Company Update

ARVIND LTD

PRICE RS.101 TARGET RS.130 BUY

Stock Details

Market cap (Rs mn)	:	26056
52-wk Hi/Lo (Rs)	:	169 / 90
Face Value (Rs)	:	10
3M Avg. daily vol (nos)	:	5,216,686
Shares o/s (mn)	:	259

Source: Bloomberg

Financial Summary – Consolidated*

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	108261	123758	141752
Growth (%)	17.2	14.3	14.5
EBITDA	9650	11937	15344
EBITDA margin (%)	8.9	9.6	10.8
PAT	3158	4316	6141
EPS	12.2	16.7	23.7
EPS Growth (%)	(1)	37	42
Book value (Rs/share)	158	172	193
Dividend per share (Rs)	2.4	2.4	2.4
ROCE (%)	8.8	10.7	13.8
ROE (%)	8.1	10.1	13.0
P/E (x)	8.4	6.1	4.3
EV/EBITDA (x)	5.9	4.8	3.8
P/BV (x)	0.6	0.6	0.5

*Source: Company, Kotak Securities – PCG; *Pre-demerger*

Shareholding Pattern (%)

(%)	Sep-18	Jun-18	Mar-18
Promoters	43.0	42.9	42.9
FII	21.6	27.1	27.1
DII	16.7	13.8	14.1
Others	18.7	13.8	15.9

Source: Company

Price Performance (%)

(%)	1M	3M	6M
Arvind Ltd	(12.8)	(25.4)	(24.8)
Nifty	3.0	(5.6)	2.3

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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Arvind has demerged its branded apparel & retail business and engineering business into separate companies Arvind Fashions Ltd (AFL) and Anup Engineering Ltd (AEL), respectively. This would create three separately listed companies focusing on different businesses which will increase focus on individual businesses. The company management is positive on the long term fundamental of all the entities. As per company PPT, AFL and AEL are expected to be listed on exchanges tentatively in early February 2019.

- Post demerger, Arvind will be present in two main businesses; textiles ~87% of FY18 revenue and advance materials ~7% of FY18 revenue, while balance ~6% of FY18 revenue was contributed by other smaller businesses. The textiles business involves manufacturing of wide variety of fabrics including, woven, knitted, denim, garments, etc. Under advance materials, it caters to high growth sectors such as infrastructure, healthcare, energy, aviation, industrial, etc.
- Arvind has adopted verticalization strategy in textiles business in order to move up in the value chain by increasing focus on garmenting business. It intends to invest ~Rs 15 bn in order to expand capacity in textiles and advance material businesses in the next three years.
- The company has reported strong performance in advance material in H1FY19 and is targeting a revenue growth rate of 24% yoy in FY19E with 9% operating margins.
- Arvind has maintained revenue guidance of ~10% on broader basis with slower growth rate of 5-6% in textiles business and 24% growth rate in advance materials in FY19E. The company has guided for 100bps improvement in EBITDA margin in the year.

Outlook & Valuation

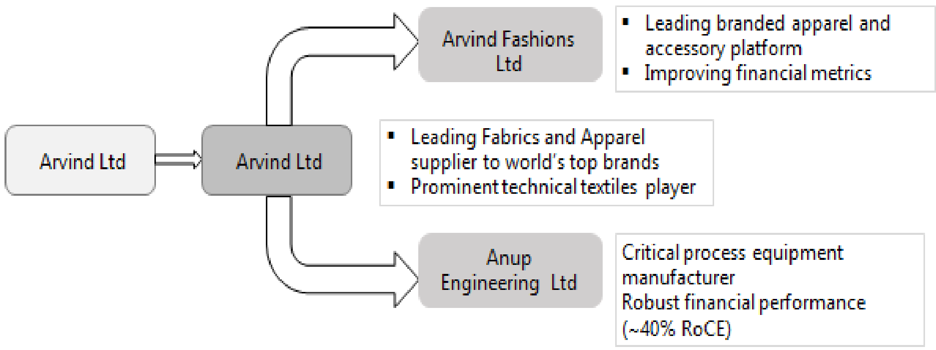
In the recent times, textiles sector witnessed challenges related to currency volatility, increased raw material cost due to elevated cotton prices and reduced government incentives. We have factored these challenges in our estimates and valuations. Based on this, we have assigned EV/EBITDA multiple of 6.5x (vs 8x earlier) which is marginally premium to industry average and arrive at a target price of Rs 130 for Arvind (Vs Rs 452 pre-demerger). At CMP, Arvind is trading at FY19E and FY20E EV/EBITDA (post demerger basis) of 6.6x and 5.7x respectively. We maintain buy rating on Arvind post demerger.

Demerger to increase focus on each business separately

Arvind has demerged its branded apparel and engineering business into separate companies and these entities are expected to be listed on exchanges tentatively in early February 2019. The branded apparel business has been demerged into AFL and engineering business has been demerged into AEL. The demerger would create three separately listed companies focusing on different businesses which will lead to increase in focus of individual businesses. As per scheme of arrangement, shareholders of Arvind Limited will be entitled for 1 equity shares of Arvind Fashions Limited (Face value Rs 4) for every 5 shares held by them. Further, Arvind shareholder will also get 1 equity shares of Anup Engineering Limited for 27 shares held by them. The record date for demerger of branded apparel business (AFL) and engineering business (AEL) was 29th November 2018. Due to the demerger, Arvind is trading at new adjusted price

(Adjusted for value of AFL and AEL) which is ~30% of the pre-demerger valuation.

Transaction detail

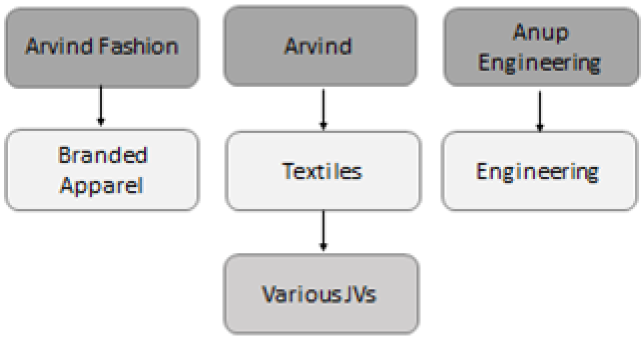


Source: Company

Arvind: Post demerger

Post demerger, Arvind will be present in two main businesses textiles and advance material. The textiles business involves manufacturing of wide variety of fabrics including, woven, knitted, denim etc. It is also manufacturing garment with large focus on exports. Under advance materials, it caters to high growth sectors such as infrastructure, healthcare, energy, aviation, industrial, etc. ~87% of Arvind's FY18 revenue is contributed by textiles business, ~7% by advance materials and balance ~6% is contributed by others which includes supply of water and waste water treatment plants for Industrial Process, environmental solutions, etc.

Structure post demerger



Source: Company

Expansion in garmenting based on verticalization strategy

The company has adopted verticalization strategy in order to move up in the value chain by increasing focus on garmenting business. Over the next five years, Arvind aims to convert ~50% of its fabrics into garments from ~10% in FY18. In order to increase garmenting, the company is increasing its garment capacity by 3x to 90 mn pcs per annum in the next three years. The company is expanding garment manufacturing business by setting up units in states like Jharkhand, AP and Gujarat where government is giving labour subsidy (upto 50% labour cost for initial 5 years) to encourage employment. This will save cost for the company particularly in the initial phase of expansion. It has also setup garmenting unit in Ethiopia where the labour cost is 50% lower and enjoys zero duty for exports to the US and Europe and helps in competing against Bangladesh and Sri Lanka. The company intends to invest ~Rs 15 bn in order to expand capacity in textiles and advance material businesses in the next three years. This includes Rs 8 bn investment for expanding garment facilities (Rs 7 bn in India and Rs 1 bn in Ethiopia) ~Rs 2 bn in advance materials, ~Rs 1-1.5 in activewear, ~Rs 1 bn in specialized garment, etc.

Growth opportunity in advance materials business

The company has reported strong performance in advance material in H1FY19 which was earlier part of textiles and others segment. The segment is expected to grow at faster pace in the longer run and has potential to achieve Rs 15 bn revenue from Rs 4.8 bn in FY18. The company is catering to various segments under this division. This includes human protection products (such as firefighting jackets, bullet proof jackets, etc), composite products for industries (such as railway coaches, automobile industry), belting for industries, etc.

Maintained 10% revenue growth guidance for Arvind

The company has maintained revenue guidance of ~10% on broader basis for Arvind Ltd (textiles, advance materials and others). In textiles business, it targets slower growth rate of 5-6% due to slowdown in denim sales and also reduced growth estimates of 20% in garmenting in FY19E as against earlier target of 35% yoy growth due to some delay in commissioning of new facilities. On the other hand, Advance materials segment is expected to grow at a strong pace of 24% on yoy. The company has maintained 100bps improvement in EBITDA margins led by sharp improvement in advance material segment margin (from -1% in FY18 to 9% in FY19E), while textiles margins is expected to be lower by 80bps.

Branded apparel through AFL to pick up pace

AFL has a portfolio of 15 international licensed brands and 12 in-house brands targeting different segments. The business is managed by qualified and experienced professionals who have vast experience in consumer and fashion industry. The rise in scale of operation of these brands resulted in increased contribution to the bottomline. The company is targeting for EBITDA positive in FY19E for most of its brands except a few (like GAP), where the losses have reduced to a larger extent. In addition, its power brands like Arrow, US Polo and Flying Machine which commands higher margins would maintain its pace in terms of growth. The company targets to improve margins in power brand to ~15% by FY21/FY22 from present ~13% (in Q2FY19). The company is positive on improving margins in branded apparel business based on increased scale of emerging brands and retail business resulting in operating leverage and improved profitability in power brands.

Targets 20% growth in AFL in FY19E

The company has guided for ~20% growth in AFL (branded apparel business) driven by Power Brands to maintain momentum, improved sales in Unlimited and traction in Innerwear business on full year basis. The company expects 100 bps improvement in margins in the business despite increase in marketing investment by about 0.5%.

AEL to achieve high growth in the longer run

Anup Engineering (engineering business) has built up capability to manufacture critical process equipment and caters to marquee clientele. The segment has grown at a CAGR of 25% in FY13-18 with high margins of 30% and RoCE of ~40%. It has net cash balance sheet and has been generating healthy cash flows. The company is also looking at global opportunity in the business and has a vision to achieve Rs 10 bn revenue in the next 5-6 years. In FY19E revenue growth guidance for AEL is maintained at 10-12% with flattish margins.

Outlook and valuation

In the recent times, textiles sector witnessed challenges related to currency volatility, increased raw material cost due to elevated cotton prices and reduced government incentives. Arvind is also facing elevated growth related challenges in denim business due to oversupply, aggression in pricing and higher credit terms offered by some of its peers in the domestic market. We have factored these challenges in our estimates and valuations. Presently, we are giving detailed consolidated financial estimates of Arvind (pre-demerger) and giving only key financial estimates of each of the demerged entities.

Based on our previous SoTP valuation, ~40% value (adjusted for debt) was attributed to listed entity Arvind Ltd (which was ~Rs 187 per share) and balance was for demerged businesses. Our valuation for Arvind's textiles business was based on FY20E EV/EBITDA of 8x. Factoring in recent challenges related to the textiles business, we have assigned EV/EBITDA multiple of 6.5x which is premium to industry average (due to presence in high growth advance material business) and arrive at a target price of Rs 130 for Arvind (Vs Rs 452 pre-demerger).

We have valued AFL (branded apparel & retail business) at 17x FY20E EV/EBITDA (Vs 15x earlier), which is discount to industry average valuation of brand and retail players. We have valued AEL (engineering business) at 10x FY20E EV/EBITDA (Vs 12x earlier) factoring in near term risk related to growth. Post demerger, share capital of AFL will be 57.7 mn shares of face value Rs 4 and for AEL will be 10.21 mn of face value Rs 10. Based on this, the one year target price for AFL and AEL would be Rs 1154 and Rs 666 respectively post listing. At CMP, Arvind is trading at FY19E and FY20E EV/EBITDA (post demerger basis) of 6.6x and 5.7x respectively. We maintain buy rating on Arvind post demerger.

Revision in estimates of Arvind

	Revised		Previous		% Change	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Revenue	124295	142289	125191	143221	-1%	-1%
EBITDA	8050	9288	8151	9396	-1%	-1%
EBITDA Margin%	11.2%	11.6%	11.2%	11.6%	0 bps	0 bps

Source: Kotak Securities - Private Client Research

Change in estimates (based on Arvind pre-demerger)

Particulars	Previous		Revised		% Change	
(Rs Mn)	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Revenue	1,24,654	1,42,684	1,23,758	1,41,752	-0.7	-0.7
EBITDA	12,124	15,528	11,937	15,344	-1.5	-1.2
EBITDA margin (%)	9.7	10.9	9.6	10.8	-5.5	-7.6
PAT	4,459	6,271	4,316	6,141	-3.2	-2.1
EPS (Rs)	17.2	24.2	16.7	23.7	-3.0	-1.9

Source: Kotak Securities - Private Client Research

Key financial estimates (entity wise)

	FY18	FY19E	FY20E
Revenue			
Arvind	68,000	71,879	80,065
AFL	42,660	49,952	59,391
AEL	2,240	2,464	2,834
Revenue Growth (%)			
Arvind	10.4%	5.7%	11.4%
AFL	47.2%	17.1%	18.9%
AEL	25.1%	10.0%	15.0%
EBITDA			
Arvind	7,510	8,050	9,288
AFL	2,290	3,212	4,355
AEL	580	591	680
EBITDA Margin (%)			
Arvind	11.0%	11.2%	11.6%
AFL	5.4%	6.4%	7.3%
AEL	25.9%	24.0%	24.0%
EBITDA Growth (%)			
Arvind	-8.3%	7.2%	15.4%
AFL	57.9%	40.3%	35.6%
AEL	7.4%	2.0%	15.0%

Source: Company, Kotak Securities – Private Client Research

Valuation: Entity wise

Entity	Para Meter	FY20E EBITDA (Rs mn)	Multiple (x)	Enterprise Value (Rs mn)	Borrowings (FY18) (Rs mn)	Equity Value (Rs mn)	Outstanding share (Nos)	Target Price (Rs/share)
Arvind Ltd (listed entity)	EV/EBITDA	9288	6.5	60369	26780	33589	258.6	130
AFL	EV/EBITDA	4355	17	74038	7450	66588	57.7	1154
AEL	EV/EBITDA	680	10	6801	0	6801	10.2	666

Source: Kotak Securities – Private Client Research

Valuation: Brand & Retail players

	PE		EV/EBITDA		EV/Sales	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Adiya Birla Fashion & Retail	79.0	49.7	24.6	19.7	1.9	1.7
Raymond	29.6	22.3	12.9	10.8	0.9	0.8
Future Lifestyle	45.5	33.2	16.2	13.2	1.5	1.2
Trent	45.7	35.9	33.6	27.4	3.6	3.1
KKCL	20.1	18.3	13	12.1	3.1	2.9
Page Industries	64.6	52.8	41.	33.9	9.3	7.8
Bata India	44.9	37.2	27.5	22.7	4.1	3.6
Titan Industries	56.5	45.1	39.9	31.9	4.3	3.6
Average (x)	**48.2**	**36.8**	**26.2**	**21.5**	**3.6**	**3.1**

Source: Bloomberg

Valuation: Textiles players

	PE		EV/EBITDA		EV/Sales	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
KPR Mills	12.7	10.6	7.2	6.3	1.4	1.3
Vardhman Textiles	8.7	7.6	5.2	4.6	0.9	0.8
Himatsinghka Seide	9.8	7.9	8.1	6.7	1.7	1.5
Welspun India	13.4	10.4	7.2	6.0	1.3	1.2
Indo Count Industries	10.9	9.2	7.1	6.1	0.8	0.7
Average (x)	**11.1**	**9.1**	**7.0**	**6.0**	**1.2**	**1.1**

Source: Bloomberg

Financials: Consolidated (on pre-demerger basis)

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	**92,355**	**108,261**	**123,758**	**141,752**
% change yoy	15.3	17.2	14.3	14.5
Raw Materials	42,094	52,738	59,544	68,202
Employees expenses	10,963	12,647	13,912	15,303
Other Expenses	29,893	33,227	38,365	42,904
Total Expenditure	82,950	98,612	111,821	126,409
EBITDA	**9,406**	**9,650**	**11,937**	**15,344**
% change yoy	(1.0)	2.6	23.7	28.5
Depreciation	2,943	3,593	3,995	4,386
EBIT	**6,463**	**6,056**	**7,941**	**10,958**
Other Income	780	626	726	826
Interest	2,884	2,579	2,811	2,811
Profit Before Tax	4,197	3,904	5,657	8,773
% change yoy	(4.8)	(7.0)	44.9	55.1
Tax	997	746	1,341	2,632
as % of EBT	23.7	19.1	23.7	30.0
PAT	**3,201**	**3,158**	**4,316**	**6,141**
% change yoy	1.2	(1.3)	36.7	42.3
Shares outstanding (mn)	258	259	259	259
EPS (Rs)	**12.4**	**12.2**	**16.7**	**23.7**
DPS (Rs)	2.4	2.4	2.4	2.4
CEPS (Rs)	23.8	26.1	32.1	40.7
BVPS (Rs)	143.8	158.1	172.0	192.9

Source: Company, Kotak Securities – Private Client Research

Balance Sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Equity	37,184	40,881	44,471	49,887
Equity Share Capital	2,584	2,586	2,586	2,586
Other Equity	33,086	35,242	38,832	44,248
Liabilities	49,496	61,703	60,872	64,737
Non-current liabilities	10,207	10,655	11,655	11,655
Financial Liabilities	8,016	8,927	9,927	9,927
Provisions	407	618	618	618
Other non-current liabilities	355	402	402	402
Current liabilities	39,289	51,048	49,217	53,082
Financial Liabilities	37,892	48,800	46,648	50,139
Provisions	168	258	295	338
Other current liabilities	1,229	1,990	2,275	2,606
Total Equities & Liabilities	**86,680**	**102,584**	**105,344**	**114,624**
Non-current assets	45,846	47,190	48,325	49,076
Property, Plant and Equip	34,801	36,255	37,260	37,874
Capital work-in-progress	497	897	897	897
Goodwill, intangible & Others	2,381	3,632	3,632	3,632
Invesmt & otr financial assets	5,183	3,392	3,522	3,659
Deferred Tax Assets (Net)	2,242	2,205	2,205	2,205
Other non-cur tax assets (Net)	742	808	808	808
Current assets	40,834	55,394	57,019	65,547
Inventories	23,828	26,194	30,177	35,341
Financial Assets	12,622	22,220	24,972	28,065
Receivable	7,948	17,670	20,199	23,136
Cash & Bank Balance	209	395	383	267
Others	4,465	4,156	4,390	4,662
Other current assets	4,384	6,980	1,870	2,142
Total Assets	**86,680**	**102,584**	**105,344**	**114,624**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Pre-Tax Profit	4,197	3,904	5,657	8,773
Depreciation	2,971	3,593	3,995	4,386
Change in WC	(3137)	(4141)	(2597)	(4917)
Other operating activities	1,404	1,833	1,470	179
Operating Cash Flow	**5,435**	**5,189**	**8,525**	**8,420**
Capex	(4426)	(5509)	(5000)	(5000)
Free Cash Flow	854	(320)	3,525	3,420
Change in Investments	4,720	0	0	0
Investment cash flow	**294**	**(5,509)**	**(5,000)**	**(5,000)**
Equity Raised	6,347	3	0	0
Debt Raised/Repaid	(8,536)	2,384	0	0
Dividend	(740)	(726)	(726)	(726)
Interest & Others	(2,885)	(1,156)	(2,811)	(2,811)
CF from Financing	**(5,815)**	**505**	**(3,537)**	**(3,537)**
Change in Cash	(86)	185	(11)	(116)
Opening Cash	296	209	395	383
Closing Cash	209	395	383	267

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Profitability Ratios				
EBITDA margin (%)	10.2	8.9	9.6	10.8
EBIT margin (%)	7.0	5.6	6.4	7.7
Net profit margin (%)	3.5	2.9	3.5	4.3
Adjusted EPS growth (%)	1.2	(1.3)	36.7	42.3
Balance Sheet Ratios:				
Receivables (days)	31	60	60	60
Inventory (days)	94	88	89	91
Payable (days)	56	72	55	55
Working capital (days)	97	105	104	105
Asset Turnover	2.0	2.2	2.3	2.4
Net Debt/ Equity	0.7	0.8	0.7	0.6
Return Ratios:				
RoCE (%)	10.2	8.8	10.7	13.8
RoE (%)	10.0	8.1	10.1	13.0
Valuation Ratios:				
P/E (x)	8.2	8.4	6.1	4.3
P/BV (x)	0.7	0.6	0.6	0.5
EV/EBITDA (x)	5.7	5.9	4.8	3.8
EV/Sales (x)	0.6	0.5	0.5	0.4

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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Disclosure/Disclaimer

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