

## ARVIND

MIDCAPS

17 MAY 2017

Quarterly Update

**HOLD**

Target Price: Rs 419

### Brands story continues, but Textiles hit

Arvind's Brands& Retail division's strong performance in Q4 (22% YoY rev growth; EBITDA margin doubled to 7%) was offset by muted performance by the Textile division (EBITDA margin declined 260 bps). FY17 EBITDA (flat YoY at Rs 9.4 bn) was impacted due to higher investments in online business.

**Outlook:** Management believes ~25% revenue CAGR for Brands& Retail division is possible with ~150 bps yearly improvement in margin as brands mature. However, margin in the textile division will continue to be impacted due to (1) adverse currency movement; (2) input costs pressure; and (3) change in product mix.

**HOLD with TP of Rs 419:** Our SoTP-based TP is based on (1) 7x FY19E EBITDA multiple for Textiles and (2) Rs 67 bn for 90% stake in Brands & Retail (based on deal valuation of Rs 74 bn; implies 20x FY19E EBITDA).

CMP : Rs 408  
Potential Upside : 3%

#### MARKET DATA

No. of Shares : 259 mn  
Free Float : 57%  
Market Cap : Rs 105 bn  
52-week High / Low : Rs 427 / Rs 283  
Avg. Daily vol. (6mth) : 1.8 mn shares  
Bloomberg Code : ARVND IB Equity  
Promoters Holding : 43%  
FII / DII : 24% / 15%

### Segmental highlights

- ♦ **Arvind Brands&Retail (32% of revenue):** Despite the continued effects of demonetization, the division's revenue grew 22% in Q4 to Rs 8.3 bn due to 29% growth in Unlimited (its retail format). Power brands' revenue grew 21% YoY to Rs 5.2 bn, while EBITDA margin increased 280 bps to ~13%. The division achieved like to like growth of 9.5% in Q4. With the repositioning of Unlimited and brands business consolidating, we expect yearly improvement of 150 bps in margin (5% in FY17). FY18 capex towards developing brands is expected at Rs 1.8 bn.

**Brands business agenda:** (1) consolidate existing business by channel expansion and enhance operational efficiencies; (2) new brand sign ups only with high growth potential; and (3) powerful omni channel digital play.

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### Financial summary (Consolidated)

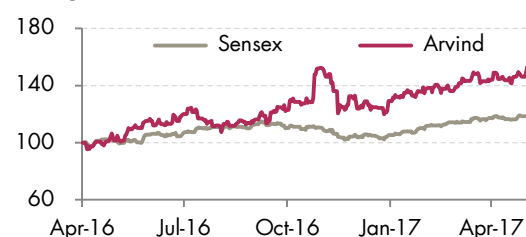
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	80,106	92,355	99,271	111,152
Adj PAT (Rs mn)	3,148	3,381	3,247	4,767
Con. EPS* (Rs)	-	-	19.4	26.6
EPS (Rs)	12.2	13.1	12.6	18.5
Change YOY (%)	(19.0)	7.4	(3.8)	46.8
P/E (x)	33.4	31.1	32.4	22.1
RoE (%)	11.7	10.9	8.8	12.0
RoCE (%)	12.6	11.2	11.8	14.0
EV/E (x)	14.6	14.0	12.4	10.4
DPS (Rs)	2.5	2.4	3.0	4.0

Source: \*Consensus broker estimates, Company, Axis Capital

### Key drivers

EBITDA (Rs bn)	FY17	FY18E	FY19E
Textile	9.0	9.4	10.0
Brands & Retail	1.4	2.0	3.1

### Price performance



**Exhibit 1: Results update**

(Rs. mn)	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	FY18E	FY17	% Chg
<b>Net sales</b>	<b>24,648</b>	<b>22,328</b>	<b>10</b>	<b>23,355</b>	<b>6</b>	<b>92,355</b>	<b>99,271</b>	<b>(7)</b>
EBIDTA	2,306	2,566	(10)	2,359	(2)	9,434	10,696	(12)
Other income	284	190	49	109	160	780	500	56
<b>PBIDT</b>	<b>2,590</b>	<b>2,756</b>	<b>(6)</b>	<b>2,469</b>	<b>5</b>	<b>10,214</b>	<b>11,196</b>	<b>(9)</b>
Depreciation	827	629	31	734	13	2,971	3,352	(11)
Interest	585	900	(35)	676	(13)	2,884	2,992	(4)
<b>PBT</b>	<b>1,178</b>	<b>1,227</b>	<b>(4)</b>	<b>1,059</b>	<b>11</b>	<b>4,359</b>	<b>4,853</b>	<b>(10)</b>
Tax	131	267	(51)	280	(53)	997	1,456	(32)
Share from Associate	11	18	-	(20)	-	13	35	-
<b>Adjusted PAT</b>	<b>1,058</b>	<b>979</b>	<b>8</b>	<b>759</b>	<b>39</b>	<b>3,362</b>	<b>3,397</b>	<b>(1)</b>
Extra ordinary income/ (exp.)	(89)	0	-	(27)	-	(181)	0	-
<b>Reported PAT</b>	<b>969</b>	<b>979</b>	<b>(1)</b>	<b>732</b>	<b>32</b>	<b>3,181</b>	<b>3,397</b>	<b>(6)</b>
No. of shares (mn)	258	258	-	258	-	258	258	-
EBIDTA margin (%)	9.4	11.5	-	10.1	-	10.2	10.8	-
PBIDT margin (%)	10.5	12.3	-	10.6	-	11.1	11.3	-
<b>EPS - annualized (Rs.)</b>	<b>16.4</b>	<b>15.2</b>	<b>8</b>	<b>11.8</b>	<b>39</b>	<b>13.0</b>	<b>13.2</b>	<b>(1)</b>

Source: Company, Axis Capital

*(...continued from page 1)*

While GST could be beneficial to organized players like Arvind, uncertainty regarding GST rates, provisions and drawback rates could pose a challenge in the near term.

Over the next couple of years, the management expects to generate cash flow from the brands division sufficient enough to fund its own growth.

- ♦ **Textiles division (64% of revenue):** In Q4, revenue increased 9% YoY to Rs 15bn. Revenue from garments increased 28% YoY to Rs 1.1 bn. The garment manufacturing plant in Ethiopia has been commissioned and expected to reach optimal production by October. The company is in the process of setting up another facility which is expected to be commissioned in Q3FY18. Revenue from wovens increased 10% YoY while that from denim segment declined 1% YoY. In FY17, volume in woven segment increased 9% YoY to 127 mn meters while denim volume increased 11% YoY to 104 mn meters. Garment segment has seen a ramp-up in utilization and margin is slated to improve as volumes ramp up. With strong collaborations, management expects revenue of Rs 10 bn by FY19 from technical textile. We expect ~7% revenue CAGR for textiles segment over FY17-19 with margin declining 50 bps due to higher RM cost and currency appreciation.

We believe Arvind will be ~20% vertically integrated (fabric to garments) over the next few years vs. ~6% currently. Fabric is a capital-intensive and low-margin commodity business. Garments have better pricing, higher margin and sticky customer base. Lower capital intensity in garmenting will lead to higher RoCE. Arvind is investing only in capital-efficient parts of the fabrics value chain by setting up processing capacities and not in spinning and weaving. In FY18, management envisages capex of Rs 1 bn towards garment manufacturing facility in Ethiopia and Rs 2 bn towards textile and garmenting facilities in India.

**Exhibit 2: SoTP**

SoTP based valuation	FY19E EBITDA (Rs mn)	Multiple (x)	FY19E value (Rs mn)
Textiles	10,073	7	70,512
90% stake in Arvind Brands and Retail (implies 20x FY19 EBITDA)			66,600
			<b>137,112</b>
Less: Net debt			28,798
Total value			108,314
<b>Value/ share (Rs)</b>			<b>419</b>

Source: Axis Capital

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	80,106	92,355	99,271	111,152
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>80,106</b>	<b>92,355</b>	<b>99,271</b>	<b>111,152</b>
Cost of goods sold	(46,628)	(56,307)	(55,095)	(61,689)
Gross profit	33,478	36,049	44,176	49,463
<i>Gross margin (%)</i>	<i>41.8</i>	<i>39.0</i>	<i>44.5</i>	<i>44.5</i>
Total operating expenses	(23,967)	(26,615)	(33,479)	(36,697)
<b>EBITDA</b>	<b>9,511</b>	<b>9,434</b>	<b>10,696</b>	<b>12,766</b>
<i>EBITDA margin (%)</i>	<i>11.9</i>	<i>10.2</i>	<i>10.8</i>	<i>11.5</i>
Depreciation	(2,405)	(2,971)	(3,352)	(3,602)
<b>EBIT</b>	<b>7,106</b>	<b>6,463</b>	<b>7,345</b>	<b>9,164</b>
Net interest	(3,586)	(2,884)	(2,992)	(2,569)
Other income	821	780	500	500
<b>Profit before tax</b>	<b>4,340</b>	<b>4,359</b>	<b>4,853</b>	<b>7,095</b>
Total taxation	(1,246)	(997)	(1,456)	(2,129)
<i>Tax rate (%)</i>	<i>28.7</i>	<i>22.9</i>	<i>30.0</i>	<i>30.0</i>
Profit after tax	3,094	3,362	3,397	4,967
Minorities	-	-	-	-
Profit/ Loss associate co(s)	54	19	(150)	(200)
Adjusted net profit	3,148	3,381	3,247	4,767
<i>Adj. PAT margin (%)</i>	<i>3.9</i>	<i>3.7</i>	<i>3.3</i>	<i>4.3</i>
Net non-recurring items	14	(181)	-	-
Reported net profit	3,161	3,201	3,247	4,767

### Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	2,582	2,584	2,580	2,580
Reserves & surplus	23,882	33,098	35,439	38,998
Net worth	26,464	35,682	38,020	41,579
Borrowing	38,190	29,660	30,190	30,190
Other non-current liabilities	(1,240)	(1,440)	(1,440)	(1,440)
<b>Total liabilities</b>	<b>63,970</b>	<b>65,415</b>	<b>67,269</b>	<b>70,828</b>
Gross fixed assets	57,031	62,031	67,031	72,031
Less: Depreciation	(22,435)	(25,406)	(28,758)	(32,359)
Net fixed assets	34,595	36,625	38,273	39,671
Add: Capital WIP	1,468	958	-	-
Total fixed assets	36,063	37,583	38,273	39,671
Total Investment	4,238	2,767	1,293	1,293
Inventory	19,205	23,828	29,197	32,788
Debtors	7,682	8,139	9,025	10,105
Cash & bank	609	539	1,392	1,040
Loans & advances	3,282	1,646	1,985	2,223
Current liabilities	16,035	19,032	24,395	27,294
Net current assets	20,687	21,833	24,388	26,548
Other non-current assets	2,981	3,233	3,315	3,315
<b>Total assets</b>	<b>63,970</b>	<b>65,415</b>	<b>67,269</b>	<b>70,828</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	4,340	4,359	4,853	7,095
Depreciation & Amortisation	2,405	2,971	3,352	3,602
<i>Chg in working capital</i>	<i>(768)</i>	<i>(449)</i>	<i>(1,232)</i>	<i>(2,010)</i>
<b>Cash flow from operations</b>	<b>8,992</b>	<b>9,547</b>	<b>9,009</b>	<b>9,627</b>
<i>Capital expenditure</i>	<i>(6,206)</i>	<i>(5,510)</i>	<i>(5,958)</i>	<i>(5,000)</i>
<b>Cash flow from investing</b>	<b>(4,977)</b>	<b>(7,354)</b>	<b>(7,800)</b>	<b>(8,315)</b>
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>1</i>	<i>(3)</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>1,494</i>	<i>(8,530)</i>	<i>530</i>	<i>-</i>
<i>Dividend paid</i>	<i>(784)</i>	<i>(586)</i>	<i>(774)</i>	<i>(1,032)</i>
<b>Cash flow from financing</b>	<b>(3,091)</b>	<b>(12,180)</b>	<b>(3,239)</b>	<b>(3,601)</b>
Net chg in cash	925	(9,986)	(2,030)	(2,289)

### Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
<b>OPERATIONAL</b>				
FDEPS (Rs)	12.2	13.1	12.6	18.5
CEPS (Rs)	21.6	23.9	25.6	32.4
DPS (Rs)	2.5	2.4	3.0	4.0
Dividend payout ratio (%)	20.5	18.3	23.8	21.7
<b>GROWTH</b>				
Net sales (%)	2.0	15.3	7.5	12.0
EBITDA (%)	(6.1)	(0.8)	13.4	19.3
Adj net profit (%)	(19.0)	7.4	(4.0)	46.8
FDEPS (%)	(19.0)	7.4	(3.8)	46.8
<b>PERFORMANCE</b>				
RoE (%)	11.7	10.9	8.8	12.0
RoCE (%)	12.6	11.2	11.8	14.0
<b>EFFICIENCY</b>				
Asset turnover (x)	1.3	1.5	1.5	1.6
Sales/ total assets (x)	1.0	1.1	1.1	1.2
Working capital/ sales (x)	0.3	0.2	0.2	0.2
Receivable days	35.0	32.2	33.2	33.2
Inventory days	99.3	104.9	120.3	121.6
Payable days	69.8	68.3	73.5	76.1
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	1.4	0.9	0.8	0.7
Net debt/ equity (x)	1.2	0.8	0.7	0.7
Current ratio (x)	2.3	2.1	2.0	2.0
Interest cover (x)	2.0	2.2	2.5	3.6
<b>VALUATION</b>				
PE (x)	33.4	31.1	32.4	22.1
EV/ EBITDA (x)	14.6	14.0	12.4	10.4
EV/ Net sales (x)	1.7	1.4	1.3	1.2
PB (x)	4.0	3.0	2.8	2.5
Dividend yield (%)	0.6	0.6	0.7	1.0
Free cash flow yield (%)	2.6	3.8	2.9	4.4

Source: Company, Axis Capital

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