

Strong growth despite unfavorable macro

Equity | India | Textile Products
17 February 2009

RESEARCH

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Earnings, PO cut on worsening macro outlook

We have cut FY10E EPS by 5% and FY11E by 14%, primarily to factor-in lower Guru sales, as management has stalled its growth plans, following global slowdown. We keep FY09E EPS unchanged, given the in-line 3Q results. PO is reduced to Rs225 (from Rs270) to reflect both earnings cut and higher risks (implied FY10E PE of 7x vs 8x earlier). The stock has corrected sharply in last few months and valuations look attractive at 3x FY10E PE. Maintain Buy.

EPS growth still strong led by new capacities

We expect EPS growth of 32% in FY10 helped by new capacities coming on-stream by March'09. These capacities would enjoy several fiscal benefits making them globally cost competitive, which should help BRFL gain market share. Management had aggressive plans for expansion of Guru operations which have now been put in the back burner. After the sharp cut in Guru's estimates, it now accounts for less than 5% of BRFL's consolidated EBIDTA versus 9% earlier.

High gearing not too big a concern

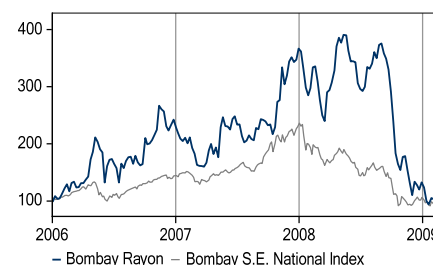
We estimate BRFL's gearing to peak at 2.1x in FY09 and fall to 1.4x by FY11. We understand that in the current risk averse environment, stocks with high gearing are no longer investors' favorites. However, for BRFL, about half of debt is at subsidized rate of just 1.5%. Hence the average cost of debt for the company is sub 5% and interest coverage at 4x which in our view is comfortable.

Valuations appear attractive

After a 70% price correction in the last six months, the stock is trading at only 3x FY10E PER. We believe the current stock price more than factors-in the macro risks and the correction is clearly overdone. At our PO the stock would trade at 7x FY10E EPS, which we believe is appropriate given strong earnings growth.

Stock Data

Price	Rs94.00
Price Objective	Rs270.00 to Rs225.00
Date Established	17-Feb-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs81.00-Rs419.90
Mrkt Val / Shares Out (mn)	US\$133 / 69.1
Average Daily Volume	433,914
ML Symbol / Exchange	BORYF / BSE
Bloomberg / Reuters	BRFL IN / BRFL.BO
ROE (2009E)	22.2%
Net Dbt to Eqty (Mar-2008A)	140.9%
Est. 5-Yr EPS / DPS Growth	40.0% / 40.0%
Free Float	56.6%



Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	544	1,227	1,647	2,170	2,936
EPS	8.64	19.48	23.84	31.41	42.49
EPS Change (YoY)	132.7%	125.6%	22.4%	31.7%	35.3%
Dividend / Share	1.25	1.50	2.00	2.25	2.50
Free Cash Flow / Share	(55.01)	(115.14)	(152.57)	(19.15)	6.47

Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	10.88x	4.82x	3.94x	2.99x	2.21x
Dividend Yield	1.33%	1.60%	2.13%	2.39%	2.66%
EV / EBIDTA*	27.09x	10.76x	7.10x	4.93x	3.93x
Free Cash Flow Yield*	-53.36%	-111.68%	-162.31%	-20.38%	6.88%

* For full definitions of *iQmethod*SM measures, see page 9.

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Refer to important disclosures on page 10 to 12. Analyst Certification on Page 8. Price Objective Basis/Risk on page 8.

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*iQprofile*SM 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)	(591)	(918)	(975)
Associates	NA	NA	NA	NA	NA
Pretax Income	756	1,787	2,459	3,239	4,382
Tax (expense) / Benefit	(212)	(551)	(811)	(1,069)	(1,446)
Net Income (Adjusted)	544	1,227	1,647	2,170	2,936
Average Fully Diluted Shares Outstanding	63	63	69	69	69

Key Cash Flow Statement Data

Net Income	544	1,227	1,647	2,170	2,936
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)	(1,865)	(1,173)	597
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	1,136	0	0
Cost of Dividends Paid	(92)	(109)	(159)	(179)	(199)
Cash Flow from Financing	5,137	5,882	10,543	1,323	(447)
Free Cash Flow	(3,466)	(7,254)	(10,543)	(1,323)	447
Net Debt	2,562	8,606	18,171	19,674	19,426
Change in Net Debt	1,971	6,059	9,565	1,502	(248)

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	18,764	20,267	20,019
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	20,640	23,007	23,532
Total Equity	4,956	6,106	8,731	10,723	13,460
Total Equity & Liabilities	9,176	16,767	29,372	33,729	36,992

*iQmethod*SM - Bus Performance*

Return On Capital Employed	10.7%	11.3%	9.4%	9.4%	11.1%
Return On Equity	16.8%	22.2%	22.2%	22.3%	24.3%
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*SM - Quality of Earnings*

Cash Realization Ratio	-1.9x	-1.7x	-1.1x	-0.5x	0.2x
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%	208.1%	183.5%	144.3%
Interest Cover	6.3x	5.2x	4.2x	4.2x	5.1x

Key Metrics

* For full definitions of *iQmethod*SM measures, see page 9.

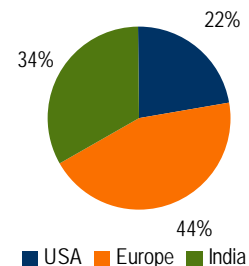
Company Description

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 33% 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.

Chart 1: Geographic mix (FY09E)



Source: Bank of America - Merrill Lynch

Stock Data

Price to Book Value 0.7x

Earnings cut on macro concerns

We have cut FY10E EPS by 5% and FY11E by 14%, primarily to factor-in lower Guru sales due to recession in Europe, which has stalled the company's growth plans. We have also trimmed capacity utilization assumptions for both fabric and garments – for FY10 from over 60% earlier to now ~56% and for FY11 from ~85% earlier to now 75-80%. We have kept FY09 estimates largely unchanged with 3Q results in-line with expectations. Post the earnings cut, Guru accounts for less than 5% of BRFL's consolidated EBIDTA versus 9% earlier.

Table 1: Earnings cut details

(Rs mn)	Earlier			Now			Change			Comment
	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	
Net Sales - BRFL	14,659	23,568	32,643	14,791	22,360	29,058	1%	-5%	-11%	Lower capacity utilization assumed than earlier due to worsening macro Mgmt has stalled growth plans for Guru; hence the sharp cut
Net sales - Guru	2,434	3,216	3,377	1,352	1,675	1,759	-44%	-48%	-48%	
Net sales - Consolidated	17,092	26,784	36,020	16,143	24,035	30,816	-6%	-10%	-14%	
EBITDA - BRFL	3,217	4,999	6,694	3,348	4,852	6,123	4%	-3%	-9%	Higher margins than earlier assumed due to stronger Re and weaker input costs
EBIDTA Margin - BRFL	21.9%	21.2%	20.5%	22.6%	21.7%	21.1%	0.7%	0.5%	0.6%	
EBIDTA - Guru	316	482	574	162	201	211	-49%	-58%	-63%	
EBIDTA - Total	3,533	5,481	7,268	3,510	5,053	6,335	-1%	-8%	-13%	
EBIDTA margin - Consolidated	20.7%	20.5%	20.2%	21.7%	21.0%	20.6%	1.1%	0.6%	0.4%	
Recurring Net Income	1,630	2,279	3,400	1,647	2,170	2,936	1%	-5%	-14%	

Source: BAS-ML

Still, earnings growth remains strong EPS CAGR of 33% over FY10E-11E

We now estimate EPS growth of 32% in FY10 and 35% in FY11. This should be driven by ~50% sales growth in FY10E and 28% in FY11E on new fabric and garment capacities coming on-stream. Garment capacity is expected to increase to 75mn pcs by March'09 from 44mn pcs in FY08 end. Fabric capacity should rise 4x to 235mn mtrs again by March'09E.

Table 2: Key assumptions

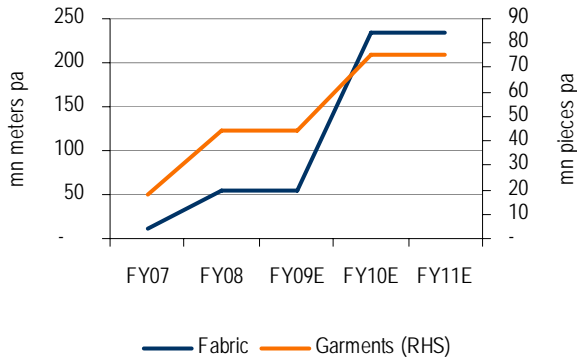
(Rs mn)	FY07	FY08	FY09E	FY10E	FY11E
Fabrics					
Volume Sold (mn meters)	27	49	52	79	110
Chg	41%	84%	8%	50%	40%
Sales value (Rsmn)	2,942	5,320	5,719	8,579	12,010
Chg	91%	81%	8%	50%	40%
Realization (Rs/mtr)	111	109	109	109	109
Chg		-2%	0%	0%	0%
Garments					
Capacity (mn pcs)	18.0	44.0	44.0	75.0	75.0
Cap uti (%)		47%	72%	65%	82%
Volume Sold (mn pieces)	7.0	20.8	31.5	49.0	61.6
Chg	293%	195%	52%	56%	26%
Sales value (Rsmn)	1,954	5,648	9,072	13,781	17,048
Chg	307%	189%	61%	52%	24%
Realization (Rs/piece)	278	272	288	281	277
Chg		-2%	6%	-2%	-2%

Source: Company, BAS-ML

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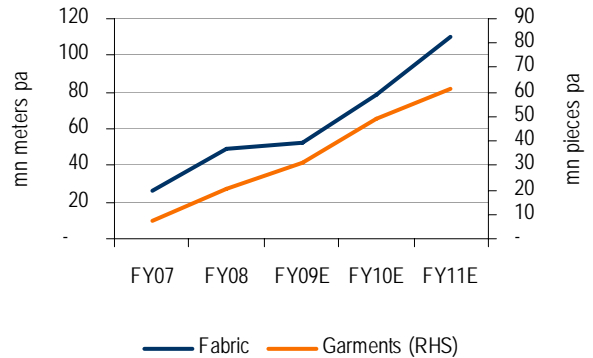
We have assumed a capacity utilization of 65% in garments and 56% in fabrics in FY10E. We expect the capacity utilization for garments to improve to about 80% and for fabric to 75% by FY11. This would imply a volume CAGR of 31% for fabric and 44% for garments over FY08E-11E.

Chart 2: Capacity ramp-up



Source: BAS-ML

Chart 3: Volume trend

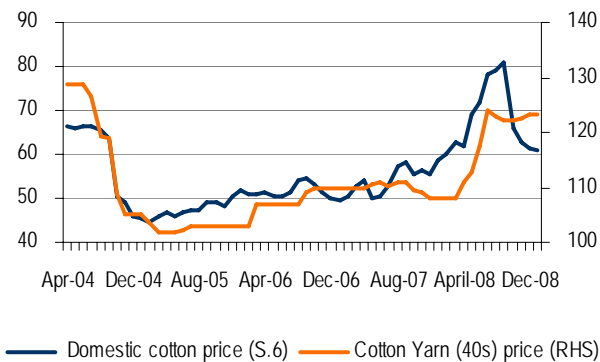


Source: BAS-ML

Can the company achieve this growth despite slowdown?

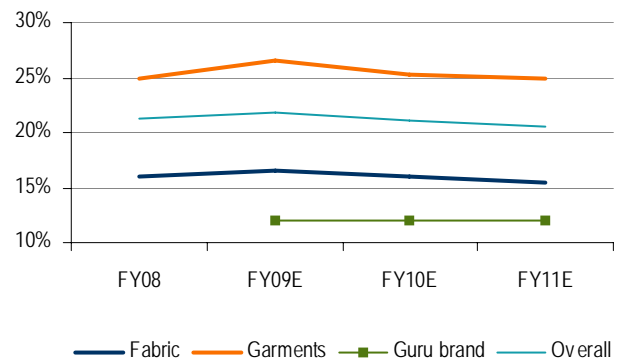
We believe the company would be able to achieve this volume growth despite the global economic slowdown as the new capacities are low cost facilities which should help BRFL gain market share. The new facilities enjoy a number of fiscal benefits from Government including reimbursement of employer contribution of provident fund for employees and subsidized power and interest costs. Further, BRFL has build strong relationships with leading global retailers such as H&M, C&A, Inditex, Walmart and Tesco over the years, which it can capitalize on to increase its share. Despite the fiscal benefits, falling input costs (cotton prices have come off 25% from peak, we expect yarn prices too to come off) and strong Re, we have assumed a dip in EBIDTA margin from 21.7% in FY09 to 20.6% in FY11 as we believe BRFL would need to pass on these benefits to the buyer in a bid to gain market share and keep the capacities running at optimal levels.

Chart 4: Cotton fiber & yarn price trend (Rs/kg)



Source: CRIS Infac, BAS-ML

Chart 5: EBIDTA margin trend



Source: BAS-ML

Bal Sheet concern not too significant

High gearing but most loans at highly subsidized rates

We estimate BRFL's gearing to peak at 2.1x in FY09 being in the capex phase before falling to 1.4x by FY11. However, we note that about half of its debt (~Rs7.5bn) is the term loan for the new Maharashtra facility which gets additional interest subsidy of 3% from the State Government in addition to the interest subsidy of 5% from the Central Government under the Technology up-gradation fund scheme (TUFS).

Interest coverage at comfortable levels

Despite the high debt levels, we think the interest burden is not too high as the average cost of debt for the company is estimated to be sub 5% p.a. Interest coverage at over 4x over FY10E-11E is comfortable in our view. Further, the term loan for Maharashtra facility has a moratorium of 2 years and post that is to be repaid over 8 years. BRFL should be in a comfortable position for meeting its repayment schedule from 2HFY11 onwards from internal accruals, as capacity utilization starts to reach optimal levels by then.

Table 3: Borrowings and interest cost details (Rs mn)

Period ending	9m Dec'08	FY09E	FY10E	FY11E
Borrowing details				
Subsidized term loan for Maharashtra project	6,500	7,500	7,500	7,100
Other term loan (incl Leela)	3,080	3,500	3,500	3,500
Borrowing for Guru	1,400	1,400	1,400	1,400
Working capital & other loans	4,000	6,364	7,867	8,019
Total Borrowings	14,980	18,764	20,267	20,019
Interest cost details				
Interest - Maharashtra project (@1.5%)		79	113	110
Interest - other TUFS loan		140	140	140
Interest - W/Cap loan		466	640	700
Interest - Guru		46	101	101
Total interest cost	433	731	993	1050
Avg interest cost	3.8%	4.9%	4.6%	4.7%
Net Gearing (x)	2.0	2.1	1.8	1.4
Interest coverage	4.7	4.2	4.2	5.1

Source: Company, BAS-ML

Working capital efficiency retained at earlier levels

BRFL had debtors of Rs2.9bn as of Dec'08 which is an improvement over March'08 in terms of debtor days. This is significant, given the payment problems which the textile industry has been facing in the current global credit crisis. BRFL's top customers include H&M, C&A, Inditex, Walmart and Tesco, most having strong balance sheets, and hence do not pose significant payment threats, in our view. For working capital financing, BRFL has shifted to Re loans as forex loans are no longer available cheaply. This has raised its average borrowing costs a few bps.

Table 4: Working Capital details

Period ending	FY08	9m Dec'08	FY09E	FY10E
Debtors	2342	2950	3807	5622
Debtor days	108	103	103	102
Inventory	3806	4750	5779	7890
Inventory days	103	116	105	105

Source: BAS-ML

3Q results in-line

3Q net profit at Rs417mn (21% yoy growth) was 6% ahead of MLe. This was on the back of 220bp expansion in EBIDTA margins to 24.4% which was ahead of our expectation. A stronger Re helped margin expansion. As a result, EBIDTA growth was strong at 59% yoy. PAT growth could have been higher but for interest costs, which more than doubled.

Table 5: 3Q & 9m FY09 results

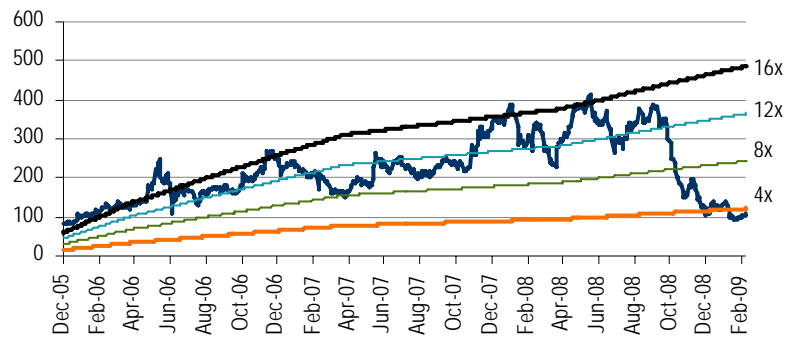
(Rs mn)	9m FY09	9m FY08	Chg yoy	3QFY09	3QFY08	Chg yoy
Sales	10,092	6,646	52%	3,449	2,388	44%
Raw material	5,776	4,144	39%	2,004	1,464	37%
% of sales	57%	62%		58%	61%	
Staff	797	407	96%	275	181	52%
% of sales	8%	6%		8%	8%	
Job Charges	221	170	30%		-	
% of sales	4%	4%			0%	
Other exps	919	509	81%	327	214	53%
% of sales	9%	8%		9%	9%	
Total Exp	7,714	5,229	48%	2,606	1,859	40%
EBIDTA	2,378	1,417	68%	843	529	59%
EBIDTA margin	23.6%	21.3%		24.4%	22.2%	
Depreciation	324	207	57%	110	76	44%
EBIT	2,054	1,210	70%	733	453	62%
Interest	433	198	119%	165	77	115%
Other income	37	200	-81%	10	66	-85%
PBT	1,658	1,213	37%	578	442	31%
tax	424	340	25%	162	96	68%
PAT	1,234	873	41%	417	346	21%

Source: Company, BAS-ML

Valuations

BRFL has seen a sharp de-rating in last few months given the aversion for export-oriented and highly geared mid-cap stocks. After a 70% price correction in the last six months, the stock is trading at only 3x FY10E PER. We believe the current stock price more than factors-in the macro risks and the correction is clearly overdone. At our PO the stock would trade at 7x FY10E EPS, which we believe is appropriate given strong earnings growth and at par with other textile companies.

Chart 6: Historic 1-yr fwd rolling PE band



Source: Bloomberg, BAS-ML

Price objective basis & risk

Bombay Rayon Fashions Ltd (BORYF)

Our PO of Rs225 is based on 6.7x 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 9x FY09E and 7x FY10E. We believe this is reasonable considering the strong earnings growth of 33% CAGR over FY09-11E and a high ROE of 22% 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
BUY				
	Bombay Rayon Fashions Ltd	BORYF	BRFL IN	Manish Sarawagi
	Godrej Consumer Products Ltd.	XGOCF	GCPL 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
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	PFI AF	PF IN	Vandana Luthra
	United Spirits	UDSRF	UNSP 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
	Welspun India	WPNIF	WLSI IN	Manish Sarawagi

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
	Amortization	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
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	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Important Disclosures

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 January 31, 2009 or such later date as indicated.

BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of January 31, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	6	26.09%	Buy	3	60.00%
Neutral	6	26.09%	Neutral	2	33.33%
Sell	11	47.83%	Sell	1	9.09%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

* 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.

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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 BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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