# Arvind Ltd

May 18, 2018

DALAL & BROACHA
STOCK BROKING PVT. LTD.

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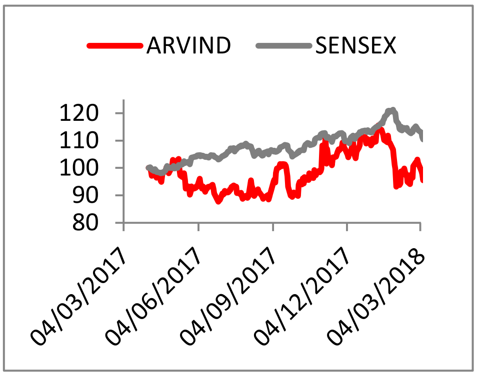
**Initiating Coverage @ Dalal & Broacha**

| **BUY** | |
|---|---|
| Current Price | 399 |
| Target Price | 556 |
| Upside/Downside | 39% |
| 52 Week Range | 353/478 |

| **Key Share Data** | |
|---|---|
| Market Cap (Rs.bn) | 103.78 |
| Market Cap (US$ mn) | 1596 |
| No of o/s shares (mn) | 258.6 |
| Face Value | 10 |
| MonthlyAvg. vol(BSE+NSE) Nos'000 | 773.09 |
| BSE Code | 500101 |
| NSE Code | ARVIND |
| Bloomberg | ARVIND:IN |

**Price performance**




| **% Shareholding** | **Mar-18** | **Dec-17** |
|---|---|---|
| Promoters | 42.92 | 42.94 |
| Institutions | 41.29 | 40.33 |
| Others | 15.79 | 16.73 |
| **Total** | **100.0** | **100.0** |

**Arvind's focus on growing asset-light brands & retail (B&R) segment and focus of textile segment on expanding high growth and value added products to drive earnings for the company. As B&R matures and becomes self-sustaining the management has decided to de-merge the entity which will be value accretive for shareholders. Improving return ratios in B&R segment to re-rate the segment. We recommend 'BUY' with target price of Rs530.**

**Brand & Retail To lead growth:** B&R segment has become self-sustaining with most of brands breaking even. We expect the segment to grow at a CAGR of 27% over FY18-20E. Brands are likely to grow at 20% CAGR driven by high growth from emerging brands while retail segment is likely to clog 40% CAGR with Unlimited turning around and GAP and Sephora showing good traction. With improving scale margin for the segment is likely to increase from 6% to 9% over FY17-19E. The segment would require capex of Rs1.5bn p.a. which will be largely met through internal accruals post de-merger. Improving profitability of the segment will improve return ratios driving re-rating for the segment.

**Textile: Focus on high turnover and advance materials:** Textile has been cash cow for Arvind. Textile segment has been focusing on less capital intensive garment segment and high growth advance material segment. Arvind is expanding its garment capacity from 30mn pieces to 100mn pieces by FY21E. The segment is likely to grow at 9% CAGR over FY17-20E. Post-demerger cash flows of the segment will be used to fund Rs15bn expansion towards high growth and better ROCE generating segments like garments and advance materials segments.

**Engineering: High ROE segment:** Arvind's engineering arm 'Anup Engineering'- critical process equipment manufacturer is expected to grow at 22% CAGR over FY17-20E. the business has high margin of 30% and generates high ROCE of 43%.

**Valuation**

Arvind's strategy to focus on asset-light growth in B&R segment and on expanding high growth and value added products in the textile segment is likely to deliver 12% CAGR topline growth over FY18-20E and 35% CAGR bottom line growth. Transition towards asset-light, high growth B&R segment is likely to improve return ratios for Arvind. ROE for the company is likely to improve from 9% to 13% over FY17-20E and ROCE to increase from 8% to 10% over FY17-20E. We value Arvind's textile business at 7xFY20E EV/EBITDA and brands and retail segment at 20xFY20E EV/EBITDA. Engineering segment is valued at 10xFY20 EV/EBITDA. Thus, we arrive at target price of Rs556 per share showing 39% upside from current level. We recommend **'BUY'**.

**Key Financials ( Rs Mns)**

| Year | Net Sales | %growth | EBIDTA | OPM% | PAT | %growth | EPS | PE(x) | RoE% | RoCE% |
|---|---|---|---|---|---|---|---|---|---|---|
| FY16 | 80,105.7 | 2.0 | 9,498.0 | 11.9% | 3,142.6 | (7.9) | 12.2 | 34.5 | 12% | 9% |
| FY17 | 92,355.4 | 15.3 | 9,405.7 | 10.2% | 3,138.4 | (0.1) | 12.1 | 34.6 | 10% | 8% |
| FY18 | 108,887.5 | 17.9 | 10,275.8 | 9.4% | 3,085.6 | (1.7) | 11.9 | 35.2 | 8% | 8% |
| FY19E | 120,423.2 | 10.6 | 12,058.1 | 10.0% | 4,319.2 | 40.0 | 16.7 | 25.1 | 11% | 9% |
| FY20E | 139,841.7 | 16.1 | 14,371.0 | 10.3% | 5,613.6 | 30.0 | 21.7 | 19.3 | 13% | 10% |

**Investment Rationale**

**Value creation through Brands & Retail**

Arvind is transforming its business model from asset heavy textile segment to asset-light B&R segment. Over FY12-17 sales for this segment increased at a CAGR of 21% increasing contribution from this segment from 25 % to 35% over the period. The company has utilized part of cash flows generated from textile division to finance growth of B&R. This investment is now generating high returns as Arvind has created elite brand portfolio in the process. Arvind holds brands like US Polo Assn, GAP, Arrow and Tommy Hilfiger which are $200mn potential brands while brands like Calvin Klein, Gant, Nautica, The children's Place, Flying Machine and Hanes are $100mn potential brands.

**Strong portfolio of iconic global brands across all markets**


**Source: Company**

**Expected scalability of brands**

| | |
|---|---|
| **US$ 100mn potential brands** | Calvin Klein |
| | Gant |
| | Nautica |
| | The Children's Place |
| | Flying Machine |
| | Hanes |
| **US$ 200mn potential brands** | US Polo Assn |
| | GAP |
| | Arrow |
| | Tommy Hilfiger |

**Source: Industry, D&B Research**

**Brand for each category covering varied price points**

Arvind has leading foreign brands catering each category like menswear, womenwear, kidswear and innerwear etc. It has India license for brands like Arrow, US Polo, Tommy Hilfiger, Calvin Klein, Gant and Nautica and specialty retail such as GAP, The Children's Place and Sephora. Arvind aspires to be no.1 player in mensear and kidswear In India and No.2 in innerwear by FY19E. The company has products with a price range starting from as low as Rs400 to as high as Rs15000, which provides a variety of choices and entry points for each and every customer.

In menswear, the company is well positioned with its power brands like Arrow, US Polo and Flying Machine. Additionally, the company also has entry level brands like Excalibur and Cherokee. For women, the company has positioned brands like Elle and Karigari. Arvind is betting big on kidswear, having an association with major brands like The Children's Place (TCP) and GAP for kids. Furthermore, brands like Tommy Hilfiger and GAP are available across categories. Also, in the innerwear segment, the company is well positioned with brands like Hanes & Calvin Klein.

With these brands the company strategically covers the upper class and the middle class customer categories. Over a period of time, Arvind has strategically built up its brand portfolio, which includes a blended combination of mass brands, entry level brands, premium brands and super premium brands. With this combination, the company manages to capture the customers present across the income pyramid.

**Power brands- continue to grow creating value**

Overall in retail industry as soon as a brand attains a turnover of Rs100-150 crore, it stops bleeding at the EBITDA level. Further, as it attains a turnover of Rs250 crore, the RoCE becomes attractive. By the time, it reaches Rs350 crore it becomes a cash cow. Currently, the four power brands contribute ~58% of the brand & retail revenues with Rs1678 crore with an EBTIDA of ~12.5%.

Arvind has four brands viz., Arrow, US Polo, Flying Machine and Tommy Hilfigre which are power brands in Arvind's portfolio. These brands contribute around 58% of total B&R revenue. These brands have 50-55% gross margin while EBITDA margin of 14%. Power brands have grown at a CAGR of 21% over FY12-17 and management expects brands to grow at a CAGR of 20-22% in future. Amongst these brands like Arrow, Tommy Hilfigre and US Polo have potential to become $200mn. With improving scale margin for these brands is likely to improve by 3-4% points.

**Arrow:** It is positioned as a workwear (formal and semi-formal) brand. It is pre-dominantly in menswear (85% share). Arrow competes with Louis Philippe and Van Heusen, with a price point of Rs1500-2500.

**US Polo:** It is positioned as an American sports and lifestyle brand in casualwear, largely menswear (85% share). US Polo is also in innerwear, denim and kids wear. Innerwear segment has large opportunity size and US Polo is well positioned to cash on to this opportunity. It has benefited from casualization trend which is seen across the industry.

**Flying Machine:** It is a top-10 Indian denim wear brand largely in the men's category and competes with Levi's, Lee and Wrangler. Management expects the brand to be Rs10bn over the medium term.

**Tommy Hilfiger:** It is Arvind's 50% joint venture in India. It is positioned as a premium or bridge-to luxury line of classic American clothes, largely in menswear and kids wear but including innerwear, with an average price point of Rs3000-3500. The brand has seen huge success in India largely on the back of the pricing, which is significantly lower than its prices internationally.

**Emerging brands- to become power brands**

Brands like Calvin Klein, Nautica, Aeropostale, GANT, IZOD, Hanes are emerging brands and contribute 26% of B&R revenue. These brands hold potential to become $100mn each and are growing at a CAGR of 30-32%. EBITDA margin for these brands is negative 2% however; with improving scale margin improvement for these brands is likely to be very sharp. EBITDA margin for these brands is likely to reach 13-14% in medium term.

Aeropostale is seeing rapid revenue growth. Fast fashion at an attractive price is its selling point. Arvind is investing in expanding the network aggressively as it sees a large opportunity. Aeropostale could be the next brand to cross-over to power brands segment.

Nautica is growing well in spite of the slightly premium pricing. Gant continues to report modest growth due to the premium nature of the brand.

**Leading brands**

| Leading brands | Arvind | ABFRL | Raymond |
|---|---|---|---|
| Premium brands | Tommy hIlfiger | Hackett | Raymond |
| | Calvin Klein | Simon Carter | |
| | GANT | | |
| | Nautica | | |
| Upper-middle class | Arrow | Van Heusen | Park Avenue |
| | GAP | Allen Solly | ColorPlus |
| | US Polo | Lousis Phillipe | |
| | Ed Hardy | | |
| Middle brands | Aeropostale | Peter England | Parx |
| | Flying Mchine | | |

**Source: Industry, B&R Research**

**Margin improvement with increasing scale**

Currently, the four power brands contribute ~58% of the brand & retail revenues with Rs1675cr with an EBTIDA of ~14%. The management focus is to increase this conversion rate of a brand to a power brand. In addition, having now established a strong portfolio of brands across multiple categories, the company is now focused on increasing the monetization of these brands. This is likely to increase overall margin for B&R segment from current 6% to 9% by FY20E.

| Brands | Revenue Size (Rs Bn) |
|---|---|
| **Power Brands** | |
| US Polo | 90 |
| Arrow | 55 |
| Tommy Hilfiger | 35 |
| Flying Machine | 25 |
| | |
| **Emerging Brands** | |
| Calvin Klein | 15 |
| GAP | 15 |
| Aeropostale | 12 |
| Nautica | 8 |
| The Children Place | 5 |
| Hanes | 5 |

**Source: Industry, B&R Research**

**Specialty Retail- Next engine of growth**

The management of ALBL is keen on developing “Specialty retail” channel. Formats under the specialty retail would include multi-offerings under Unlimited, TCP, Aeropostale, GAP and Sephora. Arvind licenses the Sephora and GAP brands for India. The company has 36 stores for the three brands (as of March 18) and, based on the company’s plans, will expand at an annual rate of 5-6 stores for each brand. Current contribution from this segment is 23% to total B&R Revenue which is likely to increase to 30% by FY20E. The management expects to break even from this segment in three years of its operations and generate positive EBITDA in the range of 7-9% by FY22.

**Unlimited taken charge of Megamart**

To counter the decline in margins, the management has repositioned Megamart from a discount store to value retail with a higher proportion of private labels. The strategy is to attract customers by offering discounts on reputed brands like Arrow, Park Avenue, and Van Heusen and try to convert them into buying its own private labels. Also, several small stores have been closed while some large format stores have been opened resulting in a reduction in the number of “Unlimited” stores from 216 in FY12 to 101 stores in as on March 18. The company plans to add 25-30 stores every year. The large format “Unlimited” stores have been positioned as a size of 10000 sq. ft. per store. Arvind currently has ~20% area under the power Unlimited format and is planning to scale it up to 50% in the next two years. The shift in favor of large format stores has led the area per store for Unlimited to increase from 3100 sq. ft. in FY12 to 8446 sq. ft. in FY17. The repositioning of Unlimited as value retail is expected to boost revenue growth and enhance margins, going ahead.

**Extensive distribution network**

Arvind has a strong distribution network of ~1297 stores across 150 cities with a total retail space of ~2 million square feet (sq ft) in India, which enables it to reach a large number of consumers and a huge potential market to sell its products. The company has been aggressive in retail space expansion in its brands business. Space addition in B&R segment is happening at 12-15% every year.

**Retail Network**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|
| Total sq. ft (mn) | 0.33 | 0.5 | 0.61 | 0.59 | 0.75 | 1.2 | 2.2 |
| No. of stores | 352 | 487 | 611 | 671 | 721 | 771 | 1297 |

Source: Company

**Distribution Network**

| Distribution Footprint (FY18) | Stores | Mn. Ft |
|---|---|---|
| Brands | 1160 | 1.04 |
| Unlimited | 101 | 0.97 |
| Sp. Retail | 36 | 0.14 |
| Total | 1297 | 2.15 |

Source: Company

Arvind has big plans on large retail formats, which enable it to offer multiple products. Among its extensive reach, ~35% consists of exclusive brand outlets (EBOs) in the name of respective brands. Further, the company also distributes through key channel partners like Lifestyle, Shoppers Stop, etc., forming another 30-35% of the distribution channel. Moreover, multi-brand outlets (MBOs) form 25-27% and e-commerce ~5% of the distribution channel. With an enviable brand portfolio and a presence in menswear, womenswear and kids segment, it envisages higher footfalls though large retail format stores at some prime locations.

**ROCE to improve in B&R Segment**

The company has been in investment phase since FY12 and has invested in B&R segment. Total capex incurred during this period is Rs20bn since FY13-17 largely in B&R segment. Large capital expenditure is incurred for acquiring brands, creating infrastructure, advertising and marketing spend etc. This is likely to reap its benefit as net investment is likely to go down to Rs150cr annually and asset turnover is likely to increase to 4-5x for new investment. Economies of scale is likely to improve margin from current 5% to 9% by FY20E. Therefore, ROCE for B&R segment is likely to improve from 5% to 15% by FY20E.

**De-Merger of B&R to unlock value for shareholders**

As B&R segment has been in investment mode cash flows from textile division have been utilized for B&R segment. However, now B&R segment is self-sustaining therefore, future investments will be made through cash flows from the business. Arvind's management proposed a demerger in November 2017, which we expect to take another 6-8 months to become effective. The demerger will create three listed entities comprised of: 1) a textiles company, which is the current listed entity; this will also house the advanced materials division and water treatment unit; 2) a brand and retail company, which will include all the Indian retail business including specialty chain (Sephora) and large-format value stores (Unlimited); and 3) an engineering company, which will include the heavy engineering fabrication unit.

**Details of demerger**

Shareholders of Arvind Ltd will be issued 1 share of Arvind Fashion (which will house the B&R business) for every 5 shares of Arvind Ltd and 1share of the Engineering business for every 27 shares of Arvind Ltd. Multiples Private Equity had acquired 10% in Arvind Fashion for Rs7.4bn in October 2016 will continue to own 10% in the demerged entity. The demerger process is likely to be completed by Sept 18.

**Textile: Stable growth with better asset turnover**

Textile segment has been cash cow for Arvind and has reported stable topline growth at a CAGR of 11% over FY12-17. Volatile cotton prices impacted margin for the segment improving EBITDA at a CAGR of 8% over the same period. In textile segment wovens contribute 35% followed by denim 32% and garments contributing 22% of textile revenue. Management is now focusing on expanding revenue contribution from asset light garment segment which will improve ROCE further.

**Textile Segment Capacity**

| Textile: Capacity | FY17 | FY21E |
|---|---|---|
| Denim (Mn mtrs) | 110 | 110 |
| Woven (Mn Mtrs) | 130 | 150 |
| Garments (Mn pcs) | 30 | 100 |
| Knits (000 t) | 9.4 | 14 |
| Voiles (mn Mtrs) | 40 | 50 |

Source: Company

Ramping up of its garmenting capacity Arvind is planning to increase its garment capacity to 40 million pieces over the next three years from 22 million pieces as on Q1FY16. On the back of this, the company plans to increase its current contribution from garments from 20% in FY17 to 28% by FY20E. The company is expanding its capacity in Vietnam as it enjoys duty free exports to Europe.

With the increase in garmenting capabilities, Arvind is positioning itself as the most preferred distribution partner in India. With majority of the brands targeting the Indian growth story, the company would help them formulate their manufacturing as well as distribution strategies. The current manufacturing capability includes production of denims and shirts. Arvind manufactures garments for associated international brands like Tommy Hilfiger, Calvin Klein and GAP for which it also has distributing licenses. For power brands like Arrow and Polo, the company manufactures 100% of its domestic requirements. Arvind also manufactures for non-associated brands like H&M, M&S, FCUK and Jack & Jones. In garments, majority of the revenues is from exports. However, approximately 10% of garments produced is marketed within India.

**Rs1500cr capex in textile over next three years**

Traditionally, textile has been asset-heavy industry. However, Arvind is incorporating asset-light model for textile division through concentrating more on value added products. State incentives announced by different sates like Jharkhand, Andhra Pradesh, Karnataka, Telangana and Gujarat makes investment in the segment more lucrative. Jharkhand government has announced a policy to give per month Rs6000 of wage subsidy. Average labour cost in Jharkhand is around Rs7000-7500 per month. So, wage subsidy will save substantial cost for the company. Therefore, Arvind is looking to expand its textile capacity in the state of Jharkhand. The company's efforts in sustainable manufacturing have enabled it to become a preferred vendor for global retailers.

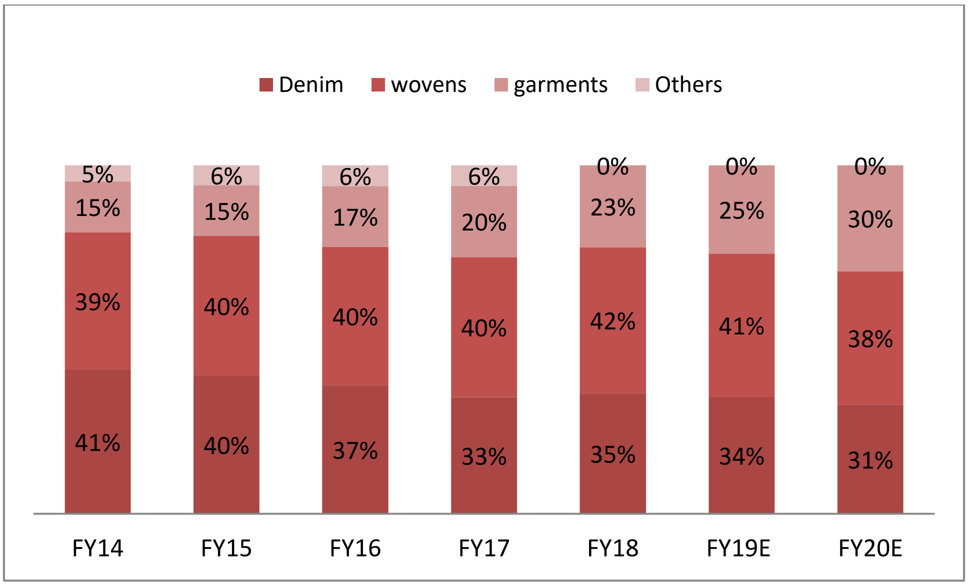
**Garmenting to be next driver**

Arvind is likely to invest more than half of total investment in garment facility. Current garment capacity of 30mn pieces is likely to improve to 45mn pieces by FY20E. Further Arvind plans to increase capacity to 100mn mtrs by FY21E. Focus towards asset light garmenting segment is likely to improve ROCE of textile segment. We expect topline to grow at a CAGR of 21% over FY17-20E and EBITDA to increase at a CAGR of 18% for garment division.

**Capacity expansion in Ethiopia**

Arvind has set up garment manufacturing capacity in Ethiopia. The company has made investment of Rs100cr in Phase-I. The expansion has taken place at two sites. At site number one, they have started our operation about a year ago. The investments in the larger facility which is a place called Hawassa has begun and we have started actually dispatches in this quarter. The first dispatches have happened in Q3FY18. Shipments for the year are likely to be 5-6mn pieces and will be ramped up next year. ***The major benefit of Ethiopia facility is duty-free access to European countries.***

***Textile: Segment Contribution***




**Source: Company, D&B Research**

**Foray into technical textile**

Arvind has forayed in the technical textiles business which it plans to grow further in the years to come. The company is currently focusing on protective wear fabrics, non-wovens (used primarily for surgical and medical purposes, for airline napkins, etc.) and composite fabrics. Being an IPR-driven business, the company has formed JVs with international peers such as the Preiss Daimler Group of Germany for composites, OG Corporation of Japan for non-wovens, etc. **Arvind currently earns**

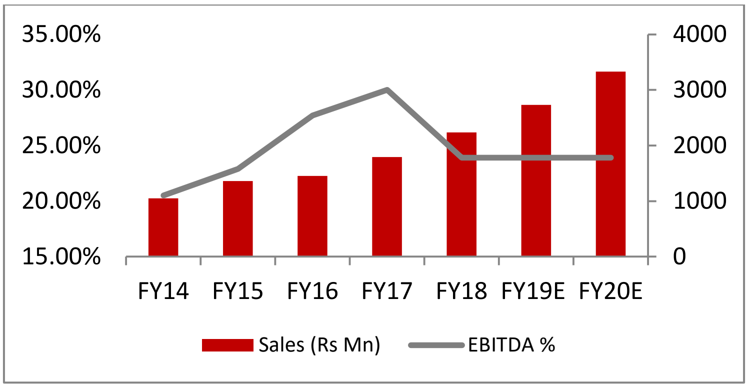
**revenues of ~Rs5bn from technical textiles and is growing at 20% CAGR. Currently segment earns EBITDA margin of5% which is expected to increase to 10% over 3-4 years with improving scale. Capex for the division is expected at Rs60-70cr p.a.**

Advanced Materials is a high-entry barriers and high-margin business and is likely to be the next growth driver for the company. Advanced materials are manufactured for various industrial purposes such as medical textiles (implants), agro textiles, and use in protective clothing and construction materials. The Indian advanced materials market is ~US$12bn and growing at 10-12% per annum. Management highlights that the largest producers of technical textiles such as Germany and the US are losing cost-competitiveness and looking to enter into JVs with Indian companies. Besides, Arvind also aims to have an active play in functional textiles using man-made fibres and blends (eg athleisure, sportswear and smart-enabled wearables).

Recent JV with Adient to enter into automotive fabrics Arvind has entered the segment with plans to expand via joint ventures with global companies that have a technological advantage and which can ease its entry into international markets. The Indian arm of global automotive seating player Adient has entered into a JV agreement with Arvind to develop, manufacture and sell automotive fabrics in India. Adient will hold majority stake (50.5%) in the JV with Arvind owning the rest. The JV would have its own manufacturing base in Ahmedabad. The JV would provide Indian and global automakers quality and innovative solutions in fabrics, enabling them to deliver new levels of comfort, aesthetic variety and design versatility to end-users in India.

**Anup Engineering: high growth, high ROE**

Arvind's engineering division, Anup Engineering, is one of the leading fabrication companies in India. Key products include critical process equipment like heat exchangers, pressure vessels, reactors, columns and centrifuges. The division has reported a robust revenue growth trajectory in the past, along with improving profitability. It recorded revenue CAGR of 19% over FY12-17 and an EBITDA CAGR of 60%. The company is debt free, cash rich. As on 30 Sept, 2017 the company holds cash balance of Rs 36cr and has net worth of Rs179cr**. The division generates very high ROCE of 43%. Management expects the company to grow at a CAGR of 20-25%.**




**Source: Company, D&B Research**

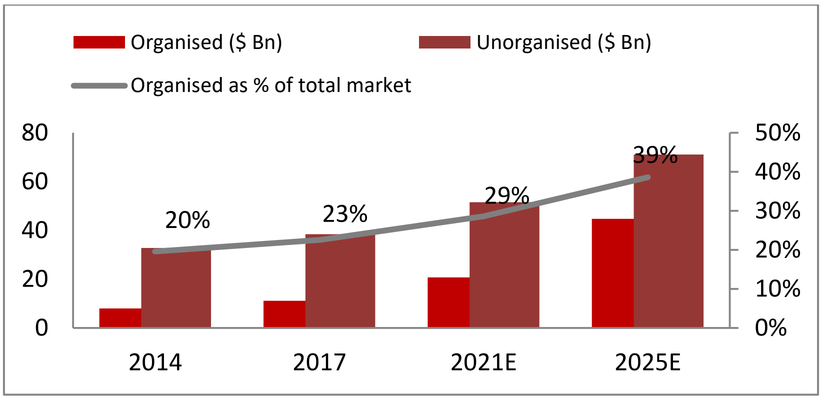
**Industry Dynamics**

**B&R: Huge untapped opportunity**

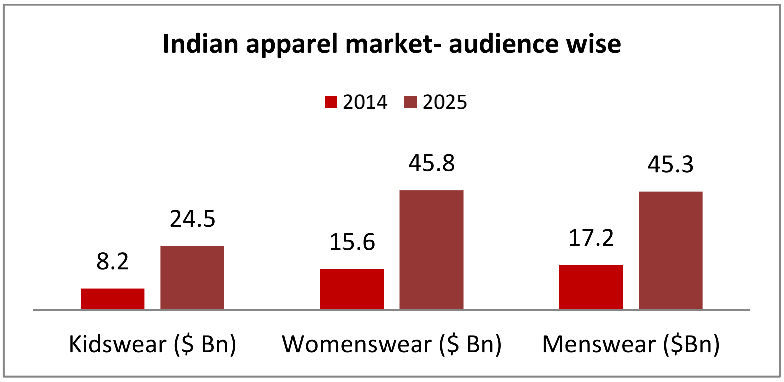
Over all textile industry in India is $120bn consisting $80bn domestic market and $40bn exports. Domestic market is growing at 9-10% p.a. Arvind's major exposure is to men's segment where market size is around $20bn and is expected to reach $40bn by 2025. Organised segment is only $4bn of the total market which is less than 20%. However, it is growing at faster rate and Arvind is likely to be major beneficiary of the trend. Organised market share is likely to go up from 20% to 24% by 2025.

The current Indian apparel market is estimated at $42 billion (Rs250000 crore). The Indian apparel market is expected to grow at a CAGR of 10% from the current $42 billion to $115 billion over CY14-25. The organised apparel market is expected to grow at a comparatively faster CAGR of 17% over the period compared to the unorganised market, which is expected to grow at a CAGR of 8%. Branded apparel is expected to outpace industry growth and grow at a CAGR of 22% over CY14-25. This would result in the share of branded garments of the organised apparel industry going up from 27% in CY12 to 50% in CY25

**Indian Textile industry**




**Source: Company, D&B Research**



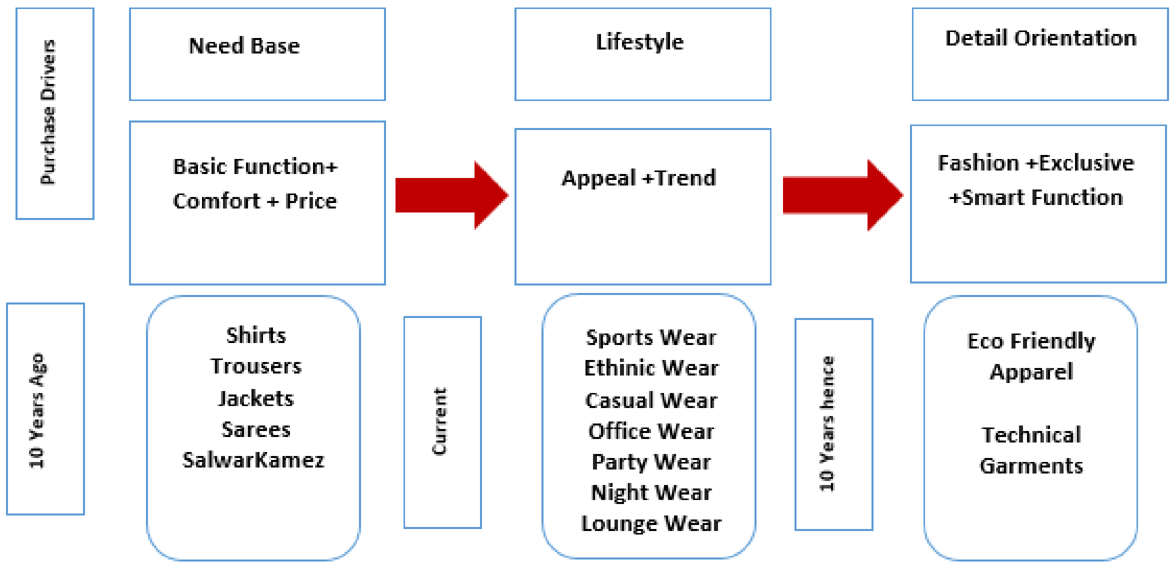

**Source: Company, D&B Research**

**Drivers for textile consumption**

**Increasing working age population:** India adds about 13 million people to its working age population every year. At about a 50% labour participation rate, 7 million of these enter the labour force each year and, based on an expected medium-term male/female participation rate of 75:25, we estimate this includes about 5 million men. In absolute terms, India's additions to its labour force in the next five years are estimated to be 1.5 times those of the rest of APAC, US and EU combined. This rate of addition over the medium to long tem favours growth in apparel demand.

**Transition towards lifestyle**

There has been a transition from “price sensitive” to “brand sensitive”. On the back of this, apparels have been able to grab a higher share of the wallet. Previously, apparels were purchased only during the festive season or during occasions. Also, these purchases were one-time and had a higher ticket size. We believe this need-based purchase has now been replaced with monthly purchases. In years to come, the apparel retail market is expected to get transformed into a more detail oriented one wherein consumers will seek their own customisation with their signature embroidery or selected painting on their garments. This would provide greater exclusivity as well as fashion orientation to customers. We believe the current portfolio of brands with the company across multiple channels and price points is distinctly positioned given the consumer proposition.




**Source: Industry, D&B Research**

**Growth in modern retail to benefit**

Modern retail includes large format store (LFS), exclusive brands outlets (EBO), speciality stores and multi-brand outlets (MBO). The theory here is to provide an array of options to the customer entering the store, increasing the average billing amount as well. Though at present modern retail contributes only 20% of the total apparel market, its share is poised to grow sharply over the next five years to contribute 28% by 2018. The increased presence of multiple retail formats across specialty retail formats, hypermarkets and cash & carry is expected to drive this growth. The emergence of non-store formats e-tailing, m-commerce, direct selling, etc. are acting as enabling factors for scalability and extending reach to smaller relevant Indian cities.

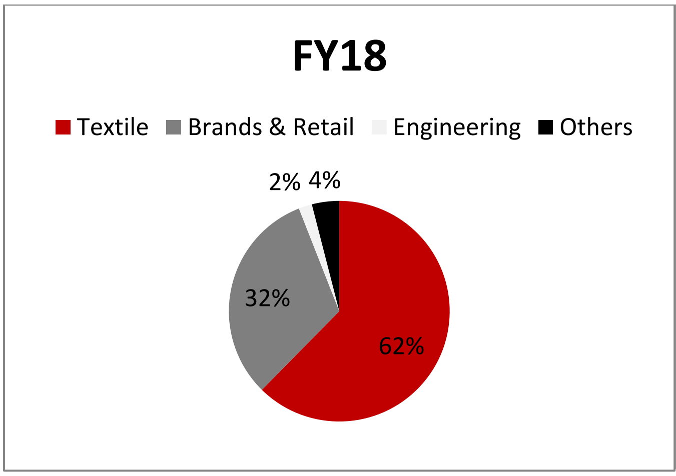
The fashion distribution channel in India is dominated by wholesale channel followed by exclusive brand outlets (EBO), large format stores (LFS) and multi-brand outlet (MBO). The larger wholesale market is on the back of a huge rural apparel market, catered to by highly unorganised and local players. The four channels together contribute 96.7% to total apparel sales in the country. Besides these four channels, hyper markets, discount stores and e-tailing channels also have their presence in the market. With enviable brand portfolio Arvind continues attract higher footfalls across segments. This enables it to garner prime retail space at attractive rates in most malls aiding in rapid expansion of the retail space.

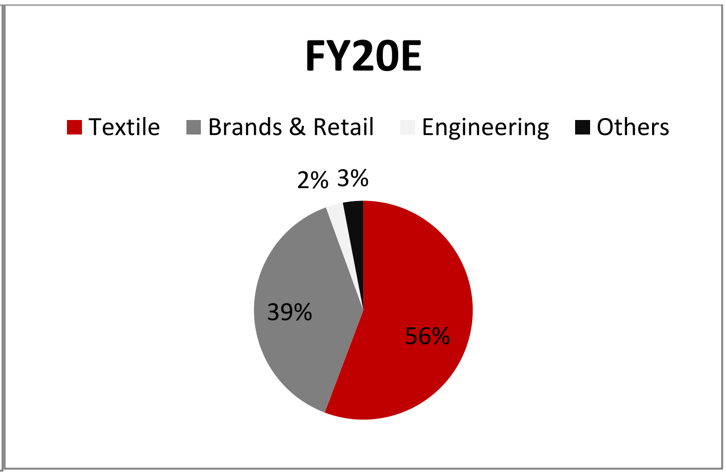
**Financial Performance**

**Topline to grow at 10% CAGR over FY18-20E**

Driver by 9% CAGR growth in textile segment and 25% CAGR in B&R segment Arvinds's topline is likely to grow at a CAGR of 12% over FY18-20E. Contribution from textile segment is likely to go down from 62% in FY17 to 56% in FY20E while the same for B&R division is likely to go up from 32% to 39% over the same period.

**Revenue Break-up**




**EBITDA to grow at 18% CAGR over FY18-20E**

Improving scalability of B&R segment will improve margin for the segment. In FY17 the division posted margin of 6% which is likely to go up to 9% by FY20E. With most of the brands becoming profit making and unlimited breaking even margin for the segment is likely to improve. As garment contribution to textile revenue is likely to increase the margin for the segment is likely to go down from 16% to 15% by FY20E. However, overall margin is likely to improve from 10.2% to 11.9% over FY17-20E.

## Valuation

We expect the company to post topline CAGR of 12% over FY18-20E and bottom-line grow at 35% CAGR over the same period. Transition towards asset-light, high growth B&R segment is likely to improve return ratios for Arvind. ROE for the company is likely to improve from 10% to 14% over FY17-20E and ROCE to increase from 8% to 11% over FY17-20E. We value Arvind's textile business at 7xFY20E EV/EBITDA and brands and retail segment at 20xFY20E EV/EBITDA. Engineering segment is valued at 10xFY20 EV/EBITDA. Thus, we arrive at target price of Rs545 per share showing 30% upside from current level.

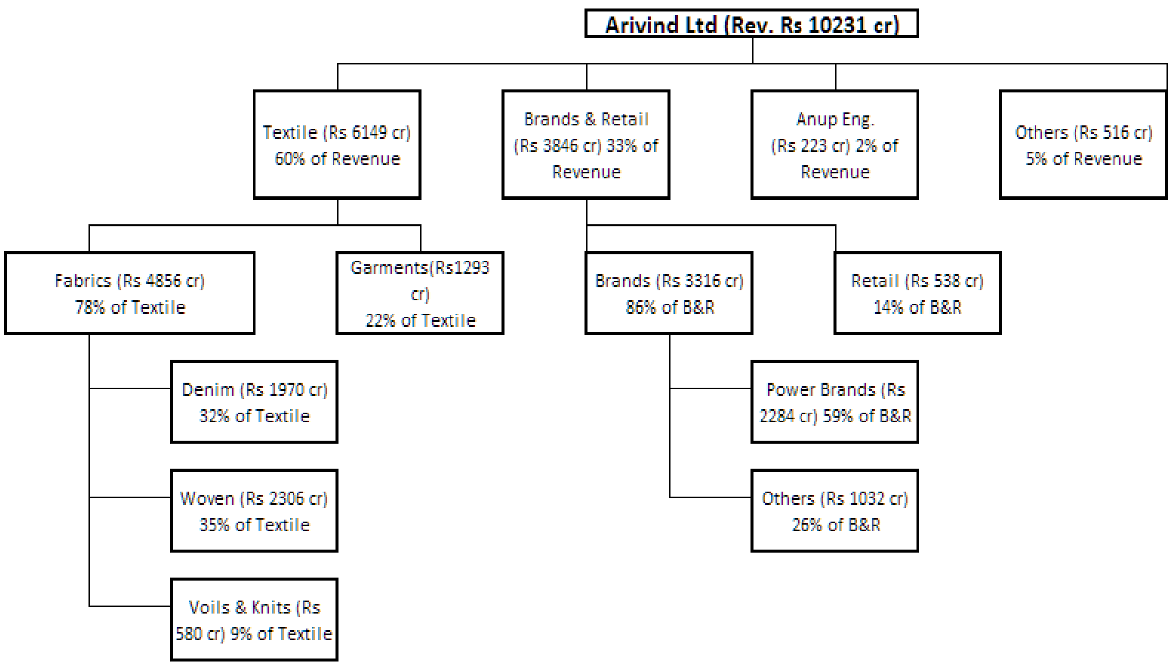
| **Particulars** | **EBITDA (FY20E)** | **Multiple** | **EV** |
|---|---|---|---|
| Textile | 9256 | 7 | 66640 |
| Brand & Retail | 4885 | 20 | 97694 |
| Anup Engineering | 795 | 10 | 7954 |
| Others | -65 | 8 | -518 |
| Total | | | 171771 |
| Debt | | | 31,125 |
| Cash | | | 3,020 |
| MCAP | | | 143666 |
| No. of shares | | | 259 |
| Price | | | 556 |
| **Target price** | | | **39%** |

## Company Background

Arvind Ltd is the flagship company of the Lalbhai Group that has been around since 1930. Arvind started as a superfine fabric manufacturer in the early 30s. Since then, the company has been constantly reinventing itself by venturing into new categories in textiles like denim, suiting, shirting, etc. Arvind has been a pioneer in India in launching domestic denim brands like Ruff & Tuff and Flying Machine. The company has also been licensing international brands like Arrow and US Polo in India. Currently, Arvind is considered India's leading fully integrated textile, branded apparel & Retail Company, which has a strong presence across the value chain. The company is a market leader in manufacturing denim in India with total capacity of 108 million metre per annum (mmpa) of which 44% is export driven. The textile division comprises sub-categories like denim, woven, voiles and knits. The company shifted gear to adopt an asset-light approach in its textiles division, by increasing garmenting capacity. Arvind intends to move towards a vertical model by increasing usage of in-house-produced fabric to make garments. It is also focused on increasing the share of performance-based materials and technical textiles in its products. The division contributes 56% to total revenue and 68% to EBITDA.

In the brand and retail division, Arvind has a rich portfolio of both home-grown and foreign-licensed brands, including Arrow, US Polo and Tommy Hilfiger, among others. US Polo, Flying Machine, Arrow and Tommy Hilfiger are power brands with high profitability. While Aeropostale, GANT, Nautica, IZOD, Ed Hardy, CK and hanes are emerging brands. Arvind rebranded its discount retail stores Megamart to Unlimited stores. Arvind also entered into specialty retail through brands like GAP, Sephora and TCP.

**Revenue Chart**



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**PEER COMPARISION**

| Company Name | CMP | M.Cap (in Million INR) | EPS | | | PE RATIO | | | EBITA(in Billion INR) | | | EV/EBITA | | | ROE % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY 18 | FY 19E | FY 20E | FY 18 | FY 19E | FY 20E | FY 18 | FY 19E | FY 20E | FY 18 | FY 19E | FY 20E | FY19 |
| **Arvind** | **399** | **58832** | **12.4** | **16.7** | **21.7** | **32.1** | **23.9** | **18.4** | **10.2** | **12.2** | **14.3** | **10.9** | **9.3** | **7.8** | **11** |
| Aditya Birla (ABFRL) | 147 | 129090 | 1.5 | 2.1 | 3.8 | 96.7 | 70.0 | 38.7 | 3.2 | 6.4 | 8.0 | 1.8 | 1.6 | 1.4 | 10 |
| Raymond | 1075 | 65430 | 18.5 | 28.7 | 37.8 | 58.0 | 37.5 | 28.5 | 3.1 | 5.5 | 6.6 | 14.6 | 14.5 | 12.1 | 9 |
| Future Retail | 589 | 291840 | 13.7 | 19.0 | 21.8 | 42.9 | 30.9 | 27.0 | 8.3 | 11.3 | 14.5 | 39.8 | 34.9 | 26.6 | 28 |
| Page Industries | 23530 | 262457 | 303.0 | 389.0 | 477.0 | 77.7 | 60.5 | 49.3 | 5.2 | 6.5 | 8.1 | 50.4 | 39.8 | 32.0 | 44 |
| Shopper Stop | 543 | 48040 | 18.0 | 11.3 | 17.1 | 30.1 | 48.2 | 31.8 | 2.3 | 2.7 | 3.5 | 31.0 | 19.6 | 15.4 | 13 |
| Vardhaman textile | 1260 | 71110 | 110.2 | 139.2 | 163.9 | 11.4 | 9.1 | 7.7 | 9.5 | 12.2 | 13.7 | 1.2 | 1.1 | 1.0 | 20 |
| KPR Mills | 655.75 | 47930 | 39.3 | 46.8 | 57.5 | 16.7 | 14.0 | 11.4 | 4.4 | 6.8 | 7.4 | 1.8 | 1.6 | 1.5 | 10 |

***Source: Bloomberg Estimates***

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| P&L (Rs mn) | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|---|---|---|---|---|---|---|---|
| Net Sales | 68,621.2 | 78,514.0 | 80,105.7 | 92,355.4 | 108,887.5 | 120,423.2 | 139,841.7 |
| Raw Materials | 31,241.2 | 34,938.8 | 34,666.1 | 41,965.2 | 27,957.9 | 51,420.7 | 59,712.4 |
| Employee Cost | 6,793.2 | 8,022.8 | 8,980.9 | 10,962.6 | 12,647.4 | - | - |
| Other Expenses | 3,638.2 | 4,322.1 | 5,336.4 | 6,372.4 | - | - | - |
| **Operating Profit** | **9,107.3** | **10,128.5** | **9,498.0** | **9,405.7** | **10,275.8** | **12,058.1** | **14,371.0** |
| Depreciation | 2,252.1 | 2,123.5 | 2,391.3 | 2,942.7 | 3,593.4 | 3,417.8 | 3,735.5 |
| PBIT ( Excl O. Income) | 6,855.2 | 8,005.0 | 7,106.7 | 6,463.0 | 6,682.4 | 8,640.3 | 10,635.4 |
| Other income | 694.0 | 932.0 | 820.5 | 780.0 | - | 800.0 | 800.0 |
| Interest | 3,312.0 | 3,946.0 | 3,586.3 | 2,884.1 | 2,578.5 | 3,270.1 | 3,415.9 |
| PBT | 4,237.2 | 4,991.0 | 4,340.9 | 4,358.9 | 4,103.9 | 6,170.3 | 8,019.5 |
| Exceptionals | (164.0) | (543.3) | 13.7 | (180.6) | (227.2) | - | - |
| Profit before tax (post exceptional) | 4,073.2 | 4,447.7 | 4,354.6 | 4,178.3 | 3,876.7 | 6,170.3 | 8,019.5 |
| Provision for tax | 547.7 | 1,071.5 | 1,246.2 | 996.8 | 727.7 | 1,851.1 | 2,405.8 |
| **Reported PAT** | **3,525.5** | **3,376.2** | **3,108.4** | **3,181.5** | **3,149.0** | **4,319.2** | **5,613.6** |
| MI | (13.4) | (34.8) | 19.5 | 62.2 | 63.4 | - | - |
| **Net Profit** | **3,512.1** | **3,341.4** | **3,127.9** | **3,243.7** | **3,212.4** | **4,319.2** | **5,613.6** |
| Adjusted Profit ( excl Exceptionals) | 3,680.8 | 3,823.4 | 3,132.8 | 3,276.1 | 3,270.2 | 4,319.2 | 5,613.6 |

| Cash Flow St. (Rs. mn) | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|---|---|---|---|---|---|---|---|
| Net Profit | 3,512.1 | 3,341.4 | 3,127.9 | 3,243.7 | 3,212.4 | 4,319.2 | 5,613.6 |
| Add: Dep. & Amort. | (2,252.1) | (2,123.5) | (2,391.3) | (2,942.7) | (3,593.4) | (3,417.8) | (3,735.5) |
| **Cash profits** | **1,260.0** | **1,217.9** | **736.6** | **301.0** | **(381.0)** | **901.4** | **1,878.1** |
| **(Inc)/Dec in** | | | | | | | |
| -Sundry debtors | 2,546.6 | 1,565.0 | (3,976.6) | 457.4 | 9,530.9 | (4,802.7) | 1,691.7 |
| -Inventories | 2,152.5 | 2,168.9 | 754.2 | 4,623.5 | 2,365.8 | 573.1 | 4,316.2 |
| -Loans/advances | 2,855.8 | 1,318.6 | (3,062.9) | (1,662.5) | 17.4 | 411.6 | 470.0 |
| '-Current Liab and Provisions | (2,035.2) | (452.2) | 2,046.7 | (2,862.5) | (10,189.5) | 6,975.8 | (3,821.6) |
| Change in working capital | 5,031.1 | 3,441.5 | (5,199.1) | 3,042.9 | 2,326.1 | 1,909.2 | 2,893.1 |
| **CF from Oper. activities** | **3,154.5** | **4,758.5** | **12,672.9** | **4,823.4** | **6,695.3** | **7,556.9** | **8,287.2** |
| Capex | 3,504.5 | 4,932.4 | 4,161.8 | 4,397.1 | 6,355.7 | 5,643.4 | 6,000.0 |
| **CF from Inv. activities** | **808.1** | **(707.8)** | **3,664.9** | **(1,479.4)** | **(639.4)** | **639.4** | **-** |
| **CF from Fin. activities** | **(3,353.0)** | **(976.9)** | **4,147.7** | **2,407.6** | **2,095.0** | **(313.4)** | **1,475.6** |
| **Cash generated/(utilised)** | **609.6** | **3,073.7** | **20,485.5** | **5,751.6** | **8,151.0** | **7,882.9** | **9,762.8** |
| Cash at start of the year | 1,548.7 | 1,663.3 | 833.2 | 609.1 | 538.8 | 654.9 | 642.1 |
| Cash at end of the year | 1,663.3 | 833.2 | 609.1 | 538.8 | 654.9 | 642.1 | 888.3 |

| Balance Sheet (Rs Mn) | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|---|---|---|---|---|---|---|---|
| Equity capital | 2,581.7 | 2,582.4 | 2,582.4 | 2,583.6 | 2,586.2 | 2,586.2 | 2,586.2 |
| Reserves | 23,248.1 | 24,656.4 | 23,893.9 | 33,112.8 | 35,242.3 | 39,216.5 | 43,932.0 |
| **Net worth** | **25,829.8** | **27,238.8** | **26,476.3** | **35,696.4** | **37,828.5** | **41,802.7** | **46,518.2** |
| MI | 242.4 | 347.6 | 556.1 | 1,514.3 | 3,052.8 | 647.9 | 842.0 |
| **Non Current Liabilites** | 30,172.4 | 34,293.5 | 38,866.8 | 30,460.5 | 31,967.0 | 34,074.9 | 35,574.9 |
| **Current Liabilites** | 16,952.8 | 17,405.0 | 15,358.3 | 18,220.8 | 28,410.3 | 21,434.5 | 25,256.1 |
| **CAPITAL EMPLOYED** | **73,197.4** | **79,284.9** | **81,257.5** | **85,892.0** | **101,258.6** | **97,960.0** | **108,191.2** |
| **Non Current Assets** | 35,492.0 | 38,800.6 | 39,085.6 | 41,090.4 | 45,376.6 | 45,536.4 | 48,336.7 |
| Fixed Assets | 28,926.8 | 32,082.3 | 33,384.9 | 35,349.3 | 37,907.2 | 40,795.2 | 43,059.6 |
| CWIP | 1,346.7 | 1,000.1 | 1,468.0 | 958.0 | 1,162.4 | 500.0 | 500.0 |
| Deferred Tax Asset | **(434.9)** | **(470.8)** | **(675.2)** | **(816.6)** | **(707.5)** | **(816.6)** | **(816.6)** |
| Long Term Loans and Advances | 5,599.6 | 6,104.1 | 31.8 | 27.7 | 25.7 | - | - |
| Other Non-current assets | 53.8 | 84.9 | 4,876.1 | 5,572.0 | 6,988.8 | 5,057.8 | 5,593.7 |
| **Current Assets** | 37,705.4 | 40,485.1 | 42,171.9 | 44,801.6 | 55,882.0 | 52,423.6 | 59,854.5 |
| **Investments** | 1,293.3 | 585.5 | 5,450.2 | 3,964.5 | 2,476.4 | 3,115.8 | 3,115.8 |
| Inventories | 16,281.4 | 18,450.3 | 19,204.5 | 23,828.0 | 26,193.8 | 26,766.9 | 31,083.2 |
| Trade Receivables | 10,093.1 | 11,658.1 | 7,681.5 | 8,138.9 | 17,669.8 | 12,867.1 | 14,558.9 |
| Cash and Bank Balances | 1,663.3 | 833.2 | 609.1 | 538.8 | 654.9 | 642.1 | 888.3 |
| Short Term Loans and Advances | 5,025.0 | 6,343.6 | 3,280.7 | 1,618.2 | 1,635.6 | 2,047.2 | 2,517.2 |
| Other Current Assets | 3,349.3 | 2,614.4 | 5,945.9 | 6,713.2 | 7,251.5 | 6,984.5 | 7,691.3 |
| **CAPITAL DEPLOYED** | **73,197.4** | **79,285.7** | **81,257.5** | **85,892.0** | **101,258.6** | **97,960.0** | **108,191.2** |

| Ratios | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|---|---|---|---|---|---|---|---|
| OPM | 13.3 | 12.9 | 11.9 | 10.2 | 9.4 | 10.0 | 10.3 |
| NPM | 5.1 | 4.2 | 3.9 | 3.5 | 3.0 | 3.6 | 4.0 |
| Tax rate | 13.4 | 24.1 | 28.6 | 23.9 | 18.8 | 30.0 | 30.0 |
| **Growth Ratios (%)** | | | | | | | |
| Net Sales | 29.7 | 14.4 | 2 | 15.3 | 17.9 | 10.6 | 16.1 |
| Operating Profit | 0.3 | 11.2 | (6.2) | (1.0) | 9.3 | 17.3 | 19.2 |
| PBIT | 55.8 | 16.8 | (11.2) | (9.1) | 3.4 | 29.3 | 23.1 |
| PAT | 42.1 | 3.9 | (18.1) | 4.6 | (0.2) | 32.1 | 30.0 |
| **Per Share (Rs.)** | | | | | | | |
| Net Earnings (EPS) | 13.6 | 12.9 | 12.1 | 12.6 | 12.4 | 16.7 | 21.7 |
| Cash Earnings (CPS) | 4.9 | 4.7 | 2.9 | 1.2 | (1.5) | 3.5 | 7.3 |
| Dividend | 2.6 | 8.7 | 9.3 | 10.9 | 13.0 | 15.7 | 20.0 |
| Book Value | 100.0 | 105.5 | 102.5 | 138.2 | 146.3 | 161.6 | 179.9 |
| Free Cash Flow | (1.4) | (0.7) | 33.0 | 1.7 | 1.3 | 7.4 | 8.8 |
| **Valuation Ratios** | | | | | | | |
| **P/E(x)** | **29.3** | **30.8** | **32.9** | **31.8** | **32.1** | **23.9** | **18.4** |
| P/B(x) | 4.0 | 3.8 | 3.9 | 2.9 | 2.7 | 2.5 | 2.2 |
| EV/EBIDTA(x) | 11.8 | 10.8 | 11.6 | 11.8 | 10.9 | 9.3 | 7.8 |
| Div. Yield(%) | 0.7 | 2.2 | 2.3 | 2.7 | 3.3 | 3.9 | 5.0 |
| **FCF Yield(%)** | **(0.3)** | **(0.2)** | **8.3** | **0.4** | **0.3** | **1.9** | **2.2** |
| **Return Ratios (%)** | | | | | | | |
| ROE | 16.9% | 15.8% | 12.1% | 10.4% | 8.8% | 10.7% | 12.6% |
| ROCE | 13.2% | 11.9% | 9.0% | 8.1% | 7.5% | 8.7% | 9.9% |

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