Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

# Arvind Limited

## Focusing on reducing debt and steady recovery

| Consumer Discretionary | Sharekhan code: ARVIND | Company Update |
|---|---|---|

| 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 | | ↔ | |

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 70** | |
| Price Target: **Rs. 95** | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

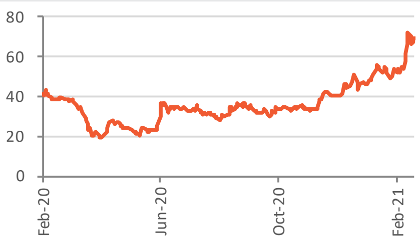
**Company details**

| | |
|---|---|
| Market cap: | Rs. 1,812 cr |
| 52-week high/low: | Rs. 75 / 19 |
| NSE volume: (No of shares) | 25.9 lakh |
| BSE code: | 500101 |
| NSE code: | ARVIND |
| Free float: (No of shares) | 14.2 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 45.1 |
| FII | 13.1 |
| DII | 6.4 |
| Others | 35.5 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 32.0 | 66.7 | 92.6 | 81.1 |
| Relative to Sensex | 28.9 | 49.9 | 60.8 | 58.0 |

*Sharekhan Research, Bloomberg*


**Summary**

- Arvind's Business recovered to 80% in the Q3 with garmenting and denim business recovering to 81% and 89% each; textile business' margins recovered to FY2020 levels at 12.5%.
- The company managed to reduce debt by Rs. 300 crore in 9MFY2021; plans to reduce it further by Rs. 100 crore in Q4 on back of better cash flows.
- High demand in export markets for garmenting and denim products and a sequential recovery in domestic market would help Arvind to improve performance 12% q-o-q in Q4; company aims for EBIDTA margins of 12%.
- The stock is currently trading at 9.2x its FY23E EPS and 4.3x its EV/EBIDTA. We maintain a Buy recommendation with a revised price target of Rs. 95.


**Arvind will be one of the key beneficiaries of the government's revamped focus on improving the textile industry's growth prospects and higher demand for textile products in the international markets. The company's business recovered to 80% in Q3FY21, mainly on account of strong export demand (denim export volumes grew by 103% in Q3). On the other domestic textile sales have started recovering due to relaxation of the lockdown. Domestic denim and woven volumes reached to 74% and 81%, respectively in Q3. Overall the company is expecting a 12% rise in revenues q-o-q. In the medium term, the advanced material business and garmenting business will be growth drivers. The advanced material (that contributes ~13% of the total revenues) is expect to grow in strong double digits and the EBIDTA margins (currently at 14%) are expected to improve by 100 bps per annum as scale of the business increases. The garmenting business is expected to clock revenues ~Rs. 2,000 crore at full capacity. Any rise in input costs will be passed on to customers and hence textile margins are expected to sustain at 12% (stood at 12.5% in Q3). Further, debt has gone down by ~Rs. 300 crore from March 2020 levels and the company expects to repay another Rs. 100 crore in Q4FY2021 with better cash flows. Interest cost fell by 12% in Q3FY2021 and expected to further decrease which will add on to the bottomline in the coming years. The company is monetising its one of the non-core assets (land) and will earning Rs. 200-300 crore over the period of next two years, which will be further utilised to reduce debt on books.**

## Our Call

**View - Maintain Buy with revised PT of Rs. 95:** We expect a strong recovery in FY2022, driven by strong recovery in the B2C retail industry in the domestic market, sustained growth in the AMD space, and improving demand for garmenting and denim products in export markets. The stock is trading at discounted valuations of 9.2x its FY2023E earnings and 4.3x its FY2023E EV/EBITDA. Improved visibility of sustained revenue growth, better margins and a reduction in debt in the coming years would be a key re-rating trigger for the stock. We maintain a Buy recommendation with a revised price target of Rs. 95.

## 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** Rs cr

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Revenues | 7,142 | 7,369 | 5,126 | 7,125 | 7,802 |
| OPM (%) | 10.0 | 9.4 | 8.7 | 9.5 | 10.0 |
| Adjusted PAT | 269 | 128 | 9 | 140 | 197 |
| *% YoY growth* | *-6.1* | *-52.3* | *-93.0* | - | *40.2* |
| Adjusted EPS (Rs.) | 10.4 | 4.9 | 0.3 | 5.4 | 7.6 |
| P/E (x) | 6.7 | 14.4 | - | 12.9 | 9.2 |
| P/B (x) | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 |
| EV/EBIDTA (x) | 5.3 | 5.5 | 7.4 | 5.0 | 4.3 |
| RoNW (%) | 10.1 | 4.6 | 0.3 | 5.1 | 6.8 |
| RoCE (%) | 7.2 | 5.9 | 3.1 | 5.8 | 6.9 |

*Source: Company; Sharekhan estimates*

## Outlook and Valuation

### ■ Sector outlook - Long-term growth prospects improving

The Indian textile sector's performance in H1FY2021 was affected by lesser exports and lower domestic sales during the lockdown period. Demand for textile products improved from August and remained good till October, largely on account of better demand from markets such as the US and Europe. Readymade garment exports rose by 10-14% in September-October. Most textile companies registered good orders from countries such as US and UK due to pent-up demand for apparel and home textile as retailers were building up stocks prior to the festive season. However, the recent spike in COVID-19 cases (especially Europe) acts as a risk to near-term demand. However, long-term growth prospects of the Indian textile industry are intact. The augmentation of capacity with value-added products, key export markets focusing on shifting to India for long-term supply and the government's support policies provide scope for textile companies to post good growth in the long run.

### ■ Company outlook - FY2021 to remain subdued, strong recovery expected in FY2022

The management expects a q-o-q recovery of 12% in Q4FY21 with a sequential revival in domestic market, while growth in exports will depends upon the pandemic scenario. A faster recovery in export markets, healthy growth in garment sales volumes and sustained growth in the AMD business will help the company clock a faster recovery in FY2022. Improving capacity utilisation of new garment facilities will drive 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. EBIDTA margins of the textile business are expected to stand at 12%, while for AMD business would stand at 14%. Better operating leverage and higher margins from AMD would mitigate the impact of a sharp increase in input prices (especially of cotton and yarn) in the near term. The company has maintained its thrust on reducing debt through better profitability and improved working capital management.

### ■ Valuation - Maintain Buy with revised PT of Rs. 95:

We expect a strong recovery in FY2022, driven by strong recovery in the B2C retail industry in the domestic market, sustained growth in the AMD space, and improving demand for garmenting and denim products in export markets. The stock is trading at discounted valuations of 9.2x its FY2023E earnings and 4.3x its FY2023E EV/EBITDA. Improved visibility of sustained revenue growth, better margins and a reduction in debt in the coming years would be a key re-rating trigger for the stock. We maintain a Buy recommendation with a revised price target of Rs. 95.

**Peer Comparison**

| Particulars | P/E (x) | | | EV/EBIDTA (x) | | | RoCE (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| KPR Mill | 16.2 | 12.7 | 10.3 | 9.9 | 8.0 | 6.4 | 17.7 | 22.4 | 25.6 |
| Arvind | - | 12.9 | 9.2 | 7.4 | 5.0 | 4.3 | 3.1 | 5.8 | 6.9 |

*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*

## 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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