

Arvind Mills

Rs94
NEUTRAL

RESULT NOTE

Mkt Cap: Rs20bn; US\$435m

Analyst: Chirag Shah (91-22-5638 3306; chiragshah@sski.co.in)
Result: Q4FY06
Comment: Results below expectations
Last report: 30 January 2006 (Price Rs91; Recommendation: Outperformer)

Key financials

Year to March (Rs m)	Net Revenues	yoy chg (%)	Net Profit	EPS* (Rs.)	yoy chg (%)	PER (x)
FY2005	16,779	17	1,192	6.1	9	15.4
FY2006	15,920	(5)	1,270	6.1	0	15.4
FY2007E	18,154	14	1,645	7.9	29	11.9
FY2008E	20,088	11	1,547	7.4	(6)	12.7

(*EPS is on fully diluted basis, after considering preference shares dividend)

Arvind Mills Q4FY06 net profit at Rs214m (drop of 60%yoy) was significantly lower than our estimates. This was mainly on the back of lower than expected production volumes in the denim, apart from Rs50m translational loss. Average denim realizations continued to slip for the quarter averaging Rs94/meter. We believe that the denim prices are unlikely to revive in the near term considering over-capacity in the domestic market. The company is in the process of merging its subsidiary Arvind Brands. We maintain our NEUTRAL call on the company. The stock is currently trading at 11.9x FY07E earnings.

KEY HIGHLIGHTS

- Revenues for the quarter dropped 19.7%yoy, primarily on account of drop in denim realizations (down 8%yoy) and volumes (down 17%yoy). On a sequential basis, denim volumes were down by 7% and realizations were down by 3%. Average denim realization during the quarter was Rs94/meter. Denim business accounted for 56% of sales during the quarter.
- Shirting production volumes continue their trend upwards for the last two quarters. However, with more and more sales moving towards vertical route, the sales of fabric to outside party have come down. We expect improvement in shirting business to continue with inclusion of few new clients during the quarter.
- Volumes in the garments (cumulative volumes of knits, shirts and jeans) were at 1.47m pieces during the quarter with an average realization of Rs318/piece (compared to Rs281/pieces for Q3FY06). With the ramp in capacity utilization of jeans manufacturing unit, we expect volume growth to continue.
- Operating margins remained strong at 25.1% cushioned by considerably lower cost cotton inventory. Arvind Mills has a long cotton cover from the previous season, which is expected to last till July'06. The company has also bought some cotton during the year and is covered till December'2007.
- Overall, net profit for the quarter was lower our estimates, even adjusting for translation forex losses of Rs51m.

❑ Merger of Arvind Brands to provide further tax shield

Arvind Mills proposes to merge its wholly owned subsidiary Arvind Brands and Arvind Fashions Ltd with itself—with this all the branded garment business except Tommy Hilfiger would become divisions of the parent company. With this merger, possibility of the company inducting a strategic partner for the branded garments business, we believe is remote. Arvind Brands however, has a carry forward loss to the tune of Rs650m, which we believe would keep tax rate's for FY07 low at around 10.4%

❑ Denim prices unlikely to bounce back in the near term

Pressure on denim prices is unlikely to ease in the near term considering strong addition in regional capacities. While the domestic market continues to grow in terms of volumes led by demand from garment exporters, there is a significant build-up in domestic capacities with serious undercutting by new entrants to establish a foothold. Denim business continues to be the mainstay of the company with 56% revenue contribution.

❑ Maintain Neutral

We believe that valuations at 11.9x FY2007E earnings reflect a fair price for Arvind Mills considering (a) Earnings growth is unlikely to be significant in the near term (b) The company continues to enjoy tax holiday on account of accumulated losses and hence earnings don't reflect impact of taxation (we have assumed a 10.4% tax rate in 2007E, before moving on full tax rate in 2008). (c) Most of the incremental capex of Arvind Mills over the next 2-3 years would be focused on Arvind Brands (the branded garments business of the company), which we believe is unlikely to contribute significantly to Arvind Mills profitability in the near term. Hence RoCE's are unlikely to improve in the near term. We maintain NEUTRAL on the stock.

Quarterly results

Year to March 31 (Rs m)	Q4FY05	FY 2005	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06E
Net Sales	4,450	16,789	4,204	4,280	3,902	3,577	15,920
Total Operating Expenses	3,332	12,902	3,055	3,220	2,984	2,714	11,930
Raw Material Consumed	1,643	6,199	1,839	1,960	1,494	1,637	6,760
Stock Adjustment	(139)	(128)	(66)	150	257	(239)	100
Employee Expenses	337	1,231	338	370	309.1	342	1,360
Power, Oil & Fuel	338	1,789	373	370	318	369.8	1,440
Other Expenses	1,153	3,812	571	370	606	604	2,270
Operating profit	1,118	3,887	1,149	1,060	918	863	3,990
<i>EBITDA Margin (%)</i>	<i>25.1</i>	<i>23.2</i>	<i>27.3</i>	<i>24.8</i>	<i>23.5</i>	<i>24.1</i>	<i>25.1</i>
Other Income	50	76	67	11	21	60	220
Interest	317	1,179	335	342	296	330	1,300
Depreciation	382	1,491	385	387	385	394	1,550
PBT	470	1,293	497	342	258	200	1,360
Provision for taxation	(45)	20	42	37	24	(15)	10
Deferred Tax	(15)	-	4				80
<i>Tax rate (%)</i>	<i>(13)</i>	<i>2</i>	<i>9.2</i>	<i>10.9</i>	<i>9.2</i>	<i>(7.4)</i>	<i>6.6</i>
Net profit	530	1,274	451	305	234	214	1,270
% growth yoy	111	32	148	84	(35)	(60)	
Revenue Break-up (Rs m)							
Denim	2,715	9,915	2,649	2,606	2,216	2,013	9,486
Shirting	712	3,143	757	768	811	643	2,996
Garments	579	1,679	378	471	396	466	1,608
Others	401	2,030	378	435	477	456	1,831
Total Revenues	4,450	16,766	4,204	4,280	3,901	3,578	15,921
Sales Mix (%)							
Denim	61	59	63	61	57	56	60
Shirting	16	19	18	18	21	18	19
Garments	13	10	9	11	10	13	10
Others	9	12	9	10	12	13	11

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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