

28 January 2008 | 6 pages

# Arvind Mills (ARMI.BO)

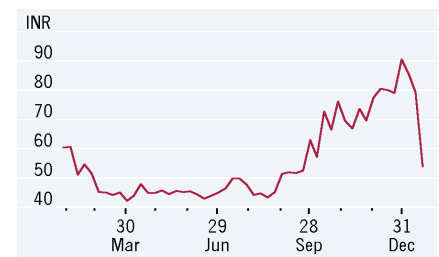
 Results 

## Sell: Weak Quarter – Denim Woes, Cost Pressures Building

- 3Q results below expectations** — Revenues increased 20% YoY while EBITDA declined 14% with margins down 440bps YoY; but for forex gains (Rs124m, adj in interest cost) on debt, earnings would have declined. Key reasons – 1) deteriorating denim outlook 2) rising cotton, power costs 3) appreciating rupee.
- Denim outlook worsens** — Volumes declined 22% YoY in 3Q with exports down, cut in US and EU orders and oversupply in domestic markets. Denim prices also slipped to Rs96/mtr vs. Rs102/mtr in 1HFY08, after having held for past 3-qtrs. With sluggish demand conditions in US, continued trouble at GAP and cotton cost on the rise, we believe outlook for denim is worsening.
- Rupee concerns on garment exports building** — Arvind's garment operations (18% of revenues) have scaled-up well; but, appreciating rupee is beginning to impact growth– drop in export orders for jeans are early signs of this trend.
- Branded apparel in growth phase** — Revenues grew 40% YoY following strong brand promotion of Flying Machine, New Port brands and growth in MegaMart, discount store. Profitability is however still under pressure. Big plans for MegaMart are under way – recently launched 40,000sqft large format store and is targeting 30 stores, which should significantly enhance growth opportunities.
- Maintain Sell** — With stock underperforming the sensx by 37% over last 1-mth, downside appears limited. However, with outlook for core business weak and risk to earnings high, we maintain Sell; Key upside risk - any progress on value unlocking from sale/development of its real estate assets (230 acres).

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (28 Jan 08)	Rs51.05
Target price	Rs53.00
Expected share price return	3.8%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>3.8%</b>
Market Cap	Rs10,689M
	US\$272M

### Price Performance (RIC: ARMI.BO, BB: ARVND IN)



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	815	3.89	-27.3	13.1	0.7	6.2	2.0
2007A	239	1.14	-70.6	44.7	0.7	1.6	0.0
2008E	324	1.55	35.6	33.0	0.7	2.0	0.0
2009E	643	3.07	98.2	16.6	0.6	3.9	0.0
2010E	966	4.61	50.3	11.1	0.6	5.6	2.0

Source: Powered by dataCentral

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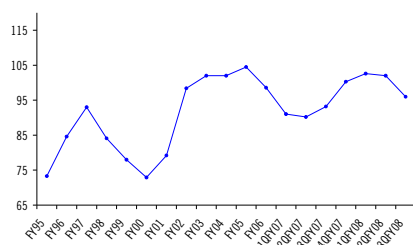
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<sup>1</sup>Citigroup Global Markets India Private Limited

Figure 2. Denim Realization



Source: Company Reports, CIR

Figure 1. Arvind Mills 3Q and 9-months Earnings Summary

	3QFY07	3QFY08	YoY	9mFY07	9mFY08	YoY
Sales	4,479	5,368	20%	13,618	16,129	18%
EBITDA	710	611	-14%	2,378	2,159	-9%
EBITDA Mgn (%)	15.8%	11.4%		17.5%	13.4%	
Interest	342	268	-22%	1,178	961	-18%
Other Income	27	73	175%	82	97	19%
Depreciation	347	352	2%	1,132	1,058	-7%
PBT	47	63	34%	151	238	58%
PAT before Ext	37	57	54%	131	220	68%
Ext Items	1,011	0		1,011	0	
PAT after Ext	1,048	57	-95%	1,142	220	-81%

Source: Company Reports, Citi Investment Research

## Arvind Mills

### Company description

Arvind Mills is one of the world's largest denim manufacturers and one of India's largest textile exporters. Aside from leadership in denim (a 72% market share) in India, Arvind Mills has a presence in shirting, knits, khakhis, voiles fabrics and a wide range of garments. It is an integrated player with a presence across the textile value chain - global capacity of 154m meters in fabrics, vertical integration to garments, strong brand franchise and a distribution network for branded apparels. Arvind's wide product range, scaleable capacities and ability to offer specialty fabrics and high-end garments make it a preferred vendor in the domestic market and to global brands. It is the flagship company of the Lalbhai Group, which owns a 34% stake.

### Investment strategy

We rate Arvind Mills to Sell / Medium Risk (3M) with a target price of Rs53 based on 8x FY08E EV/EBITDA. Our recommendation is premised on 1) denim woes continuing - volume outlook is still sluggish; 2) cost pressures and appreciating rupee adversely impacting earnings; and 3) unfavorable risk/reward with the stock trading close to our target price. Further, proposed 24% dilution from preferential warrant issue to promoters could make near-term valuations richer. Arvind's focus on richer product mix, ability to hold higher denim price realizations vs. industry, and growth in domestic branded apparel business are positives. However, we see rising concerns on appreciating rupee and increasing cost pressures to adversely impact earnings going forward. Further with sluggish outlook for core denim business expected to continue, we see downside.

### Valuation

Our target price of Rs53 is based on 8.0x FY08E EV/EBITDA, a 10% premium to sector valuations. The stock's three-year EV/EBITDA band is 7-12x, with the median around 8x. With near-term earnings subdued on account of higher interest costs but operating profits still healthy, we believe EV/EBITDA is a

more suitable valuation method. Our target multiple recognizes Arvind's 1) growing branded apparel sales (contributing ~14% of FY07 Revenues); 2) strong portfolio of brands like Arrow, Excalibur, Flying Machine, Megamart and recent foray with Diesel; and 3) existing network of 288 EBOs and Megamart stores.

## **Risks**

We rate Arvind Mills as Medium Risk, as opposed to the Low Risk rating as suggested by our quantitative risk-rating system, which tracks 260-day share-price volatility. The key reasons for our Medium Risk rating include high earnings volatility due to volatility in denim prices and its vulnerability to forex fluctuations. The main upside risks to our target price include: (1) Strong up-tick in denim prices (greater than assumed 5%) could significantly improve earnings forecasts; (2) New tie-ups with global retailers for sourcing garments could put our conservative assumptions at risk; (3) Stronger-than-expected turnaround for its branded apparel division could contribute towards higher growth; and (4) Any potential unlocking of hidden value in real estate assets in Ahmedabad and Bangalore would be a positive.

# Appendix A-1

## Analyst Certification

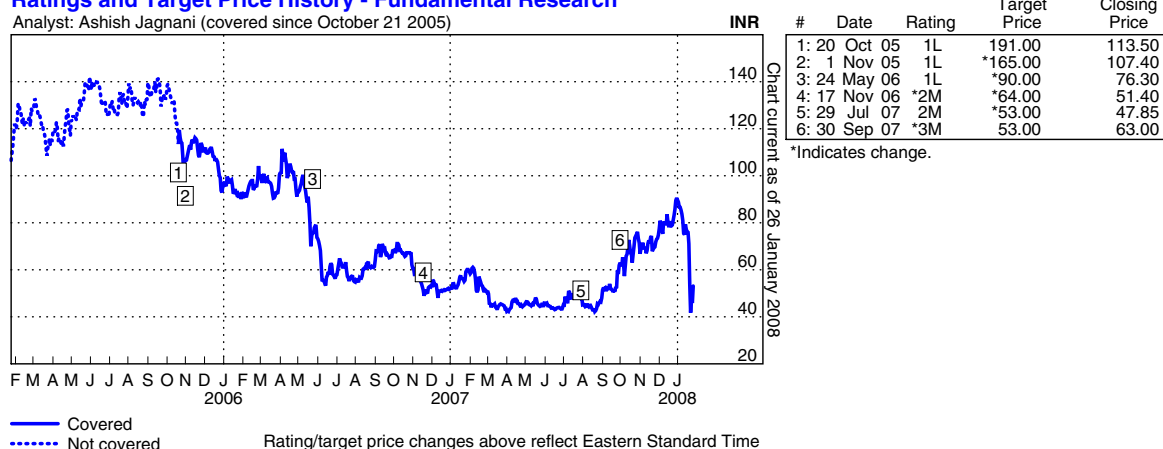
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Analyst: Ashish Jagnani (covered since October 21 2005)



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