

## Inflationary headwinds impact margins...

**About the stock:** Established in 1984 by first generation technocrat Rajendra Gogri, Aarti Industries is a leading benzene-based speciality chemical company globally.

- The company primarily operates in two segments – speciality chemicals (84%) and pharma (14%). Pharma is further divided into APIs, intermediates and xanthine derivatives
- Aarti ranks among the top five globally for 75% of its portfolio. Its 200+ products are sold to 700+ domestic and 400+ export customers across the globe in 60 countries with a major presence in the US, Europe and Japan

**Q1FY23 Results:** Numbers were higher on the revenue front while margins got compressed owing to higher RMAT cost.

- Total revenues grew 49.8% YoY to ₹ 1972 crore. Speciality business recorded 46% YoY growth to ₹ 1765.6 crore while pharma business recorded 30% YoY growth to ₹ 407.3 crore
- Gross margins contracted 936 bps YoY to ~44.3% while EBITDA margin declined 511 bps YoY to 18.7% due to higher RMAT cost (+80% YoY)
- Adjusted EBITDA was up 17.7% YoY to ₹ 369.3 crore
- Adjusted PAT increased 14.7% YoY to ₹ 189 crore

**What should investors do?** The stock appreciated at 27% CAGR in last three years.

- We retain **HOLD** rating on the back of better growth outlook from both speciality chemical and pharma segments

**Target Price and Valuation:** We value Aarti Industries at 28x P/E FY24E EPS to arrive at a revised target price of ₹ 885/share (earlier ₹ 860/share).

### Key triggers for future price performance:

- Upcoming capex bodes well for speciality chemical revenue growth
- Higher share of value added business portfolio to improve margins profile of the business
- Allocation of incremental FCF towards organic/inorganic growth likely to expand return ratios further

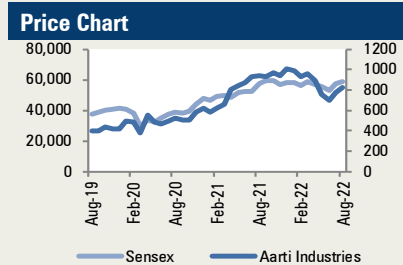
**Alternate Stock Idea:** Apart from Aarti Industries, in our chemical coverage we also like Neogen Chemical.

- Trigger for Neogen Chemical's future revenue growth would be increasing custom synthesis opportunity
- BUY with a target price of ₹ 1645



Particulars	
Particular	Amount
Market cap (₹ Crore)	29,747
FY22 Total Debt (₹ Crore)	2,218
FY22 Cash & Inv (₹ Crore)	257
EV (₹ Crore)	31,708
52 Week H/L	1168/669
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

Shareholding pattern				
in %	Sept-21	Dec-21	Mar-22	Jun-22
Promoter	44.2	44.2	44.2	44.2
DII	14.8	14.5	14.9	15.1
FII	11.9	12.3	12.5	11.8
Others	29.2	29.0	28.5	28.9



- Recent event & key risks**
- Strong realisation growth led overall performance
  - Key Risk:** (i) Higher than expected volatility in RMAT prices (ii) Upcoming capex to lead the growth trend.

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### Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Revenue	4,705.5	4,186.3	4,506.1	6,369.0	15.0%	7,920.2	9,107.7	19.6%
EBITDA	965.1	977.3	981.5	1,320.0	15.1%	1,642.3	2,041.9	24.4%
EBITDA Margins (%)	20.5%	23.3%	21.8%	20.7%		20.7%	22.4%	
Adj. PAT	504.2	536.1	525.8	785.9	20.0%	908.6	1,145.7	20.7%
Adj. EPS (₹)	13.6	14.8	14.5	21.7		25.1	31.6	
EV/EBITDA	32.4x	32.3x	32.9x	24.0x		19.6x	16.0x	
P/E	60.4x	55.4x	56.5x	22.7x		32.7x	25.9x	
ROE (%)	18.7	18.0	15.0	13.3		13.5	14.8	
ROCE (%)	14.6	13.5	10.7	12.0		13.0	13.9	

## Key takeaways of recent quarter & conference call highlight

### Q1FY23 Results: Strong growth from speciality chemical leads overall performance

- **Speciality Chemical:** Revenues before GST were up 46% YoY & 8% QoQ to ₹ 1765.6 crore, largely led by realisation growth. Shortage of key material, nitric acid, continued its impact on Q1 results. Adjusted EBIT margins for speciality chemicals fell ~531 bps YoY to 14.16%
- **Pharma:** Revenue increased 30% YoY to ₹ 407.3 crore, largely led by realisation growth. EBIT margins contracted 32 bps YoY to 18.7%. Margins in the pharma business were impacted owing to delay in passing on entire input price inflation

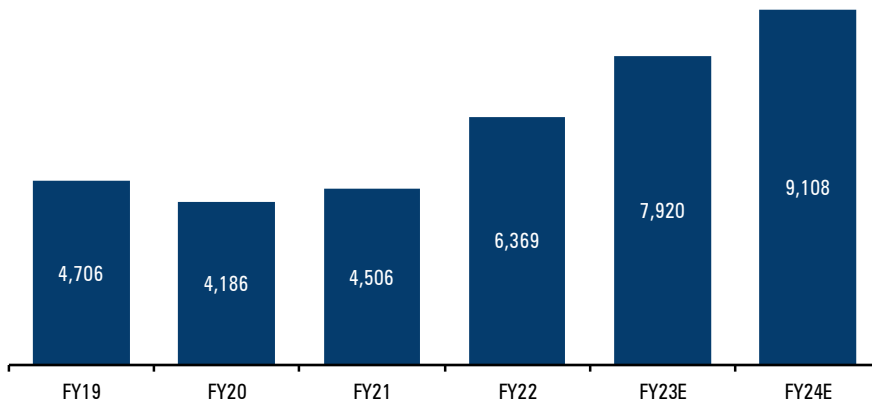
### Q1FY23 Earnings Conference Call highlights

- **Performance Overview**
  - The revenue trajectory was steered by higher volume offtake for key products as well as favourable realisation gains. This was supported by incremental volumes coming from newer capacities added in the recent past. Both first and second long term contract has seen a ramp-up during the quarter. This is expected to further improve in the ensuing quarters
  - Absolute profitability levels were maintained despite significant impact seen on account of higher input and utility costs, combined with logistical challenges and mark to market impact on the ECBs on account of steep depreciation in currency rates during this quarter
    - Absolute delta margin (expressed in per kg terms) generally remains similar, under the robust input price pass-on pricing model
    - PBT includes a negative impact of ₹ 30 crore on account of significant rupee depreciation during the quarter. Excluding this impact, the performance would have been even better
- **Speciality Chemicals**
  - Growth was fuelled by higher volume trajectory
  - Input costs continue to remain high, both YoY and QoQ; pass through of input costs initiated albeit with some time lag
  - Witnessed sustained scale-up from first and second long term contracts during Q1
- **Pharma**
  - Solid growth was led by higher demand trajectory for key products from generic pharma companies and Xanthine businesses
  - Recently commissioned new block at the USFDA approved API facility at Tarapur in early Q2FY23 – will lead to positive contribution in subsequent quarters
  - Impact of elevated input and utility costs passed on to customers leading to healthy realisation trends
- **Project Submission Related**
  - First long term project – Started to see ramp up in volumes. Target utilisation to ~70-80% in FY24
  - Second project – Will commercialise manufacturing in Q4FY22. Utilisation level is progressively increasing. Plan is to reach 80% by FY24

- Third project – Are expected to come on stream on FY23 and will get ramped up in FY23-24
- **Important Development**
  - **Backward integration** – To convert weak nitric acid to concentrated nitric acid. Capacity will be ~225-250 tpd, which will help to meet partial requirement. Capex is estimated ~₹ 150-200 crore  
Tied with technological partner and expect the facility to get commercialised around FY24
  - Benzene rate has gone from ₹ 74 to ₹ 94 in current year.
  - Slowdown in business is due to cost pressure from textile and FMCG industry. Sales from textile and industry is in the range of 10-20%
  - Intermediate for product 1 – Started product of intermediate. Will supply it to both domestic and exports customers
  - Operating leverage will be based on FY24 numbers where ramp up is expected. Asset turnover is expected to be ~1 or 2 (due to more value added products)

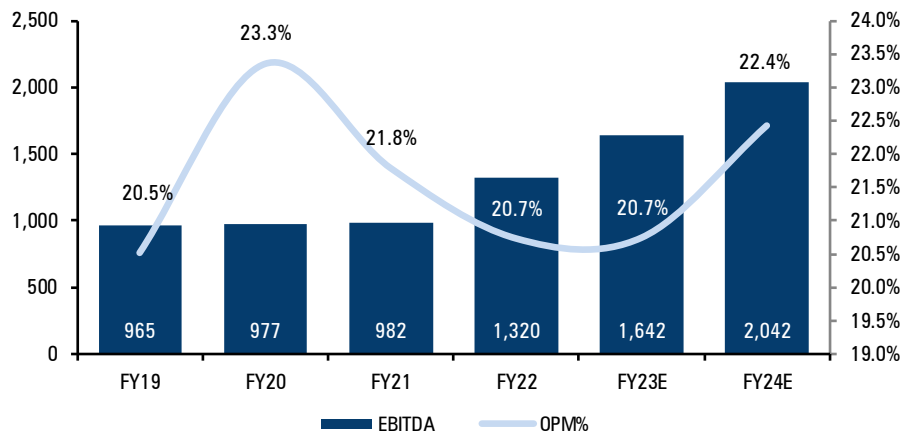
Financial story in charts....

**Exhibit 1: Revenue trend (₹ crore)**



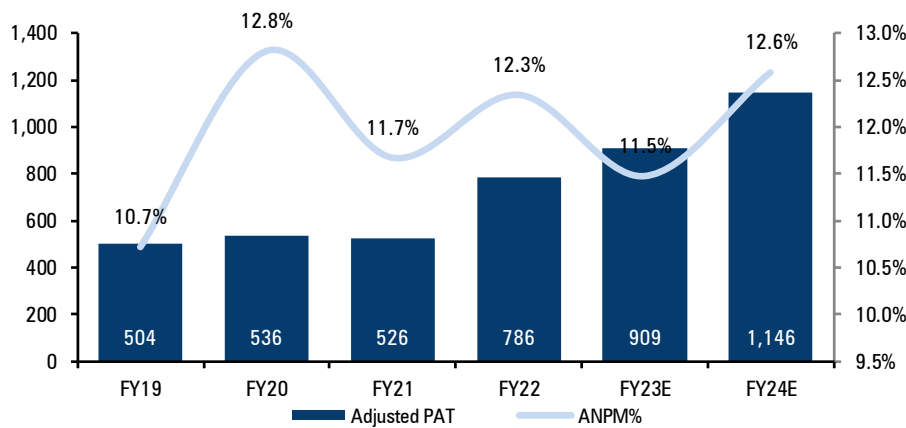
Source: Company, ICICI Direct Research

**Exhibit 2: EBITDA (₹ crore) and OPM (%) trend**



Source: Company, ICICI Direct Research

**Exhibit 3: PAT growth trend (₹ crore)**



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 4: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Operating Income	4,506.1	6,369.0	7,920.2	9,107.7
Growth (%)	7.6	41.3	24.4	15.0
Raw Material Expenses	2,128.6	3,293.8	4,190.1	4,643.4
Gross Profit	2,377.5	3,075.1	3,730.1	4,464.3
Gross Profit Margins (%)	52.8	48.3	47.1	49.0
Employee Expenses	371.4	442.1	501.6	585.1
Other Expenditure	1,024.6	1,335.3	1,586.1	1,837.2
Total Operating Expenditure	3,524.6	5,071.2	6,277.9	7,065.8
<b>EBITDA</b>	<b>981.5</b>	<b>1,320.0</b>	<b>1,642.3</b>	<b>2,041.9</b>
Growth (%)	0.4	34.5	24.4	24.3
Interest	86.4	114.3	144.3	155.9
Depreciation	231.3	288.5	366.7	455.6
Other Income	1.1	0.8	1.5	1.8
<b>PBT before Exceptional Item</b>	<b>664.9</b>	<b>918.0</b>	<b>1,132.8</b>	<b>1,432.2</b>
Less: Exceptional Items	0.0	608.8	0.0	0.0
PBT after Exceptional Items	664.9	1,526.8	1,132.8	1,432.2
Total Tax	129.3	219.4	224.2	286.4
PAT after MI	525.8	1,307.2	908.6	1,145.7
<b>Adjusted PAT</b>	<b>525.8</b>	<b>785.9</b>	<b>908.6</b>	<b>1,145.7</b>
Growth (%)	-1.9	49.5	15.6	26.1
<b>EPS (Adjusted)</b>	<b>14.5</b>	<b>21.7</b>	<b>25.1</b>	<b>31.6</b>

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	567.9	1,259.8	908.6	1,145.7
Add: Depreciation & Amortization	231.3	288.5	366.7	455.6
Net Increase in Current Assets	-136.0	-1,076.2	-686.7	-526.8
Net Increase in Current Liabilities	128.8	-109.6	130.6	102.8
Others	80.7	108.2	144.3	155.9
<b>CF from Operating activities:</b>	<b>872.7</b>	<b>470.8</b>	<b>863.4</b>	<b>1,333.2</b>
Investments	-7.8	0.0	0.0	0.0
(Purchase)/Sale of Fixed Assets	-1,314.4	-1,306.1	-1,209.6	-1,500.0
Others	0.1	0.6	1.5	1.5
<b>CF from Investing activities</b>	<b>-1,322.1</b>	<b>-1,305.5</b>	<b>-1,208.2</b>	<b>-1,498.5</b>
(inc)/Dec in Loan	745.9	-266.3	400.0	500.0
Dividend & Dividend tax	-45.1	-126.9	-90.9	-114.6
Other	-86.4	1,072.4	-144.3	-155.9
CF from Financing activities	614.5	679.2	164.8	229.6
<b>Net Cash Flow</b>	<b>165.0</b>	<b>-155.5</b>	<b>-179.9</b>	<b>64.2</b>
Cash and Cash Equivalent	247.3	412.3	256.8	76.9
<b>Cash</b>	<b>412.3</b>	<b>256.8</b>	<b>76.9</b>	<b>141.1</b>
<b>Free Cash Flow</b>	<b>-441.7</b>	<b>-835.3</b>	<b>-346.2</b>	<b>-166.8</b>

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Equity Capital	87.1	181.3	181.3	181.3
Reserve and Surplus	3,415.8	5,733.2	6,550.9	7,582.0
Total Shareholders funds	3,502.9	5,914.5	6,732.2	7,763.3
Total Debt	3,022.1	2,217.6	2,617.6	3,117.6
Deferred Tax Liability	233.9	250.2	255.2	260.3
Minority Interest	12.2	0.7	0.7	0.7
Other Non Current Liabilities	224.4	240.0	244.8	249.7
<b>Source of Funds</b>	<b>6,995.6</b>	<b>8,623.1</b>	<b>9,850.6</b>	<b>11,391.7</b>
Gross Block - Fixed Assets	5,192.4	6,086.4	7,786.4	9,486.4
Accumulated Depreciation	1,599.9	1,668.5	2,035.2	2,490.8
Net Block	3,592.6	4,417.9	5,751.2	6,995.6
Capital WIP	1,297.9	1,490.4	1,000.0	800.0
Fixed Assets	4,890.5	5,908.3	6,751.2	7,795.6
Investments	63.5	73.1	73.1	73.1
Other non-Current Assets	320.1	417.7	426.0	434.5
Inventory	935.7	1,411.3	1,755.1	2,018.2
Debtors	793.7	1,390.5	1,729.2	1,988.4
Other Current Assets	225.9	215.0	219.3	223.7
Cash	412.3	256.8	76.9	141.1
Total Current Assets	2,367.6	3,273.7	3,780.5	4,371.5
Creditors	576.3	490.1	609.4	700.8
Provisions	40.1	103.0	105.1	107.2
Other Current Liabilities	29.6	456.6	465.8	475.1
Total Current Liabilities	646.1	1,049.7	1,180.3	1,283.1
Net Current Assets	1,721.5	2,224.0	2,600.2	3,088.4
<b>Application of Funds</b>	<b>6,995.6</b>	<b>8,623.1</b>	<b>9,850.6</b>	<b>11,391.7</b>

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Per share data (₹)</b>				
Reported EPS	14.5	36.1	25.1	31.6
Cash EPS	12.3	18.1	22.6	28.4
BV per share	96.6	163.2	185.7	214.2
Cash per Share	11.4	7.1	2.1	3.9
Dividend per share	2.2	3.6	2.5	3.2
<b>Operating Ratios (%)</b>				
Gross Profit Margins	52.8	48.3	47.1	49.0
EBITDA margins	21.8	20.7	20.7	22.4
Adjusted PAT Margins	11.7	12.3	11.5	12.6
Cash Conversion Cycle	93.4	132.5	132.5	132.5
Asset Turnover	0.9	1.0	1.0	1.0
EBITDA conversion Rate	88.9	35.7	52.6	65.3
<b>Return Ratios (%)</b>				
RoE	15.0	13.3	13.5	14.8
RoCE	10.7	12.0	13.0	13.9
RoIC	14.2	15.0	14.5	15.2
<b>Valuation Ratios (x)</b>				
P/E	56.5	22.7	32.7	25.9
EV / EBITDA	32.9	24.0	19.6	16.0
EV / Net Sales	7.2	5.0	4.1	3.6
Market Cap / Sales	6.6	4.7	3.7	3.3
Price to Book Value	8.5	5.0	4.4	3.8
<b>Solvency Ratios</b>				
Debt / EBITDA	3.1	1.7	1.6	1.5
Debt / Equity	0.9	0.4	0.4	0.4
Current Ratio	3.0	2.9	3.1	3.3
<b>Quick Ratio</b>				
Inventory days	75.8	80.9	80.9	80.9
Debtor days	64.3	79.7	79.7	79.7
Creditor days	46.7	28.1	28.1	28.1

Source: Company, ICICI Direct Research

**Exhibit 8: ICICI Direct coverage universe (Chemicals)**

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
SRF	2340	2,735	Buy	69,466	63.5	68.9	82.7	36.1	33.2	27.7	22.4	20.6	17.0	23.8	21.6	22.5	22.1	20.3	20.4
PI Industries	3200	3,710	Buy	48,550	55.5	67.2	82.4	57.6	47.6	38.8	40.8	34.2	27.8	16.3	17.1	18.2	13.8	14.5	15.2
Aarti Industries	819	885	Hold	25,812	36.1	25.1	31.6	22.7	32.7	25.9	24.0	19.6	16.0	12.0	13.0	13.9	13.3	13.5	14.8
Tata Chemical	1155	1,370	Buy	29,747	47.5	63.6	73.0	24.3	18.2	15.8	14.7	10.9	8.5	6.6	8.4	9.0	6.6	8.3	8.8
Vinati Organics	2238	2,320	Hold	23,000	33.7	40.1	51.5	56.0	47.1	36.7	44.7	37.0	28.3	24.3	23.2	23.9	19.0	19.1	20.5
Sumitomo Chemical	476	565	Buy	23,809	8.5	10.9	12.5	56.1	43.5	38.0	38.9	30.4	26.1	30.2	30.4	28.2	22.0	22.6	21.0
Navin Fluorine	4200	4,450	Hold	20,812	52.3	67.4	89.0	80.3	62.3	47.2	58.4	41.8	30.6	17.8	18.7	19.6	14.0	15.8	17.9
Rallis India	208	200	Hold	3,987	8.4	8.9	12.4	24.3	23.1	16.6	13.9	14.1	10.1	12.7	11.6	15.3	9.7	9.5	12.1
Sudarshan chemical	455	515	Hold	3,153	18.8	19.3	28.5	24.0	23.3	15.8	14.2	12.8	9.6	10.9	11.3	15.4	15.6	14.3	18.3
Neogen Chemicals	1422	1,645	Buy	3,545	17.9	27.2	32.9	79.5	52.2	43.2	41.8	30.2	25.0	12.0	15.0	16.2	10.2	13.6	14.3
Astec Lifesciences	1791	2,215	Buy	3,509	45.1	54.8	69.3	39.7	32.7	25.9	24.6	20.7	16.5	19.3	17.7	19.4	22.3	21.3	21.2

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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