



Arvind Mills

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,936	ARVND IN
	REUTERS CODE
S&P CNX: 4,346	ARMI.BO

1 August 2007

Neutral

Previous Recommendation: Neutral

Rs45

Equity Shares (m)	209.4
52-Week Range (Rs)	74/42
1,6,12 Rel.Per. (%)	-2/-27/-56
M.Cap (Rs b)	9.5
M.Cap (US\$ b)	0.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	18,449	1,196	0.8	-6.0	53.8	0.6	1.1	8.2	1.5	9.0
3/08E	22,092	325	1.6	84.9	29.1	0.6	2.0	5.5	1.3	9.1
3/09E	25,166	836	4.0	157.1	11.3	0.6	5.0	7.0	1.1	7.6

- Arvind Mill's results for 1QFY08 were higher than expected. EBITDA stood at Rs721 (v/s est. of Rs671m), EBITDA margins dropped by 564bp to 14.1% v/s 19.8% in 1QFY07. Financials for 1QFY07 are re-stated numbers post merger of Arvind Brands.
- Revenues grew 21.3% YoY to Rs5.1b. Excluding revenues of R727m from the merged Arvind Brands, revenues grew 23.4% YoY to Rs4.4b.
- Reported PAT increased by 25.7% YoY to Rs58m boosted by forex gains (debt) of Rs83m, adjusted for the forex gains Arvind reported a loss of Rs24m, in 1QFY08.
- Though denim realizations improved for the second consecutive quarter, by almost 12.8% YoY to Rs102.7/meter, the denim scenario remains bleak due to overcapacity and this is unlikely to change in the near to medium term. The management is focusing on rapidly growing its downstream businesses of garment manufacturing, branded apparel and retail to de-risk itself from the vagaries of the denim cycle.
- In the near to medium term, however, we expect Arvind Mills' margins to face increasing pressure due to the bleak denim scenario, higher cotton prices, increasing energy cost and strengthening rupee. The stock trades at 29.1x FY08E EPS of Rs1.6 and 11.3x FY09E EPS of Rs4.0. We maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08E				FY07	FY08
	1Q*	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Sales	4,208	3,932	4,479	4,831	5,103	5,346	5,523	6,119	18,449	22,092
Change (%)	0.1	-8.1	14.8	35.0	21.3	36.0	23.3	26.7	15.6	19.7
Total Expenditure	3,376	3,074	3,769	4,159	4,382	4,619	4,766	5,297	14,378	19,064
EBITDA	832	859	710	672	721	727	757	822	3,051	3,028
Change (%)	-27.6	-19.1	-22.7	-22.1	-13.3	-15.3	6.6	22.2	-23.6	-0.8
As % of Sales	19.8	21.8	15.8	13.9	14.1	13.6	13.7	13.4	16.5	13.7
Depreciation	404	383	347	302	355	324	324	293	1,434	1,295
Interest	373	378	399	407	438	389	405	325	1,579	1,558
Other Income	53	6	27	81	52	42	44	38	163	175
Non Recurring Expense	-56	-46	1,068	15	83	0	0	0	1,020	83
PBT	52	58	1,058	58	63	56	72	241	1,220	432
Tax	6	2	10	4	5	3	5	12	24	24
Effective Tax Rate (%)	11.3	3.8	1.0	7.2	5.0	5.0	7.0	8.2	2.0	5.7
Reported PAT	46	55	1,048	54	58	53	67	229	1,196	408
Adj. PAT	103	101	-20	39	-24	53	67	229	176	325
Change (%)	-77.2	-72.8	-108.5	-81.6	-123.9	-47.7	-436.1	480.5	-86.2	84.9

E: MOSt Estimates, * Restated Quarterly Numbers

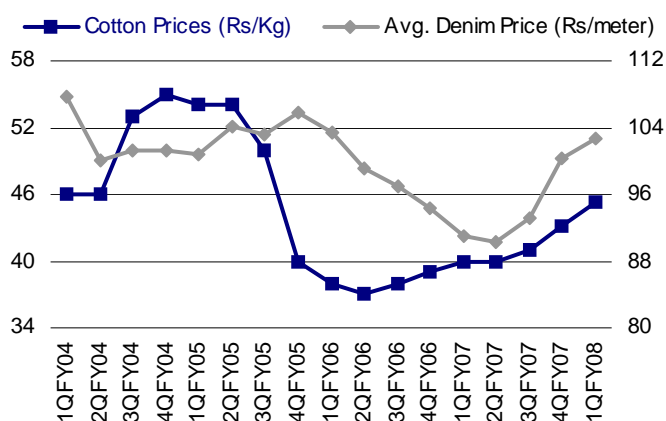
1QFY08 results above estimates

Arvind Mill's results for 1QFY08 were higher than expected. EBITDA stood at Rs721 (v/s est. of Rs671m), EBITDA margins dropped by 564bp to 14.1% v/s 19.8% in 1QFY07. Financials for 1QFY07 are re-stated numbers post the merger of Arvind Brands. Revenues grew 21.3% YoY to Rs5.1b. Excluding revenues of R727m from the merged Arvind Brands, revenues grew 23.4% YoY to Rs4.4b. Reported PAT increased by 25.7% YoY to Rs58m boosted by forex gains (debt) of Rs83m, adjusted for the forex gains Arvind reported losses of Rs24m, in 1QFY08.

Domestic denim scenario remains bleak

The denim scenario continues to remain bleak due to overcapacity. However, the outlook for denim is improving in the international market and in 1QFY08 almost ~70% of Arvind's revenues arose from exports against just 40% in 1QFY07. Consequently, the company's average denim realization per meter has increased for the second consecutive quarter by 12.8% YoY to Rs102.7/meter.

DENIM REALIZATIONS IMPROVING (RS/METER)



Source: Company/Motilal Oswal Securities

Restructuring plans for denim

Arvind Mills' total domestic denim capacity was estimated at 600-630m meters in FY07, while total demand from the domestic and export markets stood at 430-450m meters.

We believe that the domestic denim industry is likely to remain depressed over the next 1-2 years, despite the robust 25-30% demand growth, due to the severe overcapacity situation. Hence, it is deliberating several strategies to de-risk itself from its high dependence on the denim segment. It has already announced plans to substantially increase its garment manufacturing facility from 12.7m pieces in FY06 to around 42.2m pieces by FY09. It is also shifting its focus from the domestic market and concentrating on the high-end exports market. Apart from these stated measures, management is also deliberating several other strategies for turning around its denim division.

Denim dependence to decline

The management is focusing on rapidly growing its downstream businesses of garment manufacturing, branded apparel and retail to de-risk itself from the vagaries of the denim cycle. We expect Arvind Mills' revenues to increase from Rs18.5b in FY07 to Rs25.2b in FY09. This would be primarily driven by a CAGR (FY07-09) of 61% in garment sales and 16% CAGR (FY07-09) in branded apparel business.

REVENUE BREAK-UP (RS M)

PARTICULARS	FY06	FY07	FY08	FY09	CAGR (%)
Denim	9,486	7,616	8,234	8,413	5
Shirtings	2,996	2,651	3,081	3,049	7
Knits	330	345	380	436	12
Garment	1,607	2,751	4,800	7,164	61
Others	1,469	1,759	1,671	1,587	-5
Branded Garments	0	3,328	3,927	4,516	16
Total	15,888	18,449	22,092	25,166	17

Source: Motilal Oswal Securities

Focus on garments and retail increasing

The company plans to expand its garment capacities aggressively from around 12.7m pieces in FY06 to around 42m pieces by FY09. The management expects garment operations to account for Rs10b by FY08-FY09. The table below shows the planned capacity additions in its garments division.

PLANNED CAPACITY ADDITIONS IN THE GARMENT DIVISION

	CURRENT	ADDITIONS			TOTAL
	FY06	FY07E	FY08E	FY09E	(M PIECES)
Jeans	4.0	5.0	5.0	3.0	17.0
Shirts	4.5	0.0	3.0	2.0	9.5
Knits	4.2	1.0	3.0	3.0	11.2
Khakis	0.0	1.5	3.0	0.0	4.5
Total	12.7	7.5	14.0	8.0	42.2

Source: Company/Motilal Oswal Securities

Key developments in the branded retail segment in 1QFY08:

- Sales without contribution from VF licensed brands grew 25% YoY
- Sales of private labels through the Megamart channel grew by 121% YoY
- Flying machine brand was re-launched
- Number of EBOs across various brands not including the Megamart stores stood at 154 compared to 95 in 1QFY07
- The growth would have been much higher and better but for the withdrawal of Ruf N Tuf from the organized retail channel
- Formed 49% JV agreement for retailing apparel brand "Diesel"

Arvind Brands - expect 16% CAGR over FY07-09

Arvind Brands, which was merged with Arvind Mills in FY07, reported revenues of Rs727m in 1QFY08. Arvind Brands owns Excalibur, Newport, Flying Machine, Ruf N Tuf and Arrow, and runs a multi-brand retailing operation under the Megamart banner. We model 16% CAGR in branded sales over FY07-FY09 from Rs3.3b-Rs4.5b.

JV with VF Corp could yield Rs4-5b over 4-5 years

During 2QFY07, Arvind Mills formed a JV with VF Corp, the American apparel group, for sale of 60% stake in the newly formed company, for a consideration of US\$33m. As per the agreement, brands licensed from VF Corp were transferred to a new JV, VF Arvind Brands Pvt. Ltd., (VFABPL) effective September 2006. The brands transferred are Lee, Wrangler, Nautica, Jansport and

Kipling. Arvind continues to own 40% of this company, which can be sold over the next 4-5 years, at a predetermined revenue-linked formula. In our opinion, this stake could yield close to Rs4-5b over the next few years.

Arvind's real estate value unlocking 3-4 years away

As per Arvind Mills' GDR document (July 2005), the company owned close to 3,472,153 sq. m. (857 acres) of real estate and 283,553 sq. m. (70 acres) of leasehold land in India. Apart from this, the company holds close to 5,863 sq. m. (63,039 sq. ft.) of residential and office space across India. Arvind holds almost 750 acres of land at Santej, Ahmedabad, which is located around 20km away from the CBD area of Ahmedabad. Furthermore, the existing real estate is located in the industrial district, which the management believes can be converted for commercial and residential use. Out of the 750 acres of land, close to 250-300 acres is presently lying idle; and management does not see any near-term value unlocking possibility from this land. However, the management believes that over the next 3-4 years, as Ahmedabad expands, the value for this property could increase significantly, providing the company an opportunity to unlock value. In Arvind's FY06 annual report, the value of its freehold and leasehold land already stood at Rs4.6b. Hence, a significant portion of Arvind's real estate holdings is already captured in Arvind's books, which is in sharp contrast to other textile companies such as Bombay Dyeing or Century Textiles, where the land value still appears at historical cost in their annual reports.

Valuation and view

We believe that Arvind has hit a rough patch, as performance of its core business segment - denim - is likely to remain under pressure over the medium term. The management expects the garments and branded retail segments to drive future growth. However, due to slow scale-up in its garments business, near-term margin pressures and the long gestation period in the branded retail business, near-term earnings are likely to be negatively impacted. The stock trades at 29.1x FY08E EPS of Rs1.6 and 11.3x FY09E EPS of Rs4.0. We maintain **Neutral**.

Arvind Mills: an investment profile

Company description

Arvind Mills is the largest cotton textile manufacturer and exporter in India. It is also a leading player in the branded garments segment of the domestic market, operating through its subsidiaries. The company's principal business is to manufacture denim, shirting, knitted fabric, shirts and garments. It has managed to turn around its operations following a business restructuring exercise. It has also commoditized its business by reworking its product mix. Besides, it is establishing long-term contracts with key customers and reducing its financial leverage.

Key investment arguments

- Vertical integration helps the company to be a one-stop shop for global buyers.
- It is in a position to leverage its existing strong relationships with global buyers and garment brands.

Key investment risks

- High dependence on denim business.
- Remains highly dependent on cotton price movements.

Recent developments

- Arvind Brands has been merged with Arvind Mills
- Has formed a JV with VF Corporation and sold 60% stake in this company for US\$33m

Valuation and view

- We believe Arvind has hit a rough patch, as performance of its core business segment, denim is likely to remain under pressure over the medium term.
- The stock trades at 29.1x FY08E EPS of Rs1.6 and 11.3x FY09E EPS of Rs4.0. We maintain **Neutral**.

Sector view

- Exports from China are likely to be severely constrained due to safeguard measures imposed by the US and EU.
- India registered robust export growth to the US and EU in the post-quota era.
- Global buyers are focusing on building vendor partners who have high product development skills.
- There is concern of overcapacity in the industry due to the extension of TUF scheme by five years.

COMPARATIVE VALUATIONS

		ARVIND MILLS	GOKALDAS	ALOK
P/E (x)	FY08E	29.1	10.1	6.9
	FY09E	11.3	8.6	6.2
P/BV (x)	FY08E	0.6	1.6	2.1
	FY09E	0.6	1.4	2.1
EV/Sales (x)	FY08E	1.3	0.8	8.8
	FY09E	1.1	0.7	8.7
EV/EBITDA (x)	FY08E	9.1	7.6	3.2
	FY09E	7.6	6.5	2.6

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	33.9	33.9	34.2
Domestic Inst	15.1	14.5	15.4
Foreign	13.5	19.8	25.9
Others	37.5	31.8	24.6

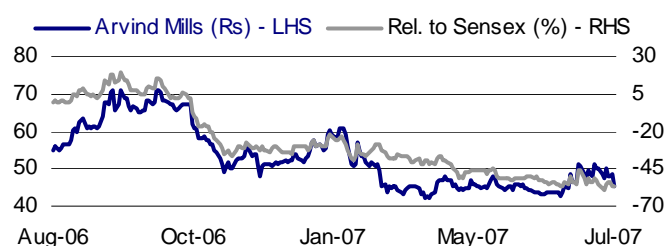
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	1.6	4.3	-63.8
FY09	4.0	4.3	-6.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
45	51	13.3	Neutral

STOCK PERFORMANCE (1 YEAR)



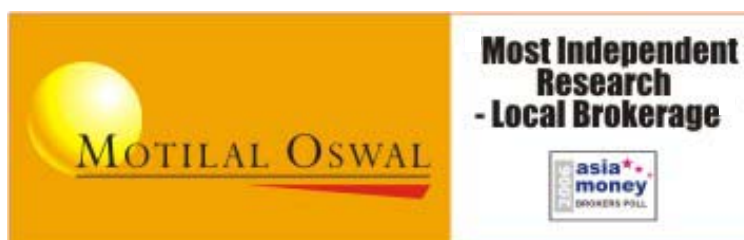
INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	16,789	15,920	18,449	22,092	25,166
Change (%)	17.0	-5.2	15.9	19.7	13.9
Raw Materials	6,199	5,749	5,584	6,581	6,973
Staff Cost	1,230	1,353	2,043	1,613	1,748
Other Mfg. Expenses	5,600	5,428	7,771	6,533	7,356
EBITDA	3,886	3,989	3,051	3,028	3,624
% of Net Sales	23.1	25.1	16.5	13.7	14.4
Depreciation	1,491	1,551	1,434	1,295	1,335
Interest	1,179	1,300	1,579	1,558	1,535
Other Income	76	225	163	175	175
Extra-ordinary Items (net)	0	0	1,020	0	0
PBT	1,293	1,364	1,220	350	929
Tax	20	92	24	24	93
Rate (%)	15	6.8	2.0	7.0	10.0
Reported PAT	1,273	1,272	1,196	325	836
Adjusted PAT	1,273	1,272	176	325	836
Change (%)	31.3	-0.1	-86.2	84.9	157.1

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Cap	1954	2094	2094	2094	2094
Share Capital	2,614	2,655	2,571	2,499	2,438
Reserves	10,198	12,665	13,832	14,133	14,948
Net Worth	12,811	15,320	16,402	16,632	17,387
Loans	16,824	18,414	18,464	18,114	18,064
Deferred Tax Liability	46	128	138	148	185
Capital Employed	29,681	33,861	35,004	34,893	35,635
Gross Fixed Assets	21,103	21,922	23,422	24,672	25,422
Less: Depreciation	7,286	8,826	10,260	11,555	12,890
Net Fixed Assets	13,817	13,096	13,162	13,117	12,532
Capital WIP	1,031	796	0	0	0
Investments	1,530	3,481	1,400	1,501	1,502
Curr. Assets	16,016	19,373	23,277	23,590	25,286
Inventory	5,112	4,793	5,273	4,842	5,285
Debtors	3,191	3,683	3,708	4,123	4,697
Cash & Bank Balance	129	96	813	316	253
Loans & Advances	7,585	10,801	13,482	14,310	15,051
Current Liab. & Prov.	2,713	2,884	2,835	3,315	3,685
Creditors	1,644	1,469	1,377	1,623	1,719
Other Liabilities	746	857	926	1,065	1,225
Provisions	324	451	532	628	741
Net Current Assets	13,303	16,489	20,441	20,275	21,601
Application of Funds	29,681	33,861	35,004	34,893	35,635

E: M0St Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	6.1	6.1	0.8	1.6	4.0
Growth (%)	313	-0.1	-86.2	84.9	157.1
Cash EPS	15.7	16.0	9.1	9.2	12.3
Book Value	62.2	70.5	76.1	77.5	81.4
DPS	1.0	1.0	0.0	0.0	0.0
Payout (incl. Div. Tax.)	17.5	18.8	0.0	0.0	0.0
Valuation (x)					
P/E		7.4	53.8	29.1	113
Cash P/E		2.8	4.9	4.9	3.7
EV/EBITDA		7.1	9.0	9.1	7.6
EV/Sales		18	15	13	11
Price/Book Value		0.6	0.6	0.6	0.6
Dividend Yield (%)		2.2	0.0	0.0	0.0
Profitability Ratios (%)					
RoE	10.9	9.5	11	2.0	5.0
RoCE	9.0	8.4	8.2	5.5	7.0
Turnover Ratios					
Debtors (Days)	67	83	70	65	65
Inventory (Days)	143	147	125	120	120
Creditors (Days)	97	93	90	90	90
Asset Turnover (x)	0.6	0.5	0.5	0.6	0.7
Fixed Asset Turnover (x)	0.8	0.7	0.8	0.9	1.0
Leverage Ratio					
Debt/Equity (x)	1.4	1.2	1.1	1.1	1.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
OP/(Loss) before Tax	1,293	1,364	1,220	350	929
Add: Depreciation & Amort.	1,491	1,551	1,434	1,295	1,335
Add: Interest Paid	1,179	1,300	1,579	1,558	1,535
Less: Direct Taxes Paid	3	28	15	15	56
Less: (Inc)/Dec in Wkg. Capita	-4,324	-3,218	-3,236	-329	-1,389
CF from Op. Activity	-1,637	-538	-796	1,123	641
CF after EO Items	-1,637	-538	-796	1,124	643
(Inc)/Dec in Fixed Assets & Cv	-177	-1,054	-2,296	-1,250	-750
(Pur)/Sale of Invest.	66	1,951	-2,081	0	0
CF from Inv. Activity	-1,326	-584	-704	-1,251	-750
Issue of Shares	-35	2,479	0	0	0
Inc / (Dec) in Debt	3,270	1,590	50	-350	-50
Interest Paid	1,179	1,300	1,579	1,558	1,535
Dividends Paid	223	239	0	0	0
CF from Fin. Activity	2,964	1,089	2,217	-370	44
Inc / (Dec) in Cash	2	-33	717	-497	-63
Add: Opening Balance	127	129	96	813	316
Closing Balance	129	96	813	316	253



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Arvind Mills

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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