



## 3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey with check	Red
Right Quality (RQ)	Green with check	Grey	Red
Right Valuation (RV)	Green	Grey with check	Red
	+ Positive	= Neutral	- Negative

## What has changed in 3R MATRIX

	Old		New
RS	Grey	↔	Grey
RQ	Green	↔	Green
RV	Green	↓	Grey

## ESG Disclosure Score NEW

ESG RISK RATING  
Updated Oct 08, 2022

18.36

## Low Risk

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

Source: Morningstar

## Company details

Market cap:	Rs. 2,452 cr
52-week high/low:	Rs. 159 / 82
NSE volume: (No of shares)	11.2 lakh
BSE code:	500101
NSE code:	ARVIND
Free float: (No of shares)	15.3 cr

## Shareholding (%)

Promoters	41.3
FII	13.1
DII	9.9
Others	35.7

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	-3.2	-0.4	-15.6	-33.0
Relative to Sensex	-8.8	-4.4	-28.1	-34.0

Sharekhan Research, Bloomberg

## Arvind Ltd

## Muted Q2; Near-term outlook weak

## Consumer Discretionary

Sharekhan code: ARVIND

Reco/View: Hold



CMP: Rs. 94

Price Target: Rs. 105



Upgrade



Maintain



Downgrade

## Summary

- Arvind Limited (Arvind) posted muted Q2FY2023 numbers as revenue grew marginally by 2.6% y-o-y. Both textile division and advanced materials division (AMD) delivered subdued performance, registering 1.9% and 5.1% y-o-y growth, respectively. Denim/garments volume was down 49%/25% y-o-y.
- Gross margin declined by 189 bps y-o-y due to input cost inflation. However, EBITDA margin stood flat y-o-y at 9.3%, aided by improved operating efficiencies and decline in logistic cost. Correction in cotton prices will drive gross margins, but lower sales volume will keep EBITDA margin at 8-9% in the near term.
- Export demand is expected to remain weak in the near term owing to weak consumer sentiments and inventory reduction by large retailers. However, domestic demand is expected to remain strong, aided by the wedding season. For FY2023, volume is expected to be similar to FY2022.
- The stock is currently trades at 7.3x/5.1x its FY2023E/FY2024E earnings. Owing to near-term headwinds, we downgrade the stock to Hold with a revised PT of Rs. 105.

Arvind Limited (Arvind) reported muted Q2FY2023 performance. Revenue grew by just 2.6% y-o-y to Rs. 2,170 crore, led by lower volumes in the denim and garments business. Textile revenue grew by 1.9% y-o-y, driven by 18%/12% y-o-y growth in the woven/garments business, while the denim business declined by 23% y-o-y. Advanced materials revenue grew by 5.1% y-o-y. Gross margin declined by 189 bps y-o-y, impacted by input cost inflation, while EBITDA margin stood flat at 9.3% aided by improved operating efficiencies. The textile division's EBITDA margin declined by 160 bps y-o-y, while advanced materials division's (AMD) EBITDA margin improved by 50 bps y-o-y. EBITDA declined by 5% y-o-y to Rs. 202 crore and adjusted PAT declined by 7% y-o-y to Rs. 66 crore. After accounting for exceptional items (Rs. 61 crore), reported PAT stood at Rs. 127.3 crore. The company reduced long-term debt of Rs. 27 crore during the quarter. For H1FY2023, revenue grew by 27% y-o-y to Rs. 4,522 crore, while adjusted PAT grew by 2.6x y-o-y to Rs. 174.5 crore and EBITDA margin largely stood flat at 9.3%. Reported PAT grew by 3.6x y-o-y.

## Key positives

- Average realisation of denim and woven improved by 38% and 24% y-o-y, respectively.
- Net debt reduced by Rs. 91 crore in Q2FY2023.

## Key negatives

- Denim/garments volume was down 49%/25% y-o-y due to lower exports.
- The textile division's EBITDA margin declined by 160 bps y-o-y to 9.7%.

## Management Commentary

- In US, large retailers are looking to reduce inventory due to the weak consumer sentiments because of high inflation and interest rate hikes. Many stores have announced shutdowns, thereby leading to loss of revenue and volume going ahead. Management expects volumes to pick up in Q4FY2023, as inventory built-up is reducing and is expected to normalise by mid-Q4. On the other hand, domestic demand is strong, aided by shift from the unorganised to organised sector and the upcoming wedding season.
- Management has indicated that input costs have started to soften, led by falling shipping costs. Management expects input costs to stay range-bound around the current level in the near term. With raw-material prices beginning to soften, gross margin is likely to improve. However, EBITDA is expected to be stable owing to volume pressure. Textile margins are expected to be in double digits in H2 from 9.7% in Q2. The garment division's EBITDA margin is also expected to improve in the coming quarters.
- The company has maintained its guidance of reducing long-term debt by ~Rs. 300 crore for FY2023 with a major part of debt to be reduced in Q4. Out of the total Rs. 300 crore reduction, Rs. 200 crore will be through operating cash flows, while the balance Rs. 100 crore would be from sale of land.

**Revision in estimates** – We have revised downwards our earnings estimates for FY2023/FY2024 to factor in lower sales in export markets due to sustained high inflationary pressures in global markets. We have introduced FY2025 through this note.

## Our Call

**View: Downgrade to Hold Buy with a revised PT of Rs. 105:** Arvind posted muted numbers in Q2FY2023, with revenue growth in low single digit, while the decline in PAT was in high single digit. EBITDA margin was maintained on a y-o-y basis, led by better operating efficiencies. Near-term outlook is weak due to unfavourable macro environment in the US and Europe, which will impact demand, while margin improvement would be dependent on softening of input costs. Having said that, the company is optimistic about its medium-term growth prospects, with emerging opportunities in the export market and improving demand in the domestic market. Better mix and softening input prices would help profitability to improve consistently in the medium-to-long term. The stock is currently trading at 7.3x/5.1x its FY2023E/FY2024E EPS. In view of near-term headwinds, we downgrade the stock to Hold with a revised price target (PT) of Rs. 105.

## Key Risks

Any slowdown in the export market will impact demand, while volatility in input costs will affect earnings growth.

## Valuation (Consolidated)

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenue	5,073	8,023	9,149	10,691	12,590
EBITDA margin (%)	9.1	9.7	8.8	9.2	9.6
Adjusted PAT	8	243	335	473	644
Adjusted EPS (Rs.)	0.3	9.4	13.0	18.3	24.9
P/E (x)	-	10.0	7.3	5.1	3.8
P/B (x)	0.9	0.8	0.7	0.7	0.6
EV/EBITDA (x)	8.8	5.1	4.8	3.5	2.7
RoNW (%)	0.3	8.6	10.8	13.6	16.1
RoCE (%)	3.1	7.7	8.2	10.0	12.0

Source: Company; Sharekhan estimates

## Muted Q2 – Revenue growth at 3% y-o-y; EBITDA margin flat y-o-y

Arvind's revenue grew by 2.6% y-o-y to Rs. 2,169.8 crore, led by modest revenue growth in textile and AMD. Textile revenue grew by 1.9% y-o-y to Rs. 1,759 crore, while advanced materials revenue grew by 5.1% y-o-y to Rs. 313.4 crore. Volumes remained muted during the quarter with denim volume declining from 25 million metre in Q2FY2022 to 13 million metre in Q2FY2023, while garment volume came in at 8 million pieces in Q2FY2023, marginally down from 9 million pieces in Q2FY2022. Overall, consolidated gross margin declined by 189 bps y-o-y to 44.9% due to higher input cost inflation. However, EBITDA margin stood flat y-o-y at 9.3%, led by lower employee expenses and flat other expenses. EBITDA declined by 5% y-o-y to Rs. 201.8 crore, impacted by muted revenue growth. The textile division's EBITDA declined by 11.4% y-o-y, while AMD's EBITDA was reported higher by 11.4% y-o-y. In line with the decline in EBITDA, adjusted PAT fell by 7% y-o-y to Rs. 66 crore. Exceptional items include allowances for doubtful receivables (Rs. 57.2 crore) and provision in value of land (Rs. 30.7 crore). After accounting for the exceptional items, reported PAT stood at Rs. 127.3 crore. The company reduced its long-term debt of Rs. 27 crore during the quarter. For H1FY2023, revenue grew by 27% y-o-y to Rs. 4,522 crore, while adjusted PAT grew by 2.6x y-o-y to Rs. 174.5 crore and EBITDA margin largely stood flat at 9.3%. Reported PAT grew by 3.6x y-o-y.

## Lower volumes impacted the textile division's revenue; Profitability impacted by input cost inflation

The textile business reported revenue of Rs. 1,759 crore in Q2FY2023, registering y-o-y growth of 1.9%, impacted by lower volumes even as realisations improved on a y-o-y basis. The denim segment's revenue declined by 23.4% y-o-y to Rs. 423 crore. The woven segment reported revenue growth of 17.7% y-o-y to Rs. 711 crore, while the garments segment's revenue increased by 12.2% y-o-y to Rs. 450 crore. Price realisation improved across segments, with denim and woven average realisation improving by 38% and 24% y-o-y, respectively, driven by higher prices to offset cost impact and currency impact. EBITDA margin stood at 9.7% in Q2FY2023 versus 11.3% in Q2FY2022, impacted by lower volumes and higher raw-material prices.

### Segment-wise performance

Category	Q2FY2023	Q2FY2022	y-o-y %
Denim	423	552	-23.4
Woven	711	604	17.7
Garments	450	401	12.2
Others	256	282	-9.2
Inter-segment	-81	-113	-
<b>Total</b>	<b>1,759</b>	<b>1,726</b>	<b>1.9</b>

Source: Company, Sharekhan Research

Denim and garment volumes were under pressure, while woven and knits stayed steady. Denim volumes declined by 49% y-o-y to 12.9 million metres, as global brands and retailers postponed buying to reduce inventory and prepare for the expected recession. Domestic volume declined by ~14% y-o-y to 6 million metres, while exports witnessed a steep decline of 61.1% y-o-y to 7 million metres. Garments volumes stood at 8.1 million pieces, down from ~9 million pieces in Q2FY2022. In the woven fabrics segment, volume growth came in at 2% y-o-y to 32 million metres, led by domestic volume growth of 15.4%, while export volumes declined by 5.6% y-o-y.

### Volume growth trend

Category	Market	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Denim	Domestic	7	8	8	8	6
	Exports	18	18	14	12	7
	<b>Total</b>	<b>25</b>	<b>26</b>	<b>22</b>	<b>20</b>	<b>13</b>
Woven	Domestic	13	12	13	14	15
	Exports	18	23	19	18	17
	<b>Total</b>	<b>31</b>	<b>35</b>	<b>32</b>	<b>32</b>	<b>32</b>
<b>Garments</b>	<b>million pcs</b>	<b>9</b>	<b>10</b>	<b>11</b>	<b>10</b>	<b>8</b>

Source: Company, Sharekhan Research

## AMD business expected to gain traction in H2FY2023

The AMD business grew by 5.1% y-o-y to Rs. 313.4 crore in Q2FY2023 and by 20.7% y-o-y to Rs. 593 crore in H1FY2023 as many orders has spilled over from Q1 to Q2 in FY2022. AMD's EBITDA margin improved from 11.8% in Q2FY2022 to 12.3% in Q2 as input cost overhang started to ease in Q2 and businesses continued to scale up. Management has indicated that the AMD business is expected to deliver topline growth of ~20% in

FY2023. Shipping costs have been softening and should help export-oriented businesses. This coupled with softening of input costs would aid in steady margin improvement.

### Key conference call highlights

- ♦ **Export demand expected to remain weak; Domestic demand to be strong in the near term** – Key export customers are deferring fresh buying, given unfavourable macro environment in the US and Europe. In the US, large retailers are looking to reduce inventory due to weak consumer sentiments because of high inflation and interest rate hikes. Many stores have announced shutdowns, thus leading to loss of revenue and volume going ahead. Management expects volumes to pick up in Q4FY2023, as inventory built-up is reducing and is expected to normalise by mid-Q4. Another factor impacting demand is European energy crisis, which has minor impact on volumes. In terms of domestic demand, management has indicated that there is 40-60% growth in retail demand, aided by shift from the unorganised to organised sector and festive demand. The upcoming wedding season will further aid in volume growth. Domestic demand will depend on how quickly cotton prices correct. For FY2023, volume is expected to be similar to FY2022.
- ♦ **Raw-material prices started to soften** – Management has indicated that input costs have started to soften. Cotton prices, which had peaked to Rs. 1 lakh per candy, have come down to Rs. 60,000-70,000 per candy. Prices of other raw materials are also stabilising due to reduced shipping costs. Management expects input costs to stay range-bound around the current level in the near term.
- ♦ **Margins to remain stable:** Gross margin is likely to improve with raw-material prices beginning to soften. However, EBITDA is expected to be stable owing to volume pressures. Textile margins are expected to be in double digits in H2 from 9.7% in Q2. The garment division's EBITDA margin is also expected to improve in the coming quarters.
- ♦ **Long-term debt reduction at ~Rs. 300 crore in FY2023:** The company has reduced its long-term debt to the extent of Rs. 83 crore in H1 and has maintained its guidance of reducing long-term debt by ~Rs. 300 for FY2023 with a major part of debt to be reduced in Q4. The company collected Rs. 40 crore in H1 as advance for land sale and expects to collect a total of Rs. 100 crore in FY2023. Thus, out of the total Rs. 300 crore reduction, Rs. 200 crore will be through operating cash flows, while the balance Rs. 100 crore would be from sale of land.
- ♦ The company plans to incur capex of Rs. 150-180 crore in FY2023.

### Results (Consolidated)

Particulars	Q2FY23	Q2FY22	Y-o-Y (%)	Q1FY23	Q-o-Q (%)
<b>Total revenue</b>	<b>2,169.8</b>	<b>2,115.1</b>	<b>2.6</b>	<b>2,352.1</b>	<b>-7.8</b>
Raw material cost	1,195.2	1,125.1	6.2	1,294.5	-7.7
Employee cost	204.7	212.0	-3.4	227.1	-9.8
Other expenses	568.1	565.5	0.5	610.4	-6.9
Total operating cost	1,968.0	1,902.7	3.4	2,132.0	-7.7
<b>EBITDA</b>	<b>201.8</b>	<b>212.5</b>	<b>-5.0</b>	<b>220.2</b>	<b>-8.4</b>
Other income	11.4	17.6	-35.1	8.5	35.1
Interest & other financial cost	42.3	48.1	-12.1	40.5	4.5
Depreciation	62.1	65.9	-5.8	62.3	-0.2
<b>Profit before tax</b>	<b>108.8</b>	<b>116.0</b>	<b>-6.2</b>	<b>125.9</b>	<b>-13.6</b>
Tax	42.8	45.1	-5.1	17.4	146.2
<b>Adjusted PAT</b>	<b>66.0</b>	<b>70.9</b>	<b>-7.0</b>	<b>108.5</b>	<b>-39.2</b>
Minority Interest (MI)	0.4	0.1	-	0.3	21.9
Extraordinary item	-60.9	0.0	-	0.0	-
<b>Reported PAT</b>	<b>127.3</b>	<b>71.1</b>	<b>79.1</b>	<b>108.8</b>	<b>16.9</b>
Adj. EPS (Rs)	2.5	2.0	23.9	4.2	-39.2
			bps		bps
GPM (%)	44.9	46.8	-189	45.0	-5
EBITDA Margin (%)	9.3	9.2	10	9.4	-6
NPM (%)	5.9	2.5	336	4.6	124
Tax rate (%)	39.3	46.0	-665	13.8	-

Source: Company, Sharekhan Research

## Segmental performance

Rs cr

Particulars	Q2FY23			Q2FY22		
	Revenue	EBITDA	EBITDA Margin (%)	Revenue	EBITDA	EBITDA Margin (%)
Textile	1,759.0	127.8	7.3	1,726.5	180.7	10.5
Advanced Materials	313.4	33.1	10.6	298.3	30.0	10.1
Others	116.1	-74.9	-64.5	103.5	-23.4	-22.6
Less: Inter segment sales	18.7			13.1		
<b>Total revenue</b>	<b>2,169.8</b>	<b>86.0</b>	<b>4.0</b>	<b>2,115.1</b>	<b>187.3</b>	<b>8.9</b>

Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Near-term outlook uncertain; Long-term growth prospects intact

Export demand would stay uncertain as inflation, rising interest rates, and geopolitical disturbances reduce demand visibility in global markets. However, domestic demand would remain firm due to the forthcoming festive season. The 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 the government's support policies provide scope for textile companies to post robust growth in the long run. Textile companies would benefit and report higher profitability with the government extending the RoSCTL scheme until March 2024 and keeping rates unchanged. Margins are likely to remain volatile in the near term but are likely to improve in FY2024. Cotton prices are expected to soften moderately by November upon new crop arrival and margins are expected to improve from Q3FY2023.

### ■ Company outlook - Near-term outlook weak; Medium-long term prospects intact

Export demand is expected to be impacted in the near term due to the slowdown in demand in global markets, while domestic demand is expected to stay strong, led by the upcoming wedding season. Medium-term growth outlook is strong as China + 1 factor, government signing FTAs with various regions, and global retailers looking for alternate supply base provide strong growth visibility in the coming years. Margins are expected to remain volatile in the near term. However, the same is expected to gradually improve once cotton prices correct further from their highs. The company is on track for its debt reduction plan and expects to reduce long-term debt by Rs. 300 crore in FY2023.

### ■ Valuation - Downgrade to Hold Buy with a revised PT of Rs. 105

Arvind posted muted numbers in Q2FY2023, with revenue growth in low single digit, while the decline in PAT was in high single digit. EBITDA margin was maintained on a y-o-y basis, led by better operating efficiencies. Near-term outlook is weak due to unfavourable macro environment in the US and Europe, which will impact demand, while margin improvement would be dependent on softening of input costs. Having said that, the company is optimistic about its medium-term growth prospects, with emerging opportunities in the export market and improving demand in the domestic market. Better mix and softening input prices would help profitability to improve consistently in the medium-to-long term. The stock is currently trading at 7.3x/5.1x its FY2023E/FY2024E EPS. In view of near-term headwinds, we downgrade the stock to Hold with a revised PT of Rs. 105.

## Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
KPR Mill	22.5	20.1	17.0	16.2	13.1	11.0	31.0	27.7	28.0
Arvind	10.0	7.3	5.1	5.1	4.8	3.5	7.7	8.2	10.0

Source: Company, Sharekhan Research

## 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 businesses 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 as 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 advanced material business.

## Investment theme

Arvind delivered strong performance in FY2022, aided by strong volume and realisation growth. 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
Swayam Saurabh	Chief Financial Officer
Ramnik V. Bhimani	Company Secretary

Source: Company

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC AMC	4.60
2	Quant Money Managers Ltd.	3.10
3	Oekoworld Lux SA	1.63
4	Zen Securities	1.38
5	Dimensional Fund Advisors LP	1.36
6	HSBC AMC	0.82
7	Mahindra Manulife Inv. Mgmt. Pvt. Ltd.	0.72
8	Tata Asset Management India	0.31
9	Grantham Mayo Van Otterloo and Co.	0.28
10	Aditya Birla Sun Life AMC Ltd.	0.55

Source: Bloomberg

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## 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 deteriorating 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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