

Margins restored in speciality chemical segment...

Aarti Industries' Q3FY21 revenues grew 9.5% YoY to ₹ 1186.8 crore, mainly due to 31.8% growth in pharma segment to ₹ 232.2 crore. Speciality chemical revenues grew 3.5% YoY to ₹ 1078.8 crore, lower than I-direct estimates of ₹ 1162.7 crore. EBITDA margins improved 55 bps YoY, 233 bps QoQ to 24%. Improvement in gross margins by 303 bps YoY, 339 bps QoQ was partially offset by increase in other expenditure. EBITDA grew 12.1% YoY to ₹ 285 crore. PAT grew 18.2% YoY to ₹ 165.3 crore. Delta vis-à-vis EBITDA was mainly due to lower interest cost.

Strong visibility in speciality chemical segment

The company is a preferred partner for customers from multiple industries for benzene-chain based solutions due to strong chemistry prowess, backward integration, larger products basket that is backed by continuous innovation and leadership position in its key products. It is the only domestic player to have products until the sixth level derivative of benzene chemistry. It also expects to leverage on its existing clientele to promote its toluene and other derivatives. Most contracts are long term cost+ contracts that offer better control on the overall cost structure. Recently, it signed three multiyear CRAMs contracts. Owing to strong order book visibility, Aarti is in an aggressive expansion mode. Focus on value-added products (~75% of FY20 revenues), integrated model and better operating leverage are likely to improve its margin profile. Speciality chemical segment revenues are expected to grow at 19% CAGR in FY20-23E.

Aggressive expansion to support long term growth

Aarti has spent ₹ 3000+ crore in capex in FY17-20, on three multiyear projects. Of this, one was recently cancelled (expects to receive ₹ 900-975 crore as compensation) while the remaining two projects have multiyear peak annual potential of ₹ 590 crore (exhibit 3). Apart from this, it has spent on new R&D unit, expansion of hydrogenation, NCB, de-bottlenecking in various specialty chemicals, and pharma. Going ahead, Aarti is likely to spend at least ₹ 1000-1200 crore per annum in the next four to six years to complete existing pipeline, expansion in value added, pharma segments in the backdrop of strong demand visibility to drive long-term growth.

Valuation & Outlook

Speciality chemical segment margins were restored amid growth revival in domestic market. The company has reiterated flattish net profit guidance for FY21 and double digit growth from FY22. Leveraging on core knowledge of benzene-based derivatives, the company is continuously expanding product basket towards value added products up the value chain. In pharma, strong growth is expected from developed markets backed by integrated model and new launches. Margins are also expected to improve due to incremental addition of high-value products. We like the company's leadership position and strong visibility on order book. We maintain **BUY** with a TP of ₹ 1340 (22x of FY23E EPS of ₹ 56.1) vs. earlier target price of ₹ 1235.

Key Financial Summary

₹ Crore	FY20	FY21E	FY22E	FY23E	CAGR FY20-23 (%)
Revenues	4186.3	4506.7	5417.0	6959.0	18.5
EBITDA	977.3	1019.1	1345.5	1750.6	21.4
EBITDA Margins (%)	23.3	22.6	24.8	25.2	
Adj. Net Profit	536.1	565.3	775.9	1062.8	25.6
EPS (Adjusted)	30.8	32.4	44.5	61.0	
PE (x)	37.7	35.7	15.7	19.0	
EV to EBITDA (x)	22.5	22.0	16.6	12.8	
RoCE (%)	13.5	11.7	13.0	15.3	
RoE (%)	18.0	16.3	16.8	19.1	

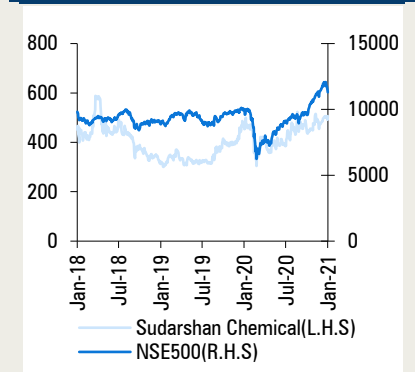
Source: ICICI Direct Research; Company



Particulars

Particular	Amount
Market Capitalisation	₹ 20188 crore
Debt (FY20)	₹ 2094 crore
Cash (FY20)	₹ 247 crore
EV	₹ 22035 crore
52 week H/L	1364/662
Equity capital	₹ 87.1 crore
Face value	₹ 2

Price Performance



Source: ICICI Direct Research, Company

Key risks to our call

- Higher than expected volatility in raw material price
- Slowdown in end users demand

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Exhibit 1: Variance Analysis

	Q3FY21	Q3FY21E	Q3FY20	Q2FY21	YoY (%)	QoQ (%)	Comments
Revenue	1,186.8	1,250.4	1,083.6	1,172.6	9.5	1.2	YoY growth mainly due to strong volume growth in pharma segment. Miss vis-à-vis I-direct estimates mainly due to lower than expected growth in speciality chemical segment
Raw Material Expense:	544.9	625.2	530.4	578.1	2.7	-5.7	
Gross Margins	54.1	50.0	51.1	50.7	303 bps	339 bps	YoY improvement amid better product mix
Employee Expenses	90.6	100.0	83.2	93.5	8.8	-3.1	
Other Expenditure	266.4	249.1	215.8	246.7	23.4	8.0	
Total Operating Expend	901.8	974.3	829.4	918.4	8.7	-1.8	
EBITDA	285.0	276.1	254.2	254.3	12.1	12.1	
EBITDA (%)	24.0	22.1	23.5	21.7	55 bps	233 bps	Better product mix was partially offset by higher other expenditure. Beat vis-à-vis I-direct estimates mainly due to better than expected margins in speciality chemical segment
Interest	17.3	34.3	28.7	22.2	-39.8	-22.0	
Depreciation	58.7	52.0	47.0	55.0	24.7	6.6	YoY increased mainly due to commercialised the part of new chlorination unit at Jhagadia
Other income	0.4	0.4	0.4	0.4	16.2	7.5	
PBT before EO	209.4	190.3	178.8	177.5	17.1	18.0	
Less: Exceptional Item:	0.0	0.0	0.0	0.0	0.0	0.0	
PBT	209.4	190.3	178.8	177.5	17.1	18.0	
Tax	40.3	38.1	36.1	33.7	11.5	19.6	
MI & Share of loss/ (ga	3.9	1.3	2.9	1.3	36.2	191.8	
Adj. Net Profit	165.3	150.9	139.8	142.5	18.2	16.0	Delta vis-à-vis EBITDA and I-direct estimates mainly due to lower interest cost
Key Metrics							
Speciality Chemicals	1,078.8	1,162.7	1,042.3	1,108.8	3.5	-2.7	Slow growth and miss vis-à-vis I-direct estimates mainly due to contributions from discretionary segment yet to recovered fully from COVID impact
Pharma	232.2	211.4	176.2	221.6	31.8	4.8	YoY growth driven by increasing contribution from regulated markets and value-added products

Source: ICICI Direct Research

Exhibit 2: Change in Estimates

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,432.6	5,417.0	-0.3	6,980.0	6,959.0	-0.3	
EBITDA	1,275.5	1,345.5	5.5	1,698.6	1,750.6	3.1	Changed mainly due to restoration of Speciality chemical segment margins
EBITDA Margin (%)	23.5	24.8	134 bps	24.3	25.2	86 bps	
PAT	681.6	775.9	13.8	976.6	1,062.8	8.8	Changed mainly in sync with operational performance and decline in Interest cost
EPS (₹)	39.1	44.5		56.1	61.0	8.8	

Source: ICICI Direct Research

Exhibit 3: Change in Estimates

(₹ crore)	Current				Earlier		Comments
	FY20	FY21E	FY22E	FY23E	FY22E	FY23E	
Speciality Chemicals	3,865.0	4,127.8	4,956.4	6,505.6	4,966.9	6,516.9	
Pharma	756.0	885.1	1,027.6	1,181.7	1,002.9	1,153.4	

Source: ICICI Direct Research

Conference Call Highlights

- The company's board of directors are evaluating the feasibility for demerger of Pharma and allied activities
- Capex in Q2FY21 and H1FY21 was at ₹ 365 crore and ~₹ 891 crore, respectively, guided for ₹ 1000-1200 crore of annual capex for next four to six years.
 - 20-25% of this capex is likely to spend on pharma segment and remaining in Speciality chemical segment
 - Dahej Intermediate facility for pharma segment will be commissioned in FY22
 - Assets turnover expected to be in vicinity of 1-1.5x
 - Expects ROCE of 20-25% from new capex mainly coming from value added products
- Annual maintenance capex would be ~₹ 300 crore
- The company has reiterated flattish net profit guidance for FY21 and 15-20% annual compounding for the next three to five years. Also, in the pharma segment, it expects 15-20% annual revenue growth and 25% of EBIT growth
- Growth in both segments is likely to come from strong end user demand and addition of capacity
- Supply to China has declined to 11-12% in Q3FY21 from 20% in Q2FY21
- Gross debt was at ~₹ 2500 crore
- Expects peak debt to equity in the range of 0.7-0.9x

Exhibit 4: Trends in quarterly performance

(₹ crore)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)	QoQ (%)
Total Operating Income	1326.5	1276.0	1141.1	1135.5	988.1	1083.6	1076.2	937.3	1172.6	1186.8	9.5	1.2
Raw Material Expenses	786.6	739.9	597.8	604.2	462.7	530.4	556.1	447.0	578.1	544.9	2.7	-5.7
% of Revenue	59.3	58.0	52.4	53.2	46.8	48.9	51.7	47.7	49.3	45.9	-303 bps	-339 bps
Gross Profit	539.9	536.2	543.3	531.3	525.4	553.3	520.1	490.4	594.5	641.9	16.0	8.0
Gross Profit Margin (%)	40.7	42.0	47.6	46.8	53.2	51.1	48.3	52.3	50.7	54.1	303 bps	339 bps
Employee Expenses	58.4	62.6	77.8	69.5	74.0	83.2	78.5	89.7	93.5	90.6	8.8	-3.1
% of Revenue	4.4	4.9	6.8	6.1	7.5	7.7	7.3	9.6	8.0	7.6	-5 bps	-34 bps
Other Expenditure	218.3	220.5	214.8	211.7	197.3	215.8	222.6	218.7	246.7	266.4	23.4	8.0
% of Revenue	16.5	17.3	18.8	18.6	20.0	19.9	20.7	23.3	21.0	22.4	253 bps	141 bps
Total Expenditure	1063.2	1022.9	890.4	885.4	734.0	829.4	857.2	755.3	918.4	901.8	8.7	-1.8
% of Revenue	80.2	80.2	78.0	78.0	74.3	76.5	79.7	80.6	78.3	76.0	-55 bps	-233 bps
EBITDA	263.3	253.1	250.7	250.1	254.1	254.2	218.9	182.0	254.3	285.0	12.1	12.1
EBITDA Margin (%)	19.8	19.8	22.0	22.0	25.7	23.5	20.3	19.4	21.7	24.0	55 bps	233 bps
Depreciation	41.7	43.7	45.5	43.2	45.7	47.0	49.3	52.0	55.0	58.7	24.7	6.6
Interest	51.8	42.0	43.8	31.0	31.1	28.7	34.0	25.3	22.2	17.3	-39.8	-22.0
Other Income	0.7	4.0	0.0	2.5	5.6	0.4	0.4	0.2	0.4	0.4	16.2	7.5
Less: Exceptional Item	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
PBT	170.6	171.5	161.4	178.4	182.9	178.8	136.1	104.9	177.5	209.4	17.1	18.0
Total Tax	32.0	31.8	34.3	36.5	31.1	36.1	25.7	21.7	33.7	40.3	11.5	19.6
Tax rate (%)	18.8	18.5	21.3	20.4	17.0	20.2	18.9	20.7	19.0	19.2	-98 bps	26 bps
PAT before MI	138.6	139.7	127.1	141.9	151.8	142.7	110.4	83.2	143.9	169.2	18.5	17.6
Minority Interest	4.3	6.0	1.9	3.8	4.2	2.9	0.0	1.3	1.3	3.9	36.2	191.8
PAT	134.3	133.7	125.3	138.1	147.6	139.8	110.4	81.9	142.5	165.3	18.2	16.0
PAT Margin (%)	10.1	10.5	11.0	12.2	14.9	12.9	10.3	8.7	12.2	13.9	102 bps	177 bps

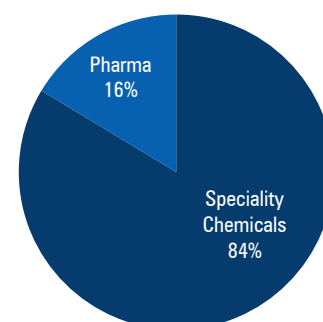
Source: ICICI Direct Research

Company Background

Aarti Industries (Aarti), established in 1984 by first generation technocrats Rajendra Gogri, is a leading benzene-based speciality chemical companies globally. The company primarily operates in two business segments – speciality chemicals (84%) and pharmaceuticals (14%). In speciality chemicals, the company is mainly into feedstock materials such as benzene, toluene, nitric acid, chlorine, methanol, aniline sulphur. In the pharmaceutical segment, Aarti is present in APIs, intermediates and xanthine derivatives for the pharmaceutical and food/beverages industry. Also, it has a de-risked portfolio that is multiproduct, multi-geography, multi-customer and multi-industry. The company 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. Also, among end user sectors, agrochemicals, pharmaceuticals and FMCG contribute 50-60% of Aarti’s revenue while other end-user industries include polymers, pigments, printing inks, dyes, fuel additives, aromatics, etc.

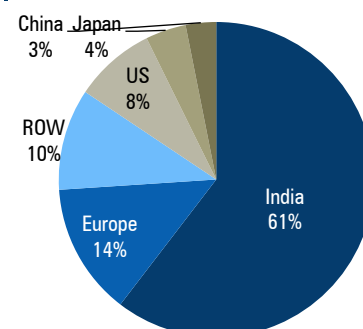
Aarti has 13 manufacturing units for speciality chemicals; five for pharma (two USFDA and three WHO/GMP), mostly located in close proximity to the large ports of western India. The company also has four R&D centres – one in Navi Mumbai, two in Vapi and one in Dombivali – which focus on innovations in new speciality chemicals and pharmaceutical applications.

Segment Bifurcation



Source: ICICI Direct Research, Company

Geographical Bifurcation



Source: ICICI Direct Research, Company

Exhibit 5: Timeline of company events

Years	Details
1984	Incorporated Aarti Organics Private Limited
1986	Commenced a 1,200 Tonnes Per Annum (TPA) unit for Nitro Chloro Benzenes (NCB) in Sarigram, Gujarat
1990	Set up the first large-scale organic plant in Vapi – a 4,500 TPA unit for NCB
2001	Set up a large-scale hydrogenation and nitration unit at Jhagadia (hydrogen gas via pipeline) Expanded the NCB and sulphuric acid capacity
2005-08	Set up a large-scale speciality chemical unit in Kutch Received US FDA approval for an Active Pharmaceutical Ingredient (API) unit in Tarapur Upgraded the hydrogenation unit from batch to continuous
2011	Received US FDA approval for the custom synthesis division at Vapi Commenced bulk shipment for global markets
2016	Commissioned an ethylation facility at Dahej SEZ (ethylene gas via pipeline) Expanded the NCB capacity from 57 KTPA to 75 KTPA
2017	Commenced the functioning of the calcium chloride facility Started operations at co-generation and solar power plants Commissioned the Nitro Toulene plant
2018	Signed two large multi-year contracts with global players Manufacturing facility being set up at Dahej SEZ
2019	Commissioned the Nitro Toulene hydrogenation facility at Jhagadia Signed another multi-year contract with a global player
2020	Operationalised Aarti Research and Technology Centre (ARTC) at Mahape, Navi Mumbai Commissioned two units at Dahej SEZ for high-value speciality chemicals

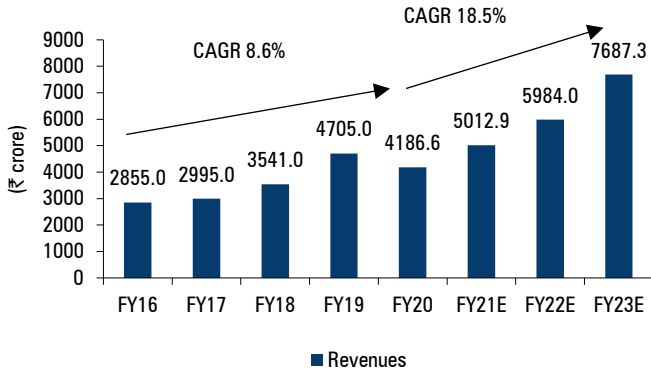
Source: ICICI Direct Research, Company

Exhibit 6: Multi-year projects

Projects	Project size (₹ cr)	Duration (year)	Peak annual potential (₹ cr)	Product	Status
Project 1	4,000	10.0	400.0	agro chemical	Cancelled, expects to get US\$ 120-130 mn as competition (US\$ 20 each in FY21E and FY22E and remaining US\$ 80-90 million in end of FY22E)
Project 2	10,000	20.0	500.0	polymer application	Guided to commissioned in FY21E
Project 3	900	10.0	90.0	NA	Guided to commissioned in FY22E

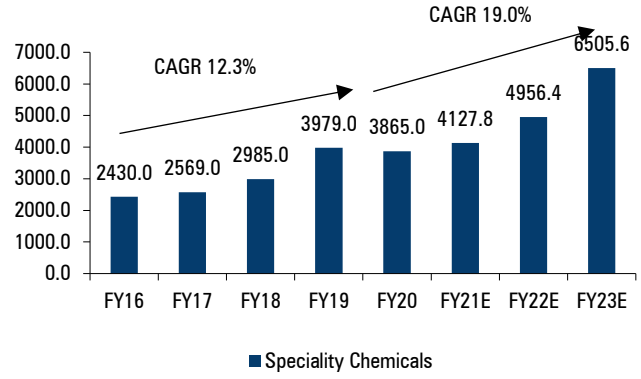
Source: ICICI Direct Research, Company

Exhibit 7: Revenues to grow at 19% CAGR in FY20-23E



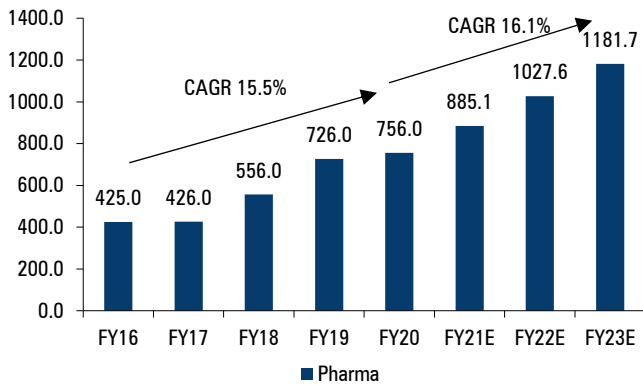
Source: ICICI Direct Research, Company; *Ex demerged entity

Exhibit 8: Chemicals to grow at 19% CAGR in FY20-23E



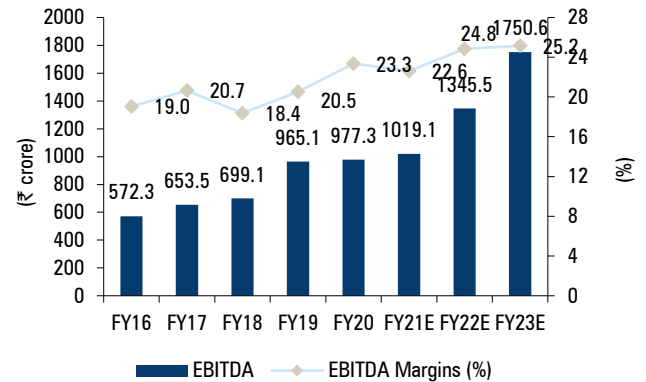
Source: ICICI Direct Research, Company

Exhibit 9: Pharma to grow at 16% CAGR in FY20-23E



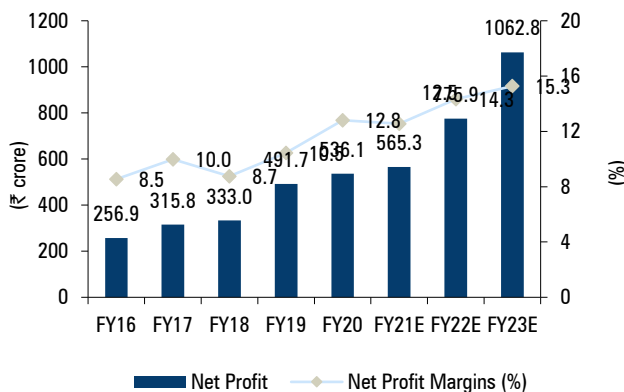
Source: ICICI Direct Research, Company

Exhibit 10: EBITDA & EBITDA margins trend



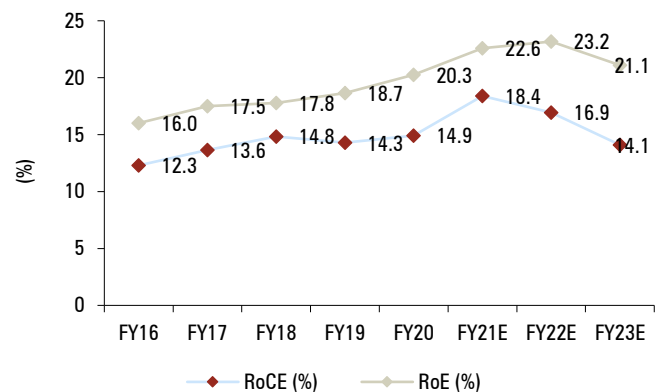
Source: ICICI Direct Research, Company

Exhibit 11: Adjusted PAT & PAT margins trend



Source: ICICI Direct Research, Company

Exhibit 12: RoE & RoCE trend



Source: ICICI Direct Research, Company

Financial Summary

Exhibit 13: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Total Operating Income	4,186.3	4,506.7	5,417.0	6,959.0
Growth (%)	-11.0	7.7	20.2	28.5
Raw Material Expenses	2,056.3	2,166.4	2,670.6	3,430.7
Gross Profit	2,130.0	2,340.2	2,746.5	3,528.3
Gross Profit Margins (%)	50.9	51.9	50.7	50.7
Employee Expenses	305.2	370.6	445.4	572.2
Other Expenditure	847.4	950.6	955.6	1,205.5
Total Operating Expenditure	3,209.0	3,487.6	4,071.6	5,208.4
EBITDA	977.3	1,019.1	1,345.5	1,750.6
Growth (%)	1.3	4.3	32.0	30.1
Interest	124.8	82.0	80.8	86.8
Depreciation	185.2	224.3	318.6	371.4
Other Income	8.8	1.5	43.3	55.7
PBT before Exceptional Item	676.2	714.2	989.4	1,348.1
Less: Exceptional Items	0.0	0.0	-637.5	0.0
PBT after Exceptional Items	676.2	714.2	1,626.9	1,348.1
Total Tax	129.4	138.4	325.4	269.6
PAT after MI	536.1	565.3	1,285.9	1,062.8
Adjusted PAT	536.1	565.3	775.9	1,062.8
Growth (%)	6.3	5.5	37.2	37.0
EPS (Adjusted)	30.8	32.4	44.5	61.0

Source: ICICI Direct Research

Exhibit 14: Cash Flow Statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit/(Loss) after taxation	512.3	565.3	1,285.9	1,062.8
Add: Depreciation & Amortiza	185.2	224.3	318.6	371.4
Net Increase in Current Asset	-68.6	-125.0	-232.3	-555.6
Net Increase in Current Liabili	358.8	27.6	76.2	128.3
Others	114.3	82.0	80.8	86.8
CF from Operating activities	1,102.1	774.3	1,529.2	1,093.7
Investments	1.3	0.0	0.0	0.0
(Purchase)/Sale of Fixed Ass	-1,125.5	-1,000.0	-1,200.0	-1,000.0
Others	0.2	9.0	9.2	9.4
CF from Investing activities	-1,124.1	-991.0	-1,190.8	-990.6
(inc)/Dec in Loan	-303.2	400.0	200.0	200.0
Dividend & Dividend tax	-106.4	-84.8	-128.6	-106.3
Other	-125.4	-82.0	-80.8	-86.8
CF from Financing activities	-534.9	233.2	-9.4	6.9
Net Cash Flow	-556.9	16.5	329.0	110.0
Cash and Cash Equivalent	804.2	247.3	263.8	592.8
Cash	247.3	263.8	592.8	702.8
Free Cash Flow	-23.4	-225.7	329.2	93.7

Source: ICICI Direct Research

Exhibit 15: Balance Sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Equity Capital	87.1	87.1	87.1	87.1
Reserve and Surplus	2,891.7	3,372.2	4,529.5	5,486.0
Total Shareholders funds	2,978.8	3,459.3	4,616.6	5,573.1
Total Debt	2,094.2	2,494.2	2,694.2	2,894.2
Deferred Tax Liability	211.0	215.2	219.5	223.9
Minority Interest	94.6	96.5	98.4	100.4
Other Non Current Liabilities	550.9	561.9	573.1	584.6
Source of Funds	5,929.5	6,827.1	8,201.9	9,376.2
Gross Block - Fixed Assets	3,837.0	5,337.0	6,637.0	7,737.0
Accumulated Depreciation	1,368.6	1,592.9	1,911.5	2,282.8
Net Block	2,468.5	3,744.2	4,725.6	5,454.2
Capital WIP	1,417.6	917.6	817.6	717.6
Fixed Assets	3,886.1	4,661.8	5,543.2	6,171.8
Investments	37.0	37.0	37.0	37.0
Other non-Current Assets	404.5	412.6	420.8	429.2
Inventory	835.7	899.6	964.7	1,239.3
Debtors	753.4	811.1	974.9	1,252.5
Other Current Assets	168.5	171.8	175.3	178.8
Cash	247.3	263.8	592.8	702.8
Total Current Assets	2,004.9	2,146.3	2,707.7	3,373.3
Creditors	345.2	371.6	446.6	573.8
Provisions	39.9	40.7	41.5	42.4
Other Current Liabilities	18.0	18.3	18.7	19.1
Total Current Liabilities	403.1	430.6	506.9	635.2
Net Current Assets	1,601.8	1,715.7	2,200.8	2,738.1
Application of Funds	5,929.5	6,827.1	8,201.9	9,376.2

Source: ICICI Direct Research

Exhibit 16: Ratio Analysis				
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
Reported EPS	30.8	32.4	73.8	61.0
Cash EPS	23.3	27.6	37.2	54.9
BV per share	171.0	198.5	265.0	319.9
Cash per Share	14.2	15.1	34.0	40.3
Dividend per share	7.5	4.9	7.4	6.1
Operating Ratios (%)				
Gross Profit Margins	50.9	51.9	50.7	50.7
EBITDA margins	23.3	22.6	24.8	25.2
Adjusted PAT Margins	12.8	12.5	14.3	15.3
Cash Conversion Cycle	108.5	108.5	100.6	100.6
Asset Turnover	1.1	0.8	0.8	0.9
EBITDA conversion Rate	112.8	76.0	113.7	62.5
Return Ratios (%)				
RoE	18.0	16.3	16.8	19.1
RoCE	13.5	11.7	13.0	15.3
RoIC	18.6	14.1	15.1	17.3
Valuation Ratios (x)				
P/E	37.7	35.7	15.7	19.0
EV / EBITDA	22.5	22.0	16.6	12.8
EV / Net Sales	5.3	5.0	4.1	3.2
Market Cap / Sales	4.8	4.5	3.7	2.9
Price to Book Value	6.8	5.8	4.4	3.6
Solvency Ratios				
Debt / EBITDA	2.1	2.4	2.0	1.7
Debt / Equity	0.7	0.7	0.6	0.5
Current Ratio	4.4	4.4	4.2	4.2
Quick Ratio	2.3	2.3	2.3	2.3

Source: ICICI Direct Research

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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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