Sharekhan
by BNP PARIBAS

Arvind Limited

Sequential recovery; yet to reach pre-COVID levels

Sector: Consumer Discretionary
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 34**	
Price Target: **Rs. 43**	↔

↑ Upgrade ↔ No change ↓ Downgrade

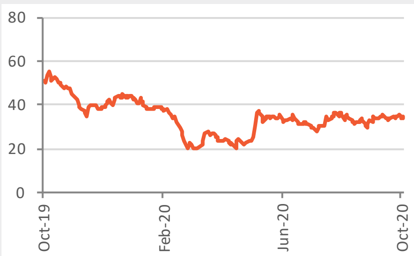
Company details

Market cap:	Rs. 874 cr
52-week high/low:	Rs. 56 / 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	44.7
FII	12.6
DII	6.4
Others	36.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.3	15.6	39.5	-34.2
Relative to Sensex	-4.4	10.6	22.0	-33.1

Sharekhan Research, Bloomberg

Arvind Limited's (Arvind's) Q2FY2021 revenues recovered to ~66%, better than ~32% recovery in Q1FY2021. Revenues declined by 33.5% y-o-y to Rs. 1,305.2 crore, lower than our expectation of Rs. 1,472 crore, largely impacted by slower recovery in the domestic market. Gross margins declined by 118 bps to 48.4%. However, a ~25% reduction in fixed costs stemmed the decline in OPM to 63 bps to 9.3%. A ~78% recovery was witnessed in September. Denim, woven and garment volumes have recovered to 80%, 60% and 66%, respectively of the corresponding quarter, driven by healthy export demand. Advanced material division (AMD) revenue has fully recovered to pre-COVID levels. The denim segment has seen good growth in the exports markets. Realisations of the woven segment were affected due to higher demand for value products. The garments segment's recovery was driven by good demand in jeans and knitwear. Management expects recovery in performance by Q3FY2021 with improvement in demand in the domestic market. Cost-savings measures helped the company reduce structural fixed costs by 15-20% that is expected to sustain. This will help Arvind recover margins gradually to FY2020 levels. Though margins are expected to slightly lower in FY2021, the management is confident of posting better margins in the medium term. Net debt has reduced by ~Rs. 100 crore from March 2020 levels (had increased in Q1) and the company expects to repay another Rs. 100 crore in Q3FY2021 with better cash flows.

Key positives

- September saw a ~78% recovery.
- Positive growth witnessed in denims in the export market; AMD has surpassed pre-COVID level revenues.
- EBITDA margin of textile business expanded by 80 bps to 11.6% and of AMD expanded by 110 bps to 15%, driven by higher share of exports and efficient cost management.
- Net debt was reduced by ~Rs. 100 crore from March 2020 and by ~Rs. 400 crore from June 2020.

Key negatives

- Gross margins declined 118 bps to 48.4% and OPM declined by 63 bps to 9.3%.

Our Call

View - Retain Buy with an unchanged PT of Rs. 43: We expect a strong recovery in FY2022, driven by strong recovery in the B2C retail industry in the domestic market, sustained growth in AMD space and improving demand in 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 by debt reduction and targets a ~Rs. 1,000 crore reduction over 18-30 months. Thus, we do not expect much stress due to near-term uncertainties. The stock is trading at discounted valuations of 4.5x its FY2023E earnings and 3.5x its FY2023E EV/EBITDA (trading at a discount of ~30% since its listing last year), factoring in near-term headwinds. We maintain our Buy recommendation with an unchanged PT of Rs. 43. Sustained improvement in 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 slow down recovery in exports. Any slowdown in the textiles business and rise in key input prices would act as a key risk to our earnings estimates.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	7,142	7,369	5,067	7,056	7,725
OPM (%)	10.0	9.4	9.0	9.6	10.0
Adjusted PAT	269	128	15	140	196
Adjusted EPS (Rs.)	10.4	4.9	0.6	5.4	7.6
P/E (x)	3.2	6.9	59.4	6.2	4.4
P/B (x)	0.3	0.3	0.3	0.3	0.3
EV/EBIDTA (x)	4.2	4.2	5.8	4.0	3.5
RoNW (%)	10.1	4.6	0.5	5.1	6.8
RoCE (%)	7.2	5.9	3.1	5.8	7.0

Source: Company; Sharekhan estimates

Revenue growth recovered to ~66% in Q2, efficiencies limited the decline margins: Q2FY2021 revenue declined by 33.5% y-o-y to Rs. 1,305.2 crore as compared to Rs. 1,962.2 crore in Q2FY2020 and Rs. 599.3 crore in Q1FY2021, driven by a q-o-q improvement in the domestic market and a bounce-back in export volumes to pre-COVID levels. Recovery levels stood at 57% in July, 65% in August and 78% in September. The denim, woven and garment volumes have recovered to 80%, 60% and 66%, respectively of the corresponding quarter. AMD is back at pre-COVID levels. Gross margins were down by 118 bps to 48.4% as a result of unfavourable mix. In spite of this, lower other expenses (fixed costs lower by 25% y-o-y) limited the decline in OPM to 63 bps to 9.3% (much better than our expectation of 6.5%). However, operating profit declined by 37.7% y-o-y to Rs. 121.5 crore due to lower operating leverage. Higher interest and depreciation charges and lower revenue dragged down profit before tax (PBT) significantly to Rs. 2.6 crore. Adjusted PAT came in at Rs. 12 crore in Q2FY2021 as compared to Rs. 45.9 crore in Q2FY2020. There was an exceptional item of Rs. 22.3 crore pertaining to provision for diminution in investments in joint venture/associate company and separation costs paid to employees. Thus, the company reported a loss of Rs. 5.9 crore.

Denim, woven and garment revenues reached 60-80% of pre-COVID levels: The textile business recovered to 62% of pre-COVID levels (75% recovery in September), with revenue increasing sequentially from Rs. 436 crore in Q1FY2021 to Rs. 1,017 crore in Q2FY2021. Demand for denims picked in the domestic and as well as exports markets; hence, sales volumes of the denim segment recovered to 80% (108% in the export market and 54% in the domestic market). Woven sales volumes witnessed a 59% recovery (56% in the export market and 60% in the domestic market). Denim realisations stood flat whereas woven realisations dipped considerably due to higher demand for low-value products. The garment business' sales volumes reached 66% of pre-COVID levels driven by good recovery in jeans and knitwear. The domestic B2C segment has been affected by lockdowns. Retailers had adequate inventory of the last year but they have started placing small orders. Demand for fresh inventory is expected to come in by the end of Q3FY2021 in the domestic market. Globally, enquiries from customers in Europe and the US have started flowing in as retailers have started gradually operating. Moreover, some of the new customers are planning to relocate their supply base in India and benefit of the same would start flowing in from Q4FY2021. AMD has witnessed robust demand and has fully recovered to pre-COVID levels. EBITDA margins of the textiles business expanded by 80 bps to 11.6% and of AMD expanded by 110 bps to 15%, driven by higher share of exports and efficient cost management.

Other conference call highlights

- Overall volumes grew sequentially led by healthy growth in export demand. Domestic market has also shown sequential improvement. Denim and woven recovery was at 54% and 60% in the domestic market. Export volumes have bounced back to pre-COVID levels and realisations stood stable. There was a strong demand in the value segment, which was reflected in realisations in the woven segment. Capacity utilisation is back to normal in the garmenting segment. AMD has seen robust demand and the order book is healthy at 2-3 months. Focus is on increasing the share of exports in the medium term.
- Arvind is expecting sequential growth of over ~10% in Q3FY2021 as compared to Q2 driven by good volumes in the woven segment and sales recovery in the domestic market. The company expects OPM of 13% and 14% for the textile business and AMD, respectively.
- The company has undertaken cost rationalisation measures of 15-20% savings in structural fixed costs as compared to FY2020 levels. The management expects the savings to sustain, which will help OPM to recover to recover to FY2020 levels. Optimum utilisation of capacities and savings in structural fixed costs will help margins to improve in the near to medium term.
- Working capital continues to remain strong. The company has strengthened its balance sheet by reducing debt from Rs. 2,371 crore in FY2020 and Rs. 2,702 crore in June 2020 to Rs. 2,291 crore in September 2020. Further debt reduction of ~Rs. 100 crore is expected in Q3FY2021 and overall debt reduction of ~Rs. 1,000 crore is expected in 18-30 months. The company does not expect any significant capex in the near term.

Results (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	Y-o-Y (%)	Q1FY21	Q-o-Q (%)
Total revenue	1305.2	1962.2	-33.5	599.3	-
Raw material cost	674.0	990.3	-31.9	287.1	-
Employee cost	173.6	256.1	-32.2	147.6	17.6
Other expenses	336.1	520.8	-35.5	193.5	73.7
Total operating cost	1183.7	1767.2	-33.0	628.2	88.4
Operating profit	121.5	195.0	-37.7	-28.9	-
Other income	13.8	11.7	17.7	3.9	-
Interest & other financial cost	60.0	60.5	-0.9	59.3	1.1
Depreciation	72.7	72.7	0.1	71.9	1.1
Profit before tax	2.6	73.5	-96.5	-156.2	-
Tax	-9.5	27.6	-	-58.8	-
Adjusted PAT	12.0	45.9	-73.8	-97.4	-
Extraordinary item	17.9	-3.9	-	0.0	-
Minority Interest (MI)	0.0	-0.1	-	0.1	-
Reported PAT	-5.9	49.7	-	-97.3	-
Adjusted PAT after MI	12.0	45.8	-73.8	-97.3	-
Adj. EPS (Rs)	0.5	1.8	-73.8	-3.8	-
			bps		**bps**
GPM (%)	48.4	49.5	-118	52.1	-374
OPM (%)	9.3	9.9	-63	-4.8	-

Source: Company; Sharekhan Research

Segmental Performance Rs cr

	Q2FY21			Q2FY20		
Particulars	**Revenue**	**EBITDA**	**EBITDA Margin (%)**	**Revenue**	**EBITDA**	**EBITDA Margin (%)**
Textile	1017	118	11.6	1647	179	10.8
Advanced Materials	186	28	14.9	183	25	13.8
Others	103	-24	-	132	-8	-

Source: Company; Sharekhan Research

Outlook

FY2021 to remain subdued, strong recovery expected in FY2022

H1FY2021 was hit by production halts and supply chain issues in Q1 and slower demand recovery in Q2. Recovery was faster in export market but remained a little slower in the domestic market. Thus, FY2021 will remain subdued. Arvind expects an over 10% sequential improvement in revenues in Q3FY2021 driven by good volumes in the woven segment. Faster recovery in the export market, healthy growth in garment sales volumes, and sustained growth in the AMD will help the company post faster recovery in FY2022. Improving capacity utilisation of new garment facilities will drive growth of 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. AMD would maintain its growth trajectory due to better demand. The company expects OPM of 13% and 14% for the textile business and AMD, respectively. Optimum utilisation of capacities and savings in structural fixed costs will help margins to improve in the near to medium term.

Valuation

Retain Buy with an unchanged PT of Rs. 43

We expect a strong recovery in FY2022, driven by a strong recovery in the B2C retail industry in the domestic market, sustained growth in the AMD space and improving demand in 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 by debt reduction and targets a ~Rs. 1,000 crore reduction in over 18-30 months. Thus, we do not expect much stress due to near-term uncertainties. The stock is trading at discounted valuations of 4.5x its FY2023E earnings and 3.5x its FY2023E EV/EBITDA (trading at a discount of ~30% since its listing last year), factoring in near-term headwinds. We maintain our Buy recommendation with an unchanged PT of Rs. 43. Sustained improvement in business fundamentals and balance sheet would act as key re-rating trigger for the stock.

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Raymond	8.3	-	-	17.3	24.1	15.1	22.1	-	2.6
Kewal Kiran Clothing	12.2	31.3	15.9	6.8	22.3	10.4	12.6	4.0	9.1
Arvind	6.9	-	6.2	4.2	5.8	4.0	5.9	3.1	5.8

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, 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 enhancing 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 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 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	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

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;