColorPlus	1,231	1,489	1,787	1,965	2,113
Total	3,607	4,996	6,240	7,310	7,991
change	24%	39%	25%	17%	9%
Light Engineering					
Files & tools	1,606	1,622	1,714	1,756	1,786
Ring Plus Acqua	721	781	967	996	1,016
Total	2,327	2,403	2,680	2,752	2,802
change	1%	3%	12%	3%	2%
JVs (Zambaiti & Fedora)	273	680	834	964	1,050
change	345%	149%	23%	16%	9%
Consolidated Sales	20,407	23,962	26,751	28,724	30,518
change	19%	17%	12%	7%	6%

Source: Merrill Lynch

iQprofile SM Raymond Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	20,407	23,962	26,751	28,724	30,518
Gross Profit	6,578	7,039	8,557	9,417	10,033
Sell General & Admin Expense	(4,114)	(5,511)	(6,153)	(6,607)	(7,019)
Operating Profit	1,207	(161)	662	929	1,007
Net Interest & Other Income	343	480	100	(133)	(133)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,549	318	762	796	874
Tax (expense) / Benefit	(421)	(287)	(229)	(239)	(288)
Net Income (Adjusted)	1,130	64	545	569	597
Average Fully Diluted Shares Outstanding	61	61	61	61	61
Key Cash Flow Statement Data					
Net Income (Reported)	1,130	64	545	569	597
Depreciation & Amortization	1,257	1,689	1,743	1,882	2,007
Change in Working Capital	(2,026)	(2,149)	(938)	(500)	(321)
Deferred Taxation Charge	(96)	(65)	(52)	(54)	(66)
Other Adjustments, Net	(113)	16	(12)	(12)	(11)
Cash Flow from Operations	153	(446)	1,286	1,884	2,205
Capital Expenditure	(4,777)	(1,250)	(2,750)	(1,200)	(1,200)
(Acquisition) / Disposal of Investments	445	(562)	757	83	66
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(4,332)	(1,812)	(1,993)	(1,117)	(1,134)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(359)	(359)	(431)	(503)	(503)
Cash Flow from Financing	3,431	1,788	1,569	(503)	(503)
Free Cash Flow	(4,624)	(1,696)	(1,464)	684	1,005
Net Debt	12,634	14,770	16,116	15,852	15,283
Change in Net Debt	4,538	2,617	1,138	(264)	(569)
Key Balance Sheet Data					
Property, Plant & Equipment	14,173	13,988	15,163	14,480	13,674
Other Non-Current Assets	4,047	3,434	3,594	3,594	3,594
Trade Receivables	4,125	4,641	5,130	5,509	5,853
Cash & Equivalents	568	579	1,233	1,497	2,066
Other Current Assets	10,910	13,652	13,342	13,808	14,241
Total Assets	33,822	36,294	38,462	38,889	39,427
Long-Term Debt	7,992	10,770	11,270	11,270	11,270
Other Non-Current Liabilities	667	644	592	537	472
Short-Term Debt	5,210	4,579	6,079	6,079	6,079
Other Current Liabilities	5,543	5,762	6,088	6,515	7,037
Total Liabilities	19,412	21,754	24,029	24,401	24,857
Total Equity	14,411	14,331	14,433	14,488	14,570
Total Equity & Liabilities	33,822	36,085	38,462	38,889	39,428
iQmethod* SM - Bus Performance					
Return On Capital Employed	5.3%	0.9%	3.0%	3.3%	3.3%
Return On Equity	8.3%	0.4%	3.8%	3.9%	4.1%
Operating Margin	5.9%	-0.7%	2.5%	3.2%	3.3%
EBITDA Margin	12.1%	6.4%	9.0%	9.8%	9.9%
iQmethod* SM - Quality of Earnings					
Cash Realization Ratio	0.1x	-7.0x	2.4x	3.3x	3.7x
Asset Replacement Ratio	3.8x	0.7x	1.6x	0.6x	0.6x
Tax Rate (Reported)	27.2%	90.3%	30.0%	30.0%	33.0%
Net Debt-to-Equity Ratio	87.7%	103.1%	111.7%	109.4%	104.9%
Interest Cover	1.7x	-0.3x	0.7x	0.8x	0.8x

Key Metrics

* For full definitions of *iQmethod* SM measures, see page X.

Company Description

Raymond is one of India's premier textile companies with a presence across the value chain from yarn to apparel. It has a well diversified product mix comprising worsted fabric, denim, apparel and files & tools. Raymond is also India's leading textile brand with one of the widest networks of exclusive retail stores across the country.

Investment Thesis

Our Underperform rating on Raymond is driven by continued depressed earnings outlook. Its core worsted fabric business has seen a revival but denim continues to be a huge drag on performance. Retail business too is affected by cost pressures and economic slowdown. Raymond plans to shift out of its high-cost Thane facility in the long term which should free up the real estate for development and likely provide upside in the long term.

Stock Data

Price to Book Value	0.4x

Arvind (Underperform)

Earnings estimates, PO cut sharply

We have cut FY09E EPS from Rs1.3 to a loss of Rs1.6 to factor-in weaker than expected 2Q results and high interest costs. We have also cut our export sales forecasts given the global slowdown. However, benefits of a likely lower cotton prices and a weaker Re should start flowing in from FY10 which should partially off set lower sales forecast. We have cut our SoTP based PO from Rs42 to Rs13 to build in market de-rating and significantly lower value for realty assets.

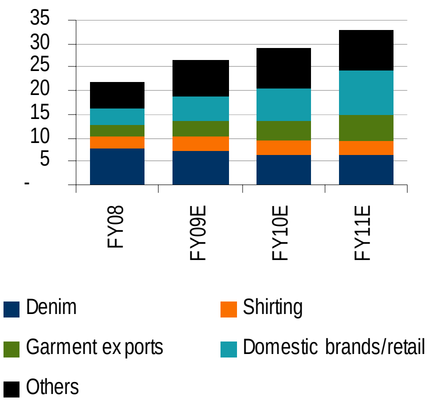
2QFY09: Margin pressure continues on high input costs

Arvind reported a loss of Rs293mn for 2Q excluding the one-time profit on sale of fixed asset and investments. This was driven by muted sales growth of 6% yoy and a dip in EBIDTA margin by over 300bp yoy on a low base. Cotton cost for the company was higher by 35-40% yoy and power cost was up 57% yoy (due to non-availability of gas for captive power). Also, the company has hedged its dollar revenues at Rs40/$ for the whole year and hence is unable to benefit from the Re depreciation.

Sales slowdown; margin upside from cotton, Re

We expect sales growth to slowdown both for its domestic retailing and its export business. However, this is likely to be offset partially by benefits of lower cotton prices and weaker Re in FY10E. We continue to maintain Underperform rating on the stock given the continued weak outlook for core denim business.

Chart 9: Arvind – sales mix



Source: Merrill Lynch

Table 13: What has changed?

	FY09E	FY10E
Sales	-3%	-8%
EBIDTA	-15%	-2%
EPS	From +Rs1.3 to loss of Rs1.6	-57%

Source: Merrill Lynch

Table 15: SoTP valuation (Rs mn)

	Basis	FY10E target	Implied EV
Textiles	EV/E	5.0	16,346
Retail	EV/Sales	0.7	6,158
Total EV			22,504
Less: Debt			21,813
Add: Realty value unlocking			2,744
Equity value			3,435
# of shares (mn)			260
Fair value per share			13

Source: Merrill Lynch

Table 14: Key assumptions

	FY07	FY08	FY09E	FY10E	FY11E
Denim					
Volumes (mn mtr)	84	76	68	64	64
Change	-13%	-10%	-11%	-6%	0%
Realisations (Rs/mtr)	94	102	102	101	101
Change	-5%	8%	0%	0%	0%
Sales value (Rs mn)	7,829	7,670	6,853	6,467	6,467
Change	-18%	-2%	-11%	-6%	0%
Shirting					
Volumes (mn mtr)	22	23	23	23	23
Change	-7%	6%	0%	0%	0%
Realisations (Rs/mtr)	121	127	127	130	130
Change	-3%	5%	0%	2%	0%
Sales value (Rs mn)	2,678	2,978	2,986	3,051	3,051
Change	-11%	11%	0%	2%	0%
Garments					
Volumes (mn pcs)	8.7	12.9	16.0	17.5	19.1
Change	26%	48%	24%	9%	9%
Realisations (Rs/pcs)	290	280	282	295	278
Change	9%	-3%	1%	4%	-6%
Sales value (Rs mn)	2,528	3,608	4,518	5,164	5,312
Change	37%	43%	25%	14%	3%
Brands					
Sales value (Rs mn)	3,471	4,834	6,767	8,798	10,997
Change	3%	39%	40%	30%	25%
Others	5,316	7,460	7,848	7,787	6,500
Total sales (Rs mn)	21,822	26,550	28,972	31,267	32,328
Chg	2%	22%	9%	8%	3%

Source: Merrill Lynch

iQprofile℠ Arvind Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	21,822	26,550	28,972	31,267	32,328
Gross Profit	10,239	11,106	11,709	13,076	14,165
Sell General & Admin Expense	(6,584)	(7,667)	(8,675)	(9,413)	(10,483)
Operating Profit	1,863	1,620	1,181	1,740	1,672
Net Interest & Other Income	(1,526)	(1,359)	(1,596)	(1,460)	(1,398)
Associates	NA	NA	NA	NA	NA
Pretax Income	337	261	(416)	280	274
Tax (expense) / Benefit	(33)	(74)	50	(34)	(33)
Net Income (Adjusted)	205	126	(383)	238	233
Average Fully Diluted Shares Outstanding	209	219	238	260	260
Key Cash Flow Statement Data					
Net Income (Reported)	270	155	(374)	238	233
Depreciation & Amortization	1,791	1,819	1,853	1,924	2,009
Change in Working Capital	585	(725)	(393)	(291)	410
Deferred Taxation Charge	(1)	0	0	0	0
Other Adjustments, Net	33	31	8	9	9
Cash Flow from Operations	2,680	1,281	1,094	1,879	2,661
Capital Expenditure	(1,950)	(2,086)	(750)	(750)	(1,000)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(1,950)	(2,086)	(750)	(750)	(1,000)
Shares Issue / (Repurchase)	0	1,079	1,253	220	0
Cost of Dividends Paid	(66)	(29)	(10)	0	0
Cash Flow from Financing	(804)	1,865	43	(780)	(1,800)
Free Cash Flow	730	(805)	344	1,129	1,661
Net Debt	20,716	21,579	20,259	19,091	17,429
Change in Net Debt	(665)	(245)	(1,587)	(1,349)	(1,661)
Key Balance Sheet Data					
Property, Plant & Equipment	24,746	25,057	23,954	22,780	21,771
Other Non-Current Assets	184	169	169	169	169
Trade Receivables	2,065	2,839	2,381	2,570	2,657
Cash & Equivalents	282	234	354	522	384
Other Current Assets	12,212	12,314	13,669	14,100	13,747
Total Assets	39,489	40,613	40,527	40,141	38,727
Long-Term Debt	20,998	21,813	20,613	19,613	17,813
Other Non-Current Liabilities	253	255	255	255	255
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	4,405	4,557	5,061	5,389	5,533
Total Liabilities	25,656	26,625	25,929	25,257	23,601
Total Equity	13,833	13,988	14,598	14,884	15,126
Total Equity & Liabilities	39,489	40,613	40,527	40,141	38,727
iQmethod*℠ - Bus Performance					
Return On Capital Employed	4.6%	3.3%	2.9%	4.4%	4.3%
Return On Equity	1.5%	1.0%	-2.8%	1.7%	1.6%
Operating Margin	8.5%	6.1%	4.1%	5.6%	5.2%
EBITDA Margin	16.7%	13.0%	10.5%	11.7%	11.4%
iQmethod*℠ - Quality of Earnings					
Cash Realization Ratio	13.1x	10.1x	NM	7.9x	11.4x
Asset Replacement Ratio	1.1x	1.1x	0.4x	0.4x	0.5x
Tax Rate (Reported)	9.8%	28.5%	12.0%	12.0%	12.0%
Net Debt-to-Equity Ratio	149.8%	154.3%	138.8%	128.3%	115.2%
Interest Cover	1.1x	1.0x	0.7x	1.1x	1.1x

Key Metrics

* For full definitions of *iQmethod*℠ measures, see page X.

Company Description

Arvind Mills Ltd., the flagship company of the Lalbhai Group, is one of India's leading textile companies and one of the world's largest producers of denim. The company is also into shirting fabric and garments, and has a presence across the value chain from yarn to garments and retailing.

Investment Thesis

Arvind Mills' stock performance is likely to remain subdued amid the continuing downturn in the core denim business. Global economic slowdown is an added concern which could offset benefit from softer input costs and weaker Re. We like management's intention to focus on domestic branded retailing but remain concerned about the high cost of retail in India and competition from larger players. Sale of non-core realty assets should help reduce the leverage on a stretched balance sheet.

Stock Data

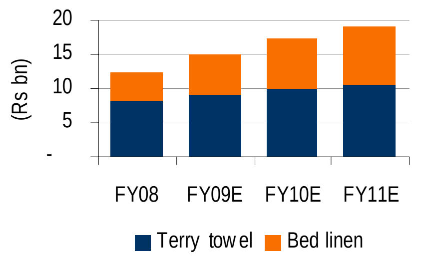
Price to Book Value	0.3x

Welspun India (Underperform)

Downgrade to Underperform, PO cut

We downgrade Welspun to Underperform and cut its PO to Rs21 (Rs71 earlier) to reflect earnings cut on economic slowdown and worse than expected consolidated balance sheet (with debt-equity ratio > 3x). In the current credit environment, refinancing / obtaining credit lines for working capital, especially for its overseas subs can become an issue. We note that Welspun has the highest exposure to US (nearly 60% of sales) within our coverage universe companies. The company is among the top 3 towel manufacturers globally and accounts for nearly 10% of total US imports. With the US retailers cutting their sales budgets, Welspun is likely to get significantly impacted.

Chart 10: Welspun – sales mix



Source: Merrill Lynch

Sharp cut in earnings estimates

We have cut our EBIDTA forecast by 21% for FY09 to reflect the disappointing 1H'09 performance. We have cut our sales forecast 5-7% largely driven by lower sales volume and realizations. We have build in a 5% drop in USD realization in FY10E and another 2% in FY11E. We believe the benefits of a weaker Re will be more than offset by negative impact of the slowdown and hence we have cut our EBIDTA for FY10E by 13%. EPS cut is sharper due to higher interest costs on higher debt levels and lower other income.

Bed linen performance likely to remain below par

We believe Welspun's bed linen business continues to operate at sub-optimal capacity utilization and hence lower margins. The company may find it difficult to ramp up this business in the current macro environment. Further, the company is likely to face competition from Himatsingka which is fast ramping up its bed linen production and is catering to similar geographies.

Table 16: What has changed?

	FY09E	FY10E
Sales	-5.2%	-7.1%
EBIDTA	-21.1%	-13.2%
EPS	-87.6%	-92.2%

Source: Merrill Lynch

Overseas subs performance at risk

The performance of Christy and Sorema (nearly 20% of FY09E sales) could be at risk given the slowdown in the European markets. The company does not report interim results for these subsidiaries. We are also concerned about the performance of the domestic retail venture – Spaces, operated under an associate company. The gestation period is likely to get elongated for the business given slowdown in the Indian economy.

Table 17: Key assumptions

	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Terry Towels					
Sales (TPA)	25,437	29,098	36,900	37,925	38,950
change	27.3%	14.4%	29.3%	2.8%	2.7%
Sales (Rs mn)	6,601	7,049	9,117	9,553	9,615
change	27.9%	6.8%	29.3%	4.8%	0.6%
Sales (Rs per ton)	259,499	242,238	247,083	251,904	246,866
change in USD terms	0.0%	2.0%	2.0%	-5.0%	-2.0%
Bed Linen					
Sales (mn meters)	16.6	27	32	36	41
change	337.4%	62.4%	16.7%	14.3%	12.5%
Sales (Rs mn)	2,672	4,091	4,773	5,854	6,586
change	427.2%	53.1%	16.7%	22.6%	12.5%
Sales (Rs per mtr)	161	152	152	163	163
change in USD terms	20.0%	3.0%	0.0%	0.0%	0.0%

Source: Merrill Lynch

iQprofile SM Welspun India Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	12,409	16,464	18,042	19,889	21,011
Gross Profit	5,228	6,852	9,828	11,241	11,895
Sell General & Admin Expense	(3,490)	(5,199)	(7,766)	(8,586)	(9,210)
Operating Profit	1,006	702	931	1,407	1,428
Net Interest & Other Income	(137)	(404)	(819)	(1,315)	(1,334)
Associates	NA	NA	NA	NA	NA
Pretax Income	869	297	112	92	94
Tax (expense) / Benefit	(54)	(192)	(17)	(14)	(14)
Net Income (Adjusted)	791	95	86	68	70
Average Fully Diluted Shares Outstanding	73	73	73	73	73
Key Cash Flow Statement Data					
Net Income (Reported)	815	105	96	78	80
Depreciation & Amortization	732	952	1,130	1,248	1,258
Change in Working Capital	(2,009)	(995)	(1,197)	247	(246)
Deferred Taxation Charge	286	128	11	0	0
Other Adjustments, Net	(277)	(151)	0	0	0
Cash Flow from Operations	(454)	40	40	1,573	1,091
Capital Expenditure	(4,605)	(4,490)	(200)	(200)	(200)
(Acquisition) / Disposal of Investments	(168)	952	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(4,773)	(3,538)	(200)	(200)	(200)
Shares Issue / (Repurchase)	(417)	(72)	0	0	0
Cost of Dividends Paid	(23)	(10)	(10)	(10)	(10)
Cash Flow from Financing	5,825	2,609	(510)	(510)	(1,510)
Free Cash Flow	(5,059)	(4,450)	(160)	1,373	891
Net Debt	12,775	16,053	16,224	14,861	13,979
Change in Net Debt	5,899	3,610	170	(1,363)	(881)
Key Balance Sheet Data					
Property, Plant & Equipment	13,617	16,894	15,964	14,916	13,859
Other Non-Current Assets	258	258	258	258	258
Trade Receivables	1,176	1,384	1,924	2,078	2,241
Cash & Equivalents	1,886	1,299	628	1,491	872
Other Current Assets	5,809	6,267	8,013	7,870	8,177
Total Assets	22,747	26,102	26,788	26,613	25,407
Long-Term Debt	12,101	14,198	14,198	13,698	12,198
Other Non-Current Liabilities	957	1,086	1,097	1,097	1,097
Short-Term Debt	2,559	3,154	2,654	2,654	2,654
Other Current Liabilities	1,567	2,189	3,279	3,536	3,760
Total Liabilities	17,185	20,627	21,228	20,985	19,709
Total Equity	5,404	5,281	5,367	5,435	5,504
Total Equity & Liabilities	22,588	25,908	26,594	26,419	25,213
iQmethod SM **- Bus Performance***					
Return On Capital Employed	5.1%	1.6%	3.3%	5.1%	5.4%
Return On Equity	15.0%	1.8%	1.6%	1.3%	1.3%
Operating Margin	8.1%	4.3%	5.2%	7.1%	6.8%
EBITDA Margin	14.0%	10.0%	11.4%	13.3%	12.8%
iQmethod SM **- Quality of Earnings***					
Cash Realization Ratio	-0.6x	0.4x	0.5x	23.2x	15.6x
Asset Replacement Ratio	6.3x	4.7x	0.2x	0.2x	0.2x
Tax Rate (Reported)	6.2%	64.6%	15.0%	15.0%	15.0%
Net Debt-to-Equity Ratio	236.4%	304.0%	302.3%	273.5%	254.0%
Interest Cover	1.9x	0.9x	0.8x	1.0x	1.0x

Key Metrics

* For full definitions of *iQmethod* SM measures, see page X.

Company Description

Welspun India Ltd is Asia's largest and one of the world's top 5 manufacturers of terry towels. It has expanded into bed linen over last 2 yrs, which has still not started operating at optimal levels. Exports make up more than 90% of its revenues. The company also operates retail stores under the names Spaces and WelHome, through an associate co.

Investment Thesis

Our Underperform rating on Welspun is driven by economic downturn in key markets, concerns on its bed linen business which continues to operate at sub-optimal levels and likely worse than expected performance by its overseas subs - Christy and Sorema. High Balance sheet leverage is an added concern.

Stock Data

Price to Book Value	0.3x

Himatsingka (Neutral)

Overseas subsidiaries performance a concern; Earnings estimates, PO cut sharply

We are concerned about the performance of Divatex and DWI (US based) and Bellora (EU based), all of whom had significantly below par performance in 1H FY09. These subs are likely to see a decline in sales over the next few quarters. As a result we have cut our consolidated sales forecast 25-28% over FY09-10. We have also cut our margin forecast for bed linen business to 11% now. As a result our earnings are now lower by 51% for FY09E and 61% for FY10E. PO has been reduced to Rs29 (vs Rs55 earlier) to reflect this. Maintain Neutral.

Table 18: What has changed?

	FY09E	FY10E
Sales	-25%	-28%
EBIDTA	-42%	-34%
EPS	-51%	-61%

Source: Merrill Lynch

Improved operating results, bed linen achieves breakeven

2Q results (ex overseas subs) were better than expected led by bed linen which finally achieved break-even. The plant is operating currently at 60% utilization levels and mgmt aims to take this up to 70% by end of 4Q'09. Bed linen made an EBIDTA margin of 9% in 2Q; we expect this to improve to 14% in FY10, as efficiencies improve. Silk business remains stable with more or less flat sales and margins maintained in the 30-33% range.

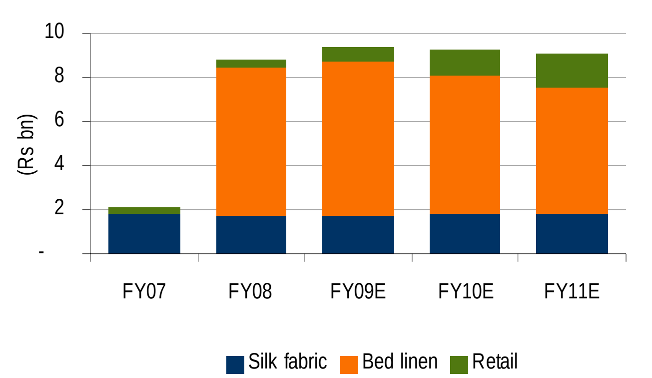
Flat sales, higher margins forecast for FY10

We have assumed a 1-2% decline in consolidated sales over FY10-11, given the economic slowdown and lack of any drivers for sales growth. EBIDTA margins, however, are likely to improve from 10% in FY09E to 14% in FY10E as bed linen plant achieves optimal efficiency levels. We have assumed that the silk business continues to make over 30% EBIDTA margin.

Derivative losses an overhang

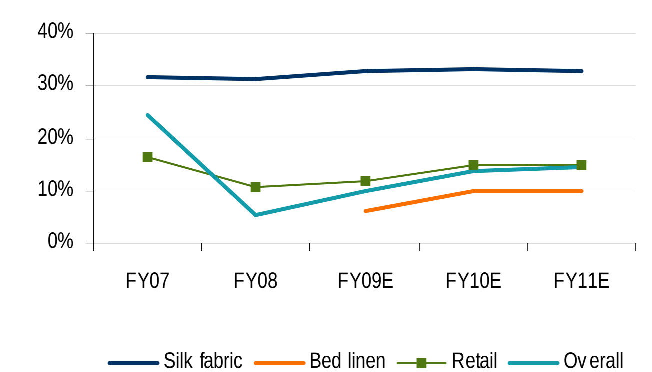
The company had reported large MTM losses on exotic derivative contracts in last couple of quarters (close to Rs2bn). While some of these contracts are under sub-judice, the issue has remained an overhang on the stock performance. The company has announced recently that the MTM losses on few of these contracts have reduced substantially. Any positive news on this front could have an impact on the stock performance.

Chart 11: Sales mix



Source: Merrill Lynch

Chart 12: EBIDTA margin forecast



Source: Merrill Lynch

iQprofile SM Himatsingka Seide Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	2,091	8,862	9,402	9,319	9,126
Gross Profit	843	1,702	6,284	5,435	4,896
Sell General & Admin Expense	(331)	(1,223)	(5,352)	(4,125)	(3,535)
Operating Profit	355	114	463	790	842
Net Interest & Other Income	345	(74)	(60)	(285)	(300)
Associates	NA	NA	NA	NA	NA
Pretax Income	700	40	403	505	542
Tax (expense) / Benefit	(69)	(54)	(97)	(167)	(179)
Net Income (Adjusted)	614	17	321	348	374
Average Fully Diluted Shares Outstanding	97	98	103	103	103
Key Cash Flow Statement Data					
Net Income (Reported)	614	17	321	348	374
Depreciation & Amortization	157	364	470	520	520
Change in Working Capital	(195)	(1,275)	(882)	(206)	(48)
Deferred Taxation Charge	11	34	62	106	114
Other Adjustments, Net	(8)	(195)	45	(14)	(10)
Cash Flow from Operations	579	(1,055)	15	754	950
Capital Expenditure	(3,660)	(2,064)	(750)	(250)	(250)
(Acquisition) / Disposal of Investments	642	299	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(3,018)	(1,764)	(750)	(250)	(250)
Shares Issue / (Repurchase)	(60)	223	531	0	0
Cost of Dividends Paid	(278)	(95)	(156)	(156)	(156)
Cash Flow from Financing	2,454	2,903	875	(156)	(156)
Free Cash Flow	(3,081)	(3,118)	(735)	504	700
Net Debt	785	5,810	6,170	5,822	5,278
Change in Net Debt	2,803	2,537	360	(348)	(544)
Key Balance Sheet Data					
Property, Plant & Equipment	4,235	5,827	6,108	5,838	5,568
Other Non-Current Assets	1,024	3,577	3,577	3,577	3,577
Trade Receivables	802	1,156	1,227	1,216	1,191
Cash & Equivalents	2,404	153	294	642	1,186
Other Current Assets	2,358	4,562	2,596	2,906	3,019
Total Assets	10,822	15,276	13,801	14,178	14,541
Long-Term Debt	2,791	3,581	4,081	4,081	4,081
Other Non-Current Liabilities	23	14	76	182	296
Short-Term Debt	398	2,382	2,382	2,382	2,382
Other Current Liabilities	1,677	3,260	483	576	615
Total Liabilities	4,888	9,238	7,023	7,222	7,375
Total Equity	5,934	6,038	6,779	6,957	7,165
Total Equity & Liabilities	10,822	15,276	13,801	14,178	14,541
iQmethod SM **- Bus Performance***					
Return On Capital Employed	5.2%	0.8%	3.1%	4.0%	4.1%
Return On Equity	10.6%	0.3%	5.1%	5.1%	5.4%
Operating Margin	17.0%	1.3%	4.9%	8.5%	9.2%
EBITDA Margin	24.5%	5.4%	9.9%	14.1%	14.9%
iQmethod SM **- Quality of Earnings***					
Cash Realization Ratio	0.9x	NM	0x	2.2x	2.5x
Asset Replacement Ratio	23.3x	5.7x	1.6x	0.5x	0.5x
Tax Rate (Reported)	9.8%	134.5%	24.0%	33.0%	33.0%
Net Debt-to-Equity Ratio	13.2%	96.2%	91.0%	83.7%	73.7%
Interest Cover	36.8x	0.4x	1.5x	2.6x	2.7x
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page X.

Company Description

Himatsingka Seide is India's leading silk/silk-blended fabric exporter. The company expanded into bed linen with 20mn meters capacity in FY08 and acquired three front end overseas companies. It also operates premium furnishing-fabric retail stores under the name Atmosphere. Its silk fabric are design intensive, which gives the company substantive pricing power and help it earn the highest EBIDTA margins in the industry at over 30%.

Investment Thesis

Himatsingka's performance will likely remain impacted by slowdown in its key markets - US and EU. Its new bed linen business has achieved break-even but we are concerned about the performance of the overseas distribution companies. We expect the retail business, Atmosphere, to continue to deliver strong growth and the silk business to remain stable.

Stock Data

Price to Book Value	0.5x

Gokaldas (Underperform)

Earnings estimates, PO cut

We have cut FY09E earnings by 11% and FY10E earnings by 29% to factor in a disappointing 2Q performance and impact of global economic slowdown. We have cut our sales forecast by 5-14% over FY09-10 and EBIDTA by 7-20%. PO is reduced to Rs116 (Rs200 earlier) as a result of the earnings cut and lower target multiple (5.5x FY10E EV/E versus 6.5x earlier).

Table 19: What has changed?

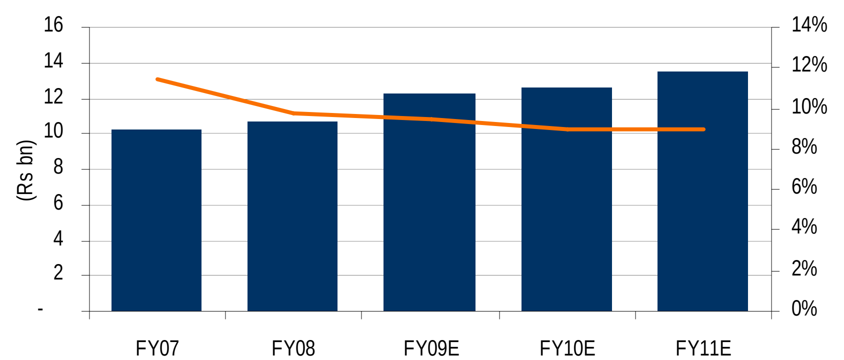
	FY09E	FY10E
Sales	-5.2%	-13.8%
EBIDTA	-7.6%	-20.4%
EPS	-11.0%	-28.9%

Source: Merrill Lynch

Muted sales growth, slightly lower margins forecast

We forecast sales growth of 5% p.a. over FY10-11. We have built in a 50bp margin dilution in FY10E on the back of lower realizations as the company might be forced to pass on the benefit of weaker Re to the buyer, given the slowdown. As a result, we expect avg. 4% decline in earnings over next 2 yrs.

Chart 13: Sales & EBIDTA forecasts



Source: Merrill Lynch

Table 20: Key assumptions

	FY07	FY08	FY09E	FY10E	FY11E
Sales (mn pieces)	24.2	27.4	30.1	30.9	33.0
% growth	13%	13%	10%	3%	7%
Realization (Rs/psc)	425	400	406	410	410
% change	4%	-6%	1%	1%	0%

Source: Merrill Lynch

iQprofile℠ Gokaldas Exports Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	10,306	10,752	12,239	12,655	13,541
Gross Profit	1,803	1,804	1,958	1,962	2,099
Sell General & Admin Expense	(649)	(751)	(796)	(823)	(880)
Operating Profit	866	686	719	660	710
Net Interest & Other Income	(77)	(82)	(25)	(29)	(54)
Associates	NA	NA	NA	NA	NA
Pretax Income	788	605	694	631	656
Tax (expense) / Benefit	(84)	(43)	(90)	(95)	(98)
Net Income (Adjusted)	705	561	604	537	558
Average Fully Diluted Shares Outstanding	34	34	34	34	34
Key Cash Flow Statement Data					
Net Income (Reported)	705	561	604	537	558
Depreciation & Amortization	288	366	443	478	508
Change in Working Capital	(806)	(234)	(471)	(126)	(282)
Deferred Taxation Charge	48	(27)	0	0	0
Other Adjustments, Net	0	0	0	0	0
Cash Flow from Operations	235	666	576	889	784
Capital Expenditure	(1,148)	(600)	(400)	(300)	(300)
(Acquisition) / Disposal of Investments	220	180	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(928)	(420)	(400)	(300)	(300)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(80)	(80)	(80)	(80)	(80)
Cash Flow from Financing	720	(180)	20	(80)	(80)
Free Cash Flow	(913)	66	176	589	484
Net Debt	2,900	2,817	2,722	2,213	1,810
Change in Net Debt	774	(166)	(96)	(509)	(403)
Key Balance Sheet Data					
Property, Plant & Equipment	2,743	2,977	2,934	2,756	2,547
Other Non-Current Assets	0	0	0	0	0
Trade Receivables	798	854	972	1,005	1,076
Cash & Equivalents	127	110	305	814	1,217
Other Current Assets	4,563	4,622	5,128	5,270	5,572
Total Assets	8,231	8,563	9,340	9,845	10,412
Long-Term Debt	646	646	646	646	646
Other Non-Current Liabilities	100	73	73	73	73
Short-Term Debt	2,381	2,281	2,381	2,381	2,381
Other Current Liabilities	1,021	1,082	1,235	1,285	1,374
Total Liabilities	4,148	4,082	4,335	4,385	4,474
Total Equity	4,083	4,481	5,005	5,461	5,938
Total Equity & Liabilities	8,231	8,563	9,340	9,845	10,412
iQmethod*℠ - Bus Performance					
Return On Capital Employed	12.0%	8.4%	8.0%	6.7%	6.9%
Return On Equity	18.7%	13.1%	12.7%	10.3%	9.8%
Operating Margin	8.4%	6.4%	5.9%	5.2%	5.2%
EBITDA Margin	11.2%	9.8%	9.5%	9.0%	9.0%
iQmethod*℠ - Quality of Earnings					
Cash Realization Ratio	0.3x	1.2x	1.0x	1.7x	1.4x
Asset Replacement Ratio	4.0x	1.6x	0.9x	0.6x	0.6x
Tax Rate (Reported)	10.6%	7.2%	13.0%	15.0%	15.0%
Net Debt-to-Equity Ratio	71.0%	62.9%	54.4%	40.5%	30.5%
Interest Cover	3.9x	2.2x	2.9x	2.6x	2.8x

Key Metrics

* For full definitions of *iQmethod*℠ measures, see page X.

Company Description

Gokaldas Exports Ltd. is one of the largest manufacturer and exporter of apparel in India. It has a production capacity of over 30mn psc per annum and employs over 54,000 staff.

Investment Thesis

We expect Gokaldas to Underperform given the global economic downturn, with exports comprising more than 95pct of its business. We like management's strategy to de-risk the business model by focusing on the domestic market, where the opportunity is huge. However, earnings growth is likely to remain subdued due to economic slowdown in its key markets, despite benefits of weaker Re and weakening Chinese competition.

Stock Data

Price to Book Value	0.8x

Appendix – I: 2Q results review

No major surprises, BRFL stands out

BRFL reported 2Q PAT at Rs367mn, a growth of 20% yoy, which was in line with MLe. This was led by 200bp margin expansion on weaker Re and higher share of garments. Profit growth could have been higher but for higher interest cost. Raymond showed a sharp improvement in its core worsted fabric business but consolidated earnings remained depressed as losses for the denim JV widened. Himatsingka's bed linen business finally achieved break-even but performance of its overseas subsidiaries deteriorated. Arvind's earnings remained depressed by high input costs and continued downturn in denim market.

Table 21: 2Q'09 results snapshot (Rs mn)

	Sales	yoy chg	EBIDTA	yoy chg	PAT	yoy chg	Comments
Bombay Rayon	2,870	28%	687	39%	367	20%	Strongest results in textile universe, PAT in line with MLe, 200bp margin expansion a +ve surprise driven by higher share of garments and weaker Re.
Raymond	7,540	27%	852	38%	NA	NM	Strong performance by worsted fabric, denim continues to be a drag (Rs400mn loss - 50% Raymond share), Overall results ahead of expectations, consolidated PAT not reported by company, forex translation losses impact results.
Arvind	5,989	6%	645	-18%	(293)	NM	Muted sales growth, Margins impacted by high input costs, results clearly below expectations.
Gokaldas	3,226	29%	211	-6%	31	-73%	Strong sales growth, EBIDTA disappoints, Results impacted by forex hedging losses.
Welspun India	3,786	29%	494	6%	5	-97%	Disappointing results, Strong sales growth but sharp margin decline, PAT impacted by forex translation loss, standalone results - consolidated (not reported by the company) could be worse.
Himatsingka	2,549	1%	204	24%	(206)	NM	Bed linen achieves break-even (9% EBIDTA margin), operational results better than expected, PAT impacted by forex translation loss.

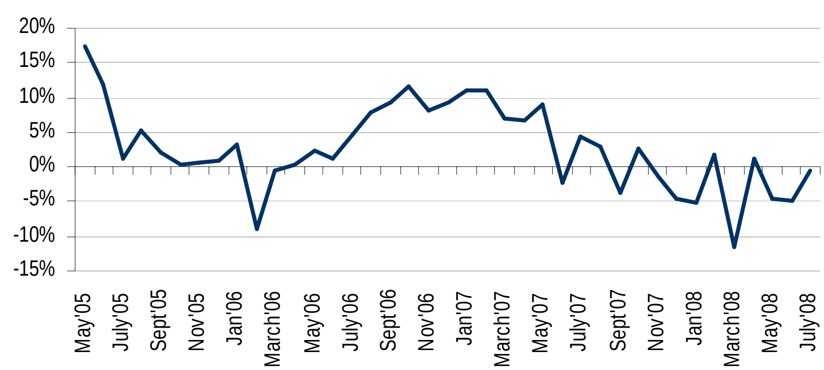
Source: Merrill Lynch

Appendix – II: Industry update

Exports scenario

US imports of textiles & apparel has declined 4% yoy for the Jan-August'08 period

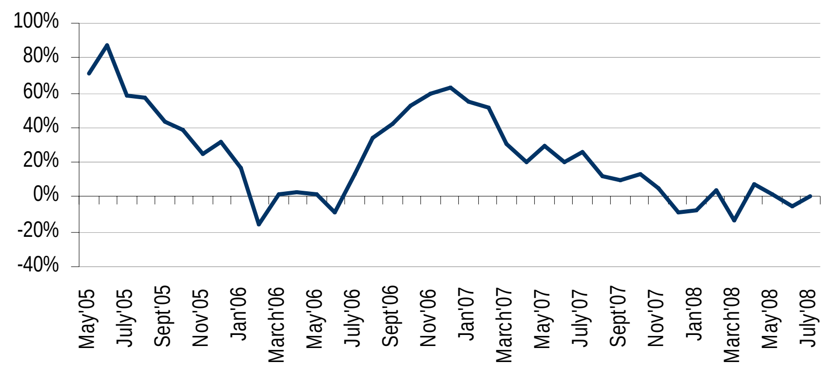
Chart 14: US imports of textiles & apparel – yoy growth trend



Source: OTEXA, Merrill Lynch

China's exports of textiles & apparel to US has declined 2% yoy for the Jan-July'08 period

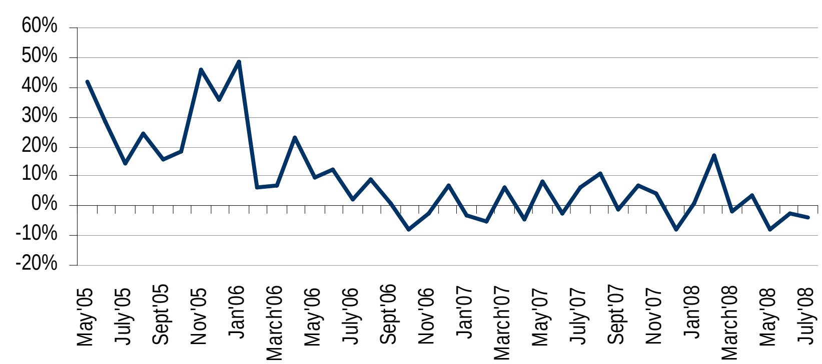
Chart 15: Chinese exports of textiles & apparel to US – yoy growth trend



Source: OTEXA, Merrill Lynch

India's exports of textiles & apparel to US has declined 2% as well for the Jan-July'08 period

Chart 16: India's exports of textiles & apparel to US – yoy growth trend



Source: OTEXA, Merrill Lynch

Table 22: Country wise textile & apparel exports to US and market shares

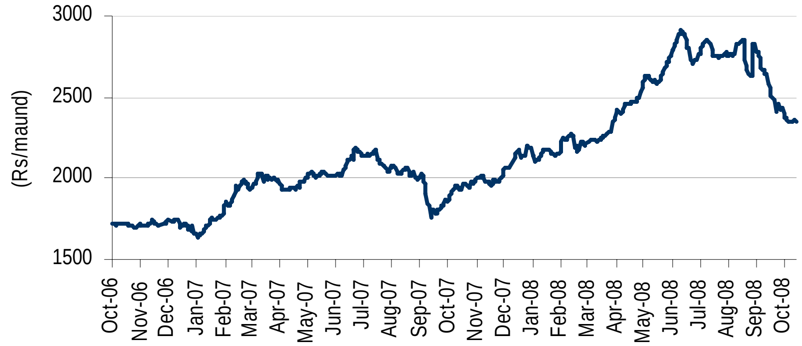
(US$mn)	Jan-August'07	Jan-August'08	YoY chg	CY06	CY07	YoY chg
Total US imports	64,052	61,696	-4%	93,279	96,410	3%
China	20,984	20,624	-2%	27,068	32,323	19%
India	3,598	3,542	-2%	5,031	5,104	1%
Vietnam	2,900	3,536	22%	3,396	4,558	34%
Mexico	3,820	3,381	-12%	6,376	5,625	-12%
Indonesia	2,893	2,887	0%	3,902	4,206	8%
Bangladesh	2,191	2,326	6%	2,998	3,191	6%
Pakistan	2,125	2,026	-5%	3,250	3,170	-2%
Market shares			Chg (bp)			Chg (bp)
China	32.8%	33.4%	67	29.0%	33.5%	451
India	5.6%	5.7%	12	5.4%	5.3%	(10)
Vietnam	4.5%	5.7%	120	3.6%	4.7%	109
Mexico	6.0%	5.5%	(48)	6.8%	5.8%	(100)
Indonesia	4.5%	4.7%	16	4.2%	4.4%	18
Bangladesh	3.4%	3.8%	35	3.2%	3.3%	10
Pakistan	3.3%	3.3%	(3)	3.5%	3.3%	(20)

Source: OTEXA, Merrill Lynch

Input cost trend

Cotton prices have come off their peak, but still remain high on a yoy basis. In 3Q (Oct-Nov'09) they are up 37% yoy.

Chart 17: Cotton price trend (medium staple)



Source: MCX, Merrill Lynch

Price objective basis & risk

Arvind Ltd (ARVZF)

Our PO of Rs13 is based on a SOTP-based valuation. (1) We have valued the textile business (74pct of EV) at 5x FY10E EV/EBITDA, at par with other textile companies and at the lower end of Arvind's historical one-year forward EV/EBITDA band. (2) The retail business (26pct EV) has been valued at 0.7x FY10E EV/sales at a discount to other Indian retailers as the format is still evolving and the profitability is lower. Upside risks: Lower cotton prices, improvement in denim volumes and higher-than-expected value unlocking from real estate. Downside risks: Lower-than-expected growth in its brands and retail business, stronger rupee and higher input costs.

Bombay Rayon Fashions Ltd (BORYF)

Our PO of Rs270 is based on 7.5x FY10E EV/EBIDTA, which we believe is reasonable considering EBIDTA growth of 43% CAGR over FY09E-11E. Also, this is at the mid-end of the stock's historical 1-year forward rolling EV/EBIDTA band. We have chosen to value Bombay Rayon and other textile companies on EV/EBIDTA as we believe this appropriately captures their core business value. At our PO the stock will trade at P/Es of 11x FY09E and 8x FY10E. We believe this is reasonable considering the strong earnings growth of 44% CAGR over FY09E-11E and a high ROE of 22% in FY09E. Risks are slowdown in key markets including the US, slower demand in the domestic market, exchange fluctuation, rise in input costs and execution risks.

Gokaldas Exports (GKLDF)

Our PO of Rs116 is based on 5.5x FY10E EV/EBIDTA. This is at a slight premium to other textile companies given higher RoE but at the lower end of its historical EV/EBIDTA band, given the moderation in growth prospects and margins on the back of global slowdown. At our PO, the stock would trade at 7.5x FY10E P/E which is at the lower end of its historical P.E band. This, in our view, is appropriate given slowing earnings growth trajectory. Upside risks: Weaker rupee and faster growth in domestic OEM business. Downside risks: Competition from neighboring countries and higher costs.

Himatsingka Seid (HMKFF)

Our PO of Rs29 is based on a SOTP valuation. (1) The silk fabric business has been valued at 5.5x FY10E EV/EBITDA at slight premium to other textile companies given higher margins and pricing power. But this is a significant discount to its historical multiples, given the moderation in growth prospects and margin erosion in the silk business. (2) The bed linen business is valued at 5.5x EV/EBIDTA which is at par with Welspun, the leading company in this space. (3) The retail business, Atmosphere, has been valued at 1.1x EV/sales, which is a premium to other retail companies, given its higher profitability. Upside risks: Fast ramp-up in the bed linen business and lower input costs. Downside risks: Longer gestation for the bed linen business and stronger rupee.

Raymond Ltd (XRAMF)

Our PO of Rs75 is based on a SOTP-based valuation. We have valued Raymond's textile business (63pct of EV) at 6x FY10E EV/EBITDA, which is a 20pct premium to other textile companies. We believe this premium is justified, given Raymond's strong brand franchise. We value the retail business (30pct of EV) at 0.8x FY10E EV/sales similar to other retail companies in India. The engineering and auto ancillary business (7pct of EV) has been valued at 4x EV/EBITDA similar to other auto ancillary companies. Upside risks: News flow on

Thane land sale, restructuring of denim business, lower input costs and weaker rupee. Downside risks: Lower-than-expected growth in worsted business, slower retail ramp-up and higher costs of retailing.

Welspun India (WPNIF)

Our PO of Rs21 is based on 5.5x FY10E EV/EBITDA, which is at the lower end of its historical one-year forward EV/EBITDA band. We believe this is justified, given the moderation in growth prospects on slowdown in key markets. We prefer to value Welspun on EV/EBIDTA as this multiple appropriately captures the core business valuation in our view and ignores the fluctuations in earnings due to changes in non-operating income. At our PO the stock trades at 18x FY09E PE, which we believe may not be the appropriate measure. On P/BV it trades at only 0.3x FY09E and has a RoE of 2%. Risks: INR/USD fluctuation, weaker input prices and weakening competitive environment.

Analyst Certification

I, Manish Sarawagi, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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India - Consumer Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Bombay Rayon Fashions Ltd	BORYF	BRFL IN	Manish Sarawagi
	Hindustan Unilever	HINLF	HUVR IN	Vandana Luthra
	ITC Limited	ITCTF	ITC IN	Vandana Luthra
	Mcleod Russel India Ltd.	XCVFF	MCLR IN	Manish Sarawagi
	Nestle India	XNTEF	NEST IN	Vandana Luthra
	Titan Inds Ltd	TTNIF	TTAN IN	Manish Sarawagi
	United Spirits	UDSRF	UNSP IN	Vandana Luthra
	Welspun India	WPNIF	WLSI IN	Manish Sarawagi
NEUTRAL				
	Asian Paints	XAPNF	APNT IN	Vandana Luthra
	Colgate India	CPIYF	CLGT IN	Vandana Luthra
	Dabur India	DBUIF	DABUR IN	Vandana Luthra
	Himatsingka Seid	HMKFF	HSS IN	Manish Sarawagi
	Pantaloon	PFIAF	PF IN	Vandana Luthra
UNDERPERFORM				
	Arvind Ltd	ARVZF	ARVND IN	Manish Sarawagi
	Gokaldas Exports	GKLDF	GEXP IN	Manish Sarawagi
	Radico Khaitan	RKHAF	RDCK IN	Vandana Luthra
	Raymond Ltd	XRAMF	RW IN	Manish Sarawagi
	Shoppers' Stop	SHPSF	SHOP IN	Manish Sarawagi
	Vishal Retail Ltd	XVHLF	VISH IN	Manish Sarawagi

Important Disclosures

Investment Rating Distribution: Textiles/Apparel Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	8	33.33%	Buy	3	42.86%
Neutral	5	20.83%	Neutral	2	40.00%
Sell	11	45.83%	Sell	1	9.09%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. *VOLATILITY RISK RATINGS*, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. *INVESTMENT RATINGS* reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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