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Stock Update

Arvind Limited

Exports driving strong recovery

Consumer Discretionary	Sharekhan code: ARVIND	Result Update

3R MATRIX

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. 52**	
Price Target: **Rs. 68**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

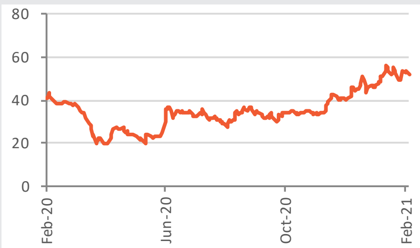
Company details

Market cap:	Rs. 1,346 cr
52-week high/low:	Rs. 58 / 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	-0.1	35.8	59.2	32.9
Relative to Sensex	-4.3	18.1	27.2	8.6

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 revenue recovered to ~80% led by a strong recovery in Denim and garments segment, which stood at 81% and 89%, of pre-COVID levels.
- Textile business' EBIDTA margins reverted to FY2020 levels of 12.5%, while advanced material prices stood at 14%, resulting in a 79 bps improvement in the OPM to 10.7%
- Better operating leverage and higher margins from AMD would mitigate impact of a sharp increase in input prices in the near term. Debt reduced by Rs. 300 crore in last nine months.
- We broadly maintained our earnings estimates for FY2022/23. We maintain our Buy recommendation with TP of Rs. 68.

Q3FY2021 revenues recovered to 81% better than ~66% in Q2FY2021 and a ~32% recovery in Q1FY2021. Revenues stood at Rs. 1513.7 crore, beating our expectation of Rs. 1,455.2 crore. Gross margins improved by 188 bps to 49.8% led by better revenue mix. This along with cost-saving measures aided the OPM expanded by 79 bps to 10.7%. Denim, woven and garment volumes have recovered to 81%, 66% and 89%, respectively of the corresponding quarter driven by healthy export demand. The advanced materials division's (AMD's) revenues grew by 2% to Rs. 188 crore. The denim segment clocked good growth in exports, while domestic volumes are recovering sequentially. Realisations of the woven segment were impacted as the mix shifted towards lower-value products. The garments segment's recovery was driven by good demand for jeans and knitwear. The management expects a sequential recovery of 12% in Q4FY21 in the domestic market, while exports growth will depend upon pandemic scenario. EBIDTA margins in the textile business are expected to stand at 12%, while for the AMD business would stand at 14%. Better operating leverage coupled with higher margins from AMD would mitigate the impact of a sharp increase in input prices (especially the cotton and yarn) in the near term. Debt fell by ~Rs. 300 crore from March 2020 levels and the company expects to repay another Rs. 100 crore in Q4FY2021 with better cash flows. The company is monetising one of its non-core assets (land) and will earn Rs. 200-300 crore over the next two years, which will be further utilised to reduce debt on books.

Key positives

- Business recovered to 81% with the Denim and Garmenting businesses reverting to 81% and 89% of pre-COVID levels, respectively.
- EBITDA margins of the textile business stood at 12.4% in Q3FY2021and recovered to FY2020 levels
- Shift of base from China to India has aided strong recovery in the textile business; strong momentum to sustain.

Key negatives

- Woven business has recovered to just 66% of pre-COVID levels.

Our Call

View - Retain Buy with an unchanged PT of Rs. 68: Arvind will be one of the key beneficiaries of government's revamped focus on improving the textile industry's growth prospects and higher demand for textile products in international markets. 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 for garmenting and denim products in export markets. The stock trades at discounted valuations of 6.7x its FY2023E earnings and 3.7x its FY2023E EV/EBITDA. Improved visibility of sustainable revenue growth and better margins in the coming years would be a key re-rating trigger for the stock. We maintain a Buy recommendation with an unchanged PT of Rs. 68.

Key Risks

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

Valuations (Consolidated) 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	0.34	5.43	7.61
P/E (x)	4.9	10.5	-	9.4	6.7
P/B (x)	0.5	0.5	0.5	0.5	0.4
EV/EBIDTA (x)	4.7	4.8	6.5	4.3	3.7
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

Revenue growth recovered to ~81% in Q3, OPM expanded y-o-y basis due to better mix and efficiencies: Q3FY2021 revenue declined by 19% y-o-y to Rs. 1,513.7 crore as compared to Rs. 1,868.8 crore in Q3FY2020 and Rs. 1305.2 crore in Q2FY2021, driven by a q-o-q improvement in domestic market and traction in key export market. The denim, woven and garment volumes have recovered to 88%, 77% and 90%, respectively, of the corresponding quarter. Gross margins were up by 188 bps to 49.8% due favourable revenue mix. Led by lower other expenses and employee costs, OPM expanded by 78 bps to 10.70% (much better than our expectation). Operating profit declined by 13% y-o-y to Rs. 162.1 crore due to lower operating leverage. Interest costs decreased by 12% y-o-y to Rs. 54.2 crore as debt reduced by Rs. 300 crore the in last nine months. Adjusted PAT came in at Rs. 22.7 crore in Q3FY2021 as compared to Rs. 36.6 crore in Q3FY2020. Reported profit stand at Rs. 22.4 crore.

Denim, woven and garment revenues reached 66-89% of pre-COVID levels: The textile business recovered to 77% of pre-COVID levels, with revenue increasing sequentially from Rs. 1,017 crore in Q2FY2021 to Rs. 1,220 crore in Q3FY2021. Demand for denims picked up in the domestic and as well as exports markets; hence, sales volumes of the denim segment recovered to 88% (103% in the export market and 74% in the domestic market). Woven sales volumes witnessed a 66% recovery (62% in the export market and 81% in the domestic market). Denim realisations stood at Rs. 184/metre vs Rs188/metre of previous year whereas woven realisations dipped considerably due to higher demand for low-value products to Rs146/metre versus Rs167/metre in the previous year. The garment business' sales volumes reached 90% of pre-COVID levels driven by good recovery in jeans and knitwear. The AMD segment has delivered robust growth. EBITDA margins of the textiles business expanded by 30 bps to 12.7% and AMD margin stood at 14.6%, driven by higher share of exports and efficient cost management.

Other conference call highlights

- Prices of all key inputs (including yarn, cotton and chemicals) increased. Most industry players have checked the inflation in the input through passing it on to the customer through relevant negotiation. The company expects some bit of price hike in Q4FY21 as well. This along with a better mix and improving volumes would help in mitigating the input cost pressures in the coming quarters.
- Arvind's woven business is domestic focus business. Most of the top brand houses were selling old inventory during the pandemic. The old inventory is out of the market and brand houses have started placing order for the fresh stock. This will help woven business to see faster recovery in the coming quarters. Further, top brands normally prefer placing order for higher value products compared to local retailers. This will further improve the mix of the business and would help in clocking better margins in the coming quarters.
- Denim business is benefiting from customers shifting base from China to India. Further, some weaker players in the industry have shut their operations completely or reduced their capacity during the pandemic. Further with large at–home population, demand for light denim garment products have increase in domestic and export markets. This has also helped major players to pass on the input cost inflation and post better margins. Denim capacity utilisation currently stands at 85% and with increasing opportunities the company expects to reach full capacity in another 2-3 years.
- Garment capacity is low in the India. Due to a shift of base from China to India there is increase in demand for Indian garment products. The companies who already have established capacities are benefit from shift. Thus, garmenting revenues of Arvind are expected to remain high in the coming years.
- The company has rationalised cost by 10-12% in structural fixed costs as compared to FY2020 levels. The management expects the savings to sustain, which will help OPM to better in FY2022. Optimum utilisation of capacities and savings in structural fixed costs will help margins to improve in the near to medium term.
- The management has maintained its target of debt reduction by ~Rs. 1,000 crore is expected over the next 18-30 months. Out of which Rs. 300 crore have already been paid. The company is planning to sell its non-core assets and generate around Rs. 200-300 crore which will be further utilise to reduce debt on books.

Result (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	Y-o-Y (%)	Q2FY21	Q-o-Q (%)
Total revenue	1513.7	1868.8	-19.0	1305.2	16.0
Raw material cost	759.1	972.4	-21.9	674.0	12.6
Employee cost	184.9	235.3	-21.4	173.6	6.5
Other expenses	407.6	475.7	-14.3	336.1	21.3
Total operating cost	1351.6	1683.4	-19.7	1183.7	14.2
Operating profit	162.1	185.4	-12.6	121.5	33.4
Other income	12.5	14.2	-12.0	13.8	-9.4
Interest & other financial cost	54.2	61.6	-11.9	60.0	-9.6
Depreciation	72.0	74.5	-3.3	72.7	-0.9
Profit before tax	48.3	63.6	-24.0	2.6	-
Tax	25.7	25.1	2.6	-9.5	-
Adjusted PAT	22.6	38.5	-41.3	12.0	87.8
Extraordinary item	0.4	1.2	-70.3	17.9	-97.9
Minority Interest (MI)	0.2	-1.9	-112.1	0.0	-2
Adjusted PAT after MI	22.8	36.6	-37.7	12.0	89.9
Adj. EPS (Rs.)	0.9	1.5	-41.3	0.5	87.8
			bps		**bps**
GPM (%)	49.8	48.0	188	48.4	149
OPM (%)	10.7	9.9	79	9.3	140

Source: Company; Sharekhan Research

Segmental Performance

Particulars	Q3FY21			Q3FY20		
	Revenue	EBITDA	EBITDA Mgn	Revenue	EBITDA	EBITDA Mgn
Textile	1220	151	12.4	1557.87	198	12.7
Advance Materials	189	28	14.6	184.56	25	13.3
Others	116	-3	-2.2	144.25	3	1.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook: Long-term growth prospects improving

The Indian textiles sector's H1FY2021 performance 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 were higher 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 the stock prior to the festive season. However, the recent spike in COVID-19 cases (especially Europe) acts as a risk to the near-term demand environment. 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 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

Arvind's Management expects sequential recovery of 12% in Q4FY21 in the domestic market, while growth in the exports markets will depends upon pandemic scenario. A faster recovery in the export market, healthy growth in garment sales volumes, and sustained growth in the AMD will help the company post 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 in the textile business is 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 the input prices (especially the 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 - Recommend Buy with PT of Rs. 68

Arvind will be one of the key beneficiaries of government's revamped focus on improving the textile industry's growth prospects and higher demand for textile products in international markets. 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 for garmenting and denim products in export markets. The stock trades at discounted valuations of 6.7x its FY2023E earnings and 3.7x its FY2023E EV/EBITDA. Improved visibility of sustainable revenue growth and better margins in the coming years would be a key re-rating trigger for the stock. We maintain a Buy recommendation with an unchanged PT of Rs. 68.

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
KPR Mill	19.4	13.9	10.9	11.3	8.7	6.8	17.7	22.4	25.6
Arvind	148.1	9.4	6.7	6.5	4.3	3.7	3.1	5.8	6.9

Source: Sharekhan Research

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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