

Arvind Mills

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,849	ARVND IN
	REUTERS CODE
S&P CNX: 2,975	ARMI.BO

30 January 2006

Neutral
Previous Recommendation: Neutral
Rs90

		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
Equity Shares (m)	209.4	3/05A	16,789	1,273	6.1	31.3	14.8	1.4	10.9	9.0	2.2	9.3
52-Week Range (Rs)	144/90	3/06E	16,784	1,453	6.9	14.1	13.0	1.3	10.7	9.6	2.0	7.8
1,6,12 Rel.Per. (%)	-11/-59/-77	3/07E	18,737	1,635	7.8	12.6	11.5	1.1	10.4	9.5	1.7	7.3
M.Cap (Rs b)	18.9											
M.Cap (US\$ b)	0.4											

*Assumed a dilution of 14m equity shares.

Arvind Mills reported a net profit of Rs234m for 3QFY06, down 36% YoY. But for forex losses of Rs100m, net profit for the quarter would have been higher than our estimate of Rs292m.

The company posted revenues of Rs3.9b, down 5.7% YoY due to the poor performance of its denim division. Denim sales declined 12.6% YoY – while volumes declined 6.6% YoY, realizations fell 5.9% YoY (2% QoQ) to Rs97/meter. Garment sales grew 10% YoY to Rs398m.

EBITDA margins expanded by 15bp YoY to 23.5%, aided by lower power and staff cost. Power and fuel cost as a percentage of sales stood at 8.1% in 3QFY06, compared to 12.1% in 3QFY05.

We are lowering our FY06 and FY07 net profit estimates by 9.8% and 13.2%, respectively. We are also lowering our revenue estimates by 10.8% and 9.1%, respectively. The stock trades at 13x FY06E and 11.5x FY07E earnings. We maintain **Neutral**.

QUARTERLY PERFORMANCE										(Rs Million)	
Y/E MARCH	FY05				FY06				FY05	FY06E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			
Sales	3,924	4,238	4,140	4,450	4,204	4,280	3,902	4,397	16,789	16,784	
Change (%)	6.2	15.1	18.5	27.8	7.1	1.0	-5.7	-1.2	17.0	0.0	
EBITDA	891	914	968	1,120	1,149	1,061	918	1,126	3,886	4,255	
Change (%)	2.4	18.9	28.0	10.3	29.1	16.1	-5.1	0.5	10.2	9.5	
As % of Sales	22.7	21.6	23.4	25.2	27.3	24.8	23.5	25.6	23.1	25.3	
Depreciation	367	372	370	380	385	387	385	405	1,491	1,562	
Interest	336	350	176	320	335	342	296	308	1,179	1,281	
Other Income	1	18	7	50	67	77	21	20	76	185	
PBT	189	210	429	470	497	409	258	433	1,293	1,596	
Tax	7	8	65	-60	46	37	24	37	20	144	
Effective Tax Rate (%)	3.7	3.8	15.0	-12.8	9.2	9.1	9.2	8.5	1.5	9.0	
Adj. PAT	182	202	365	530	451	372	234	396	1,273	1,453	
Change (%)	-16.2	90.8	108.7	32.3	147.9	84	-36	-25.3	31.8	14.1	

E: MOST Estimates

BREAK-UP OF REVENUES (RS M)

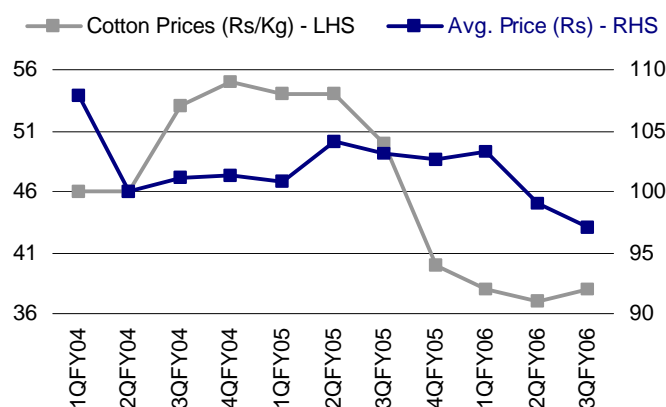
	FY04				FY05				FY06		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Denim	2,301	2,068	1,894	1,805	2,247	2,477	2,608	2,728	2,649	2,611	2,216
Shirting	732	788	775	734	853	849	752	706	772	770	811
Garment	151	242	274	303	349	502	400	594	401	471	483.1
Others	512	583	539	480	510	416	377	422	378	428	392.4
Total	3,696	3,681	3,483	3,322	3,958	4,243	4,137	4,450	4,200	4,280	3,902

Source: Company/Motilal Oswal Securities

Arvind Mills posted revenues of Rs3.9b, down 5.7% YoY due to the poor performance of its denim division. While garment sales grew 10% YoY to Rs398m, denim sales declined 12.6% YoY. Though denim accounts for a dominant 57% of Arvind’s standalone revenues, the contribution of garments has been increasing. The garments division accounted for 12.4% of 3QFY06 revenues. We expect garment sales to increase at a CAGR of 76% over FY06-08, from Rs1.7b in FY06 to around Rs5.3b in FY08.

Denim: The denim division continued its poor performance during 3QFY06. Denim sales declined 12.6% YoY – while volumes declined 6.6% YoY, realizations fell 5.9% YoY (2% QoQ) to Rs97/meter. The company expects denim prices to remain subdued.

GAP BETWEEN COTTON AND DENIM REALIZATION NARROWING

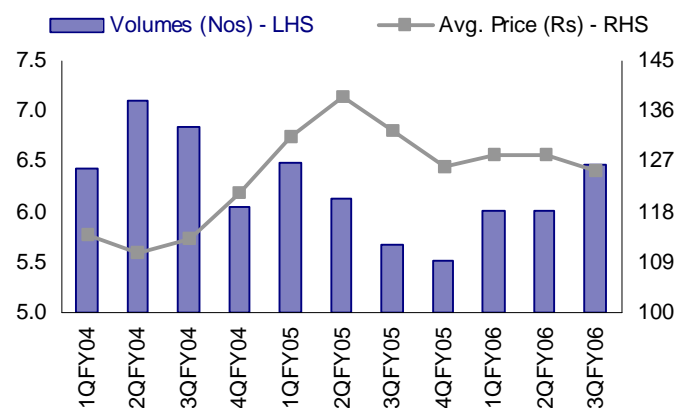


Source: Company/Motilal Oswal Securities

Shirting: The performance of the shirting division has been mixed over the last couple of quarters. Arvind specializes in yarn-dyed fabrics and is the domestic market leader in this segment. During 3QFY06, the shirting division reported

a revenue growth 7.8% YoY, though realizations declined by 5.3% YoY.

SHIRTING DIVISION: VOLUMES RISING, BUT REALIZATIONS UNDER PRESSURE



Source: Company/Motilal Oswal Securities

Garments: The management expects its garment division to start contributing positively to revenues and net profit. It is in the process of increasing its knit garment capacity by 1m pieces per annum, which would be completed by March 2006. The company’s 4m jeans capacity has been established and has received positive response from global retailers such as VF Corporation. We expect the jeans division to contribute around Rs680m in FY07.

Raw material advantage to remain

Arvind is likely to enjoy substantial raw material advantage, as it is holding on to a large cotton inventory from the last cotton season. This is likely to last till July 2006. Cotton prices during the current cotton year (October 2005 – November 2006) have gone up by 15-16%, negatively impacting the margins of other denim players.

Facilitating the setting up of textile-park for outsourcing

Arvind is facilitating the setting up of a 22m meter textile park near its Santej plant by third parties for its in-house consumption requirement. The first phase of the textile park for outsourcing shirting fabric has begun operations, with looms being set up by third party vendors. Once operational, the textile park would provide Arvind access to quality fabric at reasonable prices without any major capex.

Lowering estimates for FY06 & FY07

We are lowering our revenue and earnings estimates for both FY06 and FY07, due to lower denim realizations and slow scale up in its garment business. We are lowering our revenue estimates for FY06 and FY07 by 10.8% and 9.1%, respectively. We are downgrading our PAT estimates for FY06 and FY07 by 9.8% and 13.2%, respectively.

REVISED ESTIMATES (RS M)

	FY06		FY07	
	OLD	NEW	OLD	NEW
Sales	18,806	16,784	20,607	18,737
Change (%)		-10.8		-9.1
Profit	1,611	1,453	1,884	1,635
Change (%)		-9.8		-13.2

Source: Motilal Oswal Securities

Valuation and view

We believe Arvind has entered into a rough patch, as its main business segment 'denim', which accounts for around 60% of its standalone revenues, is likely to remain under pressure over the next few quarters. With no new capex lined up for any significant expansion in its existing textile business or foray into new segments in textiles, denim is likely to continue to be a significant part of Arvind's revenue stream for the next two years.

The management is banking on its garment and branded retail segments to drive future growth. However, due to slow scale up in its garment business and the high gestation period in branded retail business, near term earnings are likely to be negatively impacted.

We are lowering our revenue estimates for FY06 and FY07 by 10.8% and 9.1%, respectively, and are downgrading our PAT estimates by 9.8% and 13.2%, respectively. The stock trades at 13x FY06E and 11.5x FY07E earnings. 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 through its subsidiaries. The company's principal business is manufacturing denim, shirting, knitted fabric, and shirts and garments. It has managed to turn around its operations following a business restructuring exercise. It has also de-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.
- Is in a position to leverage its existing strong relationships with global buyers and garment brands.
- Sweet spot in its expansion cycle, as it has world-class capacities and no major capex requirement over the next few years.

Key investment risks

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

COMPARATIVE VALUATIONS

		ARVINDMILLS	GOKALDAS	HIMATSINGKA
P/E (x)	FY06E	13.0	16.6	26.2
	FY07E	11.5	13.3	21.9
P/BV (x)	FY06E	1.3	2.9	2.3
	FY07E	1.1	2.4	2.2
EV/Sales (x)	FY06E	2.0	1.2	5.7
	FY07E	1.7	1.0	4.8
EV/EBITDA (x)	FY06E	7.8	11.6	15.7
	FY07E	7.3	10.2	13.0

SHAREHOLDING PATTERN (%)

	DEC.05	SEP05	DEC.04
Promoters	34.2	34.5	37.9
Domestic Institutions	18.0	20.6	11.7
FII's/FDIs	23.6	24.4	26.5
Others	24.2	20.5	23.9

Recent developments

- Acquired ICICI Venture's stake in Arvind Brands for Rs1.06b
- Plans to augment its denim capacity by 10m meters to 120m meters
- Has raised US\$38.6m through a GDR issue in July 2005.

Valuation and view

- We are revising our revenue estimates for FY06 and FY07 by 10.8% and 9.1%, respectively, while we are downgrading our PAT estimates for FY06 by 9.8% and for FY07 by 13.2%.
- Arvind trades at 13x FY06E and 11.5x FY07E earnings.

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 rates to the US and EU in the post-quota era.
- Global buyers are focusing on building vendor partners who have high product development skills.
- The concern of industry overcapacity causing waves of deflation in prices is overblown.

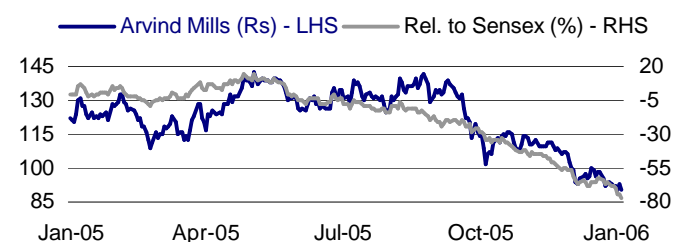
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	6.9	8.0	-13.2
FY07	7.8	9.9	-20.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
90	105	16.7	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	14,353	16,789	16,784	18,737	20,892
Change (%)	-3.0	17.0	0.0	11.6	11.5
Raw Materials	5,235	6,199	5,749	6,606	7,529
Staff Cost	1,105	1,230	1,353	1,488	1,607
Other Mfg. Expenses	4,786	5,600	5,428	6,253	7,162
EBITDA	3,525	3,886	4,255	4,389	4,594
% of Net Sales	24.6	23.1	25.3	23.4	22.0
Depreciation	1,503	1,491	1,562	1,635	1,662
Interest	1,133	1,179	1,281	1,062	660
Other Income	126	76	185	125	125
PBT	1,015	1,293	1,596	1,817	2,397
Tax	46	20	144	182	599
Rate (%)	4.5	1.5	9.0	10.0	25.0
Reported PAT	970	1,273	1,453	1,635	1,797
Adjusted PAT	970	1,273	1,453	1,635	1,797
Change (%)	-25.0	31.3	14.1	12.6	9.9

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Cap	1954	1954	2094	2094	2094
Share Capital	2,649	2,614	2,688	2,599	2,523
Reserves	9,165	10,198	12,972	14,338	15,871
Net Worth	11,813	12,811	15,660	16,937	18,394
Loans	13,554	16,824	14,724	13,274	10,824
Deferred Tax Liability	46	46	146	219	458
Capital Employed	25,413	29,681	30,530	30,430	29,677
Gross Fixed Assets	20,352	21,103	22,003	22,703	23,404
Less: Depreciation	5,837	7,286	8,849	10,483	12,145
Net Fixed Assets	14,515	13,817	13,155	12,220	11,259
Capital WIP	456	1,031	1,031	1,031	1,031
Investments	1,464	1,530	1,500	1,500	1,501
Curr. Assets	10,740	16,016	17,413	18,643	19,292
Inventory	3,804	5,112	4,977	5,700	6,475
Debtors	2,354	3,191	2,814	3,228	3,599
Cash & Bank Balance	127	129	1,039	563	327
Loans & Advances	4,456	7,585	8,583	9,152	8,891
Current Liab. & Prov.	1,762	2,713	2,568	2,964	3,406
Creditors	1,093	1,644	1,339	1,538	1,753
Other Liabilities	597	746	857	986	1,134
Provisions	73	324	372	439	518
Net Current Assets	8,978	13,303	14,845	15,679	15,886
Application of Funds	25,413	29,681	30,530	30,430	29,677

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	4.6	6.1	6.9	7.8	8.6
Growth (%)	-25.0	31.3	14.1	2.6	9.9
Cash EPS	14.0	15.7	17.1	18.6	19.6
Book Value	56.9	62.2	72.0	78.5	85.8
DPS	0.0	1.0	1.0	1.0	2.0
Payout (incl. Div. Tax.)	0.0	17.5	16.4	14.6	13.3
Valuation (x)					
P/E		14.8	13.0	11.5	10.5
Cash P/E		5.7	5.3	4.9	4.6
EV/EBITDA		9.3	7.8	7.3	6.5
EV/Sales		2.2	2.0	1.7	1.4
Price/Book Value		1.4	1.3	1.1	1.0
Dividend Yield (%)		1.1	1.1	1.1	2.2
Profitability Ratios (%)					
RoE	9.2	10.9	10.7	10.4	10.5
RoCE	8.7	9.0	9.6	9.5	10.3
Turnover Ratios					
Debtors (Days)	57	60	60	60	60
Inventory (Days)	130	150	145	145	145
Creditors. (Days)	85	85	85	85	85
Asset Turnover (x)	0.6	0.6	0.5	0.6	0.7
Fixed Asset Turnover (x)	0.7	0.8	0.8	0.8	0.9
Leverage Ratio					
Debt/Equity (x)	1.2	1.4	0.9	0.8	0.6

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
OP/(Loss) before Tax	1,015	1,293	1,596	1,817	2,397
Add: Depreciation & Amort.	1,503	1,491	1,562	1,635	1,662
Add: Interest Paid	1,133	1,179	1,281	1,062	660
Less: Direct Taxes Paid	0	3	43	109	359
Less: (Inc)/Dec in Wkg. Cap	-2,302	-4,324	-631	-1,310	-443
CF from Op. Activity	91	-1,637	2,300	1,906	3,129
CF after EO Items	91	-1,637	2,300	1,906	3,130
(Inc)/Dec in Fixed Assets & C	-350	-177	-900	-700	-701
(Pur)/Sale of Invest.	-140	66	-30	0	1
CF from Inv. Activity	-481	-1,326	-900	-700	-701
Issue of Shares	168	-35	1,670	1	2
Inc / (Dec) in Debt	152	3,270	-2,100	-1,450	-2,450
Interest Paid	1,133	1,179	1,281	1,062	660
Dividends Paid	0	223	239	239	239
CF from Fin. Activity	394	2,964	-489	-1,682	-2,664
Inc / (Dec) in Cash	4	2	910	-476	-235
Add: Opening Balance	123	127	129	1,039	563
Closing Balance	127	129	1,039	563	328



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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 |

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