Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Arvind Ltd

Robust Q3; trend to sustain in Q4

Consumer Discretionary	Sharekhan code: ARVIND
Reco/View: Buy ↔	CMP: Rs. 138
	Price Target: Rs. 183 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 19.10

Updated Jan 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

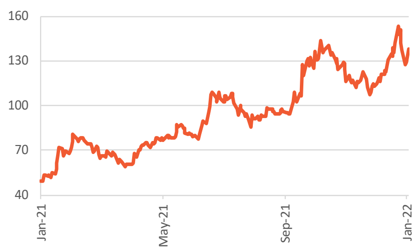
Company details

Market cap:	Rs. 3,593 cr
52-week high/low:	Rs. 158 / 49
NSE volume: (No of shares)	23.5 lakh
BSE code:	500101
NSE code:	ARVIND
Free float: (No of shares)	15.3 cr

Shareholding (%)

Promoters	41.3
FII	13.2
DII	11.0
Others	34.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	18.5	5.0	29.0	177.7
Relative to Sensex	19.6	8.4	20.2	156.9

Sharekhan Research, Bloomberg

Summary

- Q3FY2022 numbers were robust driven by high domestic and export demand for textile and advanced material (AMD) segments.
- Revenues grew by 50.3% y-o-y to Rs. 2,275.7 crore driven by 57.3% and 41.6% y-oy growth in textile and AMD businesses; due to price hikes and better operating leverage, OPM increased by 121 bps sequentially but declined by 30 bps y-o-y to 10.4%.
- Management expects Q4 revenues and margins to be in line with Q3; higher volumes and realisations will aid revenue growth while price hikes will sustain margins. Company slashed debt by Rs. 226 crore as compared to March 2021 and is expected to further reduce it in Q4.
- Stock trades at 5.7x/4.6x its FY2023E/24E EV/EBITDA. We maintain a Buy on the stock with a revised price target of Rs. 183.

Q3FY2022 performance was boosted by high domestic and export demand. Strong revenue growth of 50.3% y-o-y to Rs. 2,275.7 crore can be attributed to robust performance by both textile and advanced materials (AMD) divisions, which grew by 57.3% and 41.6% y-o-y. Higher cotton prices stressed gross margins (that dropped 449 bps y-o-y to 45.4%). The Denim, Woven and Garmenting divisions registered strong volume growth. Better operating leverage and price hikes helped OPM improve by 121 bps sequentially to 10.4% (though it declined marginally by 30 bps y-o-y). The company reduced debt by Rs. 226 crore as compared to March 2021 and net debt stands at Rs. 1,724 crore as of Q3FY22-end.

Key positives

- Denim and woven fabric sales volumes stood at 25 million metres (growth of 43% y-o-y) and 35 million metres (up 29% y-o-y), respectively. Denim and Woven realisation also improved substantially on a y-o-y basis.
- AMD business registered strong growth of 41.6% y-o-y to Rs. 267 crore; demand across all the segments improving.
- Debt reduced by Rs. 226 crore as compared to March 2021.

Key negatives

- Gross margins fell by 449 bps y-o-y and 144 bps q-o-q to 45.4%.

Management Commentary

- Export demand to remain strong as major economies are easing COVID-related restrictions and consumer sentiment in key markets is improving. As offtake by domestic retailers picks up, domestic demand for textile products is expected to recover in the quarter ahead.
- Strong demand will help volumes and price realization stay robust while EBITDA will be healthy, though margins will look under pressure as topline will be inflated. Overall, Q4 revenues and margins are likely to be similar to Q3.
- Debt reduction to continue in the coming periods, thus reducing interest cost. Further debt reduction of Rs. 1,000-1,100 crore is likely in the next 12-18 months.

Revision in estimates – We have increased our earnings estimates for FY2023 and FY2024 because of better-than-expected sales volume growth and strong outlook given by the company for the quarters ahead. Sustained reduction in debt would help interest cost to consistently reduce in the coming years.

Our Call

View: Maintain Buy with revised price target of Rs. 183: With strong performance momentum continued Q3, we expect the company to meet the target of sales volumes of 90 million metres in the denim segment, 125-128 million metres in the woven segment and 48 million-50 million pieces in the garments business in FY2022. Increased revenue, a steady improvement in OPM, and reduction in debt would result in strong improvement in return ratios. The stock is currently trading at an attractive valuation of 5.7x/4.6x its FY2023E/24E EV/EBIDTA. We maintain a Buy on the stock with a revised price target of Rs. 183 (rollover to FY24).

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.
- Any unexpected slowdown in the garmenting business would affect revenue growth in the near to medium term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenues	5,073	8,040	8,996	9,914
OPM (%)	9.0	9.2	9.6	10.5
Adjusted PAT	-1	235	314	430
% YoY growth	-	-	*33.4*	*36.9*
Adjusted EPS (Rs.)	0.0	9.1	12.1	16.6
P/E (x)	-	15.2	11.4	8.3
P/B (x)	1.3	1.2	1.1	1.0
EV/EBIDTA (x)	11.0	6.7	5.7	4.6
RoNW (%)	0.0	8.5	10.4	12.8
RoCE (%)	3.1	7.5	8.7	10.4

Source: Company; Sharekhan estimates

Revenue grew by 50.3% y-o-y; PAT grow at ~4.2x y-o-y

Revenue grew by 50.3% y-o-y and 7.6% q-o-q to Rs. 2,275.7 crore in Q3FY2022, aided by a strong growth in both export and domestic markets and robust performance of both the textile and advanced materials divisions. The textile business' revenue increased by 57.3% y-o-y to Rs. 1,918.1 crore. The textile business' EBITDA margins stood at 9.4% vs. 8.9% in Q3FY2021. AMD business' revenue increased by 41.6% y-o-y to Rs. 267 crore. The advanced material business' EBITDA margins stood at 10.8% vs 10.9% in Q3FY2021. Overall, the consolidated gross margins declined by 449 bps on y-o-y basis and 144 bps on q-o-q basis to 45.4% on account of continued increase in input prices. The OPM increased by 121 bps sequentially and marginally declined by 30 bps y-o-y to 10.4% owing to price hikes and better operating leverage. Operating profit grew by 46.1% y-o-y to Rs. 236.8 crore. This along with higher income, lower interest cost and lower depreciation led to substantial increase in PAT on y-o-y basis. The adjusted PAT stood at Rs. 94.2 crore vs. Rs. 22.6 crore in Q3FY2021.

Robust growth in textile revenues; improvement in price realization across segments

The textile business reported revenues of Rs. 1,918.1 crore in Q3FY2022 as against Rs. 1,219.1 crore in Q3FY2021, rising 57.3% y-o-y. Sequentially, revenues rose 11.1%, up from Rs. 1,726.5 crore in Q2FY2022. Price realisations improved across segments with denim average realisations improving by 23% y-o-y to Rs. 226/metre, up from Rs. 183/metre in Q3FY21, while woven fabrics' average realisations rose by 27% y-o-y to Rs. 185/metre, up from Rs. 146/meter in Q3FY21. Price hikes undertaken to offset input cost increases helped sustain EBIDTA margins. EBITDA margins came in at 9.4% versus 8.9% in Q3FY21 owing to improvement in exports, higher price realisation, better product mix, digital initiatives and better operating efficiencies. The management has targeted the fabrics segments to grow by 5-10% while the garments segment to grow by 15-20% over the next 2-3 years.

Segment-wise performance Rs cr

Category	Q3FY2022	Q3FY2021	Y-o-Y %
Denim	576	336	71.4
Woven	704	408	72.5
Garments	449	364	23.5
Others	294	224	
Inter segment	-109	-111	
Total	**1,914**	**1,220**	**56.9**

Source: Company; Sharekhan Research

Volumes were higher across segments due to continued strength in domestic market & sharp improvement in export demand. Denim volumes were up by 43% y-o-y and Arvind registered 2nd consecutive quarter of over 25 million metres. In the woven fabrics segment, volume growth came it at 29% to 35 million metres driven by sharp increase in export volumes. Garments volumes stood at 10 million pieces up from 9 million pieces in Q2FY22.

Recovery across all segments (million metres)

Category	Market	Q4 Avg	Q1FY22	Q2FY22	Q3FY22
Denim	Domestic	8	4	7	8
	Exports	12	16	18	18
	Total	**20**	**20**	**25**	**25**
Woven	Domestic	18	10	13	12
	Exports	10	13	18	23
	Total	**28**	**23**	**31**	**35**
Garments	**million pcs**	**10**	**7**	**9**	**10**

Source: Company; Sharekhan Research

Robust performance by AMD business

The AMD business grew by 41.6% y-o-y to Rs. 267 crore. Revenue growth was aided by strong demand across segments – human protection (over 50% of revenue), industrials and composites (~25% of revenue each). In the human protection segment, the company scaled up its key accounts while in the industrials segment, the company achieved secular volume growth backed by new capacities. The composites segment registered strong momentum on the back of product innovation and commenced supplies to metro rail projects. Input costs continued to surge and the price increases lagged cost increases despite the company's efforts. This along with logistics challenges continued to hamper the segment's growth. Arvind's plans to focus on building key accounts wherein they can start to deliver good repeat/continuing business and targets a growth of 25-30% in the AMD segment over the next 2-3 years.

Key conference call highlights

- **Demand to stay strong:** As major economies ease COVID-related restrictions, demand across UK/Europe is expected to rise in the coming months, which will be backed by positive consumer sentiments in these regions. The management has guided for a volume growth of 8-10% in FY2023/24.
- **Price hikes likely in Q4:** The company has hiked prices across its portfolio to mitigate the impact of cost inflation. The high demand for raw materials and supply constraints have contributed to the rising input costs. The management stated that price hikes is an on-going process and will depend on various factors like raw material prices, demand-supply situation among others. However, a lag between price hikes and a surge in input prices affected profitability during Q3FY22. The company is likely to hike prices even in Q4. While price hikes do offset some impact of rising prices, some impact is also borne by the company.
- **Capex of Rs. 300 crore over 1-2 years:** The management has stated that it will undertake a capex of ~Rs. 300 crore in the next 12-18 months in the woven fabrics, garments and AMD segments to cater to rising demand in these segments. A part of the capex will be from the PLI scheme whereas remaining will be done by the company.
- **Debt reduction to continue:** The company reduced debt by about Rs. 157 crore & Rs. 226 crore compared to September 2021 & March 2021, respectively and net debt stands at Rs. 1,724 crore as on December 31, 2021. The debt reduction in Q3 was higher due to lower tax outgo during the quarter. The company has guided on further reducing debt by Rs. 1,000-1,100 crore in the next 12-18 months. During 9MFY2022, the company reduced debt to the extent of Rs. 85-90 crore from land sale. Further, the company has identified land worth book value of Rs. 450-500 crore as non-productive land and will be monetising the same over the next 3-4 years (market value of the land is Rs. 650-700 crore), the proceeds from selling the land will aid in the company's plan to reduce debt.
- **Water business scaling up:** The management indicated that there is strong pick-up in demand in the water business and the company received a single order of over Rs. 100 crore in Q3 as compared to orders of Rs. 40-60 crore previously. The pipeline for the water business is robust and the company targets revenue of over Rs. 200 crore in FY2022 and a growth of 25-30% in FY2023 from the water business.

Results (Consolidated) Rs cr

Particulars	Q3FY22	Q3FY21	Y-o-Y %	Q2FY22	Q-o-Q %
Total revenue	**2,275.7**	**1,513.7**	**50.3**	**2,115.1**	**7.6**
Raw material cost	1,243.4	759.1	63.8	1,125.1	10.5
Employee cost	208.9	184.9	13.0	212.0	-1.4
Other expenses	586.5	407.6	43.9	565.5	3.7
Total operating cost	2,038.8	1,351.6	50.8	1,902.7	7.2
Operating profit	**236.8**	**162.1**	**46.1**	**212.5**	**11.5**
Other income	13.2	12.5	6.0	17.6	-24.8
Interest & other financial cost	40.5	54.2	-25.3	48.1	-15.8
Depreciation	67.2	72.0	-6.6	65.9	2.0
Profit before tax	**142.3**	**48.3**	**194.6**	**116.0**	**22.6**
Tax	48.1	25.7	87.1	45.1	6.8
Minority Interest (MI)	0.2	0.2	-21.7	0.1	63.6
Reported PAT	**94.3**	**22.4**	**320.4**	**71.1**	**32.8**
Adj. EPS (Rs)	3.6	0.9	313.9	2.0	76.8
			bps		**bps**
GPM (%)	45.4	49.8	-449	46.8	-144
OPM (%)	10.4	10.7	-30	9.2	121
OPM (%)	4.1	1.5	266	2.5	164
Tax rate (%)	33.8	53.3		46.0	

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q3FY22			Q3FY21		
	Revenue	EBITDA	EBITDA Margin (%)	Revenue	EBITDA	EBITDA Margin (%)
Textile	1,918.1	179.4	9.4	1,219.1	108.9	8.9
Advanced Materials	267.0	28.9	10.8	188.5	20.5	10.9
Others	111.9	-11.1		116.2	-9.2	
Gross sales	**2,297.0**	**197.2**	**8.6**	**1,523.9**	**120.2**	**7.9**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Long-term growth prospects improving

Most textile companies received strong orders from regions such as the US and Europe due to pent-up demand for garment apparel and home textile products as retailers are building up the stock with gradual opening up of economies in most of these regions. Long-term growth prospects of the Indian textile industry are intact. Augmentation of capacity with value-added products, key export markets focusing on increasing supply from India and government's support policies provide scope for textile companies to post robust growth in the long run. With the government extending the RoSCTL scheme till March 2024 and keeping rates unchanged, it will be beneficial for textile companies and add to their profitability.

■ Company outlook – Revenue to reach close to Rs. 9,000 crore by FY2023

Opening up of export markets such as US and Europe and retailers stocking up textile products resulted in strong demand. Export customers have already preponed ordering for Summer 2022 and brands continue to project strong growth momentum. Further, the company has added new customers in its list and is marketing new products to existing customers, which will drive export sales in the near term. Domestic demand is expected to stay strong post the festive season. This would result in strong double-digit growth in the textile business. The advanced materials business is expected to grow by 25% in the medium term and would see a sustained improvement in margins as the business scales up. Management targets to achieve revenue close to Rs. 9,000 crore in FY2023 without any disruption. OPM will consistently improve because of better revenue mix and higher operating efficiencies. The company is on track for its debt reduction plan and expects to reduce debt further during Q4.

■ Valuation – Maintain Buy with revised price target of Rs. 183

With strong performance momentum continued Q3, we expect the company to meet the target of sales volumes of 90 million metres in the denim segment, 125-128 million metres in the woven segment and 48 million-50 million pieces in the garments business in FY2022. Increased revenue, a steady improvement in OPM, and reduction in debt would result in strong improvement in return ratios. The stock is currently trading at an attractive valuation of 5.7x/4.6x its FY2023E/24E EV/EBIDTA. We maintain a Buy on the stock with a revised price target of Rs. 183 (rollover to FY24).

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY22E
KPR Mill	42.8	28.8	24.0	27.0	19.0	15.6	25.2	30.7	30.1
Arvind	-	15.2	11.4	11.0	6.7	5.7	3.1	7.5	8.7

Source: Company, Sharekhan estimates

About company

Arvind is an innovation-driven and customer-centric global textile play present in garmenting segments such as denim, woven, 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 helped 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 enhancing its profitability through vertical integration, introducing differentiated next-generation products, and scaling up the advance material business.

Investment theme

Arvind's FY2021 performance was affected by COVID-19 disruption. Improving capacity utilisation of new garment facilities will drive growth of the textiles business in the medium term. High export demand for textile products 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. An 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.
- Any unexpected slowdown in the garmenting business would 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	1.9
4	Vanguard Group Inc	1.8
5	Kotak Mahindra Asset Management Co	1.8
6	TT International Investment Management	1.8
7	Life Insurance Corporation of India	1.6
8	HSBC Asset Management India Pvt Ltd	1.5
9	Fundrock Management Co SA	1.1
10	Merril Lynch Markets Singapore Pte Ltd	1.1

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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