

CMP: ₹ 770

Target: ₹ 860 (12%)

Target Period: 12 months

HOLD

May 31, 2022

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

Q4FY22 Results: Topline was marginally below while margins missed owing to higher RMAT cost.

- Total revenues grew 45% YoY to ₹ 1755.6 crore. Speciality business recorded 45.1% YoY growth to ₹ 1629.4 crore while pharma business recorded 73.6% YoY growth to ₹ 388.5 crore
- Gross margins contracted 631 bps YoY to ~47.5% while EBITDA margin declined 220 bps YoY to 19.3%, due to higher COGS
- Adjusted EBITDA was up 30.3% YoY to ₹ 339.1 crore
- Adjusted PAT increased 39.1% YoY to ₹ 193.7 crore

What should investors do? The stock appreciated at 31% 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 ₹ 860/share (earlier ₹ 1175/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 ₹ 1870



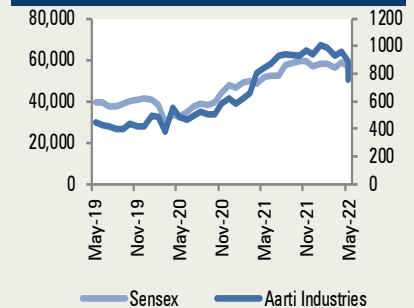
Particulars

Particular	Amount
Market cap (₹ Crore)	29,403
FY22 Total Debt (₹ Crore)	2,218
FY22 Cash & Inv (₹ Crore)	257
EV (₹ Crore)	31,364
52 Week H/L	1168/718
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

Shareholding pattern

in %	Jun-21	Sept-21	Dec-21	Mar-22
Promoter	44.9	44.2	44.2	44.2
DII	13.6	14.8	14.5	14.9
FII	11.9	11.9	12.3	12.5
Others	29.6	29.2	29.0	28.5

Price Chart



Recent event & key risks

- Strong realisation growth led overall performance
- Key Risk:** (i) Better than expected recovery in margins profile (ii) Slowdown in end user industries demand to hurt growth

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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%	7,771.2	8,904.9	18.2%
EBITDA	965.1	977.3	981.5	1,320.0	15.1%	1,606.6	2,002.6	23.2%
EBITDA Margins (%)	20.5%	23.3%	21.8%	20.7%		20.7%	22.5%	
Adj. PAT	504.2	536.1	525.8	785.9	20.0%	886.1	1,113.5	19.0%
Adj. EPS (₹)	13.6	14.8	14.5	21.7		24.4	30.7	
EV/EBITDA	30.6x	30.4x	31.1x	22.6x		18.9x	15.4x	
P/E	56.8x	52.1x	53.1x	21.4x		31.5x	25.1x	
ROE (%)	18.7	18.0	15.0	13.3		13.2	14.4	
ROCE (%)	14.6	13.5	10.7	12.0		12.6	13.6	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlight

Q4FY22 Results: Strong growth from speciality chemical leads overall performance

- **Speciality Chemical:** Adjusted revenues were up 49.3% YoY & down by 28.8% QoQ to ₹ 1629 crore, largely led by realisation growth. Shortage of key material, nitric acid, continued its impact on Q4 results. Adjusted EBIT margins for speciality chemicals fell ~380 bps YoY to 15.1%
- **Pharma:** Revenue increased 52% YoY to ₹ 388 crore, largely led by realisation growth. EBIT margins contracted 280 bps YoY to 17.2%. Margins in the pharma business were impacted owing to delay in the passing on entire input price inflation.

Q4FY22 Earnings Conference Call highlights

- **Future growth projects: FY23-24 (driven by R&D & innovation)**
 - Adding new chemistries and value added products.
 - 40+ products for chemicals
 - 50+ products for pharma
 - EBITDA margin ~25%-30%
 - Capex of about:
 - ₹ 2500-3000 crore for chemicals
 - ₹ 350-500 crore for Pharma
 - Site development work to commence on 100+ acre land at Jhagadia. Also acquired over 120 acres land at Atali, Gujarat.
 - Construction from FY22-24
 - Will drive growth from FY25 and beyond.

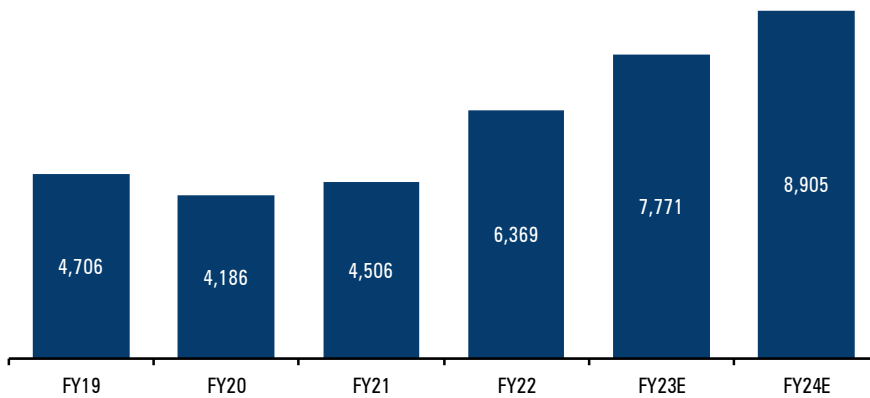
Production Details for FY22

Chemicals	Q4FY22	Q4FY21 (YoY)	Q3FY22 (QoQ)
NitroChloro Benzyne	19,951mt	19,100mt	18,504mt
Hydrogenerated Products	3,029mt	1,935mt	2,878mt
NitroToloyne	5,155mt	2,935mt	3,633mt

- **Project submission related**
 1. First long term project – Target utilisation to around 70-80% in FY24
 2. Second Project – Will commercialise manufacturing in Q4FY22. Incremental revenue will add ~₹ 500 crore in FY23
 3. Third project – Expected to come on stream on FY23 and will ramp up in FY23-24
- **Important Development**
 1. **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 around ~₹ 150-200 crore Tied with technological partner and expect the facility to commercialise around FY24
- **Ongoing demerger process**
Pharma business of Aarti Industries will get demerged into Aarti Pharmalab Limited. An appraisal has been raised in NCLAT Ahmedabad, hearing of which is on June 2022. Post this the company will take ~two to three months to complete the demerger procedure.

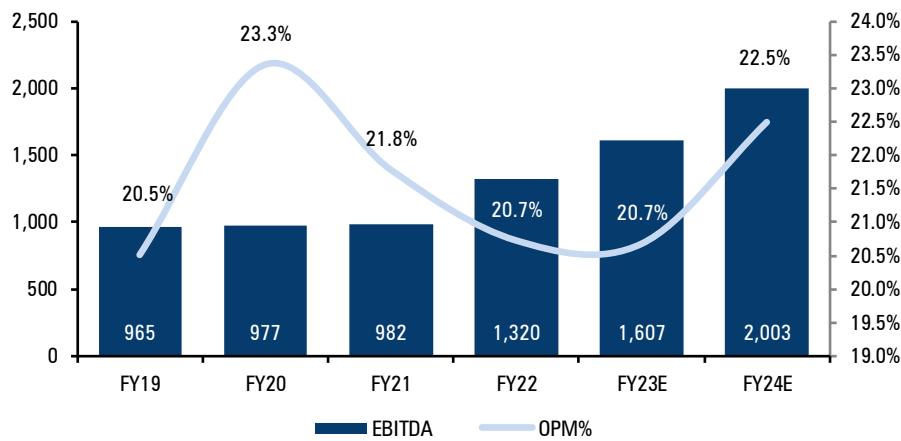
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



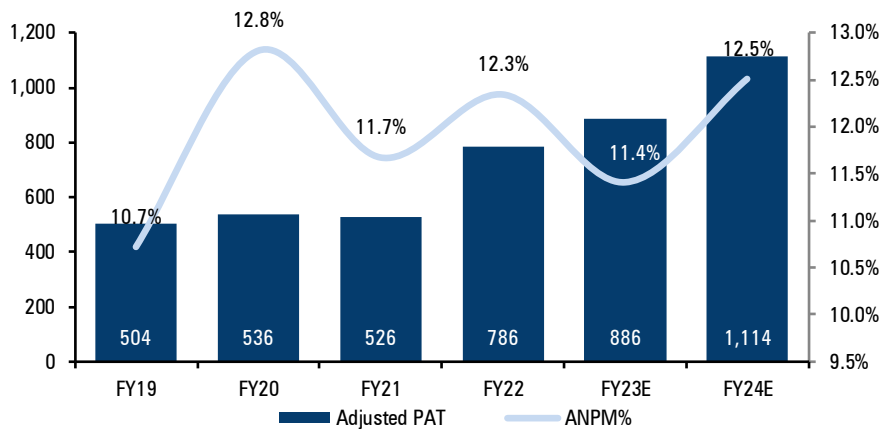
Source: Company, ICICI Direct Research

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	7,771.2	8,904.9
Growth (%)	7.6	41.3	22.0	14.6
Raw Material Expenses	2,128.6	3,293.8	4,049.0	4,539.0
Gross Profit	2,377.5	3,075.1	3,722.1	4,365.9
Gross Profit Margins (%)	52.8	48.3	47.9	49.0
Employee Expenses	371.4	442.1	508.8	571.9
Other Expenditure	1,024.6	1,335.3	1,606.7	1,791.3
Total Operating Expenditure	3,524.6	5,071.2	6,164.5	6,902.3
EBITDA	981.5	1,320.0	1,606.6	2,002.6
Growth (%)	0.4	34.5	21.7	24.6
Interest	86.4	114.3	126.0	155.9
Depreciation	231.3	288.5	373.6	455.6
Other Income	1.1	0.8	0.8	0.9
PBT before Exceptional Items	664.9	918.0	1,107.8	1,392.0
Less: Exceptional Items	0.0	608.8	0.0	0.0
PBT after Exceptional Items	664.9	1,526.8	1,107.8	1,392.0
Total Tax	129.3	219.4	221.6	278.4
PAT after MI	525.8	1,307.2	886.1	1,113.5
Adjusted PAT	525.8	785.9	886.1	1,113.5
Growth (%)	-1.9	49.5	12.8	25.7
EPS (Adjusted)	14.5	21.7	24.4	30.7

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	886.1	1,113.5
Add: Depreciation & Amortizatic	231.3	288.5	373.6	455.6
Net Increase in Current Assets	-136.0	-1,076.2	-621.2	-503.1
Net Increase in Current Liabilitie	128.8	-109.6	119.1	98.7
Others	80.7	108.2	126.0	155.9
CF from Operating activities	872.7	470.8	883.7	1,320.5
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
CF from Investing activities	-1,322.1	-1,305.5	-1,208.2	-1,498.5
(inc)/Dec in Loan	745.9	-266.3	400.0	500.0
Dividend & Dividend tax	-45.1	-126.9	-88.6	-111.4
Other	-86.4	1,072.4	-126.0	-155.9
CF from Financing activities	614.5	679.2	185.4	232.8
Net Cash Flow	165.0	-155.5	-139.1	54.8
Cash and Cash Equivalent	247.3	412.3	256.8	117.7
Cash	412.3	256.8	117.7	172.5
Free Cash Flow	-441.7	-835.3	-325.9	-179.5

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	6,530.7	7,532.9
Total Shareholders funds	3,502.9	5,914.5	6,712.0	7,714.1
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
Source of Funds	6,995.6	8,623.1	9,830.4	11,342.6
Gross Block - Fixed Assets	5,192.4	6,086.4	7,786.4	9,486.4
Accumulated Depreciation	1,599.9	1,668.5	2,042.1	2,497.7
Net Block	3,592.6	4,417.9	5,744.3	6,988.7
Capital WIP	1,297.9	1,490.4	1,000.0	800.0
Fixed Assets	4,890.5	5,908.3	6,744.3	7,788.7
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	1,722.0	1,973.3
Debtors	793.7	1,390.5	1,696.6	1,944.1
Other Current Assets	225.9	215.0	219.3	223.7
Cash	412.3	256.8	117.7	172.5
Total Current Assets	2,367.6	3,273.7	3,755.8	4,313.7
Creditors	576.3	490.1	598.0	685.2
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	1,168.8	1,267.5
Net Current Assets	1,721.5	2,224.0	2,586.9	3,046.2
Application of Funds	6,995.6	8,623.1	9,830.4	11,342.6

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
Reported EPS	14.5	36.1	24.4	30.7
Cash EPS	12.3	18.1	22.0	27.6
BV per share	96.6	163.2	185.2	212.8
Cash per Share	11.4	7.1	3.2	4.8
Dividend per share	2.2	3.6	2.4	3.1
Operating Ratios (%)				
Gross Profit Margins	52.8	48.3	47.9	49.0
EBITDA margins	21.8	20.7	20.7	22.5
Adjusted PAT Margins	11.7	12.3	11.4	12.5
Cash Conversion Cycle	93.4	132.5	132.5	132.5
Asset Turnover	0.9	1.0	1.0	0.9
EBITDA conversion Rate	88.9	35.7	55.0	65.9
Return Ratios (%)				
RoE	15.0	13.3	13.2	14.4
RoCE	10.7	12.0	12.6	13.6
RoIC	14.2	15.0	14.2	14.9
Valuation Ratios (x)				
P/E	53.1	21.4	31.5	25.1
EV / EBITDA	31.1	22.6	18.9	15.4
EV / Net Sales	6.8	4.7	3.9	3.5
Market Cap / Sales	6.2	4.4	3.6	3.1
Price to Book Value	8.0	4.7	4.2	3.6
Solvency Ratios				
Debt / EBITDA	3.1	1.7	1.6	1.6
Debt / Equity	0.9	0.4	0.4	0.4
Current Ratio	3.0	2.9	3.1	3.3
Quick Ratio	1.6	1.5	1.6	1.7
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	2463	2,755	Buy	73,005	63.5	69.2	83.7	38.8	35.6	29.4	24.0	21.9	18.1	23.8	22.7	23.6	22.1	20.3	20.6
PI Industries	2762	3,155	Buy	41,905	55.5	64.4	78.9	49.8	42.9	35.0	35.0	29.4	23.8	16.3	17.2	18.4	13.8	13.9	14.7
Aarti Industries	770	860	Hold	29,403	21.7	24.4	30.7	21.4	31.6	25.1	22.6	18.9	15.4	12.0	12.6	13.6	13.3	13.2	14.4
Tata Chemical	945	1,155	Buy	24,076	47.5	63.6	73.0	19.9	14.9	13.0	12.4	9.1	6.8	6.6	8.4	9.0	6.6	8.3	8.8
Vinati Organics	2049	2,320	Buy	21,055	33.7	39.4	51.6	60.8	52.1	39.7	48.5	39.9	30.5	24.3	23.6	26.7	19.0	18.8	20.6
Sumitomo Chemical	440	520	Buy	21,962	8.5	10.2	11.5	51.9	43.3	38.1	35.9	30.1	26.0	30.2	28.6	26.7	22.0	21.3	19.9
Navin Fluorine	3918	4,040	Hold	19,415	52.3	67.4	89.8	75.0	58.1	43.6	54.4	38.9	28.4	17.8	19.4	20.3	14.0	15.8	18.0
Rallis India	200	235	Reduce	3,898	8.4	8.9	12.4	23.7	22.6	16.2	13.5	13.8	9.8	12.7	11.6	15.3	9.7	9.5	12.1
Sudarshan chemical	456	565	Buy	3,160	18.8	23.7	31.5	24.3	19.3	14.5	14.2	11.5	8.9	10.9	13.3	16.6	15.6	17.2	19.5
Neogen Chemicals	1482	1,870	Buy	3,695	17.9	30.1	37.4	82.8	49.3	39.6	43.5	30.0	24.3	12.0	15.7	17.1	10.2	14.8	15.7
Astec Lifesciences	1823	2,215	Buy	3,573	45.1	54.8	69.3	40.4	33.2	26.3	25.0	21.0	16.7	19.3	17.7	19.4	22.3	21.3	21.2

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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