Sharekhan
by BNP PARIBAS

Arvind Limited

Weak quarter, recovery expected by FY2022

Sector: Consumer Discretionary
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 33**	
Price Target: **Rs. 43**	↓

↑ Upgrade ↔ No change ↓ Downgrade

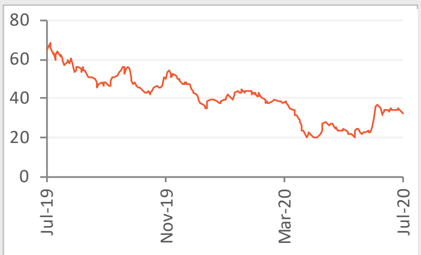
Company details

Market cap:	Rs. 846 cr
52-week high/low:	Rs. 71/19
NSE volume: (No of shares)	17.4 lakh
BSE code:	500101
NSE code:	ARVIND
Sharekhan code:	ARVIND
Free float: (No of shares)	14.3 cr

Shareholding (%)

Promoters	44.8
FII	15.8
DII	12.4
Others	27.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.3	65.6	-19.5	-49.9
Relative to Sensex	1.9	40.3	-5.2	-39.2

Sharekhan Research, Bloomberg

Arvind Limited's (Arvind's) Q4FY2020 performance was affected by stoppage of production and supply chain disruptions during the lockdown in the last 10 days of March 2020, as revenue declined by 11.7% y-o-y. However, revenue grew by 6.7% for January-February 2020 driven by 10.5% growth in the textiles business and 7.4% growth in the advanced materials (AMD) business. Though gross margins fell sharply, the fall in OPM was limited to just 27 bps to 9.6%. The company is operating at a 50-55% capacity utilisation currently which is expected to scale up in the coming months. The export market is recovering faster than the domestic market with stronger brands posting a 60-80% recovery. Net debt fell by Rs. 248 crore during the year due to efficient working capital management. We do not expect debt to rise significantly as the company has no major capex going ahead and working capital is expected to remain well-managed. We expect a slight rise in working capital cycle in FY2021 as debtor days are expected to rise with customers demanding a higher credit, which can be managed with higher creditor days. With normalisation of the situation in FY2022, working capital cycle is expected to improve. Faster recovery in the export market, good growth in garment sales volumes and sustained growth in the AMD business will help the company post good recovery in FY2022. The company is expected to benefit from lower cotton prices which will help gross margins to sustain in the near to medium term.

Key positives

- Arvind is operating at a 50-55% capacity utilisation currently; faster recovery is witnessed in the export market with strong brands posting 60-80% recovery.
- Net debt for FY2020 fell by Rs. 248 crore, from Rs. 2,619 crore in FY2019 to Rs. 2,371 crore in FY2020 due to efficient working capital management.
- Debt to equity ratio was stable at 0.9x in FY2020.

Key negatives

- Gross margins declined by 509 bps y-o-y to 50.1% due to unfavourable revenue mix.
- Denim sales volumes declined from 22 million pieces to 17 million pieces.

Our Call

View - Retain Buy with a revised price target of Rs. 43: We have lowered our earnings estimates for FY2021 and FY2022 to factor in disruption caused by the lockdown and a slow recovery in the domestic textiles business. We expect a good recovery in FY2022 driven by sustained growth in the AMD business and improving demand in the export markets. Further, the company is sensing a big opportunity in the domestic market with some signs of a shift from Chinese sourcing of inputs. The company has maintained its focus on strengthening its balance sheet and we don't expect much stress due to near-term uncertainties. The stock has corrected significantly by ~20% in the last six months and is trading at discounted valuations of 6.6x its FY2022E EPS and 4.1x its FY2022E EV/EBITDA (trading at a discount of ~28% since its listing last year) factoring in the near-term headwinds. We maintain our Buy recommendation with a revised price target of Rs. 43. A sustained improvement in the business fundamentals and balance sheet would act as key re-rating trigger for the stock.

Key Risks

If normalisation of situation takes more time than expected, it will slowdown a recovery in exports. Any slowdown in the textiles business and a rise in key input prices would also act as a key risk to our earnings estimates.

Valuation Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenues	6,794	7,142	7,369	6,255	7,687
OPM (%)	9.9	10.0	9.4	8.9	9.4
Adjusted PAT	286	269	128	49	130
Adjusted EPS (Rs.)	11.2	10.4	4.9	1.9	5.0
P/E (x)	3.0	3.2	6.8	17.5	6.6
P/B (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	4.5	4.1	4.2	5.4	4.1
RoNW (%)	11.3	10.1	4.6	1.8	4.7
RoCE (%)	10.5	7.2	5.9	4.0	5.7

Source: Company; Sharekhan estimates

Revenue fell by 11.7%, unfavourable mix affected margins: Q4FY2020 revenue declined by 11.7% y-o-y to Rs. 1,641.6 crore as compared to Rs. 1,859.4 crore in Q4FY2019, affected by stoppage of production and disruptions due to lockdown in the last few days of March 2020. Revenue growth stood at 6.7% for January-February driven by 10.5% growth in the textiles business and 7.4% growth in the AMD business. The management has estimated a revenue loss of Rs. 250 crore in March 2020 leading to a 42% decline in revenue in March. An unfavourable revenue mix dragged down gross margins by 509 bps to 50.1%. Despite this decline, considerable lower other expenses limited the decline in OPM to just 27 bps to 9.6% (below our expectation of 10.7%). Operating profit fell by 14.1% y-o-y to Rs. 157.6 crore due to lower revenue. Lower other income, higher depreciation along with lower revenue resulted in 53.5% decline in profit before tax to Rs. 36.8 crore. A higher tax incidence of tax resulted in adjusted PAT to fall by 79.8% to Rs. 14.2 crore as against Rs. 70.3 crore in Q4FY2019. Exceptional items included losses on foreign exchange, bad debts and impairments. Reported loss came in at Rs. 17.3 crore for the quarter as against a profit of Rs. 66.7 crore in Q4FY2019.

Decent growth in the first two months in key businesses, March affected by disruptions: The textiles business saw revenue decline by 8.7% y-o-y to Rs. 1,351 crore, whereas revenue of the AMD business fell by 10.9% y-o-y to Rs. 178.4 crore in Q4FY2020. However, revenue growth for the textiles business stood 10.5% for January-February driven by good growth in garment volumes. Overall, denim volumes declined from 22 million pieces to 17 million pieces whereas woven volumes fell from 34 million pieces to 25 million pieces in Q4FY2020 largely because the export dispatches got stuck from the second week of March and could not be delivered. EBITDA of the textiles business came in at Rs. 126 crore in Q4FY2020 as against Rs. 156 crore in Q4FY2019 and EBITDA margin declined by 118 bps y-o-y from 10.5% in Q4FY2019 to 9.3% in Q4FY2020 due to lower operating leverage. The AMD business grew by 7.4% y-o-y in January-February as a result of scaling-up of the business. EBITDA of the AMD business stood flat at Rs. 24 crore whereas EBITDA margin expanded by 78 bps y-o-y to 13.4% because of operating leverage as the mature part of the portfolio has started scaling along with improved realisation from higher value-added products and improved product mix.

Strong performance by AMD business, recovery seen in the textiles business: The textiles business saw revenue grow by 15% to Rs. 1,589 crore (after adjusting for the MIES benefit of Rs. 33.6 crore) driven by a 40% growth in garment volumes. The denim segment recovered as revenue grew by 10% y-o-y to Rs. 391 crore with a marginal growth in volumes and average prices. Revenue from the woven segment declined by 3% y-o-y to Rs. 580 crore, while revenue from the garments segment grew by 23% y-o-y to Rs. 409 crore driven mainly by volumes (grew from 7.6 million pieces to 10.6 million pieces) as a result of capacity additions. EBITDA margin of the textiles business improved by 220 bps y-o-y from 10.5% in Q3FY2019 to 12.7% in Q3FY2020 due to operating leverage and lower input costs. The advanced materials business put up a robust show robust, with revenue rising by 16% y-o-y to Rs. 185 crore. EBITDA of the business came in at Rs. 25 crore in Q3FY2020 as against Rs. 16 crore in Q3FY2019 and EBITDA margin expanded by 310 bps y-o-y to 13.3% because of operating leverage as the mature part of the portfolio has started scaling along with improved realisation from higher value-added products.

Other Conference call highlights

- The textiles and AMD businesses reported a revenue growth of 5% and 13%, respectively for FY2020 and 10% and 20%, respectively for the first 11 months of FY2020. Textile volumes declined to 181 million pieces in FY2019 from 186 million pieces in FY2020. However, garment volumes grew from 34 million pieces in FY2019 to 42 million pieces in FY2020.
- Production was completely stopped in the last 10 days of March leading to a revenue loss of ~Rs. 250 crore and EBITDA loss of ~Rs. 75 crore. Post the relaxation of lockdown norms, the company is operating at a 50-55% capacity utilisation. April was a complete washout, while May was affected by low capacity/ transport issues whereas June witnessed scale-up in capacity.
- The export market was impacted as dispatches from the second week of March got stuck and could not be delivered because of the lockdown. However, post the relaxation, the export market is witnessing a faster recovery than the domestic market. Arvind's order book in the export market is reasonable and

slowly returning to pre-COVID levels as strong brands are posting a 60-80% recovery. Moreover, Arvind is also expected to benefit on the demand front as sourcing from China by bigger brands is expected to come down providing opportunity for Arvind to gain share in the domestic market.

- Arvind is expected to benefit from decrease in cotton prices as no prior high-priced inventory is remaining with the company. Prices of dyes and chemicals are also expected to remain soft which will help gross margins to sustain. The company intends to rationalise fixed costs by ~15% on a sustainable basis which will help ease the pressure on margins.
- The company has repurposed factory lines and recalibrated capacities (especially in the shirts segment due to lower demand) to make PPE kits and N95 masks pursuant to government orders.

Results (Consolidated) Rs cr

Particulars	Q4FY20	Q4FY19	Y-o-Y (%)	Q3FY20	Q-o-Q (%)
Total revenue	1641.6	1859.4	-11.7	1868.8	-12.2
Raw material cost	818.5	832.4	-1.7	972.4	-15.8
Employee cost	204.2	214.5	-4.8	235.3	-13.2
Other expenses	461.3	628.9	-26.7	475.7	-3.0
Total operating cost	1483.9	1675.8	-11.4	1683.4	-11.8
Operating profit	157.6	183.6	-14.1	185.4	-15.0
Other income	8.6	19.6	-56.3	14.2	-39.4
Interest & other financial cost	52.4	61.4	-14.6	61.6	-14.8
Depreciation	77.0	62.8	22.7	74.5	3.4
Profit before tax	36.8	79.1	-53.5	63.6	-42.1
Tax	21.8	9.2	-	25.1	-12.9
Adjusted PAT	15.0	69.9	-78.6	38.5	-61.1
Extraordinary item	31.5	3.6	-	1.2	-
Minority Interest (MI)	-0.8	0.3	-	-1.9	-
Reported PAT	-17.3	66.7	-	35.3	-
Adjusted PAT after MI	14.2	70.3	-79.8	36.6	-61.2
Adj. EPS (Rs)	0.6	2.7	-78.6	1.5	-61.1
			bps		**bps**
GPM (%)	50.1	55.2	-509	48.0	218
OPM (%)	9.6	9.9	-27	9.9	-32

Source: Company; Sharekhan Research

Segmental Performance Rs cr

Particulars	Q4FY2020			Q4FY2019		
	Revenue	EBITDA	EBITDA Margin (%)	Revenue	EBITDA	EBITDA Margin (%)
Textile	1352	126	9.3	1486	156	10.5
Advanced Materials	179	24	13.4	198	25	12.6
Others	117	-9	-	177	18	10.2

Source: Company; Sharekhan Research

Outlook

FY2021 to remain subdued, recovery expected in FY2022: Revenue grew by just 3.2% y-o-y, while OPM stood at 9.4% in FY2020 due to weak demand environment and disruptions due to COVID-19. Q1FY2021 is expected to be impacted as production was completely halted in April and supply chain issues persisted in May. Thus, FY2021 will remain subdued. However, a faster recovery in the export market, healthy growth in garment sales volumes and sustained growth in the AMD business will help company post faster recovery in FY2022. Improving capacity utilisation of new garment facilities will drive the growth of the textiles business in the medium term. Scaling up of garment operations and improving efficiencies would help margins of the textiles business to improve in the near term. The AMD business would maintain its growth trajectory due to better demand. The company is expected to benefit from lower cotton prices, which will help gross margins to sustain in the near to medium term.

Valuation

Retain Buy with a revised price target of Rs. 43: We have lowered our earnings estimates for FY2021 and FY2022 to factor in disruption caused by the lockdown and a slow recovery in the domestic textiles business. We expect a good recovery in FY2022 driven by sustained growth in the AMD business and improving demand in the export markets. Further, the company is sensing a big opportunity in the domestic market with some signs of a shift from Chinese sourcing of inputs. The company has maintained its focus on strengthening its balance sheet and we don't expect much stress due to near-term uncertainties. The stock has corrected significantly by ~20% in the last six months and is trading at discounted valuations of 6.6x its FY2022E EPS and 4.1x its FY2022E EV/EBITDA (trading at a discount of ~28% since its listing last year) factoring in the near-term headwinds. We maintain our Buy recommendation with a revised price target of Rs. 43. A sustained improvement in the business fundamentals and balance sheet would act as key re-rating trigger for the stock.

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Raymond	10.1	12.0	38.6	5.2	4.7	4.0	9.3	6.2	8.7
Kewal Kiran Clothing	12.8	16.1	13.0	7.3	10.1	8.6	16.3	11.3	16.8
Arvind	6.8	17.5	6.6	4.2	5.4	4.1	5.9	4.0	5.7

Source: Company, Sharekhan estimates

About company

Arvind is an innovation-driven and customer-centric global textile play with presence in garmenting segments such as denim, woven and knits and technology-driven and high-margin business such as AMD. In FY2019, the company created value for shareholders by demerging its branded fashion and retail business and engineering business into two separate listed entities – Arvind Fashion and Anup Engineering. The demerger will help the company to scale up its core textile business in domestic as well international markets. The company is focusing on improving its return ratios by improving its profitability through vertical integration, introducing differentiated next-generation products and scaling up the advance material business.

Investment theme

Arvind's FY2020 performance was affected by a slowdown in the demand environment, volatile currency and disruptions towards the end, resulting in lower revenue growth. Improving capacity utilisation of the new garment facilities will drive the growth of the textiles business in the medium term. Scaling up of garmenting operations and improving efficiencies would help margins of the textiles business to improve in the near term. Increased scale of the AMD business would improve profitability in the long run. We will keenly monitor the performance in the coming quarters. Any uptick in the performance of the garmenting segment would act as a key trigger for the stock.

Key Risks

- Volatile currency and higher cotton prices remain one of the key risks for margin expansion and would continue to affect earnings growth in the near term.
- Sustained slowdown in the garmenting business would continue to affect revenue growth in the near to medium term.

Additional Data

Key management personnel

Sanjay S Lalbhai	Chairman and Managing Director
Jayesh K Shah	Whole Time Director and Chief Financial Officer
Ramnik V Bhimani	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	4.7
2	Franklin Resources Inc	2.3
3	Dimensional Fund Advisors LP	2.1
4	Kotak Mahindra Asset Management Co	2
5	Vanguard Group Inc	1.8
6	TT International Investment Management	1.8
7	Life Insurance Corporation of India	1.6
8	HSBC Asset Management India Pvt Ltd	1.4
9	Fundrock Management Co SA	1.1
10	Merril Lynch Markets Singapore Pte Ltd	1.1

Source: Bloomberg

Sharekhan

by BNP PARIBAS

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