

# Arvind

20 September 2012

Reuters: ARVN.BO; Bloomberg: ARVND IN

We recently had a meeting with the management of Arvind, which sounded upbeat and highlighted that the growth momentum has bounced back in 2QFY13. Meanwhile, we maintain our estimates, Buy recommendation and target price of Rs97 on the stock. Following are the key takeaways from the meeting:

**B&R division witnesses good demand:** Following a 1% drop in Megamart's revenue, Arvind reported a mere 9% growth in Brands & Retail (B&R) division in 1QFY13. As per the management, demand was poor in May 2012, but it revived in June, July and August 2012. Customers have accepted the new format of Megamart and as a result it witnessed a growth of ~10% in July and August 2012. Operating margin of B&R division improved from 1.1% in 1QFY13 to 3.5-4.0%. Earlier, Arvind was paying ~4.5% excise duty under the old format (discount on MRP) of Megamart. Under the new format (with reduced MRP), excise duty has been cut to ~3.6%, leading to savings of ~0.9%, which would improve margins of the B&R division.

**Textile division operates at full capacity:** Performance of textile division was impacted on account of workers' strike in 1QFY13. The labour strife was resolved with ~15% increase in the wages of workers in the textile division and it would increase employee costs by a mere ~Rs220mn. The textile division is operating at full capacity since 1 July 2012. Denim demand has been buoyant in export markets. Arvind increased denim prices marginally in 2QFY13. As Arvind has purchased cotton over February-May 2012 at a lower price, it would witness inventory gain in 2QFY13. The management is hopeful of achieving EBITDA margin of 16% for the textile division in 2QFY13 compared to 14.8% in 1QFY13.

**Working capital to remain under control:** Arvind had high cotton inventory in 1QFY13 which increased its interest costs by 12.2% QoQ. The management stated that cotton inventory declined to 2.5 months from a high of 6.0-7.0 months in 1QFY13. Also, Arvind has also been able to reduce inventory in its B&R division by ~20 days. The positive effect of lower working capital would be visible in 2QFY13 and 3QFY13.

**Confident of achieving revenue/profitability target:** The management is confident of achieving its revenue and profitability targets for FY13. It expects the textile division to report volume-driven growth of 10% in FY13 with operating margin at 16%. Arvind is exploring outsourcing opportunity in Bangladesh and is hopeful of increasing denim capacity by ~7% without incurring any capex. The benefits of outsourced capacity would be visible in 4QFY13 and FY14. The B&R division would witness over 10% growth with 5-6% operating margin in 2HFY13. As global cotton prices are under control, Arvind is not expecting any significant increase in cotton procurement costs.

**Valuation:** Arvind trades attractively at 6.5x/4.7x FY13/14E P/E and 5.3/4.3x EV/EBITDA, below the mean of 8.1x/6.5x, respectively. Revenue CAGR of 8.4% aided by a 151bps higher operating margin, working capital efficiency and debt reduction by 21% should lead to profit CAGR of 27.4%, generate free cash flow of Rs4bn, improve RoCE by 159bps over FY12-FY14E and calls for expansion of valuation multiple.

## BUY

Sector: Retail

CMP: Rs73

Target Price: Rs97

Upside: 33%

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### Key Data

Current Shares O/S (mn)	258.0
Mkt Cap (Rsbn/US\$bn)	18.7/346.4
52 Wk H / L (Rs)	111/59
Daily Vol. (3M NSE Avg.)	1,511,190

### Price Performance (%)

	1 M	6 M	1 Yr
Arvind	3.9	(12.5)	(21.5)
Nifty Index	4.4	5.3	10.1

Source: Bloomberg

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	32,612	40,846	49,251	51,218	57,855
YoY (%)	18.8	25.2	20.6	4.0	13.0
EBITDA	4,099	5,296	6,022	6,832	7,950
EBITDA margin (%)	12.6	13.0	12.2	13.3	13.7
Reported PAT	500	1,649	4,359	2,886	3,975
Adj. PAT	433	1,420	2,447	2,886	3,975
FDEPS (Rs)	1.8	5.6	9.5	11.2	15.4
YoY (%)	NA	204.7	69.9	17.9	37.7
RoE (%)	3.7	9.5	13.1	13.4	16.1
RoCE (%)	9.2	10.4	12.2	13.3	13.7
RoIC (%)	7.7	9.2	9.6	11.6	12.9
P/E (x)	39.8	13.0	7.7	6.5	4.7
P/BV (x)	1.3	1.1	0.9	0.8	0.7
EV/EBITDA (x)	9.2	7.4	6.5	5.3	4.3

Source: Company, Nirmal Bang Institutional Equities Research

**Financials (consolidated)**
**Exhibit 1: Income statement**

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Net sales	32,612	40,846	49,251	51,218	57,855
Growth (%)	18.8	25.2	20.6	4.0	13.0
Raw material costs	14,708	19,354	22,950	23,233	26,127
Power & fuel	2,506	3,065	3,663	3,944	4,455
Staff	3,381	3,953	4,459	4,866	5,496
Other Manufacturing Expenses	4,501	4,197	5,373	6,761	7,579
Selling and Administration Exp	2,498	3,943	4,133	3,483	3,876
Miscellaneous Expenses	919	1,038	2,651	2,100	2,372
Total expenditure	28,513	35,550	43,229	44,386	49,905
EBITDA	4,099	5,296	6,022	6,832	7,950
Growth (%)	37.5	29.2	13.7	13.4	16.4
EBITDA margin (%)	12.6	13.0	12.2	13.3	13.7
Other income	437	547	1,185	768	463
Extra-ordinary items		-	2,450		
Interest costs	2,340	2,360	3,091	2,862	2,129
Gross profit	2,197	3,483	6,567	4,739	6,284
Growth (%)	281.4	58.5	88.5	(27.8)	32.6
Depreciation	1,727	1,725	1,614	1,636	1,767
Profit before tax	470	1,758	4,953	3,103	4,517
Growth (%)	(145.7)	274.1	181.7	(37.4)	45.6
Tax	(61)	105	594	217	542
Effective tax rate (%)	(12.9)	6.0	12.0	7.0	12.0
Net profit	531	1,653	4,359	2,886	3,975
Growth (%)	(148.5)	211.6	163.6	(33.8)	37.7
Minority interest	31	5	0	0	0
Extraordinary items	67	228	1,912	-	-
Adjusted PAT	433	1,420	2,447	2,886	3,975
Growth (%)	(134.1)	228.2	72.3	17.9	37.7

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 3: Balance Sheet**

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Equity	2,320	2,544	2,580	2,580	2,580
Reserves	10,431	14,404	17,738	20,322	23,996
Net worth	12,826	16,948	20,318	22,902	26,576
Minority Int	141	161	91	91	92
Short-term loans	10,455	13,157	13,512	10,605	10,105
Long-term loans	11,570	8,945	7,770	8,136	6,636
Total loans	22,025	22,102	21,283	18,741	16,741
Deferred tax liability	134	217	189	344	570
<b>Liabilities</b>	<b>35,126</b>	<b>39,428</b>	<b>41,881</b>	<b>42,079</b>	<b>43,978</b>
Gross block	38,360	38,759	37,974	40,892	43,101
Depreciation	14,048	15,109	13,326	14,961	16,728
Net block	24,312	23,650	24,648	25,930	26,372
Capital work-in-progress	579	898	1,918	409	431
Long-term Investments	437	610	417	417	417
Inventories	8,012	12,363	11,261	12,946	14,417
Debtors	4,259	5,018	6,422	6,899	7,631
Cash	597	585	709	635	652
Other current assets	3,899	5,460	7,435	6,658	7,521
Total current assets	16,767	23,426	25,827	27,139	30,221
Creditors	5,265	9,388	9,267	9,617	10,813
Other current liabilities	1,704	1,224	2,945	3,483	3,934
Total current liabilities	6,969	10,611	12,213	13,100	14,747
Net current assets	9,798	12,815	13,614	14,039	15,474
<b>Total assets</b>	<b>35,126</b>	<b>39,428</b>	<b>41,881</b>	<b>42,079</b>	<b>43,978</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 2: Cash flow**

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
EBIT	2,372	3,571	4,408	5,196	6,183
Inc./(dec.) in working capital	(391)	(3,028)	(676)	(498)	(1,418)
<b>Cash flow from operations</b>	<b>1,982</b>	<b>544</b>	<b>3,732</b>	<b>4,698</b>	<b>4,764</b>
Other income	437	547	1,185	768	463
Depreciation	1,727	1,725	1,614	1,636	1,767
Deferred liabilities	(122)	83	(28)	155	226
Interest paid (-)	(2,340)	(2,360)	(3,091)	(2,862)	(2,129)
Tax paid (-)	61	(105)	(594)	(217)	(542)
Dividends paid	(2)	(1)	(301)	(301)	(301)
<b>Net cash from operations</b>	<b>1,712</b>	<b>427</b>	<b>2,517</b>	<b>3,877</b>	<b>4,248</b>
Capital expenditure (-)	(1,296)	887	(3,843)	(1,409)	(2,231)
<b>Net cash after capex</b>	<b>416</b>	<b>1,314</b>	<b>(1,326)</b>	<b>2,468</b>	<b>2,017</b>
Inc./(dec.) in short-term borrowing	1,139	2,702	355	(2,908)	(500)
Inc./(dec.) in long-term borrowing	(2,210)	(2,625)	(1,175)	366	(1,500)
Inc./(dec.) in preference capital	(336)	(76)	-	-	-
Inc./(dec.) in borrowings	(1,407)	2	(820)	(2,542)	(2,000)
(Inc.)/Dec. in investments	(355)	(1,628)	365	-	-
Minority Int	31	20	(69)	0	0
Equity issue/(buyback)	195	336	(332)	-	-
<b>Cash from financial activities</b>	<b>(1,536)</b>	<b>(1,271)</b>	<b>(856)</b>	<b>(2,542)</b>	<b>(2,000)</b>
Extraordinary Items	-	-	2,450	-	-
Others	1,320	(54)	(146)	-	(0)
Opening cash	397	597	585	709	635
Closing cash	597	585	709	635	652
Change in cash	200	(11)	123	(73)	17

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Key ratios**

Y/E March	FY10	FY11	FY12	FY13E	FY14E
<b>Per share (Rs)</b>					
EPS	1.8	5.6	9.5	11.2	15.4
Book value	55.3	66.6	78.7	88.8	103.0
<b>Valuation (x)</b>					
P/E	39.8	13.0	7.7	6.5	4.7
P/sales	0.5	0.5	0.4	0.4	0.3
P/BV	1.3	1.1	0.9	0.8	0.7
EV/EBITDA	9.2	7.4	6.5	5.3	4.3
EV/sales	1.2	1.0	0.8	0.7	0.6
<b>Return ratios (%)</b>					
RoIC	7.7	9.2	9.6	11.6	12.9
RoCE	9.2	10.4	12.2	13.3	13.7
RoE	3.7	9.5	13.1	13.4	16.1
<b>Margins (%)</b>					
EBITDA margin	12.6	13.0	12.2	13.3	13.7
PBIT margin	7.3	8.7	9.0	10.1	10.7
PBT margin	1.4	4.3	10.1	6.1	7.8
PAT margin	1.3	3.5	5.0	5.6	6.9
<b>Turnover ratio</b>					
Asset turnover ratio (x)	0.9	1.0	1.2	1.2	1.3
Avg. inventory period (days)	101	125	94	105	104
Avg. collection period (days)	47	44	47	48	47
Avg. payment period (days)	66	95	77	78	78
<b>Solvency ratios (x)</b>					
Debt-equity	1.7	1.3	1.0	0.8	0.6
Interest coverage	1.0	1.5	1.4	1.8	2.9
Debt/EBITDA	5.4	4.2	3.5	2.7	2.1
<b>Growth (%)</b>					
Sales	18.8	25.2	20.6	4.0	13.0
EBITDA	37.5	29.2	13.7	13.4	16.4
PAT	(134.1)	228.2	72.3	17.9	37.7

Source: Company, Nirmal Bang Institutional Equities Research

## Ratings track

Date	Rating	Market price (Rs)	Target price (Rs)
13 April 2012	Buy	84	117
10 May 2012	Buy	77	117
27 July 2012	Buy	69	97
20 September 2012	Buy	73	97

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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