Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Arvind Ltd

Disappointing Q3; Near-term outlook weak

Consumer Discretionary	Sharekhan code: ARVIND
Reco/View: Hold ↔	CMP: **Rs. 86**
	Price Target: **Rs. 95** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 18.36

Updated Dec 08, 2022

Low Risk

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

Source: Morningstar

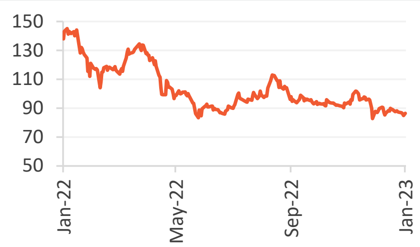
Company details

Market cap:	Rs. 2,255 cr
52-week high/low:	Rs. 159 / 82
NSE volume: (No of shares)	11.4 lakh
BSE code:	500101
NSE code:	ARVIND
Free float: (No of shares)	15.3 cr

Shareholding (%)

Promoters	41.3
FII	12.3
DII	9.1
Others	37.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.6	-7.0	-6.4	-37.4
Relative to Sensex	2.0	-6.0	-9.4	-40.9

Sharekhan Research, Bloomberg

Summary

- As anticipated, Arvind Limited (Arvind) posted yet another muted Q3FY2023 numbers as revenues decreased by 13% y-o-y to Rs. 1,980 crore. . Textile business revenues were down by 19.2% y-o-y with denim/garments volume down 61%/20% y-o-y. AMD business outshined with 20%+ revenue growth.
- EBIDTA margins stood stable at 9.4% for 3rd consecutive quarter. Margins will improve with correction in the key input prices. The company will accrue savings of Rs. 25-30 crore on energy costs through recent investment done.
- Demand in export and domestic markets remained muted. The same is expected to be slightly better in Q4. However, substantial improvement in textile business volume growth will be gradual. AMD business will maintain 20%+ growth.
- The stock currently trades at 6.6x/5.3x/4.0x its FY2023E/FY2024E/FY2025E earnings. With concerns hovering around the core textile business, we maintain Hold recommendation on the stock with revised PT of Rs. 95.

Arvind Limited (Arvind) reported yet another quarter of muted performance in Q3FY2023, with revenues and PAT declining on a y-o-y basis affected by a dismal performance by the core textile business impacted by lower export demand. Arvind's revenues decreased by 13% y-o-y to Rs. 1,979.8 crore with textile business revenues down by 19% to Rs. 549.5 crore. Textile business revenues declined on account of 25% decline in the denim business and a 10% decline in the garment business. AMD business registered a y-o-y growth of 26.5% to Rs. 337.9 crore. Gross margins improved by 230 bps y-o-y to 47.7% on account of a correction in the input prices. However, weaker sales led to 101 bps y-o-y decline in the EBIDTA margins to 9.4%. EBIDTA was down by 21.4% y-o-y to Rs. 186.1 crore. Adjusted PAT decreased by 18% y-o-y to Rs. 77.4 crore during the quarter. In 9MFY2023 revenues grew by 12% y-o-y to Rs. 6,501.7 crore, gross margins decreased by 139 bps y-o-y to 45.8% while OPM largely remained flat at 9.4%, and the adjusted PAT decreased by 56% y-o-y to Rs. 253 crore.

Key positives

- AMD business revenues grew by 26.5% y-o-y to Rs. 338 crore; EBIDTA margins improved by ~100 bps y-o-y to 11.9%.
- Overall debt reduced by Rs. 215 crore (including long term debt of Rs. 135 crore).
- Gross margins improved by 230 bps y-o-y and 275 bps q-o-q to 47.7%.

Key negatives

- Denim/garments volume was down 61%/20% y-o-y due to lower exports.
- EBIDTA margins decreased by 101 bps y-o-y to 9.4% due to lower operating leverage.

Management Commentary

- Most export customers are not making large orders but are postponing their purchases and ordering. Correction in the input prices would lead to smaller purchases or further inventory drop in the coming quarter.
- In the domestic market, the value segment is seeing a moderation in demand while winter products demand was lower due to delayed winters (pick started from January 2023). The distributor is stuck with high-cost inventory in the backdrop of the decline in the cotton price, which might lead to some inventory correction in the coming quarters. The upcoming wedding season and pick-up in the value product demand will drive demand in the domestic market.
- EBIDTA margins have remained consistent at around 9-10% in the last nine months. The cotton prices have corrected from their high but oil prices have remained volatile. The company expects EBITDA margins to correct with a consistent reduction in the input prices.
- The company has maintained its guidance of reducing long-term debt by ~Rs. 300 crore for FY2023. Out of the total debt reduction plan, the company has already repaid Rs. 200 crore in 9MFY2023 and expects to repay another Rs. 100 crore in Q4.
- The company will be doing capex of Rs. 210 crore in FY2023 (AMD and garments being the primary focus). 40% of the capex in FY2023 has gone into AMD and in building newer capacities and 20-25% is towards cost optimization, and the rest is scattered. In FY2024, the company plans to invest Rs. 250 crores which will focus on expanding the capacities in AMD and garments businesses.

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

Our Call

View: Retain Hold with a revised PT of Rs. 95: Arvind posted yet another quarter of muted performance in Q3 with a decline in revenues and PAT. The near-term outlook is weak due to the 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 long-term growth prospects, with emerging opportunities in the export market and improving demand in the domestic market. A better mix and softening input prices would help profitability to improve consistency in the medium-to-long term. The stock is currently trading at 6.6x/5.3x/4.0x its FY2023E/FY2024E/FY2025E EPS. In view of near-term headwinds, we maintain our Hold rating on the stock with a revised price target of Rs. 95 over the next 12-months.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenues	5,073	8,023	8,505	9,082	10,683
EBITDA margin (%)	9.1	9.7	9.5	10.0	10.3
Adjusted PAT	8	243	341	421	564
Adjusted EPS (Rs.)	0.3	9.4	13.2	16.3	21.8
P/E (x)	-	9.2	6.6	5.3	4.0
P/B (x)	0.8	0.8	0.7	0.6	0.5
EV/EBITDA (x)	8.4	4.9	4.4	3.5	2.8
RoNW (%)	0.3	8.6	11.0	12.2	14.4
RoCE (%)	3.1	7.7	8.3	9.2	10.9

Source: Company; Sharekhan estimates

Weak Q3 – Revenue decline at 13% y-o-y; EBITDA margin contracted by 101 bps y-o-y

Arvind's revenue declined by 13% y-o-y to Rs. 1,980 crore in Q3FY2023 due to subdued performance by the textile division, which declined by 19% y-o-y to Rs. 1,550 crore, while the advanced materials division grew by 27% y-o-y to Rs. 338 crore. Volumes remained muted during the quarter, with denim volume declining from 25 million metres in Q3FY2022 to 11 million metres in Q3FY2023, while garment volume came in at 8 million pieces in Q3FY2023, marginally down from 10 million pieces in Q3FY2022. Overall, the consolidated gross margin improved by 230 bps y-o-y to 47.7% due to softening of input costs. However, the EBITDA margin declined by 101 bps y-o-y to 9.4% due to negative operating leverage. EBITDA declined by 21% y-o-y to Rs. 186 crores, impacted by the decline in revenue growth. The textile division's EBITDA margin declined by 165 bps y-o-y to 7.7%, while the AMD division's EBITDA margin improved by 111 bps y-o-y to 11.9%. In line with a decline in EBITDA, adjusted PAT declined by 18% y-o-y to Rs. 77 crore. Exceptional items of Rs. 9 crore includes tax impact of change in tax estimate on profit on sale of subsidiary made during Q2FY23. Reported PAT stood at Rs. 87 crores. The company reduced its long-term debt of Rs. 135 crores during the quarter.

Lower volumes impacted the textile division's performance

The textile business revenue declined by 19% y-o-y to Rs. 1,550 crores in Q3FY2023, as volumes were lower, especially in the denim segment. Also, the price realisations started to trend down since Q2FY2023 reflecting the recent softness in raw material prices. The denim segment's revenue declined by 44.8% y-o-y to Rs. 318 crores, the garments segment reported a revenue decline of 9.5% y-o-y to Rs. 409 crore, while the wowen segment's revenue marginally declined by 1.3% y-o-y to Rs. 695 crore. Price realisation improved across segments, with denim and woven average realisation improving by 27% and 17% y-o-y, respectively. EBITDA margin stood at 7.7% in Q3FY2023 versus 9.4% in Q3FY2022, impacted by lower denim and garment volumes, partly offset by higher realisation.

Segment-wise performance Rs cr

Category	Q3FY2023	Q3FY2022	y-o-y %	Q2FY2023	q-o-q %
Denim	318	576	-44.8	423	-24.8
Woven	695	704	-1.3	711	-2.3
Garments	409	452	-9.5	450	-9.1
Others	251	294	-14.6	256	-2.0
Inter segment	-125	-109	-	-81	-
Total	**1,548**	**1,917**	**-19.2**	**1,759**	**-12.0**

Source: Company, Sharekhan Research

Woven volumes remained strong, denim volumes saw a decline, and garment volumes were under pressure in Q3FY2023. Denim volumes declined by 62% y-o-y to 10 million metres due to lower demand. Domestic volume declined by 50% y-o-y to 4 million metres, while exports witnessed a steep decline of 67% y-o-y to 6 million metres. Denim as a business has been calibrating and the company has been maintaining this for the last few quarters because of extreme volatility in cotton prices; the company's focus has been to curtail the bottom end, primarily focused on managing or working with deals where margins are above a threshold, and/or with strategic customers. As indicated by the management, 12 million meters a quarter is the volume set as a target for future quarters which is roughly 60% of where denim historically used to stand. Denim at the current level is profitable and further benefit in margin will be seen with rupee depreciation and a number of cost optimization initiatives. Other focus for denim is improving verticalisation with the garmenting business, which will create value for the entire chain.

Garments volumes stood at 8 million pieces, down from 10 million pieces in Q3FY2022, impacted by various factors, including the Russia war, which is impacting the buying cycle in Europe and inventory build-up due to covid restrictions. Management believes this business should double in revenue in the next 3-5 years.

In the woven fabrics segment, volume declined by 11% y-o-y to 31 million metres, with domestic volume growth of 8%, while export volumes declined by 22% y-o-y. As stated by the management, woven is running at full capacity and this trend will continue as well as a good demand momentum is expected to be continued in this segment.

Volume growth trend Rs cr

Category	Market	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Denim	Domestic	7	8	8	8	6	4
	Exports	18	18	14	12	7	6
	Total	**25**	**26**	**22**	**20**	**13**	**10**
Woven	Domestic	13	12	13	14	15	13
	Exports	18	23	19	18	17	18
	Total	**31**	**35**	**32**	**32**	**32**	**31**
Garments	**million pcs**	**9**	**10**	**11**	**10**	**8**	**8**

Source: Company, Sharekhan Research

Strong growth in AMD business in Q3

The AMD business grew by 27% y-o-y to Rs. 338 crores in Q3FY2023 aided by strong demand across all segments. AMD's EBITDA margin improved from 10.8% in Q3FY2022 to 11.9% in Q3FY2023 as input cost overhang increased and businesses continued to scale up. Management has indicated that the AMD business is expected to deliver topline growth of ~20% in FY2023.

Key conference call highlights

- **Volatile demand environment:** According to the management, export markets are seeing lower than expected slow-down. Marco environment in US/EU markets has started to show some improvement in the outlook, though the overall prognosis remains cautious given still higher than target inflation in US, continuing war in Europe and the reopening of China. Key export customers continue to defer fresh buying to the last minute given uncertainty. Wholesale buying is yet to pick up, while retail demand in domestic textile and apparel segments is expected to improve from an unexpectedly muted Q3. As per the management, Q4 will be similar to the current quarter with slight improvements. Internationally, demand is on the lower side and will see marginal improvement in the coming quarters.
- **Raw-material prices continue to soften:** The management has indicated that input costs have softened in Q3. 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 remain volatile in the near term. Cotton and other input costs are expected to stay range-bound around the current level, while oil prices may firm up in the near term.
- **Long-term debt reduction at ~Rs. 300 crore in FY2023:** The company has reduced its long-term debt to Rs. 215 crores in Q3FY2023 (including a long-term reduction of Rs. 135 crore) 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.
- **Capex as per plan:** As indicated by the management, the company will be totaling the capex at Rs. 210 crores by FY2023-end (AMD and garments being the primary focus). 40% of the CAPEX in FY2023 has gone into AMD and in building newer capacities and 20-25% is towards cost optimization and the rest is scattered. In FY2024, the company plans to invest Rs. 250 crores which will focus on expanding the capacities in AMD and garments businesses.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y (%)	Q2FY23	Q-o-Q (%)
Total revenue	**1,979.8**	**2,275.7**	**-13.0**	**2,169.8**	**-8.8**
Raw material cost	1,036.2	1,243.4	-16.7	1,195.2	-13.3
Employee cost	218.3	208.9	4.5	204.7	6.6
Other expenses	539.2	586.5	-8.1	568.1	-5.1
Total operating cost	1,793.7	2,038.8	-12.0	1,968.0	-8.9
EBITDA	**186.1**	**236.8**	**-21.4**	**201.8**	**-7.8**
Other income	12.3	13.2	-6.9	11.4	7.9
Interest & other financial cost	43.2	40.5	6.6	42.3	2.2
Depreciation	62.8	67.2	-6.6	62.1	1.1
Profit before tax	**92.4**	**142.3**	**-35.1**	**108.8**	**-15.0**
Tax	15.0	48.1	-68.9	42.8	-65.0
Adjusted PAT	**77.4**	**94.2**	**-17.8**	**66.0**	**17.3**
Minority Interest (MI)	0.4	0.2	-	0.4	-2.6
Extraordinary item	-9.2	0.0	-	-60.9	-84.9
Reported PAT	**87.0**	**94.3**	**-7.8**	**127.3**	**-31.6**
Adj. EPS (Rs)	3.0	3.6	-17.8	2.5	17.3
			bps		**bps**
GPM (%)	47.7	45.4	230	44.9	275
EBITDA Margin (%)	9.4	10.4	-101	9.3	10
NPM (%)	4.4	4.1	25	5.9	-147
Tax rate (%)	16.2	33.8	-	39.3	-

Source: Company, Sharekhan Research

Segmental performance Rs cr

Particulars	Q3FY23			Q3FY22		
	Revenue	EBITDA	EBITDA Margin (%)	Revenue	EBITDA	EBITDA Margin (%)
Textile	1,549.5	119.4	7.7	1,918.1	179.4	9.4
Advanced Materials	337.9	40.3	11.9	267.0	28.9	10.8
Others	115.3	-3.4	-3.0	111.9	-11.1	-9.9
Less: Inter segment sales	22.9			21.4		
Total revenue	**1,979.8**	**156.2**	**7.9**	**2,275.7**	**197.2**	**8.7**

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. The value segment in the domestic market witnessed a drop in demand. However, the same is expected to see some pick up in the quarters ahead. 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 extended 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 in the quarters ahead.

■ 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. The medium-term growth outlook is strong as China + 1 factor, the 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 crores in FY2023.

■ Valuation - Retain Hold with a revised PT of Rs. 95

Arvind posted yet another quarter of muted performance in Q3 with a decline in revenues and PAT. The near-term outlook is weak due to the 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 long-term growth prospects, with emerging opportunities in the export market and improving demand in the domestic market. A better mix and softening input prices would help profitability to improve consistency in the medium-to-long term. The stock is currently trading at 6.6x/5.3x/4.0x its FY2023E/FY2024E/FY2025E EPS. In view of near-term headwinds, we maintain our Hold rating on the stock with a revised price target of Rs. 95 over the next 12-months.

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
KPR Mill	21.1	21.9	17.8	15.2	13.9	11.3	31.0	24.3	26.1
Arvind	9.2	6.6	5.3	4.9	4.4	3.5	7.7	8.3	9.2

Source: Company; Sharekhan Research

About company

Arvind is an innovation-driven and customer-centric global textile play in garments 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 focuses 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 a strong performance in FY2022, aided by strong volume and realisation growth. Improving capacity utilisation of new garment facilities will drive the growth of the textiles business in the medium term. High export demand for textile products and improving efficiencies would hthe elp margins of the textiles business in the near term. The 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 garment segment would act as a key trigger for the stock.

Key Risks

- Volatile currency and higher cotton prices remain among the key risks for margin expansion and would continue to affect earnings growth in the near term.
- Any unexpected slowdown in the garment 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 & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential AMC	7.75
2	Plenty Private Equity Fii	6.66
3	Plenty Ci Fund	2.68
4	Ellipsis Partners	2.26
5	Shah Bhupendra	1.84
6	Franklin Resources	1.72
7	University of Notre Dam	1.18
8	Dimensional Fund Advisors	0.83
9	Nippon Life AMC	0.16
10	Blackrock Inc	0.16

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

Sharekhan

by BNP PARIBAS

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