

# Stake sale positive

## Stake sale to help de-risk the business, Maintain Buy

We view the recent 20.67% stake sale by Bombay Rayon to Bestseller (family- owned European clothing company with sales of ~Euro1.5bn and brands like Jack & Jones) positively on two counts. First, the company is looking at selling as much as 50% of the additional / new capacity (in the process of getting commissioned) to Bestseller. We think this will substantially alleviate concerns of volume off take from the enhanced capacity (44mn pcs p.a. increasing to 75mn) in the current weak economic scenario. Second, infusion of Rs3.33bn cash should result in a substantial easing of working capital funding needs and improves Balance Sheet.

## EPS cut on equity dilution

We have cut EPS 13-15% over FY09E-11E on the back of 26% equity dilution (18mn new shares at Rs185/share) net of interest cost savings. We have kept our sales and margin forecasts unchanged for now, despite concerns that business from Bestseller could fetch lower margins. Management sounded very confident that they will not compromise on margins for any business from Bestseller. We have built in 150bp margin dilution over FY09E-11E, in any case.

## Balance sheet would improve substantially in our view

We forecast debt-equity of 1.2x in FY09 improving to 0.9x in FY11 vs 2.1x-1.4x earlier. We note that most of the term loan is at a subsidized rate of 1.5%. But working capital loan costs have risen substantially. The company could use the cash for meeting its additional working capital needs on enhanced capacities.

## Bestseller stake could be nearly as large as promoters

If the open offer for 20% stake (mandatory requirement as per SEBI rules) goes through in its entirety, we estimate Bestseller could hold as much as 40.67% stake which would be very close to promoters' stake at ~43%. However, the company said that Bestseller will not hold any Board seat or have any role in the mgmt. It gives them the opportunity to increase sourcing from a low cost facility with lots of fiscal benefits and bring in other synergies like better time to market.

## Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	544	1,227	1,750	2,380	3,155
EPS	8.64	19.48	20.09	27.32	36.23
EPS Change (YoY)	132.7%	125.6%	3.1%	36.0%	32.6%
Dividend / Share	1.25	1.50	2.00	2.25	2.50
Free Cash Flow / Share	(55.01)	(115.14)	(119.87)	(12.79)	7.65

## Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	17.45x	7.73x	7.50x	5.52x	4.16x
Dividend Yield	0.829%	0.995%	1.33%	1.49%	1.66%
EV / EBITDA*	30.40x	12.07x	7.96x	5.53x	4.41x
Free Cash Flow Yield*	-26.80%	-56.10%	-80.75%	-8.62%	5.15%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

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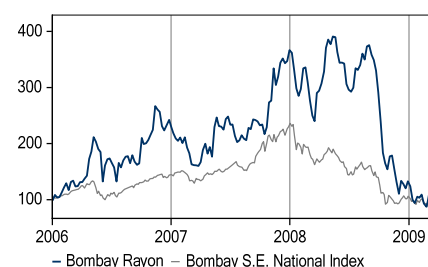


## RESEARCH

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## Stock Data

Price	Rs150.70
Price Objective	Rs225.00
Date Established	17-Feb-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs80.05-Rs419.90
Mrkt Val / Shares Out (mn)	US\$259 / 87.1
Average Daily Volume	1,528,314
ML Symbol / Exchange	BORYF / BSE
Bloomberg / Reuters	BRFL IN / BRFL.BO
ROE (2009E)	19.2%
Net Dbt to Eqty (Mar-2008A)	140.9%
Est. 5-Yr EPS / DPS Growth	40.0% / 40.0%
Free Float	56.6%



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Refer to important disclosures on page 5 to 7. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3.

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# *iQprofile*<sup>SM</sup> Bombay Rayon Fashions Ltd

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	4,894	10,891	16,143	24,035	30,816
Gross Profit	1,885	4,838	7,860	11,513	14,544
Sell General & Admin Expense	(965)	(2,521)	(4,350)	(6,460)	(8,210)
Operating Profit	815	1,964	3,050	4,158	5,357
Net Interest & Other Income	(59)	(177)	(439)	(606)	(647)
Associates	NA	NA	NA	NA	NA
Pretax Income	756	1,787	2,611	3,552	4,709
Tax (expense) / Benefit	(212)	(551)	(862)	(1,172)	(1,554)
Net Income (Adjusted)	544	1,227	1,750	2,380	3,155
Average Fully Diluted Shares Outstanding	63	63	87	87	87

## Key Cash Flow Statement Data

Net Income	544	1,227	1,750	2,380	3,155
Depreciation & Amortization	104	352	460	896	978
Change in Working Capital	(1,676)	(3,696)	(3,972)	(4,239)	(3,317)
Deferred Taxation Charge	124	112	0	0	0
Other Adjustments, Net	(124)	(112)	0	0	0
Cash Flow from Operations	(1,028)	(2,118)	(1,763)	(964)	816
Capital Expenditure	(2,438)	(5,136)	(8,678)	(150)	(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)	(8,678)	(150)	(150)
Shares Issue / (Repurchase)	2,844	126	4,466	0	0
Cost of Dividends Paid	(92)	(109)	(200)	(225)	(250)
Cash Flow from Financing	5,137	5,882	10,441	1,114	(666)
Free Cash Flow	(3,466)	(7,254)	(10,441)	(1,114)	666
Net Debt	2,562	8,606	14,781	16,120	15,704
Change in Net Debt	1,971	6,059	6,175	1,339	(416)

## Key Balance Sheet Data

Property, Plant & Equipment	3,540	8,327	16,545	15,799	14,971
Other Non-Current Assets	1,358	181	181	181	181
Trade Receivables	1,020	2,342	3,807	5,622	7,539
Cash & Equivalents	773	593	593	593	593
Other Current Assets	2,486	5,324	8,246	11,534	13,708
Total Assets	9,176	16,767	29,372	33,729	36,992
Long-Term Debt	3,335	9,199	15,374	16,713	16,297
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	2,494	3,267
Total Liabilities	4,220	10,661	17,250	19,453	19,810
Total Equity	4,956	6,106	12,122	14,276	17,181
Total Equity & Liabilities	9,176	16,767	29,372	33,729	36,992

## *iQmethod*<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	10.7%	11.3%	9.4%	9.4%	11.1%
Return On Equity	16.8%	22.2%	19.2%	18.0%	20.1%
Operating Margin	16.7%	18.0%	18.9%	17.3%	17.4%
EBITDA Margin	18.8%	21.3%	21.7%	21.0%	20.6%

## *iQmethod*<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	-1.9x	-1.7x	-1.0x	-0.4x	0.3x
Asset Replacement Ratio	23.3x	14.6x	18.9x	0.2x	0.2x
Tax Rate (Reported)	28.0%	30.8%	33.0%	33.0%	33.0%
Net Debt-to-Equity Ratio	51.7%	140.9%	121.9%	112.9%	91.4%
Interest Cover	6.3x	5.2x	5.3x	6.1x	7.4x

## Key Metrics

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.

## Company Description

NA

## Investment Thesis

Our Buy rating on Bombay Rayon is premised on strong earnings growth of 34% pa over FY09-11E and inexpensive valuations. We expect strong volume growth in both fabric and garments driven by new capacities coming on stream. We believe BRFL would be able to achieve this growth, despite the global slowdown, through market share gains as the new facilities are cost competitive.

## Stock Data

Price to Book Value 1.1x

## Price objective basis & risk

### Bombay Rayon Fashions Ltd (BORYF)

Our PO of Rs225 is based on 7x FY10E EV/EBIDTA, which we believe is reasonable considering EBIDTA growth of 34% CAGR over FY09-11E. Also, this is at the lower-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 8x FY10E. We believe this is reasonable considering the strong earnings growth of 34% CAGR over FY09-11E and a high ROE of 19% in FY09E. Risks are sharper than expected slowdown in key markets, slower demand in the domestic market, exchange fluctuation, rise in input costs and execution risks.

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## India - Consumer Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Bombay Rayon Fashions Ltd	BORYF	BRFL IN	Manish Sarawagi
	Godrej Consumer Products Ltd.	XGOCF	GCPL IN	Anuj Bansal
	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
<b>NEUTRAL</b>				
	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
	United Spirits	UDSRF	UNSP IN	Vandana Luthra
<b>UNDERPERFORM</b>				
	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
	Titan Inds Ltd	TTNIF	TTAN IN	Manish Sarawagi
	Vishal Retail Ltd	XVHLF	VISH IN	Manish Sarawagi
	Welspun India	WPNIF	WLSI IN	Manish Sarawagi

## iQmethod<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
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
<b>Quality of Earnings</b>		
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	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
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	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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### BORYF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2009 or such later date as indicated.

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### Investment Rating Distribution: Textiles/Apparel Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	6	27.27%	Buy	4	80.00%
Neutral	5	22.73%	Neutral	3	60.00%
Sell	11	50.00%	Sell	5	45.45%

### Investment Rating Distribution: Global Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1243	38.21%	Buy	520	46.39%
Neutral	841	25.85%	Neutral	349	47.04%
Sell	1169	35.94%	Sell	388	36.30%

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