

Recovery still not in sight...



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Results disappoint once again, Maintain Sell

Arvind reported 4Q PAT of Rs40mn (down 85% YoY) and consolidated FY07 PAT of Rs271mn (down 68% YoY) – both of which were significantly below our expectations with full year EBIDTA being ~10% below our estimates. The earnings visibility stays extremely poor on the back of continued structural downturn in the core denim business and rising cost pressures on all fronts. Sell.

Margins collapse on rising costs, changing business mix

EBIDTA margins for 4Q collapsed to 14% from 26% in 4Q06 and 19% in 3Q07. Key reasons: 1) rise in cotton costs 10% YoY and 5% QoQ, 2) higher share of lower margin garment exports and domestic retail business (the latter now merged with the standalone entity and hence 4Q nos not strictly comparable with previous year), 3) rise in salary cost and gestation cost for the recently expanded jeans facility and 4) appreciating rupee. The margin decline was despite a ~7% rise in denim realizations. Denim volumes, however, were down 9%. Garment exports business did well, with sales growing 57% YoY aided by contribution from the jeans facility.

Earnings visibility extremely poor for FY08 and beyond

We have cut earnings estimates by ~40% for FY08-09 primarily to factor in the margin pressure. We note that the company has drawn out aggressive plans to expand its domestic retail and garments exports businesses which may support top line growth in the mid-teens. However, earnings are likely to remain subdued in the foreseeable future on rising cost pressures including gestation costs for retail and garment exports businesses. With recovery in core denim business still not in sight, we maintain our Sell rating.

Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	1,046	806.20	187.98	431.06	824.23
EPS	5.35	3.85	0.898	2.06	3.94
EPS Change (YoY)	NA	-28.1%	-76.7%	129.3%	91.2%
Dividend / Share	1.00	1.00	0	0	0.567
Free Cash Flow / Share	(8.31)	(29.91)	15.08	3.98	1.62

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	8.45x	11.75x	50.40x	21.98x	11.49x
Dividend Yield	2.21%	2.21%	0%	0%	1.25%
EV / EBITDA*	6.92x	6.83x	8.08x	7.29x	6.42x
Free Cash Flow Yield*	-17.13%	-66.10%	33.33%	8.79%	3.59%

* For full definitions of *iQmethod*SM measures, see page 5.

Stock Data

Price (Common / ADR)	Rs45.25
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs42.05-Rs94.50
Market Value (mn)	US\$230
Shares Outstanding (mn)	209.4 / NA
Average Daily Volume	774,663
ML Symbol / Exchange	ARVZF / BSE
Bloomberg / Reuters	ARVND IN / ARMI.BO
ROE (2007E)	1.2%
Net Dbt to Eqty (Mar-2006A)	134.9%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	66.3%



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*iQprofile*SM Arvind Mills Ltd.

Key Income Statement Data (Mar)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Sales	19,608	21,304	21,822	24,859	28,298
Gross Profit	8,469	10,020	10,207	12,400	14,062
Sell General & Admin Expense	(4,209)	(5,703)	(6,560)	(8,359)	(9,471)
Operating Profit	2,445	2,317	1,856	2,236	2,725
Net Interest & Other Income	(1,322)	(1,386)	(1,519)	(1,634)	(1,670)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,123	930	337	602	1,055
Tax (expense) / Benefit	(21)	(106)	(33)	(60)	(127)
Net Income (Adjusted)	1,046	806	188	431	824
Average Fully Diluted Shares Outstanding	195	209	209	209	209

Key Cash Flow Statement Data

Net Income (Reported)	1,174	858	270	489	857
Depreciation & Amortization	1,815	2,001	1,791	1,806	1,866
Change in Working Capital	(4,070)	(2,253)	621	(515)	(1,455)
Deferred Taxation Charge	(1)	83	(1)	0	0
Other Adjustments, Net	(72)	(34)	976	53	72
Cash Flow from Operations	(1,153)	656	3,658	1,833	1,340
Capital Expenditure	(470)	(6,919)	(500)	(1,000)	(1,000)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(470)	(6,919)	(500)	(1,000)	(1,000)
Shares Issue / (Repurchase)	(35)	1,535	(102)	(139)	(139)
Cost of Dividends Paid	(350)	(261)	(83)	(58)	(151)
Cash Flow from Financing	1,992	4,038	(2,185)	(1,197)	(490)
Free Cash Flow	(1,623)	(6,263)	3,158	833	340
Net Debt	18,767	21,496	18,522	17,886	17,836
Change in Net Debt	2,008	4,990	(2,973)	(636)	(50)

Key Balance Sheet Data

Property, Plant & Equipment	18,689	23,237	21,946	21,140	20,274
Other Non-Current Assets	1,381	397	397	397	397
Trade Receivables	2,020	1,672	1,794	2,043	2,326
Cash & Equivalents	205	240	1,214	850	700
Other Current Assets	12,278	15,240	14,613	15,413	17,070
Total Assets	34,572	40,787	39,963	39,843	40,766
Long-Term Debt	13,023	14,293	12,978	12,320	12,189
Other Non-Current Liabilities	166	249	249	249	249
Short-Term Debt	5,948	7,443	6,758	6,416	6,347
Other Current Liabilities	2,509	2,871	2,985	3,520	4,005
Total Liabilities	21,646	24,856	22,969	22,504	22,789
Total Equity	12,926	15,932	16,994	17,339	17,977
Total Equity & Liabilities	34,572	40,787	39,963	39,843	40,766

*iQmethod*SM - Bus Performance*

Return On Capital Employed	7.3%	5.9%	4.5%	5.5%	6.6%
Return On Equity	9.5%	6.1%	1.2%	2.7%	5.0%
Operating Margin	12.5%	10.9%	8.5%	9.0%	9.6%
EBITDA Margin	21.7%	20.3%	16.7%	16.3%	16.2%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	-1.1x	0.8x	19.5x	4.3x	1.6x
Asset Replacement Ratio	0.3x	3.5x	0.3x	0.6x	0.5x
Tax Rate (Reported)	1.8%	11.4%	9.8%	10.0%	12.0%
Net Debt-to-Equity Ratio	145.2%	134.9%	109.0%	103.2%	99.2%
Interest Cover	1.7x	1.3x	1.1x	1.2x	1.5x

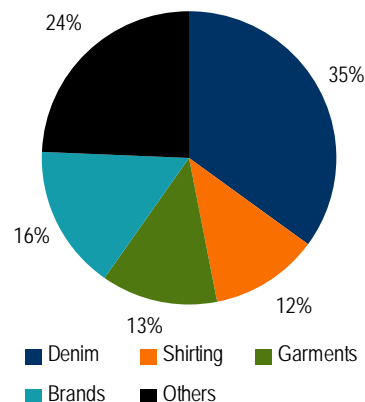
Key Metrics

* For full definitions of *iQmethod*SM measures, see page 5.

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.

Chart 1: Sales Mix (FY07)



Source: Company, Merrill Lynch

Stock Data

Shares / ADR	1.00
Price to Book Value	0.6x

Table 1: 4QFY07* results review

	4QFY07*	4QFY06*	YoY chg	3QFY07	QoQ chg
Net sales	4,831	3,580	35.0%	4,479	7.9%
Raw material cost	1,452	981	48.1%	1,152	26.0%
% of sales	30.1%	27.4%		25.7%	
Staff cost	517	342	51.1%	549	-5.9%
% of sales	10.7%	9.6%		12.3%	
Power & fuel	395	370	6.9%	436	-9.3%
% of sales	8.2%	10.3%		9.7%	
Other expenditure	1,795	971	84.9%	1,484	21.0%
% of sales	37.1%	27.1%		33.1%	
Total expenditure	4,159	2,663	56.2%	3,621	14.9%
EBIDTA	672	917	-26.6%	858	-21.6%
EBIDTA margin	13.9%	25.6%		19.2%	
Depreciation	302	394	-23.3%	347	-13.0%
Interest	407	330	23.4%	399	2.2%
Other income	81	60	34.3%	27	204.2%
PBT	44	253	-82.7%	139	-68.5%
Tax	4	(15)		10	-58.8%
% of PBT	9.6%	-5.8%		7.4%	
PAT (recurring)	40	268	-85.2%	129	-69.3%
Forex loss	(83)	53		(57)	
Non recurring losses	(68)	-		(148)	
PAT (reported)	54	215	-74.8%	37	46.3%

Source: Company, Merrill Lynch

*Note: 4QFY07 results not strictly comparable with 4QFY06 as they include the nos of brands (retail) business which was merged with the standalone entity with effect from 1st April'06.

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14 May 2007

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Investment Rating Distribution: Textiles/Apparel Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	15	62.50%	Buy	3	20.00%
Neutral	8	33.33%	Neutral	2	25.00%
Sell	1	4.17%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

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