

# Aarti Industries

## Pharma segment outshines

We maintain our BUY recommendation on Aarti Industries (AIL) with a target price of INR 1,400/share. We expect AIL's PAT to grow at a 15% CAGR over FY21-23E. AIL's constant focus on R&D will enable the company to remain competitive and expand its customer base. The toluene segment in India is mainly untapped and catered to through imports; AIL will benefit in the long term by entering this segment. 3Q EBITDA/APAT were 15/22% above our estimates, attributable to lower-than-anticipated raw material expenses, a lower-than-expected interest cost, offset by a higher-than-expected tax outgo.

- Financial performance:** Revenue grew 10/1% YoY/ QoQ to INR 11.9bn, with revenue growth driven mainly by volume expansion and 76% contribution attributable to value-added products. EBITDA was up 12/12% YoY/ QoQ to INR 2.9bn, owing to a significant reduction in raw material expenses. Sequentially, interest cost has fallen by 40/22% YoY/QoQ to INR 173mn. APAT grew 18/18% YoY/ QoQ to INR 1.7bn.
- Speciality Chemicals segment:** Revenue/EBIT grew 4/4% YoY to INR 10.8/2.2bn. Revenue growth was backed by 90% utilisation across operationalised facilities. EBIT margin for the segment was reported at 20.7%. Return of demand from established markets drove margin improvement.
- Pharma segment:** Revenue/EBIT grew 32/54% YoY to INR 2.3/0.6bn, with the highest-ever revenue reported in a quarter, owing to more share of value-added products in the product basket. EBIT margins for the segment grew by 338bps YoY to 23.8% on the back of a better operating leverage.
- Concall takeaways:** (1) Capex spent in 3Q/9MFY21 was INR 4/9bn. (2) Interest cost has fallen significantly due to lower cost of funds and forex-linked revaluation gains on long-term borrowings. (3) AIL is considering demerging its Pharma segment as it is performing well and has a different manufacturing process and market from the rest of the company's.
- Change in estimates:** We raise our FY21 EPS estimate by 3.5% to INR 27.0 and cut FY22E EPS by 4.0% to INR 27.4 to account for overall performance in 9MFY21.
- DCF-based valuation:** Our target price is INR 1,400 (WACC 10%, terminal growth 3.5%). The stock is currently trading at 32.4x FY23E EPS.

### Financial Summary (Consolidated)

| INR mn       | 3Q<br>FY21 | 2Q<br>FY21 | QoQ<br>(%) | 3Q<br>FY20 | YoY<br>(%) | FY19   | FY20   | FY21E  | FY22E  | FY23E  |
|--------------|------------|------------|------------|------------|------------|--------|--------|--------|--------|--------|
| Net Sales    | 11,868     | 11,726     | 1.2        | 10,836     | 9.5        | 41,676 | 41,863 | 44,638 | 49,844 | 58,543 |
| EBITDA       | 2,850      | 2,543      | 12.1       | 2,542      | 12.1       | 9,651  | 9,773  | 9,366  | 10,075 | 12,236 |
| APAT         | 1,653      | 1,402      | 17.8       | 1,398      | 18.2       | 5,042  | 5,468  | 4,804  | 4,877  | 6,352  |
| AEPS (INR)   | 9.5        | 8.0        | 17.8       | 8.0        | 18.2       | 28.2   | 30.8   | 27.0   | 27.4   | 35.8   |
| P/E (x)      |            |            |            |            |            | 41.1   | 37.7   | 43.0   | 42.4   | 32.4   |
| EV/EBITDA(x) |            |            |            |            |            | 22.6   | 22.6   | 24.1   | 22.3   | 18.2   |
| RoE (%)      |            |            |            |            |            | 23.4   | 19.1   | 14.7   | 13.2   | 15.2   |

Source: Company, HSIE Research

### Change in estimates (Consolidated)

| YE Mar          | FY21E<br>Old | FY21E<br>New | % Ch | FY22E<br>Old | FY22E<br>New | % Ch  | FY23E<br>Old | FY23E<br>New | % Ch  |
|-----------------|--------------|--------------|------|--------------|--------------|-------|--------------|--------------|-------|
| EBITDA (INR mn) | 9,080        | 9,366        | 3.2  | 10,336       | 10,075       | (2.5) | 12,508       | 12,236       | (2.2) |
| AEPS (INR/sh)   | 26.1         | 27.0         | 3.5  | 28.5         | 27.4         | (4.0) | 37.0         | 35.8         | (3.2) |

Source: Company, HSIE Research

**BUY**

|                         |           |
|-------------------------|-----------|
| CMP (as on 29 Jan 2021) | INR 1,159 |
| Target Price            | INR 1,400 |
| NIFTY                   | 13,635    |

| KEY CHANGES  | OLD            | NEW            |
|--------------|----------------|----------------|
| Rating       | BUY            | BUY            |
| Price Target | INR 1,440      | INR 1,400      |
| EPS %        | FY21E<br>+3.5% | FY22E<br>-4.0% |

### KEY STOCK DATA

|                             |              |
|-----------------------------|--------------|
| Bloomberg code              | ARTO IN      |
| No. of Shares (mn)          | 174          |
| MCap (Rs bn) / (\$ mn)      | 202/2,769    |
| 6m avg traded value (Rs mn) | 423          |
| 52 Week high / low          | Rs 1,366/662 |

### STOCK PERFORMANCE (%)

|              | 3M    | 6M    | 12M  |
|--------------|-------|-------|------|
| Absolute (%) | 14.4  | 20.1  | 17.2 |
| Relative (%) | (2.0) | (1.5) | 4.8  |

### SHAREHOLDING PATTERN (%)

|                 | Sept-20 | Dec-20 |
|-----------------|---------|--------|
| Promoters       | 47.55   | 47.34  |
| FIs & Local MFs | 15.78   | 14.60  |
| FPIs            | 7.52    | 9.00   |
| Public & Others | 29.15   | 29.06  |
| Pledged Shares  | 0.00    | 0.00   |

Source: BSE

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