

# Arvind

27 July 2012

Reuters: ARVN.BO; Bloomberg: ARVND IN

## Rebound In Textile Margins

Following the workers' strike and weak performance of Brands & Retail (B&R) division, EBITDA/net profit for 1QFY13 fell 21.6%/45.1% to Rs1.3bn/Rs0.3bn, 6.7%/32.5% below our estimates, respectively. The strike caused revenue/EBITDA/PAT loss of ~Rs950mn/Rs350mn/Rs330mn, adjusted for which revenue/PAT were ~3.4%/8.9% up YoY and 3.2%/36.1% up from our estimates. Operating margin of textile division bounced back to 16.8% (adjusted for strike) from 13.4% in 4QFY12. Due to weak performance of B&R division and the strike, we trim our EBITDA/PAT estimates by 5.5%/14.8% for FY13E and by 6.4%/13.4% for FY14E, respectively. We retain Buy on Arvind with a revised TP of Rs97 (from Rs117), valuing it at 9.0x/6.1x/1.1x PE, EV/EBITDA, P/B, respectively, on FY13E.

**Textile margins return to normal levels:** Due to inventory write-down, the margin fell to 13.4% in 4QFY12 from 18.0% in 3QFY12. Following lower raw material prices, operating margin of textile division bounced back to 16.8% (adjusted for strike) in 1QFY13. As Arvind lost EBITDA of ~Rs350mn due to the strike, reported EBITDA margin stood at 14.75% for textile division. Arvind carried high-cost inventory in the B&R division and in addition, Megamart (ARL) posted a 1% fall in revenue following which operating margin of B&R division was subdued at 1.1% in 1QFY13 from 6.6% in 1QFY12. The management claims the B&R division is out of the high-cost inventory grip and operating margin should improve to 5% in 2QFY13 from 1.1% in 1QFY13.

**Strong 2HFY12 to drive stock valuation:** 1QFY13 was impacted adversely on account of the strike. We expect profitability to improve on sequential basis in the remaining three quarters of FY13. With the benefit of low-cost cotton prices, operating margin of the B&R division should bounce back to 6.0% in 2HFY13 from 1.2%/1.1% in 4QFY12/1QFY13, respectively. As capacity utilisation at its denim plant has improved after the strike was called off, the margins of the textile division would improve. In addition, Arvind is exploring the opportunity to source raw denim from Bangladesh and process it at its Indian plant. As per the management, it would increase denim capacity by 6-7% in a span of six months. Following gradual improvement in revenue and profitability in 2HFY13 we expect a re-rating of its valuation.

**Valuation:** Following weak performance in 4QFY12/1QFY13 on account of inventory write-off and workers' strike, Arvind trades attractively at 6.4x/4.7x FY13/FY14E P/E and 5.1/4.1x EV/EBITDA, below the mean of 8.1x/6.5x, respectively. Revenue CAGR of 8.3% aided by 120bps higher operating margin, working capital efficiency and debt reduction by 16.8% should lead to a profit CAGR of 24.6%, generate free cash flow of Rs3.3bn, improve RoIC by 202bps over FY12-14E and calls for valuation expansion.

## BUY

Sector: Retail

CMP: Rs69

Target Price: Rs97

Upside: 40%

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### Key Data

Current Shares O/S (mn)	258.0
Mkt Cap (Rsbn/US\$m)	17.9/322.6
52 Wk H / L (Rs)	111/62
Daily Vol. (3M NSE Avg.)	2,493,995

### Price Performance (%)

	1 M	6 M	1 Yr
Arvind	(3.9)	(26.1)	(20.6)
Nifty Index	(0.8)	(2.0)	(8.1)

Source: Bloomberg

Y/E March (Rsmn)	1QFY12	4QFY12	1QFY13	Chg (YoY)%	Chg (QoQ)%	FY11	FY12	Chg (%)
Net sales	12,109	12,781	11,566	(4.5)	(9.5)	40,846	49,357	20.8
Net raw material & purchase of finished goods	5,808	6,198	5,039	(13.2)	(18.7)	18,925	23,566	24.5
% of sales	48.0	48.5	43.6	-	-	46.3	47.7	-
Employee costs	1,070	1,163	1,271	18.8	9.3	3,953	4,515	14.2
% of sales	8.8	9.1	11.0	-	-	9.7	9.1	-
Other expenses	3,583	4,108	3,965	10.7	(3.5)	12,729	15,087	18.5
% of sales	29.6	32.1	34.3	-	-	31.2	30.6	-
Operating profit	1,648	1,312	1,291	(21.6)	(1.6)	5,240	6,190	18.1
OPM (%)	13.6	10.3	11.2	-	-	12.8	12.5	-
Interest costs	778	664	745	(4.2)	12.2	2,305	3,300	43.2
Depreciation	411	410	447	8.9	9.0	1,725	1,614	(6.4)
Other income	138	415	217	56.8	(47.7)	548	1,190	117.3
Extraordinary income	19	-	-	(100.0)	-	-	2,487	-
PBT	617	653	316	(48.7)	(51.6)	1,758	4,953	181.8
Provision for tax	1	(13)	(7)	(1,420.0)	(48.4)	106	594	463.1
Effective tax rate	0.1	(2.0)	(2.1)	-	-	6.0	12.0	-
Reported PAT	611	667	325	(46.8)	(51.3)	1,647	4,359	164.6
Adjusted PAT	592	667	325	(45.1)	(51.3)	1,534	2,447	59.6
NPM (%)	4.9	5.2	2.8	-	-	3.8	5.0	-
EPS (Rs)	2.3	2.6	1.3	(45.9)	(51.9)	6.0	9.6	59.4

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

## Exhibit 1: Financial summary

Y/E Mar (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	32,612	40,897	49,357	51,218	57,855
YoY (%)	18.8	25.4	20.7	3.8	13.0
EBITDA	4,099	5,562	6,190	6,832	7,950
EBITDA margin (%)	12.6	13.6	12.5	13.3	13.7
Reported PAT	500	1,649	4,359	2,785	3,799
Adj PAT	433	1,420	2,447	2,785	3,799
EPS (Rs)	1.8	5.6	9.5	10.8	14.7
YoY (%)	-	204.7	69.8	13.8	36.4
RoE (%)	3.7	9.5	13.1	12.7	15.0
RoCE (%)	9.2	11.5	13.1	13.0	13.2
RoIC (%)	7.7	10.3	10.5	11.4	12.5
P/E (x)	37.8	12.4	7.3	6.4	4.7
P/BV (x)	1.3	1.0	0.9	0.8	0.7
EV/ EBITDA (x)	9.0	6.5	6.0	5.1	4.1

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Segmental performance

Y/E Mar (Rsmn)	1QFY12	4QFY12	1QFY13	YoY (%)	QoQ (%)	FY11	FY12	YoY (%)
<b>Sales</b>								
Textiles	9,159	8,810	8,360	(8.7)	(5.1)	30,337	34,363	13.3
Branded garments	2,664	3,015	2,700	1.4	(10.4)	9,001	13,174	46.4
Others	380	1,075	580	52.6	(46.0)	2,398	2,124	(11.4)
<b>EBIT (%)</b>								
Textile	16.1	14.0	12.5	(363)bps	(150)bps	12.5	16.0	353bps
Branded garments	4.1	(0.4)	(0.9)	(502)bps	(53)bps	6.3	3.8	(249)bps
Others	(0.2)	12.5	7.2	735bps	(535)bps	6.8	8.5	169bps
<b>RoCE (%)</b>								
Textile	22.3	19.0	15.5	(680)bps	(353)bps	15.4	21.2	578bps
Branded garments	7.5	(0.8)	(1.5)	(904)bps	(71)bps	11.0	8.9	(215)bps
Others	(0.1)	23.0	6.4	650bps	(1,667)bps	12.3	7.7	(457)bps
<b>Total</b>	<b>14.9</b>	<b>13.0</b>	<b>10.3</b>	<b>(463)bps</b>	<b>(271)bps</b>	<b>11.5</b>	<b>14.8</b>	<b>336bps</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Textile segment

Arvind reported buoyant performance of its textile division if the impact of workers' strike is not taken into account. Woven, garment and voiles reported revenue growth of 11.0%, 8.5% and 17.5%, respectively, in 1QFY13. Following the strike, the company lost 4.3mn metres of denim production and as a result, denim volume/revenue were down 12.3%/21.2% YoY. Reported textile revenue was lower by 3.8% to Rs8,510mn in 1QFY13. Adjusting for a loss of Rs950mn due to the strike, adjusted revenue of Rs9,470mn was up 7%. Operating margin of the textile division bounced back to 14.8% (adjusted for the strike, it stands at 16.8%) following lower cost of raw materials in 1QFY13.

## Exhibit 3: Textile revenue and volume break-up

Y/E Mar (Rsmn)	1QFY12	4QFY12	1QFY13	YoY (%)	QoQ (%)	FY11	FY12	YoY (%)
<b>Textile revenue</b>								
Denim	4,490	3,760	3,540	(21.2)	(5.9)	13,590	16,020	17.9
Woven	2,810	2,570	3,120	11.0	21.4	9,870	10,990	11.3
Garments	1,170	1,120	1,270	8.5	13.4	4,580	4,600	0.4
Voiles	570	550	670	17.5	21.8	2,110	2,280	8.1
Knits	430	380	370	(14.0)	(2.6)	1,090	1,490	36.7
Gross total	9,470	8,380	8,970	(5.3)	7.0	31,240	35,380	13.3
Less inter segment	620	140	460	(25.8)	228.6	1,880	1,580	(16.0)
<b>Net textile revenue</b>	<b>8,850</b>	<b>8,240</b>	<b>8,510</b>	<b>(3.8)</b>	<b>3.3</b>	<b>29,360</b>	<b>33,800</b>	<b>15.1</b>
<b>EBITDA (%)</b>	<b>17.6</b>	<b>13.4</b>	<b>14.8</b>	<b>(285)</b>	<b>135.0</b>	<b>15.5</b>	<b>16.4</b>	<b>90</b>
<b>Volume (mn mtr)</b>								
Denim	23.6	25.3	20.7	(12.3)	(18.2)	96.4	95.9	(0.5)
Woven	15.7	18.3	18.7	19.1	2.2	68.0	67.7	(0.4)

Note: 4QFY12 numbers are derived from audited annual figures and hence may not be accurate

Source: Company, Nirmal Bang Institutional Equities Research

## Brands and retail businesses

Arvind slowed down its expansion plan for ALBL (Arvind Lifestyle Brand) and ARL (Arvind Retail), which is visible from the fact that retail area increased 5%/2.4% QoQ to 0.347/0.708mn sq ft, respectively, in 1QFY13. Following like-to-like growth of 4% ALBL reported a 20% growth in revenue to Rs1,360mn. However, ARL reported a decline in sales by 1% to Rs1,100mn following a 6% decline in like-to-like growth. The B&R division witnessed 13.6%/3.2% YoY/QoQ increase in retail area, which resulted in revenue growth of 9% even after reporting a 2% decline in volume. As the company carried high-cost inventory in 4QFY12/1QFY13 and like-to-like growth reduced to 4%/(6%) for ALBL/ARL in 1QFY13 from a robust 14%/6%, respectively, in 1QFY12, its operating margin declined to 1.1% in 1QFY13 from 6.6% in 1QFY12.

### Exhibit 4: Retail area and revenue details

Y/E Mar (Rsmn)	1QFY12	4QFY12	1QFY13	YoY (%)	QoQ (%)	FY11	FY12	YoY (%)
<b>Retail revenue</b>								
ALBL	1,133	2,577	1,360	20.0	(47.2)	4,160	6,580	58.2
ARL	1,111	699	1,100	(1.0)	57.4	3,970	5,140	29.5
<b>Total retail revenue</b>	<b>2,250</b>	<b>3,276</b>	<b>2,460</b>	<b>9.3</b>	<b>(24.9)</b>	<b>8,130</b>	<b>11,720</b>	<b>44.2</b>
<b>EBITDA (%)</b>	<b>6.6</b>	<b>1.2</b>	<b>1.1</b>	<b>(550)bps</b>	<b>(10)bps</b>	<b>7.2</b>	<b>5.1</b>	<b>(210)bps</b>
<b>Area ('000 sq ft)</b>								
ALBL	243	331	347	42.9	5.0	215	331	54.0
ARL	687	692	708	3.2	2.4	617	692	12.1
<b>Total</b>	<b>930</b>	<b>1,023</b>	<b>1,056</b>	<b>13.6</b>	<b>3.2</b>	<b>832</b>	<b>1,023</b>	<b>22.9</b>
<b>Like-to-like growth (%)</b>								
ALBL	14.0	-	4.0	-	-	20.0	18.0	-
ARL	6.0	-	(6.0)	-	-	20.0	6.8	-

Note: 4QFY12 numbers are derived from audited annual figures and hence they may not be accurate.

Source: Company, Nirmal Bang Institutional Equities Research

### Our estimates versus actual performance

Following revenue loss of Rs950mn due to the workers' strike, net revenue at Rs11,566mn was 4.7% below our estimate. Lower revenue coupled with lower B&R division's EBITDA margin at 1.1% compared to our estimate of 3.0% led reported operating profit to decline by 6.7% compared to our estimate of Rs1,384mn. Following lower operating profit and higher interest costs, net profit at Rs325mn was 32.5% below our estimate of Rs481mn. However, post adjusting for impact of the strike, net revenue/EBITDA/PAT were 3.2%/18.6%/36.1% higher than our estimates, respectively.

### Exhibit 5: Our estimates versus actuals

Description	1QFY12	4QFY12	1QFY13	YoY (%)	QoQ (%)	1QFY13A*	1QFY13E	Devi. (%)	Devi.* (%)
Revenue	12,109	12,781	11,566	(4.5)	(9.5)	12,516	12,132	(4.7)	3.2
EBITDA	1,648	1,312	1,291	(21.6)	(1.6)	1,641	1,384	(6.7)	18.6
EBITDA (%)	13.6	10.3	11.2	(244)bps	90bps	13.1	11.4	(23)bps	171bps
Adjusted PAT	592	667	325	(45.1)	(51.3)	655	481	(32.5)	36.1

Note: \* Adjusted for impact of the strike; Source: Company, Nirmal Bang Institutional Equities Research

### Change in our estimates

On account of the strike, Arvind lost revenue/EBITDA/PAT to the extent of Rs950mn/350mn/Rs330mn, respectively, in 1QFY13. In addition, its B&R division's growth slowed down to 9% in 1QFY13 compared to 44.2% in FY12. Arvind pruned the expansion plan of its B&R division and it would now add only 0.1mn sq ft area in FY13 compared to the earlier plan of 0.3-0.5mn sq ft. We have tweaked our revenue estimates by 0.9%/(0.3%) for FY13E/FY14E, respectively. Following lower margin of the B&R division and lower profits due to the strike, we have trimmed our operating margin estimates by 90bps each for FY13E/FY14E to 13.3%/13.7%, respectively. We have cut our EBITDA estimates by 5.5%/6.4% for FY13E/FY14E to Rs6,832mn/Rs7,950mn, respectively. Following high interest costs, we have trimmed net profits by 14.8%/13.4% to Rs2,785mn/Rs3,799mn for FY13E/FY14E, respectively.

Y/E Mar (Rsmn)	Earlier assumptions		New assumptions		Change (%)	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Sales	50,768	58,027	51,218	57,855	0.9	(0.3)
EBITDA	7,230	8,498	6,832	7,950	(5.5)	(6.4)
EBITDA (%)	14.2	14.6	13.3	13.7	(90)bps	(90)bps
APAT	3,267	4,389	2,785	3,799	(14.8)	(13.4)

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

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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