

## Margin recovery to be key; capex momentum to continue...

**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 key value chains, which include nitro chloro benzenes, di-chlorobenzenes, phenylenediamines, nitro toluene value chain, sulphuric acid & downstream
- 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

**Q4FY23 Results:** Numbers were higher on the revenue front while margins got compressed owing to higher RMAT cost.

- Total revenues grew 15.2% YoY to ₹ 1656 crore
- Gross margins contracted 402 bps YoY to ~41.9% while EBITDA margin declined 308 bps YoY to 15.2%, due to higher RMAT cost (+23.8% YoY)
- Adjusted EBITDA was down 4.2% YoY to ₹ 252 crore
- Adjusted PAT increased 2.1% YoY to ₹ 149 crore

**What should investors do?** The stock depreciated at 2% CAGR in last three years.

- We retain **HOLD** rating as we monitor better growth outlook (due to strong capex) and foray into nitro-toluene value chain in the backdrop of lingering inventory built up and apparent realisation pressure besides FCF generation

**Target Price and Valuation:** We value Aarti Industries at 22x P/E FY25E EPS to arrive at a revised target price of ₹ 515/share.

### Key triggers for future price performance:

- Upcoming capex of ₹ 2500–3000 crore bodes well for speciality chemical revenue growth
- Increasing share of value-added business portfolio
- Adding new chemistries and 40+ value added products along with foray into chlorotoluene value chain

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

- Trigger for Tata Chemical's future revenue growth would be increasing soda ash capacity
- BUY with a target price of ₹ 1130



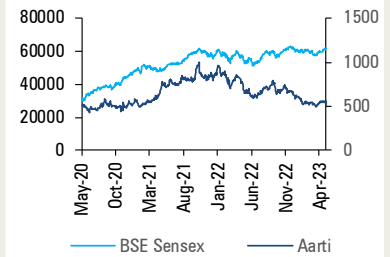
### Particulars

Particular	Amount
Market cap (₹ Crore)	18,664
FY23 Total Debt (₹ Crore)	2,874
FY23 Cash & Inv (₹ Crore)	217
EV (₹ Crore)	21,321
52 Week H/L	839/482
Equity Capital (₹ Crore)	181.0
Face Value (₹)	5

### Shareholding pattern

in %	Jun-22	Sept-22	Dec-22	Mar-23
Promoter	44.2	44.2	44.2	44.1
DII	15.1	15.0	14.5	14.7
FII	11.8	12.1	12.1	12.3
Others	28.9	28.7	29.3	28.9

### Price Chart



### Recent event & key risks

- Revenue growth driven by higher volumes from expanded capacities for key products
- Key Risk:** (i) Macro concerns on demand front expected to continue in FY24. (ii) Better-than-expected execution of earlier capex

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### Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	FY23	5 year CAGR (FY18-23)	FY24E	FY25E	2 year CAGR (FY23-25E)
Net Revenue	4,705.5	4,186.3	4,506.1	5,454.8	6,619.0	11.7%	7,290.6	8,322.4	6.8%
EBITDA	965.1	977.3	981.5	1,110.7	1,089.2	9.3%	1,326.9	1,654.7	11.7%
EBITDA Margins (%)	20.5%	23.3%	21.8%	20.4%	16.5%		18.2%	19.9%	
Adj.PAT	504.2	536.1	525.8	658.5	545.5	10.4%	653.3	848.7	14.0%
Adj. EPS (₹)	13.6	14.8	14.5	18.2	15.0		18.0	23.4	
EV/EBITDA	32.4x	32.3x	32.9x	28.9x	29.7x		24.6x	19.9x	
P/E	60.4x	55.4x	56.5x	25.1x	54.4x		45.4x	35.0x	
ROE (%)	18.7	18.0	15.0	14.6	11.1		11.9	13.5	
ROCE (%)	15.1	14.0	11.1	11.8	9.7		10.4	12.0	

## Key takeaways of recent quarter & conference call highlight

### Q4FY23 Results: Strong volume growth while EBITDA remains muted

- **Speciality Chemical:** Revenues before GST were up 11% YoY to ₹ 1826 crore, largely led by realisation growth. Inflation in raw materials prices impacted gross margins by 402 bps YoY to 41.9%. Normalisation in energy cost is seen in Q4FY24 numbers
- In FY23, revenues were up 21.3% YoY while raw material expenses were up 34.6% YoY impacting gross margins by 570 bps to 42%. Other expenditure largely led by power and fuel increases by ~13% from ₹ 1154.1 crore in FY24 to ₹ 1302.3 crore in FY25

### Aarti Ind– ESG Disclosure Score\*

Score	FY20	FY21	FY22
Environmental	17.6	42.5	
Social	20.2	55.6	
Governance	78.6	91.1	
Overall ESG Score	38.9	63.1	

Source: Bloomberg, ICICI Direct Research, \*Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

### Q4FY23 Earnings Conference Call highlights

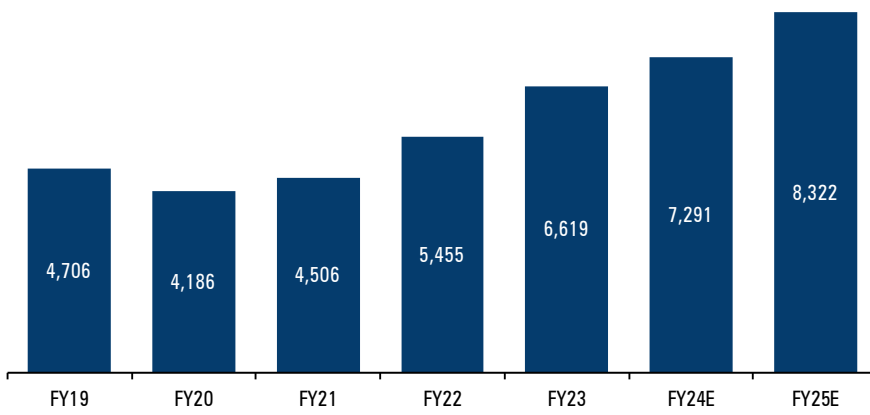
- FY23 was challenging from various aspects, starting with Russia-Ukraine conflict that disrupted the global supply chain, transferred into inflationary surge in input prices and energy cost
- Chemical business EBITDA has grown over 2x in the last five years. Also, ₹ 534 crore in FY18 to ₹ 41091 crore in FY23
- On the project front, ALL commercialised the facility for a third long term contract and two specialty chemical purchase block in Jhagadia in FY23
- Other expansions in existing product are on track
- Growth in revenue was on account of higher volume from expanded capacity for key products as well as from value added products
- Maintenance shutdown at acid unit and at the Kutch Unit resulted in higher costs by ~ ₹ 10 crore. Also, there had been some volume impact due to lower operating days
- Demand from consumer discretionary is expected to start recovering during FY24
- The company witnessed normalisation in energy cost while RM increased QoQ. Inflation in RM prices was passed on to customers
- FY24 tax rate is estimated at 15-17%
- Production details Q4FY23.

Nitrochloro Benzene	18842 MT
Hydrogenation	3315 MT
Nitro Toluene	6130 MT

- The management expects volume growth to be robust in FY24(~25%). EBITDA growth guidance remains unchanged at 25%.
- Capex to get commissioned in FY24-25
  - NCB plant expansion will be completed and some other specialty chemical plant in Q4FY24
  - Acid division capacity will be expanded around 22% at the end of FY24 or early FY25
  - Nitrotoluene debottlenecking – FY25
  - Ethylation Plant – Tripling capacity in FY25

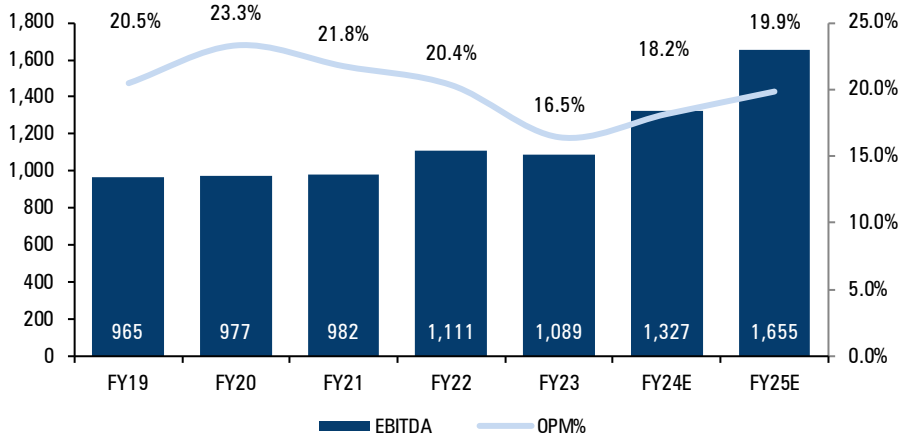
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



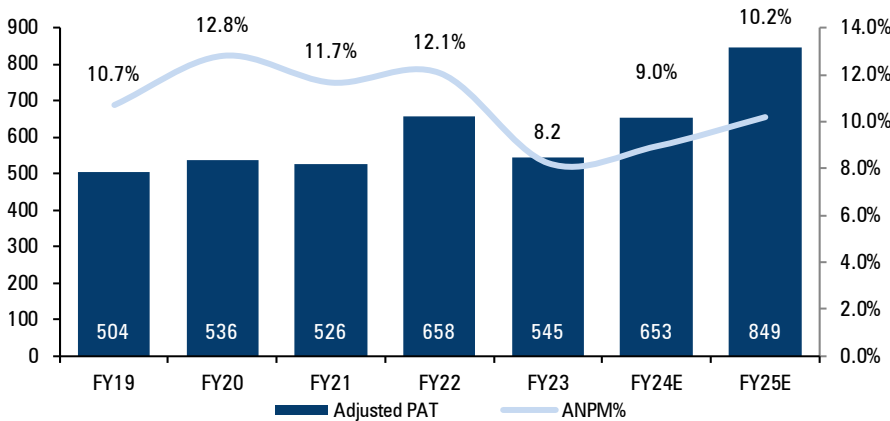
Source: Company, ICICI Direct Research

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



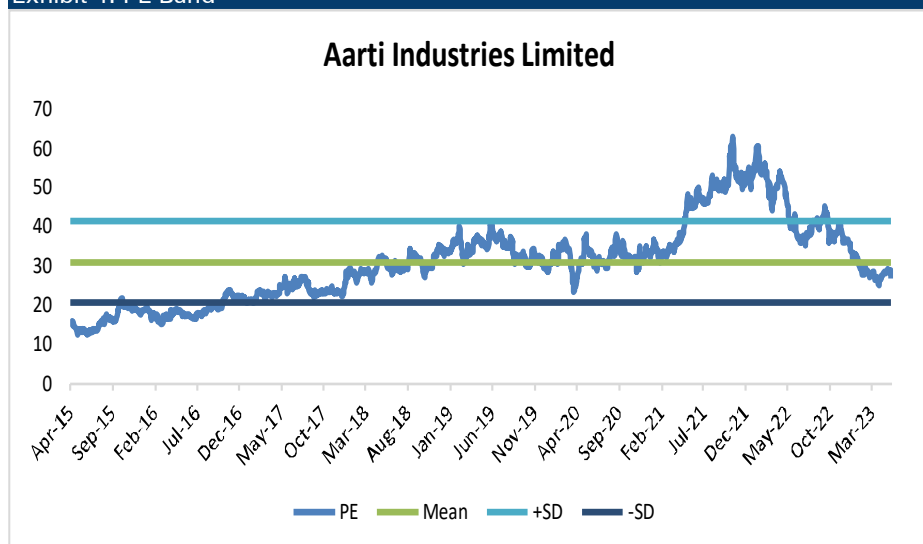
Source: Company, ICICI Direct Research

Exhibit 3: PAT growth trend (₹ crore)



Source: Company, ICICI Direct Research

Exhibit 4: PE Band



Source: ICICI Direct Research

Exhibit 5: Trends in Quarterly Performance

(₹ crore)	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	YoY (%)	QoQ (%)
Total Operating Income	1186.8	1209.4	1316.8	1255.9	2076.2	1437.0	1610.3	1685.0	1667.7	1656.0	15.2	-0.7
Raw Material Expenses	544.9	558.6	610.1	662.3	805.7	777.0	926.2	978.1	975.7	962.0	23.8	-1.4
% of Revenue	45.9	46.2	46.3	52.7	38.8	54.1	57.5	58.0	58.5	58.1	402 bps	-41 bps
Gross Profit	641.9	650.7	706.7	593.5	1270.5	660.0	684.1	706.9	692.0	694.0	5.2	0.3
Gross Profit Margin (%)	54.1	53.8	53.7	47.3	61.2	45.9	42.5	42.0	41.5	41.9	-402 bps	41 bps
Employee Expenses	90.6	97.6	99.5	73.1	95.5	89.0	91.0	92.8	92.7	109.0	22.5	17.6
% of Revenue	7.6	8.1	7.6	5.8	4.6	6.2	5.6	5.5	5.6	6.6	39 bps	103 bps
Other Expenditure	266.4	292.8	293.4	265.6	285.2	310.0	311.6	347.1	310.7	333.0	7.4	7.2
% of Revenue	22.4	24.2	22.3	21.1	13.7	21.6	19.4	20.6	18.6	20.1	-146 bps	148 bps
Total Expenditure	901.8	949.1	1003.0	1001.0	1186.4	1176.0	1328.8	1418.0	1379.0	1404.0	19.4	1.8
% of Revenue	76.0	78.5	76.2	79.7	57.1	81.8	82.5	84.2	82.7	84.8	295 bps	209 bps
EBITDA	285.0	260.3	313.8	254.9	889.8	261.0	281.5	267.0	288.7	252.0	-3.4	-12.7
EBITDA Margin (%)	24.0	21.5	23.8	20.3	42.9	18.2	17.5	15.8	17.3	15.2	-295 bps	-209 bps
Depreciation	58.7	65.6	68.6	57.4	57.2	63.0	71.8	72.9	82.1	84.0	33.3	2.3
Interest	17.3	21.6	38.3	14.5	23.6	26.0	44.5	43.7	47.0	33.0	26.9	-29.7
PBT	209.4	173.1	207.0	183.5	809.1	172.0	165.6	150.4	159.9	135.0	-21.5	-15.6
Total Tax	40.3	33.7	41.9	33.6	83.7	28.0	30.1	25.9	23.4	-14.0	-150.0	-159.9
Tax rate (%)	19.2	19.5	20.2	18.3	10.3	16.3	18.2	17.2	14.6	-10.4	-2665 bps	-2498 bps
PAT before MI	169.2	139.3	165.1	150.0	725.4	144.0	135.5	124.5	136.5	149.0	3.5	9.1
Minority Interest	3.9	3.2	0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PAT	165.3	136.1	164.9	150.0	725.4	146.0	135.5	124.5	136.5	149.0	2.1	9.1
PAT Margin (%)	13.9	11.3	12.5	11.9	34.9	10.2	8.4	7.4	8.2	9.0	-116 bps	81 bps

Source: ICICI Direct Research

## Financial summary

### Exhibit 6: Profit and loss statement ₹ crore

(Year-end March)	FY21	FY22	FY23	FY24E	FY25E
Total Operating Income	4,506.1	5,454.8	6,619.0	7,290.6	8,322.4
Growth (%)	7.6	21.1	21.3	10.1	14.2
Raw Material Expenses	2,128.6	2,855.1	3,842.0	4,171.0	4,577.3
Gross Profit	2,377.5	2,599.7	2,776.9	3,119.5	3,745.1
Gross Profit Margins (%)	52.8	47.7	42.0	42.8	45.0
Employee Expenses	371.4	357.1	385.5	468.3	520.2
Other Expenditure	1,024.6	1,154.1	1,302.3	1,324.4	1,570.1
Total Operating Expenditure	3,524.6	4,366.3	5,529.8	5,963.7	6,667.7
<b>EBITDA</b>	<b>981.5</b>	<b>1,110.7</b>	<b>1,089.2</b>	<b>1,326.9</b>	<b>1,654.7</b>
Growth (%)	0.4	13.2	-1.9	21.8	24.7
Interest	86.4	102.3	168.2	150.8	166.2
Depreciation	231.3	246.2	310.7	400.0	480.0
Other Income	1.1	0.6	0.7	1.7	2.0
<b>PBT before Exceptional Items</b>	<b>664.9</b>	<b>762.8</b>	<b>610.9</b>	<b>777.8</b>	<b>1,010.4</b>
Less: Exceptional Items	0.0	608.8	0.0	0.0	0.0
PBT after Exceptional Items	664.9	1,371.6	610.9	777.8	1,010.4
Total Tax	129.3	187.2	65.4	124.4	161.7
PAT after MI	525.8	1,184.2	545.5	653.3	848.7
<b>Adjusted PAT</b>	<b>525.8</b>	<b>658.5</b>	<b>545.5</b>	<b>653.3</b>	<b>848.7</b>
Growth (%)	-1.9	25.2	-17.2	19.8	29.9
<b>EPS (Adjusted)</b>	<b>14.5</b>	<b>18.2</b>	<b>15.0</b>	<b>18.0</b>	<b>23.4</b>

Source: Company, ICICI Direct Research

### Exhibit 7: Cash flow statement ₹ crore

(Year-end March)	FY21	FY22	FY23	FY24E	FY25E
Profit/(Loss) after taxation	567.9	1,126.0	520.0	653.3	848.7
Add: Depreciation & Amortization	231.3	246.0	310.0	400.0	480.0
Net Increase in Current Assets	-136.0	-918.0	325.0	-132.0	-279.9
Net Increase in Current Liabilities	128.8	-38.0	-13.0	47.2	55.0
Others	80.7	103.0	167.0	150.8	166.2
<b>CF from Operating activities:</b>	<b>872.7</b>	<b>519.0</b>	<b>1,309.0</b>	<b>1,119.2</b>	<b>1,270.1</b>
Investments	-7.8	-5.0	-4.0	0.0	0.0
(Purchase)/Sale of Fixed Assets	-1,314.4	-1,165.0	-1,326.0	-1,200.0	-1,300.0
Others	0.1	1.0	0.0	-2.9	1.9
<b>CF from Investing activities</b>	<b>-1,322.1</b>	<b>-1,169.0</b>	<b>-1,330.0</b>	<b>-1,202.9</b>	<b>-1,298.1</b>
(inc)/Dec in Loan	745.9	-546.0	306.0	300.0	150.0
Dividend & Dividend tax	-45.1	-127.0	-91.0	-65.3	-84.9
Other	-86.4	1,085.0	-168.0	-150.8	-166.2
CF from Financing activities	614.5	412.0	47.0	83.9	-101.1
<b>Net Cash Flow</b>	<b>165.0</b>	<b>-238.0</b>	<b>26.0</b>	<b>0.2</b>	<b>-129.1</b>
Cash and Cash Equivalent	247.3	412.0	174.0	200.0	200.2
<b>Cash</b>	<b>412.3</b>	<b>174.0</b>	<b>200.0</b>	<b>200.2</b>	<b>71.0</b>
<b>Free Cash Flow</b>	<b>-441.7</b>	<b>-646.0</b>	<b>-17.0</b>	<b>-80.8</b>	<b>-29.9</b>

Source: Company, ICICI Direct Research

### Exhibit 8: Balance sheet ₹ crore

(Year-end March)	FY21	FY22	FY23	FY24E	FY25E
Equity Capital	87.1	181.0	181.0	181.0	181.0
Reserve and Surplus	3,415.8	4,335.0	4,739.0	5,327.0	6,090.8
Total Shareholders funds	3,502.9	4,516.0	4,920.0	5,508.0	6,271.8
Total Debt	3,022.1	2,568.0	2,874.0	3,174.0	3,324.0
Deferred Tax Liability	233.9	0.0	0.0	0.0	0.0
Minority Interest	12.2	1.0	1.0	1.0	1.0
Other Non Current Liabilities	224.4	239.0	242.0	242.0	246.8
<b>Source of Funds</b>	<b>6,995.6</b>	<b>7,324.0</b>	<b>8,037.0</b>	<b>8,925.0</b>	<b>9,843.6</b>
Gross Block - Fixed Assets	5,192.4	5,306.5	6,692.9	7,684.9	8,884.9
Accumulated Depreciation	1,599.9	1,668.5	1,725.9	2,125.9	2,605.9
Net Block	3,592.6	3,638.0	4,967.0	5,559.0	6,279.0
Capital WIP	1,297.9	1,303.0	992.0	1,200.0	1,300.0
Fixed Assets	4,890.5	4,941.0	5,959.0	6,759.0	7,579.0
Investments	63.5	28.0	17.0	17.0	17.0
Deferred Tax Assets	0.0	28.0	53.0	54.1	55.1
Other non-Current Assets	320.1	155.0	94.0	95.9	97.8
Inventory	935.7	934.0	1,031.0	1,098.6	1,231.3
Debtors	793.7	1,092.0	940.0	998.7	1,140.0
Other Current Assets	225.9	499.0	287.0	292.7	298.6
Cash	412.3	174.0	200.0	200.2	71.0
Total Current Assets	2,367.6	2,699.0	2,458.0	2,590.2	2,740.9
Creditors	576.3	345.0	405.0	449.4	501.6
Provisions	40.1	32.0	30.0	30.6	31.2
Other Current Liabilities	29.6	150.0	109.0	111.2	113.4
Total Current Liabilities	646.1	527.0	544.0	591.2	646.2
Net Current Assets	1,721.5	2,172.0	1,914.0	1,999.0	2,094.7
<b>Application of Funds</b>	<b>6,995.6</b>	<b>7,324.0</b>	<b>8,037.0</b>	<b>8,925.0</b>	<b>9,843.6</b>

Source: Company, ICICI Direct Research

### Exhibit 9: Key ratios

(Year-end March)	FY21	FY22	FY23	FY24E	FY25E
<b>Per share data (₹)</b>					
Reported EPS	14.5	32.7	15.0	18.0	23.4
Cash EPS	12.3	14.9	13.5	16.2	21.1
BV per share	96.6	124.6	135.7	151.9	173.0
Cash per Share	11.4	4.8	5.5	5.5	2.0
Dividend per share	2.2	3.3	1.5	1.8	2.3
<b>Operating Ratios (%)</b>					
Gross Profit Margins	52.8	47.7	42.0	42.8	45.0
EBITDA margins	21.8	20.4	16.5	18.2	19.9
Adjusted PAT Margins	11.7	12.1	8.2	9.0	10.2
Cash Conversion Cycle	93.4	112.5	86.4	82.5	82.0
Asset Turnover	0.9	1.0	1.0	0.9	0.9
EBITDA conversion Rate	88.9	46.7	120.2	84.4	76.8
<b>Return Ratios (%)</b>					
RoE	15.0	14.6	11.1	11.9	13.5
RoCE	11.1	11.8	9.7	10.4	12.0
RoIC	14.9	14.8	11.4	12.3	13.9
<b>Valuation Ratios (x)</b>					
P/E	56.5	25.1	54.4	45.4	35.0
EV / EBITDA	32.9	28.9	29.7	24.6	19.9
EV / Net Sales	7.2	5.9	4.9	4.5	4.0
Market Cap / Sales	6.6	5.4	4.5	4.1	3.6
Price to Book Value	8.5	6.6	6.0	5.4	4.7
<b>Solvency Ratios</b>					
Debt / EBITDA	3.1	2.3	2.6	2.4	2.0
Debt / Equity	0.9	0.6	0.6	0.6	0.5
Current Ratio	3.0	4.8	4.2	4.0	4.1
<b>Quick Ratio</b>					
Inventory days	75.8	62.5	56.9	55.0	54.0
Debtor days	64.3	73.1	51.8	50.0	50.0
Creditor days	46.7	23.1	22.3	22.5	22.0

Source: Company, ICICI Direct Research

**Exhibit 10: 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	2439	2,550	Buy	72,305	63.5	58.3	73.6	34.4	37.4	29.7	21.3	22.4	17.9	23.8	18.9	21.0	22.1	17.7	19.0
PI Industries	3030	3,615	Buy	45,971	55.5	76.9	91.8	56.1	40.5	33.9	39.7	31.1	25.3	16.3	18.8	19.5	13.8	16.2	16.3
Aarti Industries	502	515	Hold	18,373	32.7	15.0	18.0	25.1	54.4	45.4	28.9	29.7	24.6	11.8	9.7	10.4	14.6	11.1	11.9
Tata Chemical	978	1,130	Buy	24,807	47.5	89.5	109.3	20.6	10.9	8.9	12.7	7.7	5.2	6.6	10.4	10.8	6.6	11.6	12.5
Vinati Organics	2027	2,055	Hold	20,829	33.7	41.6	48.0	56.0	45.4	39.4	44.7	35.6	30.3	24.3	23.9	22.4	19.0	19.7	19.2
Sumitomo Chemical	425	525	Buy	21,236	8.5	10.8	12.4	51.6	40.5	35.2	35.7	28.4	24.2	30.2	30.1	28.1	22.0	22.4	20.9
Navin Fluorine	4526	4,285	Hold	22,438	52.3	65.7	86.0	79.6	63.4	48.4	57.9	42.3	31.2	17.8	18.3	19.1	14.0	15.5	17.4
Rallis India	206	223	Hold	4,000	8.4	8.7	11.8	26.5	25.7	18.9	15.2	15.5	11.4	12.7	11.4	14.7	9.7	9.4	11.6
Sudarshan chemical	417	370	Hold	2,885	18.8	4.4	18.1	19.2	81.8	19.9	11.9	16.9	9.7	10.9	4.7	12.3	15.6	3.6	13.2
Neogen Chemicals	1605	1,535	Buy	4,003	17.9	28.2	35.2	72.4	45.9	36.8	38.1	26.9	21.5	12.0	15.4	14.8	10.2	14.0	15.0
Astec Lifesciences	1356	1,307	Reduce	2,659	45.1	27.5	39.9	30.8	50.4	34.8	19.4	26.8	19.7	19.3	10.1	12.6	22.3	12.0	14.8

Source: Bloomberg, ICICI Direct Research

## RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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