

Arvind

28 September 2012

Reuters: ARVN.BO; Bloomberg: ARVND IN

Buys India Businesses Of Two UK Retailers, Nautica Brand

Arvind has acquired India businesses of British fashion retailers Debenhams and Next and also American brand Nautica from Planet Retail having FY12 revenue of Rs700mn for a total sum of ~Rs550mn, valuing the acquisitions at ~0.8x P/S. As per the management, these brands are making marginal profit at the store level, but losses at EBITDA/PAT levels due to corporate overheads. Due to the losses coupled with aggressive Rs1.5bn expansion, we believe the latest acquisitions would exert pressure on free cash flow and return ratios in the near term. Accordingly, we have increased our revenue estimates by 0.8%/1.7% but cut EBITDA and PAT estimates by 0.8%/3.5% and 10.9%/22.8% for FY13E/FY14E, respectively. We have rolled forward our valuation to FY14 estimates (from FY13) and factored in lower free cash flow/return ratios due to aggressive capex. We have retained our Buy rating on Arvind with a revised SOTP-based TP of Rs92 (from Rs97 earlier).

Expanding its reach: Arvind caters to all segments of consumers - mass market, premium market and bridge to luxury market. However, its presence in bridge to luxury market was limited, with only two brands Gant and Energie. With the latest acquisition of brands (in India), particularly Nautica, its portfolio in bridge to luxury market will strengthen. Debenhams will enable Arvind to foray into bridge to luxury department stores and Next will facilitate entry into apparel specialty retail chain. This will strengthen Arvind's market share in women and kids wear segment. The management has stated that apparel specialty segment is growing fast and the company is planning to compete with brands like Zara etc.

Brief details about brands: Next is UK-based most valuable retailer with ~US\$5.3bn revenue and 500 stores in the UK and 180 stores spread across 30 countries. In India, Next started its operations in September 2006. Debenhams is UK's leading lifestyle department store with ~US\$3.4bn revenue and 169 stores in the UK and 66 international franchise stores in 25 countries. It offers a unique combination of own brands and international brands. Established in 1983, Nautica, with revenue of ~US\$1.6bn, is a global lifestyle brand in the casual wear space with 200 stores spread across 70 countries.

Aggressive Brands and Retail division's growth to pressure free cash flow, RoCE: Currently, Debenhams/Next/Nautica have 2/3/11 stores in India (see Exhibit 2) and Arvind would set up 6/9/30 stores, respectively, apart from 70 shop-in-shop (SIS) stores for Nautica in the next three years. Arvind plans to increase total stores to 131 (stores plus SIS) from 16 currently in the next three years. Including acquisition costs of ~Rs550mn, Arvind would invest Rs1.5bn on these brands over the next three years and increase its revenue from Rs700mn in FY12 to Rs3,000mn/Rs5,000mn in FY15E/FY17E, respectively. The management plans to increase B&R division's revenue from Rs16bn to Rs50bn over FY12-FY17E, including Rs20bn from inorganic growth opportunities. It has planned an investment of Rs10bn over the next five years. Such an aggressive capex plan for the B&R division would exert pressure on free cash flow and RoCE. We have increased our capex estimates for FY13E/FY14E but cut free cash flow assumptions from Rs2,468mn/Rs2,017mn to Rs794mn/Rs247mn, respectively, for the same period.

BUY

Sector: Retail

CMP: Rs79

Target Price: Rs92

Upside: 16%

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Key Data

Current Shares O/S (mn)	258.0
Mkt Cap (Rsbn/US\$m)	20.3/382.7
52 Wk H / L (Rs)	111/59
Daily Vol. (3M NSE Avg.)	1,597,175

Price Performance (%)

	1 M	6 M	1 Yr
Arvind	24.2	(0.8)	(20.5)
Nifty Index	5.9	8.8	14.2

Source: Bloomberg

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	32,612	40,846	49,251	51,614	58,845
YoY (%)	18.8	25.2	20.6	4.8	14.0
EBITDA	4,099	5,296	6,022	6,781	7,670
EBITDA margin (%)	12.6	13.0	12.2	13.1	13.0
Reported PAT	500	1,649	4,359	2,571	3,069
Adj. PAT	433	1,420	2,611	2,571	3,069
FDEPS (Rs)	1.8	5.6	10.1	10.0	11.9
YoY (%)	-	204.7	81.2	(1.5)	19.4
RoE (%)	3.7	9.5	14.0	12.0	12.8
RoCE (%)	9.2	10.4	12.2	12.6	12.4
RoIC (%)	7.7	9.2	9.6	10.9	11.4
P/E (x)	42.9	14.1	7.8	7.9	6.6
P/BV (x)	1.4	1.2	1.0	0.9	0.8
EV/ EBITDA (x)	9.6	7.7	6.7	5.8	5.1

Source: Company, Nirmal Bang Institutional Equities Research

Valuation

Arvind trades attractively at 7.9x/6.6x FY13E/FY14E P/E and 5.8/5.1x EV/EBITDA, below the mean of 8.1x/6.5x, respectively. We have rolled forward our valuation to FY14 estimates from FY13 and reduced our target multiple for textile/B&R divisions to 5.0x/7.0x EV/EBITDA from 5.5x/8.0x, respectively, to factor in lower free cash flow and pressure on return ratios. Resuming operations after a strike by the workers recently, its textile plants are running at full capacity since 1 July 2012 and hence margins are expected to bounce back to 16.0% in 2HFY13 from 14.7% in 1QFY13, while its B&R division has witnessed improvement in margins as well as revenue on a sequential basis. Following better performance on sequential basis, we expect a re-rating of the valuation multiple. Based on 5.0x FY14E EV/EBITDA of textile business and 7.0x FY14E EV/EBITDAE of B&R business, we have valued core business at Rs82 per share. Arvind has a huge land bank of ~500 acres and it is planning to monetise it, either through developing land parcels or selling land parcel in bits and pieces. According to the management, the value of its land after development will be around Rs10bn i.e. Rs39 per share. We have valued the land parcel at 25% (earlier 33%) of its net asset value of Rs39 in our target price. The management expects to receive Rs1.0bn-1.5bn cash flow from its real estate venture each year in FY13E/FY14E, which should support its cash flow. We have retained our Buy rating on the stock with a revised SOTP-based TP of Rs92 (from Rs97 earlier).

Exhibit 1: SOTP-based valuation

Segment	SOTP			SOTP		
	Old valuation factoring FY13 estimates			New valuation factoring FY14 estimates		
	EBITDA (Rsmn)	Target EV/EBITDA multiple (x)	Value (Rsmn)	EBITDA (Rsmn)	Target EV/EBITDA multiple (x)	Value (Rsmn)
Textile	6,107	5.5	33,586	6,532	5.0	32,658
Brands & retail	528	8.0	4,222	987	7.0	6,911
Others	139	4.5	696	146	4.5	658
Enterprise value			38,504			40,227
Less: Debt			17,689			19,116
Target market capitalisation			20,816			21,111
Core business target price (Rs/share)			84			82
Land bank: 25% of its NAV of Rs39 (Rs/share)			13			10
Target price (Rs/share)			97			92

Source: Nirmal Bang Institutional Equities Research

Exhibit 2: Aggressive expansion plan for acquired brands

Brand	Current outlets	Addition in three years	SIS	Total	Average size (sq ft)
Debenhams	2	6	-	8	25,000-30,000
Next	3	9	-	12	5,000-6,000
Nautica	11	30	70	111	1,500-2,000
Total	16	45	70	131	-

Source: Company

Change in our estimates

Arvind has acquired India business operations of British fashion retailers Debenhams and Next and also American brand Nautica in India from Planet Retail having total revenue of Rs700mn. Following these acquisitions, we have increased our revenue estimates by 0.8%/1.7% for FY13E/FY14E, respectively. These brands are not positive at the operating level currently. Arvind plans to increase total outlets for these brands to 131 (stores plus SIS) from 16 currently in the next three years and margins of these outlets will be under pressure initially. Hence, we have cut our operating margin estimates by 20bps/71bps for FY13E/FY14E to 13.1%/13.0%, respectively. We have reduced our operating profit estimates by 0.8%/3.5% to Rs6,781mn/Rs7,670mn for FY13E/FY14E, respectively. Following higher capex and lower free cash flow, we do not expect any significant debt reduction. In the wake of higher interest costs, we have cut our net profit estimates by 10.9%/22.8% for FY13E/FY14E to Rs2,571mn/Rs3,069mn, respectively.

Exhibit 3: Change in our earnings estimates

Y/E March (Rsmn)	Old assumptions		New assumptions		Change (%)	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Sales	51,218	57,855	51,614	58,845	0.8	1.7
EBITDA	6,832	7,950	6,781	7,670	(0.8)	(3.5)
EBITDA (%)	13.3	13.7	13.1	13.0	(20)bps	(71)bps
Interest costs	2,862	2,129	2,972	2,704	3.8	27.0
APAT	2,886	3,975	2,571	3,069	(10.9)	(22.8)

Source: Nirmal Bang Institutional Equities Research

Financials (consolidated)

Exhibit 4: Income statement

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Net sales	32,612	40,846	49,251	51,614	58,845
Growth (%)	18.8	25.2	20.6	4.8	14.0
Raw material costs	14,708	19,354	22,950	23,517	26,990
Power & fuel costs	2,506	3,065	3,663	3,974	4,531
Staff costs	3,381	3,953	4,459	4,903	5,590
Other manufacturing expenses	4,501	4,197	5,373	6,813	7,709
Selling and administration expenses	2,498	3,943	4,133	3,510	3,943
Miscellaneous expenses	919	1,038	2,651	2,116	2,413
Total expenditure	28,513	35,550	43,229	44,834	51,175
EBITDA	4,099	5,296	6,022	6,781	7,670
Growth (%)	37.5	29.2	13.7	12.6	13.1
EBITDA margin (%)	12.6	13.0	12.2	13.1	13.0
Other income	437	547	1,185	774	471
Extra-ordinary items	-	-	2,450	-	-
Interest costs	2,340	2,360	3,091	2,972	2,704
Gross profit	2,197	3,483	6,567	4,583	5,436
Growth (%)	281.4	58.5	88.5	(30.2)	18.6
Depreciation	1,727	1,725	1,614	1,819	1,949
Profit before tax	470	1,758	4,953	2,764	3,488
Growth (%)	(145.7)	274.1	181.7	(44.2)	26.2
Tax	(61)	105	594	193	419
Effective tax rate (%)	(12.9)	6.0	12.0	7.0	12.0
Net profit	531	1,653	4,359	2,571	3,069
Growth (%)	(148.5)	211.6	163.6	(41.0)	19.4
Minority interest	31	5	0	0	0
Extraordinary items	67	228	1,748	-	-
Adjusted PAT	433	1,420	2,611	2,571	3,069
Growth (%)	(134.1)	228.2	83.8	(1.5)	19.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: 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	20,007	22,775
Net worth	12,826	16,948	20,318	22,588	25,355
Minority Interest	141	161	91	91	92
Short-term loans	10,455	13,157	13,512	13,012	12,512
Long-term loans	11,570	8,945	7,770	7,270	7,270
Total loans	22,025	22,102	21,283	20,283	19,783
Deferred tax liability	134	217	189	327	501
Liabilities	35,126	39,428	41,881	43,289	45,731
Gross block	38,360	38,759	37,974	42,292	45,315
Depreciation	14,048	15,109	13,326	15,144	17,093
Net block	24,312	23,650	24,648	27,147	28,222
Capital work-in-progress	579	898	1,918	423	453
Long-term Investments	437	610	417	417	417
Inventories	8,012	12,363	11,261	13,076	14,784
Debtors	4,259	5,018	6,422	6,953	7,761
Cash	597	585	709	503	250
Other current assets	3,899	5,460	7,435	6,710	7,650
Total current assets	16,767	23,426	25,827	27,241	30,445
Creditors	5,265	9,388	9,267	9,714	11,088
Other current liabilities	1,704	1,224	2,945	3,510	4,001
Total current liabilities	6,969	10,611	12,213	13,224	15,089
Net current assets	9,798	12,815	13,614	14,018	15,355
Total assets	35,126	39,428	41,881	43,289	45,731

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Cash flow

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
EBIT	2,372	3,571	4,408	4,962	5,721
Inc./(dec.) in working capital	(391)	(3,028)	(676)	(609)	(1,591)
Cash flow from operations	1,982	544	3,732	4,353	4,131
Other income	437	547	1,185	774	471
Depreciation	1,727	1,725	1,614	1,819	1,949
Deferred liabilities	(122)	83	(28)	138	174
Interest paid (-)	(2,340)	(2,360)	(3,091)	(2,972)	(2,704)
Tax paid (-)	61	(105)	(594)	(193)	(419)
Dividends paid	(2)	(1)	(301)	(301)	(301)
Net cash from operations	1,712	427	2,517	3,617	3,300
Capital expenditure (-)	(1,296)	887	(3,843)	(2,823)	(3,053)
Net cash after capex	416	1,314	(1,326)	794	247
Inc./(dec.) in short-term borrowing	1,139	2,702	355	(500)	(500)
Inc./(dec.) in long-term borrowing	(2,210)	(2,625)	(1,175)	(500)	-
Inc./(dec.) in preference capital	(336)	(76)	-	-	-
Inc./(dec.) in borrowings	(1,407)	2	(820)	(1,000)	(500)
(Inc.)/dec. in investments	(355)	(1,628)	365	-	-
Minority interest	31	20	(69)	0	0
Equity issue/(buyback)	195	336	(332)	-	-
Cash from financial activities	(1,536)	(1,271)	(856)	(1,000)	(500)
Extraordinary items	-	-	2,450	-	-
Others	1,320	(54)	(146)	(0)	-
Opening cash	397	597	585	709	503
Closing cash	597	585	709	503	250
Change in cash	200	(11)	123	(206)	(253)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Key ratios

Y/E March	FY10	FY11	FY12	FY13E	FY14E
Per share (Rs)					
EPS	1.8	5.6	10.1	10.0	11.9
Book value	55.3	66.6	78.7	87.5	98.3
Valuation (x)					
P/E	42.9	14.1	7.8	7.9	6.6
P/sales	0.6	0.5	0.4	0.4	0.3
P/BV	1.4	1.2	1.0	0.9	0.8
EV/EBITDA	9.6	7.7	6.7	5.8	5.1
EV/sales	1.2	1.0	0.8	0.8	0.7
Return ratios (%)					
RoIC	7.7	9.2	9.6	10.9	11.4
RoCE	9.2	10.4	12.2	12.6	12.4
RoE	3.7	9.5	14.0	12.0	12.8
Margins (%)					
EBITDA margin	12.6	13.0	12.2	13.1	13.0
PBIT margin	7.3	8.7	9.0	9.6	9.7
PBT margin	1.4	4.3	10.1	5.4	5.9
PAT margin	1.3	3.5	5.3	5.0	5.2
Turnover ratio					
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
Solvency ratios (x)					
Debt-equity	1.7	1.3	1.0	0.9	0.8
Interest coverage	1.0	1.5	1.4	1.7	2.1
Debt/EBITDA	5.4	4.2	3.5	3.0	2.6
Growth (%)					
Sales	18.8	25.2	20.6	4.8	14.0
EBITDA	37.5	29.2	13.7	12.6	13.1
PAT	(134.1)	228.2	83.8	(1.5)	19.4

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
28 September 2012	Buy	79	92

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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