

## Upcoming capex bodes well for growth outlook...

**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

**Q2FY22 Results:** Topline was above estimates but margins missed owing to the subdued operational performance from pharma

- Reported revenue growth was 32.3% YoY to ₹ 1551.6 crore, led by higher growth from speciality chemical segment (up 36% YoY)
- Gross margins declined 370 bps YoY to ~47% while EBITDA margin contracted 170 bps YoY to 20%, due to absorption of fixed overheads
- EBITDA was up 21.8% YoY to ₹ 309.8 crore
- PAT increased 23.6% YoY to ₹ 176.1 crore

**What should investors do?** The stock appreciated at 41% CAGR in last five years.

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

**Target Price and Valuation:** We value Aarti Industries at 35x P/E FY23E EPS to arrive at a revised target price of ₹ 1120/share (earlier ₹ 1085/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 ₹ 1570



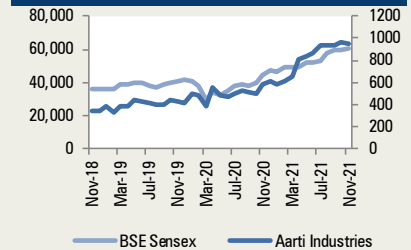
### Particulars

Particular	Amount
Market cap (₹ Crore)	34,744
FY21 Total Debt (₹ Crore)	2,492
FY21 Cash & Inv (₹ Crore)	412
EV (₹ Crore)	36,824
52 Week H/L	1168/495
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

### Shareholding pattern

in %	Dec-20	Mar-21	Jun-21	Sept-21
Promoter	47.3	46.8	44.9	44.2
DII	14.6	15.6	13.6	14.8
FII	9.0	8.7	11.9	11.9
Others	29.1	28.9	29.6	29.2

### Price Chart



### Recent event & key risks

- Pharma business margins likely to get normalised ahead
- Key Risk:** (i) Higher than expected volatility in RMAT prices (ii) Slowdown in end user industries demand to hurt growth

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### Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Revenue	4,705.5	4,186.3	4,506.1	8.4%	5,821.9	8,459.7	37.0%
EBITDA	965.1	977.3	981.5	11.4%	1,278.1	1,952.4	41.0%
EBITDA Margins (%)	20.5%	23.3%	21.8%		22.0%	23.1%	
Adj. PAT	504.2	536.1	525.8	15.4%	681.6	1,160.9	48.6%
Adj. EPS (₹)	13.6	14.8	14.5		18.8	32.0	
EV/EBITDA	37.9x	37.6x	38.3x		29.0x	19.2x	
P/E	71.1x	65.2x	66.5x		51.3x	30.1x	
ROE (%)	18.7	18.0	15.0		12.8	18.3	
ROCE (%)	14.6	13.5	10.7		11.0	16.1	

## Key takeaways of recent quarter & conference call highlight

### Q2FY22 Results: Strong growth from speciality chemical leads overall performance

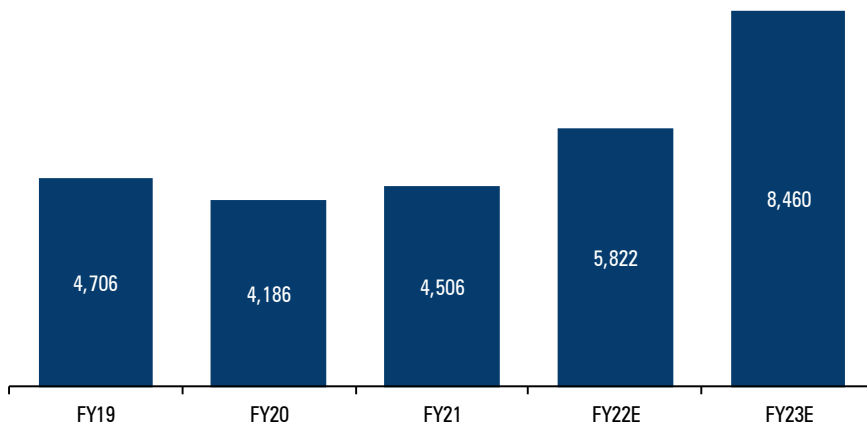
- **Speciality Chemical:** Revenues were up 36% YoY & 21% QoQ to ₹ 1483.5 crore, largely led by realisation growth. Volumes grew 7% YoY. Further, there has been income recognition of around \$7 million towards the shortfall fees in respect of the first long term contract, which has also supported performance, to some extent. EBIT margins for speciality chemicals fell ~95 bps YoY to 16.3%
- **Pharma:** Revenue increased 15% YoY to ₹ 278.5 crore, largely led by realisation growth. EBIT margins contracted 932 bps YoY to 14.8%. Margins in the pharma business were impacted owing to delay in the passing on entire input price inflation. Moreover, increased cost due to trial runs led higher operational cost and thereby dragged the operational performance

### Q2FY22 Earnings Conference Call highlights

- Sustained revenue growth driven by volume expansion and 74% contribution from value-added products
- Domestic demand for discretionary products has returned to pre-Covid levels while for exports markets the same are recovering gradually
- Higher crude prices led to an improvement in benzene prices. Hence, it is able to hike prices for different business portfolios
- Key projects such as project of long term contracts, pharma expansion are nearing the final stages and are expected to commercialised in H2FY22
- **Speciality chemical:** The company has operated at around 90% utilisation levels. The share of revenue from value added products was 74% during the quarter. Volume growth for the quarter remains 7% YoY
- Pharma margins for the quarter were impacted owing to lag in passing on input price inflation.
- Second long term contract is expected to be commissioned in Q3FY22. The full ramp up can be seen from FY23. The third long term contract would be commissioned by Q1FY23
- The company has received income of around US\$7 million towards the shortfall fees in respect of the first long term contract
- Reiterated revenue guidance of over 25% for FY22
- Capex in Q2FY22: ₹ 317 crore; 6M aggregate capex of ₹ 620 crore – in line with guidance of ₹ 1,200-1,500 crore for FY22

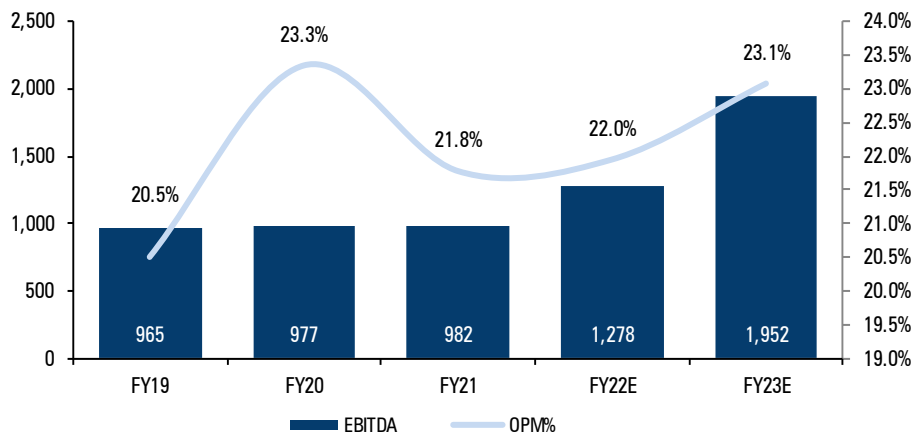
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



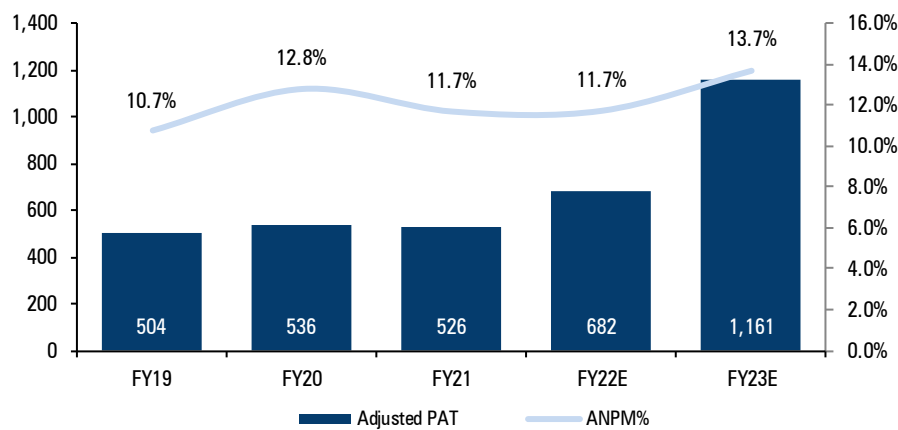
Source: Company, ICICI Direct Research

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)	FY20	FY21	FY22E	FY23E
Total Operating Income	4,186.3	4,506.1	5,821.9	8,459.7
Growth (%)	-11.0	7.6	29.2	45.3
Raw Material Expenses	2,056.3	2,128.6	2,938.4	4,270.8
Gross Profit	2,130.0	2,377.5	2,883.5	4,188.8
Gross Profit Margins (%)	50.9	52.8	49.5	49.5
Employee Expenses	305.2	371.4	405.1	476.6
Other Expenditure	847.4	1,024.6	1,200.3	1,759.9
Total Operating Expenditure	3,209.0	3,524.6	4,543.8	6,507.3
<b>EBITDA</b>	<b>977.3</b>	<b>981.5</b>	<b>1,278.1</b>	<b>1,952.4</b>
Growth (%)	1.3	0.4	30.2	52.8
Interest	124.8	86.4	137.3	167.6
Depreciation	185.2	231.3	287.7	350.7
Other Income	8.8	1.1	1.6	21.1
<b>PBT before Exceptional Item</b>	<b>676.2</b>	<b>664.9</b>	<b>854.6</b>	<b>1,455.3</b>
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	676.2	664.9	854.6	1,455.3
Total Tax	129.4	129.3	173.0	294.7
PAT after MI	536.1	525.8	681.6	1,160.9
<b>Adjusted PAT</b>	<b>536.1</b>	<b>525.8</b>	<b>681.6</b>	<b>1,160.9</b>
Growth (%)	6.3	-1.9	29.6	70.3
<b>EPS (Adjusted)</b>	<b>14.8</b>	<b>14.5</b>	<b>18.8</b>	<b>32.0</b>

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Profit/(Loss) after taxation	512.3	567.9	681.6	1,160.9
Add: Depreciation & Amortiza	185.2	231.3	287.7	350.7
Net Increase in Current Asset	-68.6	-136.0	-417.1	-975.1
Net Increase in Current Liabili	358.8	128.8	63.1	290.5
Others	114.3	80.7	130.3	167.6
<b>CF from Operating activities</b>	<b>1,102.1</b>	<b>872.7</b>	<b>745.5</b>	<b>994.5</b>
Investments	1.3	-7.8	0.0	0.0
(Purchase)/Sale of Fixed Ass	-1,125.5	-1,314.4	-1,200.0	-1,200.0
Others	0.2	0.1	3.0	3.1
<b>CF from Investing activities</b>	<b>-1,124.1</b>	<b>-1,322.1</b>	<b>-1,197.0</b>	<b>-1,196.9</b>
(inc)/Dec in Loan	-303.2	745.9	200.0	0.0
Dividend & Dividend tax	-106.4	-45.1	-68.2	-116.1
Other	-125.4	-86.4	1,062.7	-167.6
CF from Financing activities	-534.9	614.5	1,194.5	-283.6
<b>Net Cash Flow</b>	<b>-556.9</b>	<b>165.0</b>	<b>743.0</b>	<b>-486.1</b>
Cash and Cash Equivalent	804.2	247.3	412.3	1,155.4
<b>Cash</b>	<b>247.3</b>	<b>412.3</b>	<b>1,155.4</b>	<b>669.3</b>
<b>Free Cash Flow</b>	<b>-23.4</b>	<b>-441.7</b>	<b>-454.5</b>	<b>-205.5</b>

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Equity Capital	87.1	87.1	181.3	181.3
Reserve and Surplus	2,891.7	3,415.8	5,128.0	6,172.8
Total Shareholders funds	2,978.8	3,502.9	5,309.3	6,354.1
Total Debt	2,094.2	3,022.1	3,222.1	3,222.1
Deferred Tax Liability	211.0	233.9	238.6	243.4
Minority Interest	94.6	12.2	12.5	12.7
Other Non Current Liabilities	550.9	224.4	228.9	233.5
<b>Source of Funds</b>	<b>5,929.5</b>	<b>6,995.6</b>	<b>9,011.4</b>	<b>10,065.8</b>
Gross Block - Fixed Assets	3,837.0	5,192.4	6,492.4	7,792.4
Accumulated Depreciation	1,368.6	1,599.9	1,887.5	2,238.2
Net Block	2,468.5	3,592.6	4,604.9	5,554.2
Capital WIP	1,417.6	1,297.9	1,197.9	1,097.9
Fixed Assets	3,886.1	4,890.5	5,802.8	6,652.1
Investments	37.0	63.5	63.5	63.5
Other non-Current Assets	404.5	320.1	326.5	333.0
Inventory	835.7	935.7	1,116.5	1,622.4
Debtors	753.4	793.7	1,025.5	1,490.1
Other Current Assets	168.5	225.9	230.4	235.0
Cash	247.3	412.3	1,155.4	669.3
Total Current Assets	2,004.9	2,367.6	3,527.8	4,016.8
Creditors	345.2	576.3	638.0	927.1
Provisions	39.9	40.1	40.9	41.7
Other Current Liabilities	18.0	29.6	30.2	30.8
Total Current Liabilities	403.1	646.1	709.1	999.6
Net Current Assets	1,601.8	1,721.5	2,818.6	3,017.1
<b>Application of Funds</b>	<b>5,929.5</b>	<b>6,995.6</b>	<b>9,011.4</b>	<b>10,065.8</b>

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>				
Reported EPS	14.8	14.5	18.8	32.0
Cash EPS	11.2	12.3	16.9	28.8
BV per share	82.2	96.6	146.5	175.3
Cash per Share	6.8	11.4	31.9	18.5
Dividend per share	3.6	2.2	1.9	3.2
<b>Operating Ratios (%)</b>				
Gross Profit Margins	50.9	52.8	49.5	49.5
EBITDA margins	23.3	21.8	22.0	23.1
Adjusted PAT Margins	12.8	11.7	11.7	13.7
Cash Conversion Cycle	108.5	93.4	94.3	94.3
Asset Turnover	1.1	0.9	0.9	1.1
EBITDA conversion Rate	112.8	88.9	58.3	50.9
<b>Return Ratios (%)</b>				
RoE	18.0	15.0	12.8	18.3
RoCE	13.5	10.7	11.0	16.1
RoIC	18.6	14.2	14.9	19.3
<b>Valuation Ratios (x)</b>				
P/E	65.2	66.5	51.3	30.1
EV / EBITDA	37.6	38.3	29.0	19.2
EV / Net Sales	8.8	8.3	6.4	4.4
Market Cap / Sales	8.3	7.8	6.0	4.1
Price to Book Value	11.7	10.0	6.6	5.5
<b>Solvency Ratios</b>				
Debt / EBITDA	2.1	3.1	2.5	1.7
Debt / Equity	0.7	0.9	0.6	0.5
Current Ratio	4.4	3.0	3.3	3.3
<b>Quick Ratio</b>	<b>2.3</b>	<b>1.6</b>	<b>1.8</b>	<b>1.7</b>
Inventory days	72.9	75.8	70.0	70.0
Debtor days	65.7	64.3	64.3	64.3
Creditor days	30.1	46.7	40.0	40.0

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		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
PI Industries	2963	3,855	Buy	44,961	48.6	59.2	77.1	68.3	56.0	43.0	47.8	39.2	30.1	17.2	18.6	20.4	13.8	14.6	16.1
Aarti Industries	964	1,120	Buy	34,775	14.5	18.8	32.0	66.5	51.3	30.1	38.3	29.0	19.2	10.7	11.0	16.1	15.0	12.8	18.3
Tata Chemical	890	1,035	Buy	22,679	10.1	39.9	49.3	88.5	22.3	18.0	16.9	11.2	8.9	4.1	6.6	7.7	1.8	6.8	7.9
Vinati Organics	1970	2,300	Buy	20,252	26.2	40.2	44.3	74.6	48.6	44.1	56.4	36.2	32.3	21.7	29.4	27.1	17.4	22.1	20.4
Sumitomo Chemical	378	505	Buy	18,868	6.9	8.5	10.1	54.6	44.4	37.4	37.7	30.6	25.3	29.8	29.3	28.1	22.4	22.1	21.2
Navin Fluorine	3397	3,710	Hold	16,829	45.0	53.0	73.1	77.8	66.0	47.9	54.0	46.7	31.9	21.0	19.0	22.6	13.6	14.2	17.0
Rallis India	265	305	Hold	5,161	11.4	9.7	14.0	24.8	29.0	20.2	16.2	18.7	12.9	18.0	14.0	18.4	13.9	11.0	14.0
Sudarshan chemical	568	735	Buy	3,935	20.4	19.4	29.4	27.9	29.2	19.3	15.4	16.2	11.2	15.2	12.8	17.3	19.0	16.0	20.4
Neogen Chemicals	1236	1,570	Buy	2,884	13.4	18.8	28.4	92.1	65.7	43.5	47.9	35.8	26.3	15.1	16.5	18.9	17.1	19.8	23.4
Astec Lifesciences	1200	1,575	Buy	2,351	33.2	39.6	51.3	36.1	30.3	23.4	22.7	19.0	14.9	18.9	19.7	21.0	21.0	20.3	21.0

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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