12th November,2020

Q2FY21 RESULT UPDATE

Retail Equity Research (South India Focus)

Aarti Industries Ltd

Specialty chemicals

BSE CODE : 524208 NSE CODE: AARTIIND

BLOOMBERG CODE: ARTO:IN SENSEX : 43,357

Accumulate

12M Investment Period Rating as per Mid Cap

CMP Rs.1,085 TARGET Rs.1,232 RETURN 14%

(Closing: 12-11-20)

KEY CHANGES: *TARGET* ↑ *RATING* ↔ *EARNINGS* ↓

Recovery to be gradual...but growth story intact

AARTI Industries Ltd (ARTO) is a global leader in Benzene based derivative products. The company has a diversified product portfolio with end users in pharma, agrochemicals, specialty polymers, paints & pigments.

- **Q2 revenue grew by 9% YoY, as revenue from Specialty chemicals & Pharma grew by ~24% & 22% YoY.**
- **EBITDA margins declined by 190bps YoY due to weak product mix and higher cost. Consequently, PAT was down by 5% YoY.**
- **Revival in discretionary portfolio, ~40% of specialty chemicals (Auto, industrial, dyes/pigments), is expected to take some more time.**
- **Recent expansion in new capacities/new products, which are either backward or forward integrated, is margin accretive.**
- **Pharma segment continues to gain traction led by value added products.**
- **We remain constructive on ARTO given its niche capabilities including wining of multi year contracts, expanding value added products, strong off-take from Pharma segments and improved outlook on account of issues in China.**
- **We value ARTO at P/E of 25x as we roll forward to FY23E, with a target price of Rs1,232 and downgrade to Accumulate from Buy.**

Revenue growth stable...

Q2FY21 Revenue grew by 9% YoY, as revenue from Specialty chemicals grew by 24% & Pharma business grew by 22% YoY. The supply disruptions has eased out, while overall revenue growth was aided by higher volumes in specialty chemicals and better traction in Pharma segment. The capacity utilization reached 85-90%. Q2FY21 revenue growth was aided by volume push in non-regular markets given subdued demand in certain specialty chemicals. ARTO's 40% of Specialty chemicals revenue comes from the discretionary (Autos, industrial, dyes, pigments), which continues to be subdued. Given overall weakness, we expect revival in these sectors will take some more time. In Pharma segment, revenue growth was aided by increasing contribution from regulated markets and value added products. The capacity augmentation is on track with an investment of Rs1,200cr. Though second multi year contract was delayed due to Covid-19 disruptions, but we expect the plant to commission in Q1FY22. ARTO will continue to benefit from backward integration, expansion of product portfolio and higher volumes due to China issues in the medium term. We expect revenue to grow by 17% CAGR over FY21E-23E.

Profitability to improve...

EBITDA margins declined by 190bps YoY to 21.7%, due to weak product mix and higher cost. PAT declined by 5% YoY to Rs140cr. Specialty chemicals EBIT margins declined by 680bps YoY. Pharma segment continues to gain traction along with margin expansion leading to 67% YoY growth in segment profitability. Pharma segment margin expanded by 700bps largely on account of higher contribution from regulated markets and higher value addition. We expect Specialty chemical margins to be volatile in the near term, considering this we lower our EBIDTA estimates by 150bps & 90 bps for FY21E & FY22E. We expect PAT to grow by 32% CAGR over FY21E-23E.

Valuations

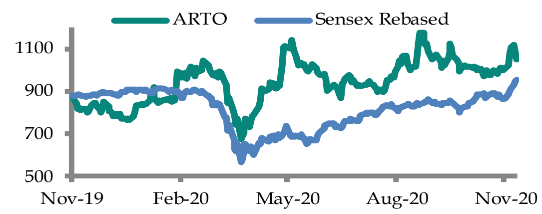
We remain constructive on ARTO's as execution of multi year contracts, revival in volumes from Specialty chemicals and improved outlook on account issues in China, will benefit the company in the medium term. We value ARTO at 25x as we roll forward to FY23 and downgrade to Accumulate from Buy with target price of Rs1,232.

Company Data	
Market Cap (cr)	Rs.9,406
Enterprise Value (cr)	Rs.11,483
Outstanding Shares (cr)	8.7
Free Float	52.4%
Dividend Yield	0.33%
52 week high	Rs.1,229
52 week low	Rs.662
6m average volume (cr)	0.01
Beta	0.9
Face value	Rs. 5

Shareholding (%)	Q4FY20	Q1FY21	Q2FY21
Promoters	47.7	47.4	47.6
FII's	8.3	7.4	7.5
MFs/Institutions	16.5	16.2	15.8
Public	23.7	25.4	25.8
Others	3.8	3.5	3.3
Total	100.0	100.0	100.0
Promoter pledge	NIL	NIL	NIL

Price Performance	3 month	6 Month	1 Year
Absolute Return	4.8%	2.2%	28.1%
Absolute Sensex	13.8%	40.2%	8.2%
Relative Return*	-9.0%	-38.0%	19.9%

over or under performance to benchmark index*



Consolidated (cr)	FY21E	FY22E	FY23E
Sales	4,558	5,371	6,202
Growth (%)	*8.9*	*17.8*	*15.5*
EBITDA	953	1,246	1,476
EBITDA Margin(%)	*20.9*	*23.2*	*23.8*
PAT Adjusted	492	706	859
Growth (%)	*(8.3)*	*43.7*	*21.6*
Adjusted EPS	28.2	40.5	49.3
Growth (%)	*(8.3)*	*43.7*	*21.6*
P/E	38.5	26.8	22.0
P/B	5.6	4.8	4.0
EV/EBITDA	12.2	8.7	7.3
ROE (%)	*15.5*	*19.3*	*19.8*
D/E	0.8	0.6	0.5

Anil R
Research Analyst

Quarterly Financials

Profit & Loss

	Q2FY21	Q2FY20	YoY Growth %	H1FY21	H1FY20	YoY Growth %
Sales	**1,173**	**1,077**	*8.9*	**2,110**	**2,212**	*(4.6)*
EBITDA	**254**	**254**	*0.1*	**436**	**504**	*(13.5)*
EBITDA margins	**21.7**	**23.6**	*(190bps)*	**20.7**	**22.8**	*(210bps)*
Depreciation	55	46	*20.4*	107	89	*20.4*
EBIT	**199**	**208**	*(4.4)*	**329**	**415**	*(20.7)*
Interest	22	31	*(29.0)*	47	62	*(23.5)*
Other Income	0.4	6	*(99.3)*	0.3	8.0	*(96.8)*
Exceptional Items	-	-	-	-	-	-
PBT	**177**	**183**	*(3.1)*	**282**	**361**	*(21.9)*
Tax	34	31	*(8.2)*	55	68	*(18.1)*
Share of profit from Associate	-	-	-	-	-	-
Minority Interest	3	4	*(22.7)*	5	4	*9.0*
Reported PAT	**140**	**148**	*(5.0)*	**222**	**289**	*(23.3)*
Adjustments	-	-	-	-	-	-
Adjusted PAT	**140**	**148**	*(5.0)*	**222**	**289**	*(23.3)*
No. of Shares	**8.7**	**8.7**	-	**8.7**	**8.7**	-
EPS (Rs)	**8.0**	**8.5**	*(5.0)*	**12.7**	**16.6**	*(23.3)*

Change in Estimates

	Old estimates		New estimates		Change %	
Year / Rs cr	**FY21E**	**FY22E**	**FY21E**	**FY22E**	**FY21E**	**FY22E**
Revenue	4,269	5,279	4,558	5,371	*6.8*	*1.7*
EBITDA	956	1,272	953	1,246	*(0.3)*	*(2.0)*
Margins (%)	22.4	24.1	20.9	23.2	*(150bps)*	*(90bps)*
Adj. PAT	492	716	492	706	-	*(1.4)*
	28.2	41.1	28.2	40.5	-	*(1.4)*

Consolidated Financials

PROFIT & LOSS

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Sales	**4,168**	**4,186**	**4,558**	**5,371**	**6,202**
% change	*9.5*	*0.4*	*8.9*	*17.8*	*15.5*
EBITDA	**965**	**977**	**953**	**1246**	**1476**
% change	*38.0*	*1.3*	*(2.5)*	*30.8*	*18.5*
Depreciation	163	185	210	240	275
EBIT	802	792	742	1,006	1,201
Interest	183	125	127	133	138
Other Income	2	9	5	9	10
PBT	**622**	**676**	**620**	**883**	**1,073**
% change	*45.0*	*8.7*	*(8.3)*	*42.3*	*21.6*
Tax	118	129	124	177	215
Tax Rate (%)	*18.9*	*19.1*	*20.0*	*20.0*	*20.0*
Reported PAT	**497**	**479**	**492**	**706**	**859**
Adj.*	5.3	57.4	-	-	-
Adj. PAT	**492**	**536**	**492**	**706**	**859**
% change	*47.7*	*9.0*	*(8.3)*	*43.7*	*21.6*
No. of shares (cr)	8.7	17.4	17.4	17.4	17.4
Adj EPS (Rs)	**28.2**	**30.8**	**28.2**	**40.5**	**49.3**
% change	*47.7*	*9.0*	*(8.3)*	*43.7*	*21.6*
DPS (Rs)	5.1	6.1	6.1	6.1	6.1
CEPS (Rs)	**75.5**	**41.4**	**40.3**	**54.3**	**65.1**

BALANCE SHEET

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash	804	247	356	979	803
Accounts Receivable	776	753	874	1,074	1,240
Inventories	772	836	929	1,067	1,192
Other Cur. Assets	532	573	637	706	782
Investments	33	37	67	97	127
Gross Fixed Assets	3,321	3,796	4,296	5,096	5,896
Net Fixed Assets	2,145	2,468	2,757	3,318	3,843
CWIP	795	1,418	1,450	300	300
Intangible Assets	13	9	9	9	9
Def. Tax (Net)	(193)	(211)	(211)	(211)	(211)
Other Assets	-	-	-	-	-
Total Assets	**5,665**	**6,121**	**6,861**	**7,331**	**8,076**
Current Liabilities	599	647	743	736	851
Provisions	42	40	44	51	59
Debt Funds	2,309	2,361	2,615	2,485	2,355
Other Liabilities	84	95	95	95	95
Equity Capital	43	87	87	87	87
Reserves & Surplus	2,587	2,892	3,277	3,877	4,629
Shareholder's Fund	2,631	2,979	3,364	3,964	4,716
Total Liabilities	**5,665**	**6,121**	**6,861**	**7,331**	**8,076**
BVPS	**304**	**171**	**193**	**228**	**271**

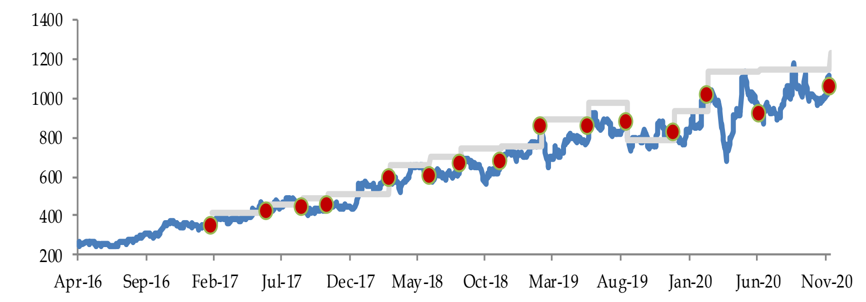
CASH FLOW

Y.E March (Rs Cr)	FY19A	FY20A	FY21E	FY22E	FY23E
Net inc. + Depn.	667	732	702	946	1133
Non-cash adj.	169	80	127	133	138
Changes in W.C	(99)	290	(178)	(407)	(243)
C.F. Operation	**736**	**1,102**	**651**	**672**	**1028**
Capital exp.	(791)	(1126)	(532)	350	(800)
Change in inv.	(6)	1	(30)	(30)	(30)
Other invest.CF	-	-	-	-	-
C.F - Investment	**(797)**	**(1,124)**	**(562)**	**320**	**(830)**
Issue of equity	741	-	-	-	-
Issue/repay debt	136	(428)	127	(263)	(268)
Dividends paid	(44)	(106)	(106)	(106)	(106)
Other finance.CF	-	-	-	-	-
C.F - Finance	**833**	**(535)**	**20**	**(369)**	**(374)**
Chg. in cash	772	(557)	109	623	(176)
Closing cash	804	247	356	979	803

RATIOS

Y.E March	FY19A	FY20A	FY21E	FY22E	FY23E
Profitab & Return					
EBITDA margin (%)	23.2	23.3	20.9	23.2	23.8
EBIT margin (%)	19.3	18.9	16.3	18.7	19.4
Net profit mgn.(%)	11.8	12.8	10.8	13.2	13.8
ROE (%)	23.4	19.1	15.5	19.3	19.8
ROCE (%)	14.3	11.8	10.2	13.1	14.3
W.C & Liquidity					
Receivables (days)	59.9	66.7	65.2	66.2	68.1
Inventory (days)	128.5	142.7	142.5	135.6	132.7
Payables (days)	96.6	110.6	112.2	100.5	93.2
Current ratio (x)	4.5	3.5	3.6	4.9	4.4
Quick ratio (x)	2.3	1.5	1.2	1.5	1.5
Turnover &Leverage					
Gross asset T.O (x)	1.3	1.2	1.1	1.1	1.1
Total asset T.O (x)	0.8	0.7	0.7	0.8	0.8
Int. covge. ratio (x)	4.4	6.3	5.8	7.6	8.7
Adj. debt/equity (x)	1.0	0.9	0.8	0.6	0.5
Valuation					
EV/Sales (x)	2.5	2.7	2.5	2.0	1.7
EV/EBITDA (x)	10.9	11.4	11.8	8.4	7.1
P/E (x)	37.1	34.1	37.1	25.8	21.3
P/BV (x)	3.5	6.1	5.4	4.6	3.9

Recommendation summary



Source: Bloomberg, Geojit Research.

Dates	Rating	Target
25-January-2017	Buy	411
29-May-2017	Accumulate	461
17-August-2017	Accumulate	485
13-October-2017	Accumulate	514
1-March-2018	Accumulate	656
30-May-2018	Buy	698
08-August-2018	Accumulate	747
06-November-2018	Accumulate	755
06-February-19	Hold	894
23-May-19	Buy	975
16-August-19	Reduce	786
28-November-2019	Accumulate	933
17-February-2020	Accumulate	1,133
08-June-2020	Buy	1,151
12-November-2020	Accumualte	1,232

Investment Criteria

Ratings	Large caps	Midcaps	Small caps
Buy	**Upside is above 10%**	**Upside is above 15%**	**Upside is above 20%**
Accumulate	-	**Upside is between 10% - 15%**	**Upside is between 10% - 20%**
Hold	**Upside is between 0% - 10%**	**Upside is between 0% - 10%**	**Upside is between 0% - 10%**
Reduce/sell	**Downside is more than 0%**	**Downside is more than 0%**	**Downside is more than 0%**
Not rated		-	

Definition:

Buy: Acquire at Current Market Price (CMP), with the target mentioned in the research note.

Accumulate: Partial buying or to accumulate as CMP dips in the future.

Hold: Hold the stock with the expected target mentioned in the note.

Reduce: Reduce your exposure to the stock due to limited upside.

Sell: Exit from the stock.

Not rated : The analyst has no investment opinion on the stock.

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

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