

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

Q3FY22 Results: Numbers were above our estimates across all parameters.

- Reported adjusted revenue growth was 47% YoY to ₹ 1744.7 crore, led by higher growth from speciality chemical segment (up 56% YoY)
- Gross margins contracted 796 bps YoY to ~46.1% while EBITDA margin declined 361 bps YoY to 20.4%, due to absorption of fixed overheads
- Adjusted EBITDA was up 24.9% YoY to ₹ 356 crore
- Adjusted PAT increased 35.5% YoY to ₹ 229.3 crore

What should investors do? The stock appreciated at 44% CAGR in last three 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 28x P/E FY24E EPS to arrive at a revised target price of ₹ 1175/share (earlier ₹ 1120/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 margin 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 ₹ 2160



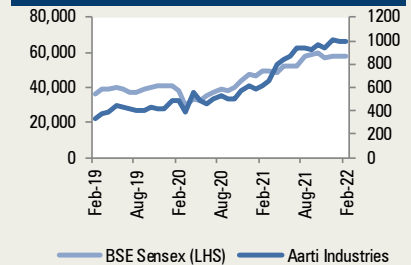
Particulars

Particular	Amount
Market cap (₹ Crore)	36,258
FY21 Total Debt (₹ Crore)	2,492
FY21 Cash & Inv (₹ Crore)	412
EV (₹ Crore)	38,338
52 Week H/L	1168/536
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

Shareholding pattern

in %	Mar-21	Jun-21	Sept-21	Dec-21
Promoter	46.8	44.9	44.2	44.2
DII	15.6	13.6	14.8	14.5
FII	8.7	11.9	11.9	12.3
Others	28.9	29.6	29.2	29.0

Price Chart



Recent event & key risks

- Sum of ₹ 631.25 crore received as termination fees in regards to first long term contract
- 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	FY24E	3 year CAGR (FY21-24E)
Net Revenue	4,705.5	4,186.3	4,506.1	8.4%	7,047.4	9,161.8	10,882.9	34.2%
EBITDA	965.1	977.3	981.5	11.4%	1,981.5	2,052.8	2,448.8	35.6%
EBITDA Margins (%)	20.5%	23.3%	21.8%		28.1%	22.4%	22.5%	
Adj. PAT	504.2	536.1	525.8	15.4%	1,344.4	1,271.6	1,524.4	42.6%
Adj. EPS (₹)	13.6	14.8	14.5		37.1	35.1	42.1	
EV/EBITDA	39.2x	39.0x	39.6x		19.3x	18.8x	15.7x	
P/E	73.7x	67.6x	68.9x		27.0x	28.5x	23.8x	
ROE (%)	18.7	18.0	15.0		22.8	18.0	18.1	
ROCE (%)	14.6	13.5	10.7		17.7	16.0	17.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlight

Q3FY22 Results: Strong growth from speciality chemical leads overall performance

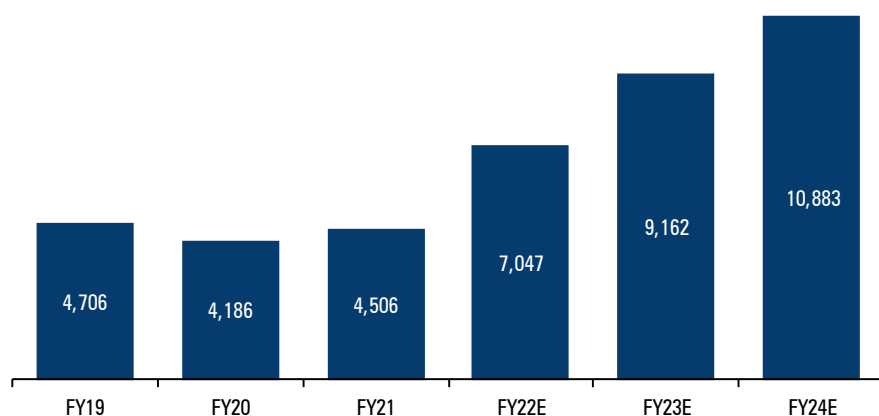
- **Speciality Chemical:** Adjusted revenues were up 55.9% YoY & 12% QoQ to ₹ 1657 crore, largely led by realisation growth. The company received termination fees of ₹ 631.25 crore towards first contract. Apart from this, it also mobilised US\$6.5 million towards termination fees with respect to the first long term contract in Q3FY22. Adjusted EBIT margins for speciality chemicals fell ~390 bps YoY to 17.1%
- **Pharma:** Revenue increased 40.3% YoY to ₹ 348 crore, largely led by realisation growth. EBIT margins contracted 520 bps YoY to 17.2%. 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

Q3FY22 Earnings Conference Call highlights

- Sustained revenue growth driven by volume expansion and 71% contribution from value-added products
- Higher crude prices led to an improvement in benzene prices. Hence, it was 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 be commercialised in Q4FY22
- **Speciality chemical:** The company has operated at ~85% utilisation. The share of revenue from value added products was 71% during the quarter
- Due to nitric acid shortage last quarter, volumes related to nitric based products impacted. The loss could be around ₹ 50 crore
- Second long term contract is expected to be commissioned in Q4FY22. The full ramp up can be seen from FY23
- The management expects ₹ 400 crore revenue from the dedicated plant related to first long term contract. It can achieve ₹ 400 crore annual revenues from FY24E. Margins are expected to be between 30% and 40%
- Aarti has received income of around US\$ 6.5 million towards the shortfall fees in respect of the first long term contract. Apart from this, it also received termination fees of ₹ 631.25 crore during this quarter
- The company had received ₹ 140 crore termination fees towards first contract last year while it received US\$18 million for 9MFY22 (~₹ 135 crore). Thus, cumulatively all termination fees, the amount was at ~₹ 906 crore, in line with earlier guidance
- Reiterated revenue guidance of 25-35% for FY22
- Capex in Q3FY22: ₹ 312 crore; 9M aggregate capex of ₹ 913 crore – in line with guidance of ₹ 1,200-1,500 crore for FY22

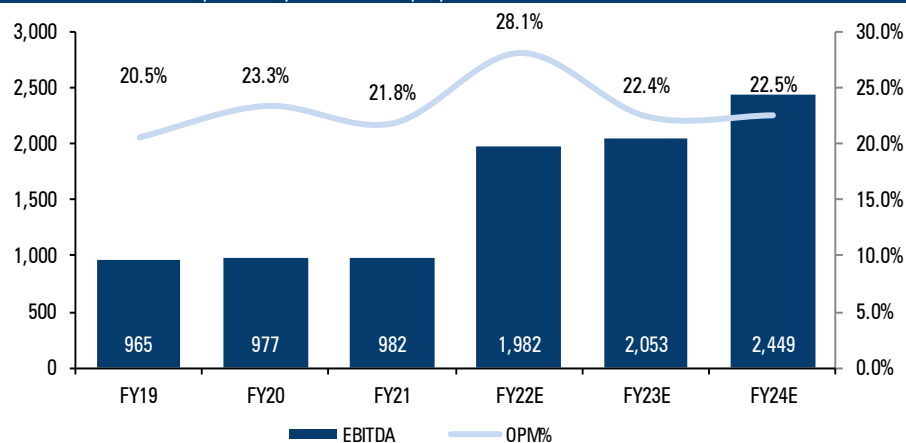
Financial story in charts....

Exhibit 1: Revenue trend (₹ crore)



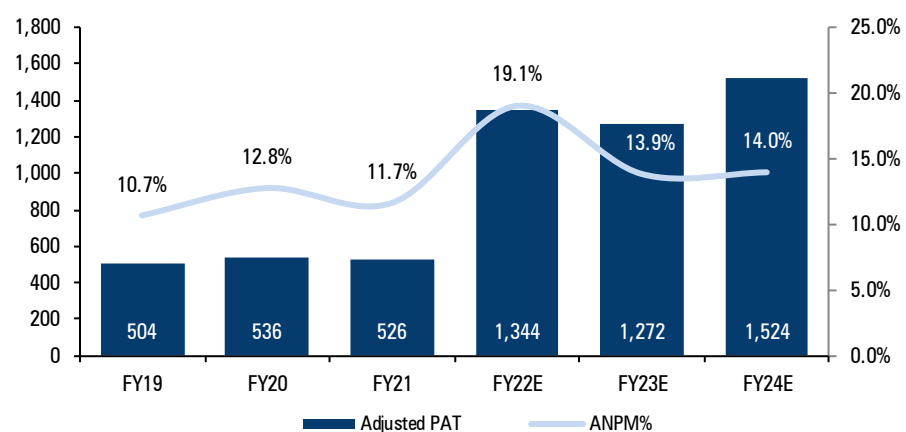
Source: Company, ICICI Direct Research

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	FY24E
Total Operating Income	4,186.3	4,506.1	7,047.4	9,161.8	10,882.9
Growth (%)	-11.0	7.6	56.4	30.0	18.8
Raw Material Expenses	2,056.3	2,128.6	3,327.6	4,672.5	5,550.3
Gross Profit	2,130.0	2,377.5	3,719.7	4,489.3	5,332.6
Gross Profit Margins (%)	50.9	52.8	52.8	49.0	49.0
Employee Expenses	305.2	371.4	439.2	533.8	635.6
Other Expenditure	847.4	1,024.6	1,299.0	1,902.7	2,248.2
Total Operating Expenditure	3,209.0	3,524.6	5,065.8	7,108.9	8,434.1
EBITDA	977.3	981.5	1,981.5	2,052.8	2,448.8
Growth (%)	1.3	0.4	101.9	3.6	19.3
Interest	124.8	86.4	111.9	135.3	161.1
Depreciation	185.2	231.3	286.3	350.7	409.2
Other Income	8.8	1.1	0.7	22.9	27.2
PBT before Exceptional Item	676.2	664.9	1,584.1	1,589.8	1,905.7
Less: Exceptional Items	0.0	0.0	0.0	0.0	0.0
PBT after Exceptional Items	676.2	664.9	1,584.1	1,589.8	1,905.7
Total Tax	129.4	129.3	239.4	318.0	381.1
PAT after MI	536.1	525.8	1,344.4	1,271.6	1,524.4
Adjusted PAT	536.1	525.8	1,344.4	1,271.6	1,524.4
Growth (%)	6.3	-1.9	155.7	-5.4	19.9
EPS (Adjusted)	14.8	14.5	37.1	35.1	42.1

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet					
	₹ crore				
(Year-end March)	FY20	FY21	FY22E	FY23E	FY24E
Equity Capital	87.1	87.1	181.3	181.3	181.3
Reserve and Surplus	2,891.7	3,415.8	5,724.6	6,869.0	8,241.0
Total Shareholders funds	2,978.8	3,502.9	5,905.8	7,050.3	8,422.2
Total Debt	2,094.2	3,022.1	3,222.1	3,222.1	3,222.1
Deferred Tax Liability	211.0	233.9	238.6	243.4	248.3
Minority Interest	94.6	12.2	12.5	12.7	13.0
Other Non Current Liabilities	550.9	224.4	228.9	233.5	238.1
Source of Funds	5,929.5	6,995.6	9,608.0	10,762.0	12,143.7
Gross Block - Fixed Assets	3,837.0	5,192.4	6,492.4	7,792.4	9,092.4
Accumulated Depreciation	1,368.6	1,599.9	1,886.2	2,236.8	2,646.0
Net Block	2,468.5	3,592.6	4,606.3	5,555.6	6,446.5
Capital WIP	1,417.6	1,297.9	1,197.9	1,097.9	997.9
Fixed Assets	3,886.1	4,890.5	5,804.2	6,653.5	7,444.4
Investments	37.0	63.5	63.5	63.5	63.5
Other non-Current Assets	404.5	320.1	326.5	333.0	339.7
Inventory	835.7	935.7	1,544.6	2,008.1	2,385.3
Debtors	753.4	793.7	1,241.4	1,613.8	1,917.0
Other Current Assets	168.5	225.9	230.4	235.0	239.7
Cash	247.3	412.3	1,240.8	931.7	1,020.9
Total Current Assets	2,004.9	2,367.6	4,257.2	4,788.5	5,562.8
Creditors	345.2	576.3	772.3	1,004.0	1,192.7
Provisions	39.9	40.1	40.9	41.7	42.6
Other Current Liabilities	18.0	29.6	30.2	30.8	31.4
Total Current Liabilities	403.1	646.1	843.5	1,076.6	1,266.7
Net Current Assets	1,601.8	1,721.5	3,413.8	3,711.9	4,296.2
Application of Funds	5,929.5	6,995.6	9,608.0	10,762.0	12,143.7

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement					
	₹ crore				
(Year-end March)	FY20	FY21	FY22E	FY23E	FY24E
Profit/(Loss) after taxation	512.3	567.9	1,344.4	1,271.6	1,524.4
Add: Depreciation & Amortiza	185.2	231.3	286.3	350.7	409.2
Net Increase in Current Asset	-68.6	-136.0	-1,061.1	-840.5	-685.1
Net Increase in Current Liabili	358.8	128.8	197.4	233.1	190.1
Others	114.3	80.7	104.9	135.3	161.1
CF from Operating activities	1,102.1	872.7	871.8	1,150.3	1,599.6
Investments	1.3	-7.8	0.0	0.0	0.0
(Purchase)/Sale of Fixed Ass	-1,125.5	-1,314.4	-1,200.0	-1,200.0	-1,200.0
Others	0.2	0.1	3.0	3.1	3.1
CF from Investing activities	-1,124.1	-1,322.1	-1,197.0	-1,196.9	-1,196.9
(inc)/Dec in Loan	-303.2	745.9	200.0	0.0	0.0
Dividend & Dividend tax	-106.4	-45.1	-134.4	-127.2	-152.4
Other	-125.4	-86.4	1,088.1	-135.3	-161.1
CF from Financing activities	-534.9	614.5	1,153.7	-262.5	-313.5
Net Cash Flow	-556.9	165.0	828.5	-309.2	89.2
Cash and Cash Equivalent	804.2	247.3	412.3	1,240.8	931.7
Cash	247.3	412.3	1,240.8	931.7	1,020.9
Free Cash Flow	-23.4	-441.7	-328.2	-49.7	399.6

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios					
(Year-end March)	FY20	FY21	FY22E	FY23E	FY24E
Per share data (₹)					
Reported EPS	14.8	14.5	37.1	35.1	42.1
Cash EPS	11.2	12.3	33.4	31.6	37.8
BV per share	82.2	96.6	162.9	194.5	232.3
Cash per Share	6.8	11.4	34.2	25.7	28.2
Dividend per share	3.6	2.2	3.7	3.5	4.2
Operating Ratios (%)					
Gross Profit Margins	50.9	52.8	52.8	49.0	49.0
EBITDA margins	23.3	21.8	28.1	22.4	22.5
Adjusted PAT Margins	12.8	11.7	19.1	13.9	14.0
Cash Conversion Cycle	108.5	93.4	104.3	104.3	104.3
Asset Turnover	1.1	0.9	1.1	1.2	1.2
EBITDA conversion Rate	112.8	88.9	44.0	56.0	65.3
Return Ratios (%)					
RoE	18.0	15.0	22.8	18.0	18.1
RoCE	13.5	10.7	17.7	16.0	17.0
RoIC	18.6	14.2	23.6	19.5	20.1
Valuation Ratios (x)					
P/E	67.6	68.9	27.0	28.5	23.8
EV / EBITDA	39.0	39.6	19.3	18.8	15.7
EV / Net Sales	9.1	8.6	5.4	4.2	3.5
Market Cap / Sales	8.7	8.0	5.1	4.0	3.3
Price to Book Value	12.2	10.3	6.1	5.1	4.3
Solvency Ratios					
Debt / EBITDA	2.1	3.1	1.6	1.6	1.3
Debt / Equity	0.7	0.9	0.5	0.5	0.4
Current Ratio	4.4	3.0	3.6	3.6	3.6
Quick Ratio					
Inventory days	72.9	75.8	80.0	80.0	80.0
Debtor days	65.7	64.3	64.3	64.3	64.3
Creditor days	30.1	46.7	40.0	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	2570	3,375	Buy	39,064	48.6	55.4	70.1	52.9	46.4	36.7	36.5	32.0	25.7	17.2	17.2	18.8	13.8	13.8	15.0
Aarti Industries	1000	1,175	Buy	36,250	14.5	37.1	35.1	68.9	27.0	28.5	39.6	19.3	18.8	10.7	17.7	16.0	15.0	22.8	18.0
Tata Chemical	919	1,035	Buy	23,419	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	1948	2,320	Buy	20,022	26.2	31.5	41.8	74.3	61.9	46.6	56.3	49.4	35.2	21.7	23.3	26.0	17.4	18.0	20.0
Sumitomo Chemical	418	520	Buy	20,864	6.9	8.7	10.3	60.4	47.8	40.6	41.8	33.4	28.0	29.8	30.0	28.5	22.4	22.6	21.4
Navin Fluorine	4230	4,520	Hold	20,939	45.0	53.6	76.8	93.9	78.9	55.1	65.7	55.7	37.1	21.0	19.2	23.6	13.6	14.4	17.7
Rallis India	277	305	Hold	5,388	11.4	9.7	13.8	24.3	28.7	20.1	15.9	18.5	12.8	18.0	13.9	18.2	13.9	10.9	13.9
Sudarshan chemical	579	695	Buy	4,011	20.4	19.7	25.7	28.4	29.4	22.6	15.7	15.9	12.7	19.0	16.1	18.2	15.2	13.6	16.2
Neogen Chemicals	1659	2,160	Buy	4,137	13.4	16.5	33.5	123.6	100.5	49.6	63.3	47.4	30.6	15.1	11.2	16.9	17.1	9.3	16.0
Astec Lifesciences	1730	2,120	Buy	3,389	33.2	43.1	55.0	52.1	40.2	31.5	32.0	23.9	19.3	18.9	21.6	22.4	21.0	21.6	21.9

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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