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Arvind Limited

Strong demand in exports market will drive growth in the medium term

Consumer Discretionary	Sharekhan code: ARVIND	Result Update

Summary

- Arvind's denim and woven volumes grew by 13% and 12%, respectively; garments volume recovered to 93% in Q4FY2021. OPM expanded by 297 bps to 12.6% with textile EBIDTA margin at 12.6% and advance material EBIDTA margin at 13.8%.
- Demand environment in export markets remain strong (especially in the US); domestic market to regain momentum from Q2/Q3 prior to start of the festive season. In a stable business environment, management targets revenue of Rs. 8,000 crore in FY2023.
- Debt on books has reduced by Rs. 421 crore in FY2021. The company is expected to further reduce it through working capital efficiencies and sale of non-core assets (will fetch Rs. 350 crore in three years).
- The stock is currently trading at attractive valuation of 4.7x its FY2023E EV/EBIDTA. We maintain Buy on Arvind with an unchanged PT of Rs. 95.

Arvind Limited's (Arvind) revenue stood flat in Q4FY2021 at Rs. 1,655 crore. Denim and woven sales volume grew by 13% and 12%, respectively, during the quarter. Garmenting sales volume recovered to 93% (Q2 and Q3 stood at 10mn each). Despite the sharp increase in raw-material prices, gross margin improved by 139 bps to 51.5%, led by better revenue mix and selective price hikes of 4%-5% to pass on raw-material inflation. This along with cost-saving measures aided OPM to expand by 297 bps to 12.6%. Textile business margins remained strong at 12.6% in Q4 (in-line with Q3 margins of 12.5%). The advanced material business revenue grew by 11% to Rs. 198.7 crore and EBIDTA margin of the business stood at 13.8%. Arvind's revenue stood at Rs. 5,073 crore (down 31% y-o-y) and OPM stood stable at 9.1% in FY2021 (due to Rs. 470 crore cost savings). Strong export demand and recovery in the domestic market led to business recovering to 90% in H2FY2021, with OPM at around 12.5%. Opening up of exports markets such as US and Europe and retailers stocking up textile products resulted in strong demand from exports markets. Further, the company has added new customers in its list and is marketing new products to its existing customers, which will drive exports sales in the near term. Further, domestic demand is expected to come back prior to the festive season as domestic retailers will go for fresh buying as old inventory is sold off. Thus, the textile business is expected to post strong recovery from Q2FY2022 in the backdrop of stable business enviornment. Advance material business is expected to grow by 25% in the medium term and would see sustained improvement in margins with scale-up in the business. Operating profit margin (OPM) is expected to remain under pressure in H1FY2022 due to higher non-operating hours in factories during Q1 because of stringent lockdown norms in factory located areas and surge in input cost. However, OPM is expected to remain stable at 11%-12% in H2FY2022 because of strong recovery in the operating performance. The company is planning to save operating cost of Rs. 150 crore-160crore in FY2022. Management targets to achieve revenue of Rs. 8,000 crore in FY2023 without any disruption. OPM will consistently improve because of better revenue mix and higher operating efficiencies. Debt reduced by Rs. 421 crore, which stands at Rs. 1,951 crore at the end of the current fiscal. Management is expected to further reduce it through working capital efficiencies and sale of non-core assets (will fetch Rs. 350 crore in three years).

Key positives

- Volumes of denim and woven segments grew by 13% and 12%, respectively, in Q4FY2021 because of strong export demand.
- EBITDA margin of the textile business stood sturdy 12.6% in Q4FY2021, in-line with Q3 margin of 12.4%.
- The company reduced its debt by Rs. 132 crore in Q4FY2021.
- The company is getting enquiry from new customers from export markets; textile business outlook is strong in the medium term.

Key negatives

- Garment segment sales volume are yet to recover to pre-covid levels.

Our Call

View - Retain Buy with an unchanged PT of Rs. 95: We have reduced our earnings estimates for FY2022 to factor in COVID-led disruption in Q1FY2022 and lower-than-earlier expected margins due to increased raw-material prices. We have fine-tuned our estimates for FY2023 to factor in higher-than-earlier expected export revenue and better OPM. 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 international markets. In the stable business environment, management is confident of doing sales volume of 90 million meter in the denim segment, 125 million-128 million meter in the woven segment and 48 million-50 million pieces in the garments business. Increased revenue, steady improvement in OPM, and reduction in debt would result in strong improvement in return ratios. The stock is currently trading at attractive valuation of 4.7x its FY2023E EV/EBIDTA. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 95.

Key Risks

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

Valuation (Consolidated)

Rs cr

Particulars	FY19	FY20	FY21	FY22E	FY23E
Revenue	7,142	7,369	5,073	6,508	7,874
OPM (%)	10.0	9.4	9.1	9.2	10.4
Adjusted PAT	269	128	1	102	241
Adjusted EPS (Rs.)	10.4	4.9	0.05	4.0	9.3
P/E (x)	7.5	16.0	-	19.7	8.4
P/B (x)	0.7	0.7	0.7	0.7	0.7
EV/EBIDTA (x)	5.6	5.8	8.3	6.2	4.7
RoNW (%)	10.1	4.6	-	3.7	8.3
RoCE (%)	7.2	5.9	3.0	4.9	7.5

Source: Company; Sharekhan estimates

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. 78**	
Price Target: **Rs. 95**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

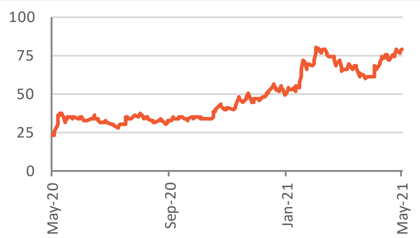
Company details

Market cap:	Rs. 2,020 cr
52-week high/low:	Rs. 84 / 23
NSE volume: (No of shares)	22.7 lakh
BSE code:	500101
NSE code:	ARVIND
Free float: (No of shares)	14.2 cr

Shareholding (%)

Promoters	45.1
FII	15.2
DII	6.4
Others	33.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	28.7	-3.0	91.4	236.2
Relative to Sensex	23.3	-6.9	75.9	169.5

Sharekhan Research, Bloomberg

Revenue stood flat; OPM expanded by 297 bps

Arvind's consolidated revenue stood flat at Rs. 1,654.9 crore, slightly lower than our expectation of Rs. 1,707.4 crore. Revenue of the textile business stood flat at Rs. 1,325 crore. Denim volumes have recovered to 113% of the previous year; Woven volumes recovered to 112% and garment volumes stood at 92% of the previous year. Advance material business revenue grew by 11% to Rs. 198 crore. Margin of the textile business improved to 12.6% (improved by 330 bps y-o-y) despite increased raw-material prices. Advance material business margins stood at 13.8%. Overall gross margins of the company improved by 139 bps to 51.5% and consolidated OPM improved by 297 bps to 12.6%. Operating profit grew by 32% y-o-y to Rs. 208.0 crore. This along with higher other income, lower depreciation charges, and flat interest cost led to a 4.2x increase in PAT to Rs. 63.8 crore (better than our expectation of Rs. 32.7 crore).

Textile revenue remained lower on a full-year basis due to shortfall in H1 but recovered to near FY2020 levels by Q4FY2021

The textile business reported revenue of Rs. 1,331.2 crore in Q4FY2021 as against Rs. 1,350.9 crore in Q4FY2020. On a sequential basis, the segment reported revenue growth of 9.2%, up from Rs. 1,219.1 crore in Q3FY2021. For the full year, revenue declined by 35.2% to Rs. 3,997.4 crore mainly due to COVID-led disruptions. Performance was supported by export markets, where recovery started from Q2 as countries learned to manage COVID-19 and stores started reopening, whereas the domestic market's performance was lagged as customers reduced pipeline inventories and fresh ordering started only for the Diwali/festival season.

In comparison to Q4FY2020, denim volumes recovered to 113% at ~20 million metres and woven volumes to 112% at ~28 million metres. Garment volumes recovered to 92% of FY2020 levels in H2. Denim prices moved up from Rs. 184/m in Q3FY2021 to Rs. 195/m in Q4FY2021. Wovens moved from Rs. 146/m to Rs. 151/m during the same period. Higher volume and better price realisation in the textile segment aided overall profitability.

Advance material business reported revenue growth of 11% and margin improvement despite setbacks in Q1

Advance material business reported revenue growth of 11.3% y-o-y/5.4% q-o-q basis, respectively, to Rs. 198.7 crore in Q4FY2021. For the full year FY2021, revenue declined by 4.8% to Rs. 679.5 crore. Contribution of advance material business to overall business has significantly increased from 9.7% in FY2020 to 13.4% in FY2021. Sports composites and mass transports emerged as promising businesses with clear momentum. Industrial products focused on calibrated capacity addition and cost leadership. Arvind plans to focus on building a differentiated product portfolio for advance material business with 35%-40% gross margin and exit businesses that are taking time to scale.

Key conference call highlights

- **Some misses in Q4 performance:** The supply of export goods was affected by non-availability cargo, which affected revenue by 4%-5% in Q4FY2021. The company has not accrued for export incentives under the RODTEP scheme as new rates are not yet decided by the government. At 2% rate, export incentives would have been around Rs. 12 crore for the quarter.
- **Second COVID-19 wave impacted operations:** Arvind is facing supply-side constraints as its plants in Ahmedabad and Bangalore are impacted by COVID-related issues. Higher absenteeism was recorded in the latter part of April and the first fortnight of May in Ahmedabad plant, which led to a temporary impact on production. However, with cases coming down, absenteeism has reduced and operations are coming back on track. Garmenting plants in Bangalore are likely to remain closed for about one month. Moreover, state-level lockdown norms have led to delay in the supply for inputs /other products from one state to another. Management sees it to be a short-termdisruption and expects things to normalise by July.
- **Buoyancy in textile export to sustain:** Export demand is likely to be resilient across most markets, especially the US. With mobility improving in key international geographies and replacement days for new garment has reduced the demand for garmenting products is expected to improve in the coming quarters. The company has strong order book to cater to the exports markets. China plus factor is playing well for Indian textile companies as new customers have turned to India to fulfill their requirement. Arvind has also added new clients to its list. A number of requests are coming from new clients for new

designs/samples, which give a hint to the company of better order prospects in the coming quarters. Further, existing clients are enquiring for new products from the company. Thus, post normalisation of the pandemic, higher export sales would lead to faster recovery for the company.

- **Domestic demand expected to recover prior to the festive season:** In FY2021, domestic demand took time to recover, as the retailers were engaged in liquidating the old inventory. With most retailer shelfs empty, retailers are expected to stock up prior to the festive season. Hence, domestic demand for textile products is expected to come back by mid of Q2 or early Q3FY2022.
- **Margins are likely to remain under pressure in H1; To recover in H2:** Cotton prices have gone up by 40%. This along with spike in yarn prices and other key input prices would put pressure on margins in the near term. The company has undertaken price hike of 4%-5% to pass on raw-material inflation. Thus, OPM is expected to remain under pressure in H1FY2022 due to higher non-operating hours in factories during Q1 because of stringent lockdown norms in factory located areas and surge in input cost. However, OPM is expected to remain stable at 11%-12% in H2FY2022 because of strong recovery in operating performance.
- **Cost saving of Rs. 150 crore-160crore in FY2022:** Arvind saved operating cost by Rs.470 crore in FY2021. Cost saving was largely on fixed cost element as no operations in Q1FY2021 and limited operations in Q2FY021 led to significant fixed cost savings. The company has undertaken some initiatives to reduce cost. This would result in operating cost of Rs. 150 crore-160crore in FY2022, (alsoaided by lower operational hours in Q1FY2022 due to lockdown led restrictions).
- **Advance material business to grow by 25%:** Advance material business decreased by 5% in FY2021. Management is confident of business growing by 25% in the coming years. This will be driven by repeat orders by existing customers, new customer addition, and addition of more products in the basket. Advance material ended the year with EBIDTA margin of 14.4%. With increased scale of the business, the EBITDA margin of the business is expected to further improve in the coming years.
- **Focus on sustained debt reduction through better cash flows and sell-off of non-core assets:** Arvind's debt has reduced by ~25% over the past two years to Rs. 1,951 crore. In FY2021, it reduced by Rs. 421 crore. This was due to 35% reduction in net working capital for the past two years and limited capital expenditure. Though in Q1 debt is expected to increase by Rs. 150 crore to manage cost in the period of limited operations/sales, management expects it to remain flat on a y-o-y basis. The company plans to monetise two of its land parcels. One land parcel would result in upfront payment of Rs. 90 crore, while the second land parcel is allocated to sister company to develop, which would fetch around Rs. 60 crore-70 crore in FY2022 and Rs. 100 crore each in subsequent years. This will be largely utilised to reduce debt on books.
- **Capital expenditure would be limited in the near term:** At the current capacity, the company is confident of achieving 10% growth in revenue with better capacity utilisation in all its segments. The company has recently added capacities in verticals such as active wearing fabrics, knitted garments, and advance material, which are running at capacity utilisation of 90%. The company is planning to augment capacity in all these verticals over the next 18-36 months, starting with advanced material.
- **Effective tax rate to remain at 33%:** Management has indicated that effective tax for accounting purpose would remain at 33% for FY2022-FY2023. However, actual cash outflow would be at the rate of 18.5% as the company will receive MAT credit.

Result table (consolidated) Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Total revenue	1654.9	1641.6	0.8	1513.7	9.3
Raw material cost	802.1	818.5	-2.0	759.1	5.7
Employee cost	190.4	204.2	-6.8	184.9	3.0
Other expenses	454.4	461.3	-1.5	407.6	11.5
Total operating cost	1446.9	1483.9	-2.5	1351.6	7.1
Operating profit	208.0	157.6	31.9	162.1	28.3
Other income	21.4	8.6	149.0	12.5	71.4
Interest & other financial cost	50.9	52.4	-2.8	54.2	-6.1
Depreciation	68.6	77.0	-11.0	72.0	-4.8
Tax	46.1	21.8	111.3	25.7	79.3
Adjusted PAT	63.8	15.0	-	22.6	182.4
Extraordinary item	10.5	31.5	-66.5	0.4	-
Reported PAT	53.3	-17.3	-	22.4	137.7
Adj. EPS (Rs)	2.5	0.6	-	0.9	182.4
			bps		**bps**
GPM (%)	51.5	50.1	139	49.8	168
OPM (%)	12.6	9.6	297	10.7	186

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q4FY21	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
	Revenue	EBITDA	EBITDA Margin (%)	Revenue	EBITDA	EBITDA Margin (%)
Textile	1325	167	12.6	1352	126	9.3
Advanced Materials	198	27	13.6	179	24	13.4
Others	131	35	26.7	110	17	15.5

Source: Company; Sharekhan Research

Textile business revenue-break up Rs cr

Particulars	Q4FY21	Q4FY20	yoy%	FY2021	FY2020	yoy%
Denim	412	334	23.4	1225	1634	-25.0
Woven	444	390	13.8	1259	2164	-41.8
Garments	360	391	-7.9	1242	1648	-24.6
Others	218	345	-36.8	643	1309	-50.9
eliminations	-109	-108	-	-370	-549	-
Revenues	**1325**	**1352**	**-2.0**	**3999**	**6206**	**-35.6**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Export boom to improve business fundamentals

The Indian textiles sector's H1FY2021 performance was affected by lower exports and lower domestic sales during the lockdown. 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 received strong orders from countries such as the US and UK due to pent-up demand for apparel and home textiles 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 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 government's support policies provide scope for textile companies to post robust growth in the long run.

■ Company outlook - Revenues to reach close to Rs8000crore by FY2023

With exports markets such as US and Europe opened up and retailers stocking up the textile products resulted in strong demand from exports markets. Further the company has added new customers in its list and is marketing new products to its existing customers which will drive the exports sales in the near term. This would result in strong double digit growth in the textile business. Advance material business is expected to grow by 25% in the medium term and would see sustain improvement in the margins with scale-up in the business. The management targets to achieve revenues of Rs8000crore in FY2023 without any disruption. The OPM will consistently improve on back of better revenue mix and higher operating efficiencies.

■ Valuation - Retain Buy with an unchanged PT of Rs. 95

We have reduced our earnings estimates for FY2022 to factor in covid led disruption in Q1FY2022 and lower than earlier expected margins due to increase in raw material prices. We increased our estimates for FY2023 to factor in higher than earlier expected export revenues and better OPM. 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. In stable business environment the management is confident of doing sales volume of 90mn meter in denim segment, 125-128mn meter in woven segment and 48-50mn pieces in garments business. The increase in revenues, steady improvement in the OPM and reduction in debt would result in strong improvement in the return ratios. The stock is currently trading at attractive valuation of 4.7x its FY2023E EV/ EBIDTA. We maintain our Buy recommendation on the stock with an unchanged price target of Rs 95.

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
KPR Mill	20.6	17.2	13.5	13.3	11.1	8.6	25.2	25.6	27.5
Arvind	-	19.7	8.4	8.3	6.2	4.7	3.0	4.9	7.5

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 FY2021 performance was affected by covid-19 disruption. Improving capacity utilisation of the 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. 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 (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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