

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

Q1FY22 Results: Overall numbers were above our estimates.

- Reported revenue growth was 40.5% YoY to ₹ 1316.8 crore, led by higher growth from speciality chemical segment (up 50% YoY)
- Gross margins rose 140 bps YoY to ~53.7% while EBITDA margin improved 440 bps YoY to 23.8%, due to better gross margins and operating leverage
- EBITDA was up 72% YoY to ₹ 313.8 crore
- PAT increased 101.3% YoY to ₹ 164.9 crore owing to strong operational performance

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 ₹ 1085/share (earlier ₹ 960/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 ₹ 1095



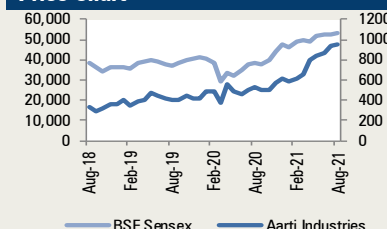
Particulars

Particular	Amount
Market cap (₹ Crore)	33,477
FY21 Total Debt (₹ Crore)	2,492
FY21 Cash & Inv (₹ Crore)	412
EV (₹ Crore)	35,557
52 Week H/L	987/483
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

Shareholding pattern

in %	Sept-20	Dec-20	Mar-21	Jun-21
Promoter	47.6	47.3	46.8	44.9
DII	15.8	14.6	15.6	13.6
FII	7.5	9.0	8.7	11.9
Others	29.2	29.1	28.9	29.6

Price Chart



Recent event & key risks

- Overall revenue growth guidance remains 25-35% for FY22
- 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%	5,362.5	7,671.2	30.5%
EBITDA	965.1	977.3	981.5	11.4%	1,283.4	1,875.9	38.2%
EBITDA Margins (%)	20.5%	23.3%	21.8%		23.9%	24.5%	
Adj. PAT	504.2	536.1	525.8	15.4%	681.9	1,125.7	46.3%
Adj. EPS (₹)	13.6	14.8	14.5		18.8	31.1	
EV/EBITDA	36.3x	36.1x	36.8x		27.6x	19.1x	
P/E	68.1x	62.4x	63.7x		49.1x	29.7x	
ROE (%)	18.7	18.0	15.0		12.8	17.8	
ROCE (%)	14.6	13.5	10.7		11.2	15.6	

Key takeaways of recent quarter & conference call highlight

Q1FY22 Results: Strong growth from speciality chemical led overall performance

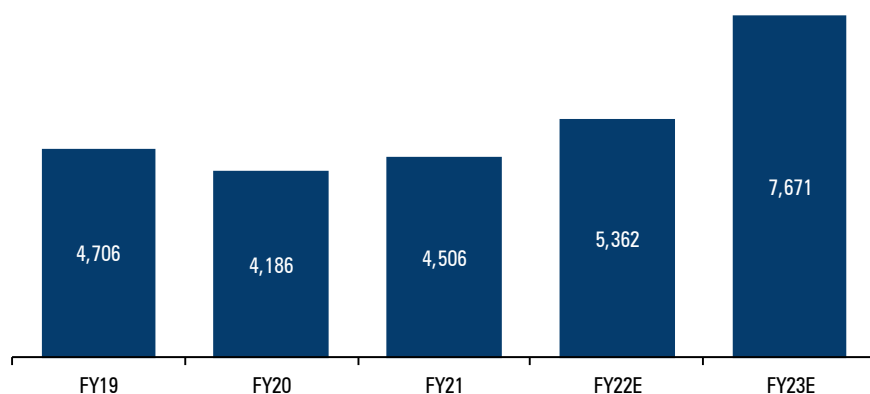
- **Speciality Chemical:** Revenues were up 50% YoY & 12% QoQ to ₹ 1263.1 crore, led by both volumes and realisation growth. Volumes grew around 9-10% QoQ. Further, there has been income recognition of around \$4.5 million towards the shortfall fees in respect of the first long term contract, which has also supported performance, to some extent. EBIT margins for speciality chemicals expanded 258 bps YoY to 18.8%
- **Pharma:** Revenue increased 24% YoY to ₹ 240.2 crore, led by both volume and realisation growth. EBIT margins contracted 336 bps YoY to 19.8%. Margins in the pharma business were impacted owing to higher inventory of final product, which could not be shipped due to logistics issue

Q1FY22 Earnings Conference Call highlights

- Business activities have been normalised and reached pre-Covid level
- There had been some logistic related challenges, which hampered shipment to US and LatAm
- Higher crude prices led to an improvement in benzene prices. Hence, it is able to hike prices for different business portfolios
- Volume for Nitro toluene remained at 3340 MT while the same from NCB was 18155 MT and PDA 570 MT/month
- The company has operated at around 80% utilisation levels
- Pharma margins for the quarter were impacted owing to higher inventory of final product, which could not be shipped due to logistics issue
- Additional capacities for APIs and intermediates are expected to be operational in H2FY22
- The company has received income of around US\$4.5 million towards the shortfall fees in respect of the first long term contract
- There was revenue contribution of ~70% from value added portfolio during the quarter
- Reiterated revenue guidance of 25-35% for FY22. Planning to launch 40 plus molecules in specialty business
- Capex of ₹ 295 crore was done during Q1FY22, with expected spending of about ₹ 1500 crore during FY22

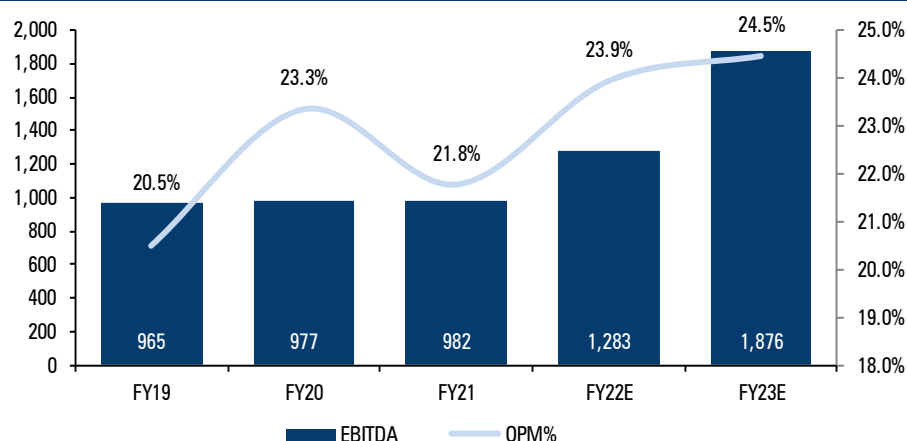
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



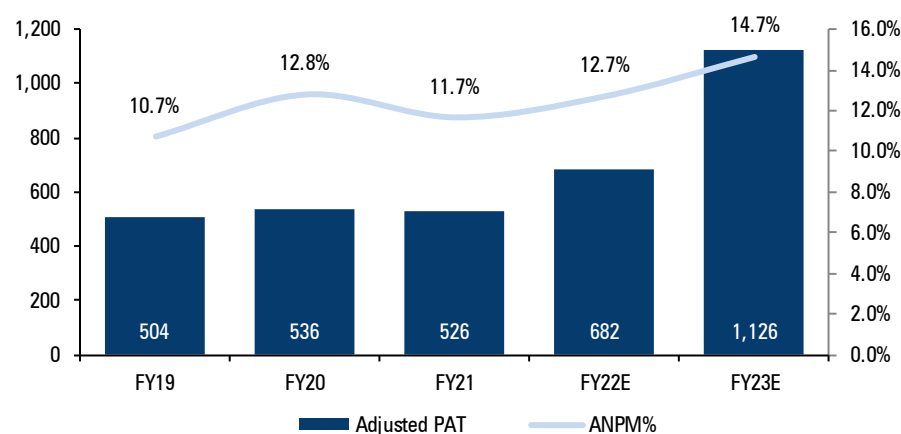
Source: Company, ICICI Direct Research

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	5,362.5	7,671.2
Growth (%)	-11.0	7.6	19.0	43.1
Raw Material Expenses	2,056.3	2,128.6	2,484.5	3,554.1
Gross Profit	2,130.0	2,377.5	2,878.0	4,117.0
Gross Profit Margins (%)	50.9	52.8	53.7	53.7
Employee Expenses	305.2	371.4	405.1	579.5
Other Expenditure	847.4	1,024.6	1,189.5	1,661.7
Total Operating Expenditure	3,209.0	3,524.6	4,079.1	5,795.3
EBITDA	977.3	981.5	1,283.4	1,875.9
Growth (%)	1.3	0.4	30.8	46.2
Interest	124.8	86.4	153.2	153.2
Depreciation	185.2	231.3	274.4	329.3
Other Income	8.8	1.1	0.2	19.2
PBT before Exceptional Item	676.2	664.9	856.1	1,412.6
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	676.2	664.9	856.1	1,412.6
Total Tax	129.4	129.3	173.3	286.0
PAT after MI	536.1	525.8	681.9	1,125.7
Adjusted PAT	536.1	525.8	681.9	1,125.7
Growth (%)	6.3	-1.9	29.7	65.1
EPS (Adjusted)	14.8	14.5	18.8	31.1

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	1,190.3	1,125.7
Add: Depreciation & Amortiza	185.2	231.3	274.4	329.3
Net Increase in Current Asset	-68.6	-136.0	-248.1	-854.0
Net Increase in Current Liabili	358.8	128.8	12.7	254.4
Others	114.3	80.7	153.2	153.2
CF from Operating activities	1,102.1	872.7	1,382.5	1,008.6
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
CF from Investing activities	-1,124.1	-1,322.1	-1,197.0	-1,196.9
(inc)/Dec in Loan	-303.2	745.9	200.0	0.0
Dividend & Dividend tax	-106.4	-45.1	-119.0	-112.6
Other	-125.4	-86.4	-153.2	-153.2
CF from Financing activities	-534.9	614.5	-72.2	-265.7
Net Cash Flow	-556.9	165.0	113.3	-454.1
Cash and Cash Equivalent	804.2	247.3	412.3	525.6
Cash	247.3	412.3	525.6	71.5
Free Cash Flow	-23.4	-441.7	182.5	-191.4

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	4,392.9	5,406.1
Total Shareholders funds	2,978.8	3,502.9	4,574.2	5,587.4
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
Source of Funds	5,929.5	6,995.6	8,276.3	9,299.1
Gross Block - Fixed Assets	3,837.0	5,192.4	6,492.4	7,792.4
Accumulated Depreciation	1,368.6	1,599.9	1,874.2	2,203.5
Net Block	2,468.5	3,592.6	4,618.2	5,588.9
Capital WIP	1,417.6	1,297.9	1,197.9	1,097.9
Fixed Assets	3,886.1	4,890.5	5,816.1	6,686.8
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	1,028.4	1,471.2
Debtors	753.4	793.7	944.6	1,351.2
Other Current Assets	168.5	225.9	230.4	235.0
Cash	247.3	412.3	525.6	71.5
Total Current Assets	2,004.9	2,367.6	2,729.0	3,129.0
Creditors	345.2	576.3	587.7	840.7
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	658.8	913.2
Net Current Assets	1,601.8	1,721.5	2,070.2	2,215.7
Application of Funds	5,929.5	6,995.6	8,276.3	9,299.1

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
Reported EPS	14.8	14.5	18.8	31.1
Cash EPS	11.2	12.3	16.9	27.9
BV per share	82.2	96.6	146.5	174.4
Cash per Share	6.8	11.4	34.8	22.3
Dividend per share	3.6	2.2	1.9	3.1
Operating Ratios (%)				
Gross Profit Margins	50.9	52.8	53.7	53.7
EBITDA margins	23.3	21.8	23.9	24.5
Adjusted PAT Margins	12.8	11.7	12.7	14.7
Cash Conversion Cycle	108.5	93.4	94.3	94.3
Asset Turnover	1.1	0.9	0.8	1.0
EBITDA conversion Rate	112.8	88.9	67.6	53.8
Return Ratios (%)				
RoE	18.0	15.0	12.8	17.8
RoCE	13.5	10.7	11.2	15.6
RoIC	18.6	14.2	15.4	19.0
Valuation Ratios (x)				
P/E	62.4	63.7	49.1	29.7
EV / EBITDA	36.1	36.8	27.6	19.1
EV / Net Sales	8.4	8.0	6.6	4.7
Market Cap / Sales	8.0	7.4	6.2	4.4
Price to Book Value	11.2	9.6	6.3	5.3
Solvency Ratios				
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
Quick Ratio	2.3	1.6	1.8	1.7
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	3316	3,855	Buy	50,403	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	924	1,085	Buy	33,477	14.5	32.8	31.1	63.7	28.1	29.7	36.8	28.2	19.5	10.7	12.2	16.8	15.0	14.9	20.1
Sumitomo Chemical	431	505	Buy	21,513	6.9	8.5	10.1	62.3	50.6	42.6	43.1	35.1	29.0	29.8	29.3	28.1	22.4	22.1	21.2
Vinati Organics	1954	2,300	Buy	20,086	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
Tata Chemical	824	925	Hold	20,997	10.1	39.1	42.6	81.9	21.1	19.3	15.8	10.0	8.3	4.1	7.1	7.7	1.8	6.6	6.9
Navin Fluorine	3720	3,712	Hold	18,413	45.0	53.0	73.1	82.6	70.2	50.9	57.5	49.7	33.9	21.0	19.0	22.6	13.6	14.2	17.0
Rallis India	320	400	Buy	6,215	11.4	12.7	16.0	28.1	25.1	20.0	18.4	16.8	13.0	18.0	17.7	20.0	13.9	13.9	15.3
Sudarshan chemical	642	795	Buy	4,447	20.4	26.2	31.7	31.5	24.5	20.3	17.2	13.7	11.4	15.2	18.2	19.7	19.0	20.7	21.1
Neogen Chemicals	897	1,095	Buy	2,093	13.4	18.8	28.8	66.8	47.7	31.2	35.6	26.7	19.4	15.1	16.5	20.1	17.1	19.8	23.7

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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