

INDIA

Arvind Mills

14 May 2007

ARVND IN Underperform

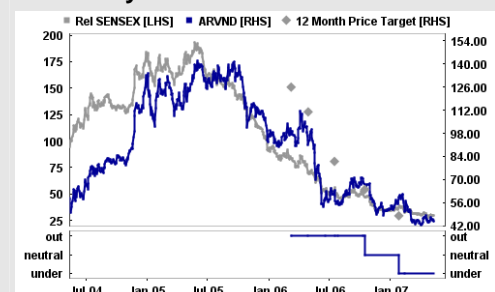
Stock price as of 11 May 07	Rs	45.25
12-month target	Rs	41.00
Upside/downside	%	-9.4
Valuation	Rs	46.00
- DCF (WACC 13.0%)		

GICS sector	consumer durables & apparel		
Market cap	Rs m	9,474	
30-day avg turnover	Rs m	42.8	
Market cap	US\$m	233	
Number shares on issue	m	209.4	

Investment fundamentals

Year end 31 Mar		2007A	2008E	2009E	2010E
Total revenue	m	20,109	24,256	28,417	33,799
EBIT	m	1,533	1,631	2,324	3,278
EBIT Growth	%	-41.5	6.4	42.5	41.0
Recurring profit	m	291	698	1,290	2,188
Reported profit	m	1,188	575	819	1,370
Adjusted profit	m	260	575	819	1,370
EPS rep	Rs	5.67	2.75	3.91	6.54
EPS rep growth	%	2.1	-51.6	42.3	67.4
EPS adj	Rs	1.24	2.75	3.91	6.54
EPS adj growth	%	-77.7	121.4	42.3	67.4
PE rep	x	8.0	16.5	11.6	6.9
PE adj	x	36.5	16.5	11.6	6.9
Total DPS	Rs	0.74	0.52	0.95	1.53
Total div yield	%	1.6	1.1	2.1	3.4
ROA	%	3.9	4.1	6.0	8.1
ROE	%	1.5	3.1	4.4	7.0
EV/EBITDA	x	5.0	4.8	4.0	3.3
Net debt/equity	%	48.2	39.6	41.0	42.6
Price/book	x	0.5	0.5	0.5	0.5

ARVND IN rel SENSEX performance, & rec history



Source: Datastream, Macquarie Research, May 2007 (all figures in INR unless noted)

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Denim weakness continues

Event

- Arvind Mills reported standalone 4Q FY3/07 results on 12 May. Recurring PAT declined 85% (to Rs40m), which was >40% below consensus and our expectations.

Impact

- Sales grew 35% YoY as the merger with Arvind Brands introduced the branded garment segment (Rs810m). On a like-for-like basis, sales increased 12% YoY, due to 65% YoY growth in garment exports volumes (17% of sales). Denim (40% of sales) declined 4% YoY as it experienced a 9% YoY decline in volume, partially offset by 6% YoY increase in pricing (figure 3).
- Shirt fabric division (~14% of sales) sales increased 7% YoY (to Rs687m), on back of 10% YoY increase in shirt volume and 3% YoY decline in realisations. Garment exports now contribute 17% to top line (vs 14% in 4Q FY3/06). While the ramp-up is encouraging, the contribution is not yet significant enough to offset weak results in denim.
- Raw material costs increased 40% YoY, which offset the 35% YoY growth in revenues resulting in 27% YoY decline in EBITDA. Power costs increased 7% YoY as margin gains from the switch to gas from naphtha (for captive power plant) were affected, due to a cut in gas availability (refer to figures 1 and 2).
- Reported PAT contains forex gains (Rs83m) and a one-off extraordinary loss of Rs68m. Adjusting for these, Arvind reported PAT of Rs40m (figures 1 and 2), which is >40% below our and consensus estimates.
- We believe weakness in denim is likely to last for at least 6–9 months. We may not see a solid turnaround for at least 12–15 months. Any turnaround will likely be impacted by a surge in power costs. This is because price renegotiations during the gas supply contract renewal in November 2007 are likely to increase power costs by 9% in FY3/08E and 18% in FY3/09E.

Earnings revision

- We reduce our FY3/08E EPS estimate by 14% and FY3/09E EPS by 7% to account for the more pessimistic scenario in denim business.

Price catalyst

- 12-month price target: Rs41.00 based on a DCF methodology.
- Catalyst: Higher power costs. Continuing weakness in denim business.

Action and recommendation

- We reiterate our Underperform recommendation due to the downside risk in denim, the primary revenue driver, and gas, a significant cost. Our price target has been revised down by 14% to Rs41.00 to reflect the cut in earnings estimates.
- Greater focus on garment exports and branded retail should lead to long-term margin expansion and help reduce the over-exposure to denim. Until then, the denim business will drive profits and share price performance.

Please refer to the important disclosures on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Fig 1 Arvind Mills: snapshot of 4Q FY3/07 results

(Rs m)	Q4FY07	Q4FY06	Change YoY	Q3FY07	Change QoQ
Net sales	4,831	3,580	35.0%	4,479	7.9%
Raw materials	2,683	2,007	33.7%	2,539	5.7%
Personnel cost	517	342	51.1%	529	-2.3%
Other expenses	959	314	205.5%	651	47.4%
Total expenses	4,159	2,663	56.2%	3,719	11.8%
EBITDA	672	917	-26.6%	760	-11.5%
Interest	407	330	23.4%	399	2.2%
Depreciation	302	394	-23.3%	347	-13.0%
Other income	81	60	34.3%	27	204.2%
Recurring pre-tax income	44	253	-82.7%	40	8.2%
Extraordinary income/(expense)*	15	(53)		1,018	
Taxation	4	(15)	-128.6%	10	-58.8%
Reported net income	54	215	-74.8%	1,048	-94.8%
Recurring net income	40	271	-85.5%	30	30.8%

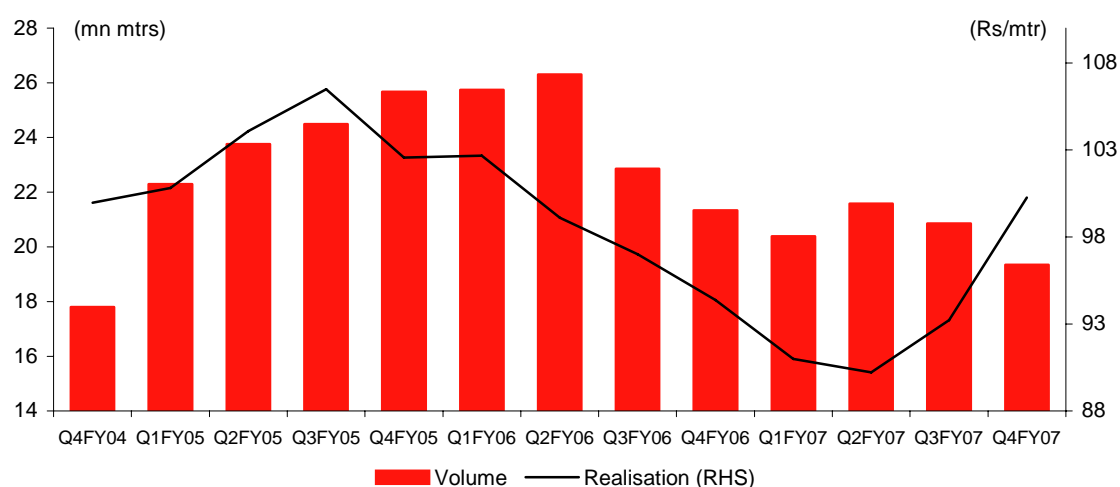
* Profit on account of foreign exchange

Source: Company data, Macquarie Research, May 2007

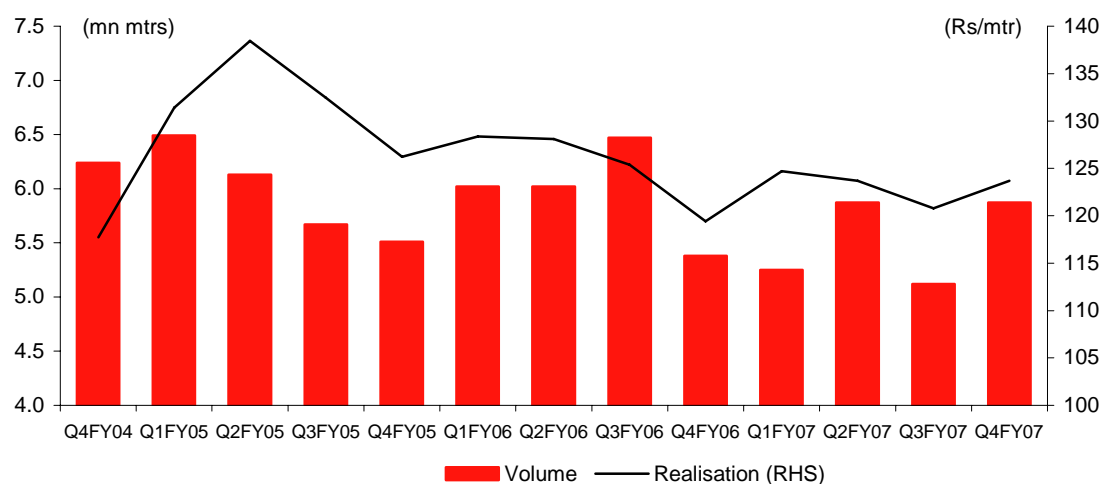
Fig 2 Reconciliation of PAT

Reported PAT (incl. extraordinary)	54
Less: Non-recurring extraordinary expense (net)	68
Less: Foreign Exchange Gain	83
Recurring net income	40

Source: Company data, Macquarie Research, May 2007

Fig 3 Arvind Mills: Denim division – weak volumes continue to plague results

Source: Company data, Macquarie Research, May 2007

Fig 4 Arvind Mills: Shirt division – volumes and realisations recovered

Source: Company data, Macquarie Research, May 2007

Arvind Mills Ltd (ARVND IN, Underperform, Target price: Rs41.00)

Arvind Mills Ltd (ARVND LN, Underperform, Target price: RS41.00)											
Profit & Loss		2003A	2004A	2005A	2006A	Profit & Loss		2007A	2008E	2009E	2010E
Revenue	m	18,074	15,710	19,608	23,581	Revenue	m	20,109	24,256	28,417	33,799
Cost of Goods Sold	m	11,701	10,172	13,779	17,039	Gross Profit	m				
EBITDA	m	4,884	4,096	4,260	4,587	Cost of Goods Sold	m	14,910	18,526	21,613	25,593
Depreciation	m	1,889	1,861	1,815	1,966	EBITDA	m	3,680	3,878	4,623	5,629
Amortisation of Goodwill	m	0	0	0	0	Depreciation	m	2,147	2,246	2,299	2,351
Other Amortisation	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
EBIT	m	2,995	2,235	2,445	2,621	Other Amortisation	m	0	0	0	0
Net Interest Income	m	-2,154	-1,404	-1,437	-1,821	EBIT	m	1,533	1,631	2,324	3,278
Associates	m	0	0	0	0	Net Interest Income	m	-1,458	-1,245	-1,379	-1,480
Exceptionals	m	0	0	0	-270	Associates	m	0	0	0	0
Forex Gains / Losses	m	0	0	0	0	Exceptionals	m	928	0	0	0
Other Pre-Tax Income	m	230	88	114	365	Forex Gains / Losses	m	0	0	0	0
Pre-Tax Profit	m	1,071	919	1,123	895	Other Pre-Tax Income	m	216	312	345	391
Tax Expense	m	-2	49	-20	-90	Pre-Tax Profit	m	1,219	698	1,290	2,188
Net Profit	m	1,073	870	1,103	805	Tax Expense	m	-48	-139	-486	-830
Minority Interests	m	-25	-42	72	37	Net Profit	m	1,171	559	803	1,358
Reported Earnings	m	1,098	912	1,174	842	Minority Interests	m	17	16	15	12
Adjusted Earnings	m	1,098	912	1,174	1,112	Reported Earnings	m	1,188	575	819	1,370
EPS (rep)		6.18	4.82	6.01	4.12	Adjusted Earnings	m	260	575	819	1,370
EPS (adj)		6.18	4.82	6.01	5.45	EPS (rep)		5.67	2.75	3.91	6.54
		0.00	-21.89	24.6	-9.3	EPS (adj)		1.24	2.75	3.91	6.54
						EPS Growth (adj)	%	-77.7	121.4	42.3	67.4
						PE (rep)	x	8.0	16.5	11.6	6.9
						PE (adj)	x	36.5	16.5	11.6	6.9
Total DPS		0.38	0.50	1.23	1.29	Total DPS		0.74	0.52	0.95	1.53
Total Div Yield	%				2.2	Total Div Yield	%	1.6	1.1	2.1	3.4
Weighted Average Shares	m	178	189	195	204	Weighted Average Shares	m	209	209	209	209
Period End Shares	m	179	195	195	209	Period End Shares	m	209	209	209	209

Profit and Loss Ratios					Cashflow Analysis						
		2007A	2008E	2009E	2010E		2007A	2008E	2009E	2010E	
Revenue Growth	%	-0.6	20.6	17.2	18.9	EBITDA	m	3,680	3,878	4,623	5,629
EBITDA Growth	%	-19.8	5.4	19.2	21.8	Tax Paid	m	-48	-139	-486	-830
EBIT Growth	%	-41.5	6.4	42.5	41.0	Chgs in Working Cap	m	-1,116	222	-1,395	-2,083
Gross Profit Margin	%	nmf	nmf	nmf	nmf	Net Interest Paid	m	-1,458	-1,245	-1,379	-1,480
EBITDA Margin	%	18.3	16.0	16.3	16.7	Other	m	852	-79	-79	-83
EBIT Margin	%	7.6	6.7	8.2	9.7	Operating Cashflow	m	1,910	2,637	1,283	1,154
Net Profit Margin	%	5.8	2.3	2.8	4.0	Acquisitions	m	0	0	0	0
Payout Ratio	%	59.5	18.9	24.2	23.3	Capex	m	-700	-700	-700	-400
EV/EBITDA	x	5.0	4.8	4.0	3.3	Asset Sales	m	0	0	0	0
EV/EBIT	x	12.1	11.4	8.0	5.7	Other	m	373	-57	-870	-1,281
Balance Sheet Ratios						Investing Cashflow	m	-327	-757	-1,570	-1,681
ROE	%	1.5	3.1	4.4	7.0	Dividend (Ordinary)	m	-155	-109	-198	-319
ROA	%	3.9	4.1	6.0	8.1	Equity Raised	m	-104	-139	-174	-174
ROIC	%	5.2	4.7	5.4	7.4	Debt Movements	m	-294	-2,137	-307	-313
Net Debt/Equity	%	48.2	39.6	41.0	42.6	Other	m	175	-87	151	249
Interest Cover	x	1.1	1.3	1.7	2.2	Financing Cashflow	m	-378	-2,472	-528	-558
Price/Book	x	0.5	0.5	0.5	0.5	Net Chg in Cash/Debt	m	1,206	-592	-815	-1,085
Book Value per Share		86.9	87.9	90.6	95.8						

Balance Sheet					2007A	2008E	2009E	2010E	
Cash	m	8,707	8,114	7,300	6,215				
Receivables	m	1,673	1,892	2,613	3,606				
Inventories	m	6,491	6,311	7,544	9,423				
Investments	m	337	337	337	337				
Fixed Assets	m	16,771	15,319	13,815	11,958				
Intangibles	m	0	0	0	0				
Other Assets	m	6,165	6,558	7,852	9,634				
Total Assets	m	40,143	38,532	39,461	41,172				
Payables	m	0	0	0	0				
Short Term Debt	m	0	0	0	0				
Long Term Debt	m	17,793	15,656	15,348	15,035				
Provisions	m	0	0	0	0				
Other Liabilities	m	3,483	3,815	4,498	5,442				
Total Liabilities	m	21,276	19,470	19,847	20,477				
Shareholders' Funds	m	18,190	18,401	18,969	20,061				
Minority Interests	m	677	661	646	634				
Other	m	0	0	0	0				
Total S/H Equity	m	18,867	19,062	19,614	20,695				
Total Liab & S/H Funds	m	40,143	38,532	39,461	41,172				

All figures in INR unless noted.

Source: Macquarie Research, May 2007

Important disclosures:**Recommendation definitions****Macquarie Australia/New Zealand**

Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)
 Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)
 Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

Macquarie Asia

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South Securities (South Africa)

Outperform – expected return >+5%
 Neutral – expected return from -5% to +5%
 Underperform – expected return <-5%

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Recommendation proportions

	AU/NZ	Asia	RSA
Outperform	44.37%	58.37%	42.60%
Neutral	44.01%	21.30%	46.80%
Underperform	11.62%	20.33%	10.60%

For quarter ending 31 March 2007

Volatility index definition*

This is calculated from the volatility of historic price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

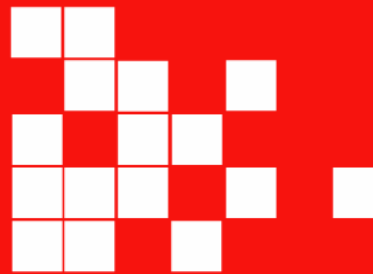
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Regional Heads of Sales

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Thomas Renz (Geneva)	(41) 22 818 7712
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Stuart Smythe (India)	(9122) 6653 3200
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Depository Receipts - Robert Ansell	(852) 2823 4688
Derivatives - Vipul Shah	(852) 2823 3523
Futures - Tim Smith	(852) 2823 4637
Hedge Fund Sales - Darin Lester	(852) 2823 4736
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