

Company Flash

14 May 2007 | 5 pages

Arvind Mills (ARMI.BO)

Hold: 4QFY07 Results below Expectations, Denim Woes Continue

- Results below expectations, not comparable YoY** — Arvind Mills reported 4QFY07 revenues of Rs4,831m and net profit (before extraordinary items) of Rs122m. Results are not comparable on a YoY basis because of merger of the branded apparel business (100% subsidiary Arvind Brands) in 3QFY07.
- Denim Realization improves, but near-term outlook negative** — 4QFY07 denim realizations increased 6% YoY to Rs100.26/mtr but sales declined 4% YoY on account of a 9% YoY decline in denim volumes. Though the company is making efforts to increase presence in the U.S. and E.U. markets, near-term outlook is negative since these efforts are not expected to contribute positively before 2HFY08 while the supply glut in the domestic market continues.
- Garment Operations Growing Steadily** — The garmenting business, augmented by shirts and jeans operations, contributes 15% of the company's revenues. In FY07 the company doubled the capacity of its jeans plant to 8m pieces and now has a full order book for jeans while the shirts segment is operating at optimum capacity utilization with improved productivity.
- Branded Apparel on Growth Path** — The branded apparel business (excluding VF license brands) grew 18% in FY07. Going forward Arvind Mills intends to create a strong portfolio of owned & licensed brands that will be complemented by an intensified focus on its retail foray with plans to increase the number of exclusive brand outlets from 122 at present to 193 in FY08.
- Maintain Hold** — Maintain Hold given weak outlook for core denim business.

Hold/Medium Risk	2M
Price (14 May 07)	Rs45.00
Target price	Rs64.00
Expected share price return	42.2%
Expected dividend yield	0.0%
Expected total return	42.2%
Market Cap	Rs9,422M US\$231M

Figure 1. Consolidated Statistical Abstract

Year to Mar-31	FD EPS (Rs)	EPS Gr. (%)	P/E (x)	P/BV (x)
2005	5.4	31.2	8.4	0.8
2006	3.9	-27.3	11.6	0.6
2007E	2.4	-38.0	18.6	0.6
2008E	4.6	88.9	9.9	0.6
2009E	6.7	45.9	6.8	0.6

Source: Citigroup Investment Research estimates

Figure 2. 4Q Earnings Summary (Rs m)

	4QFY06	4QFY07	YoY
Sales	3577.5	4831.3	35.0%
EBITDA	863.6	755.0	-12.6%
EBITDA Mgn (%)	24.1%	15.6%	
Interest	330.0	407.3	23.4%
Other Income	60.0	80.6	34.3%
Depreciation	393.6	302.0	-23.3%
PAT before Ext.	214.7	122.1	-43.1%
Less: Extra-ordinaries		68.1	
PAT after Ext.	214.7	54.0	-74.8%

Source: Company Reports, CIR

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See Appendix A-1 for Analyst Certification and important disclosures.

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Arvind Mills

Company description

Arvind Mills is one of the world's largest denim manufacturers and one of India's largest textile exporters. Aside from leadership in denim (a 72% market share) in India, Arvind Mills has a presence in shirting, knits, khakhis, voiles fabrics and a wide range of garments. It is an integrated player with a presence across the textile value chain — global capacity of 154m meters in fabrics, vertical integration to garments, strong brand franchise and a distribution network for branded apparels. Arvind's wide product range, scaleable capacities and ability to offer specialty fabrics and high-end garments make it a preferred vendor in the domestic market and to global brands. It is the flagship company of the Lalbhai Group, which owns a 34% stake.

Investment thesis

We rate Arvind Mills as Hold/Medium Risk (2M). While poor prospects for denim are dampening sentiment toward the stock, we believe the company's vertically integrated business model across cotton textiles, focus on a richer product mix and close ties with global retailers are positives. We see Arvind's thrust on garments and efforts to relocate denim capacities overseas will reduce earnings sensitivity to denim fabric prices over the long term.

Valuation

Our target price of Rs64 is based on 14x FY08E P/E, at a discount to the 16.5x we ascribe to the top-tier textile companies in India. We ascribe a discount due to the weak prospects facing the denim business. However, we still believe it will trade at a premium to our India textile universe valuation of 9x FY08E P/E. The premium is attributable to Arvind's initiatives to vertically integrate and move up the value chain, its domestic leadership, close relationship with global retailers and presence in branded apparel retailing in the domestic market. We use P/E as our primary valuation tool because it captures growth potential.

Risks

We rate Arvind Mills as Medium Risk, as opposed to the Low Risk rating based on our quantitative risk-rating system, which tracks 260-day share-price volatility. The key reasons for our Medium Risk rating include high earnings volatility due to the pressure on denim prices and an adverse impact from forex fluctuations. The main upside risks to our target price include: (1) Strong up-tick in denim prices would significantly improve earnings growth visibility. An increase in denim prices of more than 5% would impact Arvind's profitability. (2) Large tie-ups with global retailers for sourcing garments would put our assumptions at risk. (3) Stronger-than-expected turnaround for its branded apparel division would contribute towards higher growth.

The main downside risks to our target price include: (1) Changes in fashion could hurt denim demand; (2) any sharp decrease in cotton prices from its existing inventory cost of Rs42.5/kg; (3) delay in the ramp-up of garment capacities; and (4) rupee depreciation from Rs46/US\$1 (average rate at which forex exposures are hedged) would lead to forex losses.

Appendix A-1

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Arvind Mills (ARMI.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 21 2005)



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