

Aarti Industries

31 March, 2023

Reuters: ARTI.BO; Bloomberg: ARTO IN

Earnings acceleration from FY25

Our recent interaction with Aarti Industries' (ARTO) management along with Jhagadia and Dahej plant visit gave some perspective on the demand environment, update on recently commissioned facilities (including long-term contracts) and most importantly growth trajectory going ahead over the next couple of years. Nearly 52% of the business comes from discretionary segments (i.e. ex-Agrochemicals and Pharma), wherein the management expects a gradual demand recovery during FY24. Despite the near term demand challenges, the management sounded upbeat on future growth outlook, especially Chlorotoluene (which is a new value chain for ARTO). The entire future expansion in new value chains in Jhagadia would be done in Zone IV (95 acres land), wherein the pilot plant is already operational. The management has planned a total capex of Rs25-30bn (by FY26) at this site for exploring new as well as profitable value chains. We believe that there should be reasonable revenue visibility, led by strong customer engagement, import substitution etc. Growth should accelerate from FY25, led by ramp-up of existing capacities and new commissioning during the current year. Total capex incurred during FY19-1HFY23 stood at Rs49bn and over H1FY23 to FY25, ARTO's capex at Jhagadia should be ~Rs10bn. Maintenance/refurbishment capex going ahead should be lower compared to the last five years. Also, even if new value chains are more profitable, operating profit growth over the medium term should be mainly a function of volume growth. Global and domestic macro environment can have a reasonable impact on demand for ARTO's portfolio vis-à-vis chemical companies focused largely on Agrochemicals and Pharma innovators. Execution of new projects is the key in terms of driving profitable growth and improving overall return ratios. Post earnings revision, we are building in Revenue/EBITDA/APAT CAGR of 21%/24%/28% over FY23-FY25E. We maintain ACCUMULATE with a revised Target Price (TP) of Rs550 (earlier Rs600) based on 23x PE FY25E earnings.

KTAs of our discussion are as follows.

Details of both the sites: Jhagadia site (3 zones) is spread over ~130 acres, wherein there is enough scope for future expansion. Zone 4 site in Jhagadia would act as a growth catalyst over the medium term. Total area is ~95 acres wherein ARTO is planning to start new value chains such as Chlorotoluene. The management indicated a total capex of Rs25-30bn by FY26 at this location and projected potential EBITDA of Rs10bn at peak utilization. The pilot plant is already operational at the site. The management sounded upbeat about the Chlorotoluene chain wherein the major growth driver is import substitution followed by the exports opportunity. Dahej plants are divided in three divisions (including sites for long term contracts) with a total area of ~50 acres. The Dahej site has ~1K employees whereas Jhagadia employs ~1.8K employees (in three shifts).

RM sourcing: Sulfuric Acid is made in-house by ARTO wherein Sulfur is sourced from RIL and imports. Acid plant currently has capacity of ~550 tonnes/day and ARTO is in the process of expanding the same to ~670 tonnes/day. Demand for Concentrated Nitric Acid is ~200 tonnes/day at present. Sourcing of Nitric Acid going forward should not be a challenge after the strategic sourcing arrangement with Deepak Fertilizers. Currently, apart from Deepak Fertilizers, ARTO also buys Nitric Acid from GNFC in some quantity. Prices of Nitric Acid is a function of ammonia prices. Sourcing of Benzene (daily requirement of ~250 tonnes/day and expected to increase to ~300 tonnes/day) and Toluene is seamless due to long-term relations with the suppliers. Benzene is sourced from RIL, Essar Group etc. to a large extent whereas Toluene is sourced via imports.

Update on key value chains: Chloroaniline forms one of the important products for ARTO with a capacity of 36K MTPA. It is mainly used in Agrochemicals and a small share goes to Dyes & Pigments, which is under pressure currently. Nitrotoluene (NT) capacity is ~30K MTPA and ARTO is in the process of expanding the same by 50% (brownfield expansion). ONT is used as key RM in manufacturing MEA (current capacity is ~10K MTPA at Dahej and in process to expand it to 30K MTPA). Post expansion, MEA capacity should be ~25% of global capacity. MEA is mainly used in Agrochemicals. NB is used as key starting material in making PDA (NPDA- major end user industry - Dyes & Pigments). PDA capacity stands at 12K MTPA. NCB capacity has increased from 75K MTPA to 108K MTPA. In NCB value chain, capacity of MCB/DCB stood at 65K MTPA and PNCB/ONCB capacity is ~75K MTPA. DCNB capacity is ~10K MTPA and TCB has overall capacity of 12K MTPA.

ACCUMULATE

Sector: Chemicals

CMP: Rs511

Target Price: Rs550

Upside: 8%

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Key Data

Current Shares O/S (mn)	362.5
Mkt Cap (Rsbn/US\$bn)	185.3/2.3
52 Wk H / L (Rs)	864/482
Daily Vol. (3M NSE Avg.)	720,263

Price Performance (%)

	1 M	6 M	1 Yr
Aarti Industries	(3.4)	(21.4)	(38.8)
Nifty Index	(1.3)	(0.1)	(2.4)

Source: Bloomberg

Long Term Contract 1 facility still under-utilized: With regards to the Long Term Contract 1, which got cancelled, the facility is operating at lower utilization at present. Final product, which ARTO was supposed to supply, is operating at ~20% utilization. RM (DCA) are operating at ~50% utilization. Excess DCA can be used to make DCB. The management informed that in terms of utilizing the same capacity to full extent, a clear strategy would be highlighted in the next few quarters. Capex towards Long Term Contract 1 stood at ~Rs9bn (Rs5.9bn in Dahej and rest in Jhagadia). In Dahej, capex incurred towards the final product is ~Rs4bn (10K MTPA) and for RM (20K MTPA) the capex is ~Rs1bn. Conversion rate from RM to final intermediate is 1.5:1. The management believes that capacity of the final product could be ~25% of global capacity.

Long Term Contract 2 facility has been commissioned in 3QFY22. ARTO has a dedicated facility for the same spread over 12 acres. While the utilization is currently lower at ~50%, the contract with the customer has a 'Take or Pay' clause and hence profitability is not a function of demand for that particular intermediate. Margin profile of the intermediate is lower (~12-15%) as technology is shared by the customer. RM is also purchased from the same client. The management indicated that ARTO has a long standing relationship with the customer and hence possibility of new contracts in future cannot be ruled out. While the details of the molecule were not shared, this is a totally new chemistry with 4-step process and complex reaction.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	45,061	54,745	66,177	78,399	97,082
Growth YoY%	7.6%	21.5%	20.9%	18.5%	23.8%
Gross margin %	52.8%	47.9%	42.1%	43.6%	44.6%
EBITDA	9,815	11,091	11,521	13,338	17,769
EBITDA margin %	21.8%	20.3%	17.4%	17.0%	18.3%
Adj PAT	5,352	5,749	5,283	5,807	8,675
Adj EPS	15.4	15.9	14.6	16.0	23.9
Growth YoY%	-0.2%	7.4%	-8.1%	9.9%	49.4%
RoCE	13.9%	13.6%	11.6%	11.5%	14.0%
RoE	16.5%	14.3%	11.2%	11.4%	15.6%
P/E	33.3	32.2	35.1	31.9	21.4
EV/EBITDA	19.7	17.9	17.9	15.6	12.0
P/BV	5.1	4.1	3.8	3.5	3.2

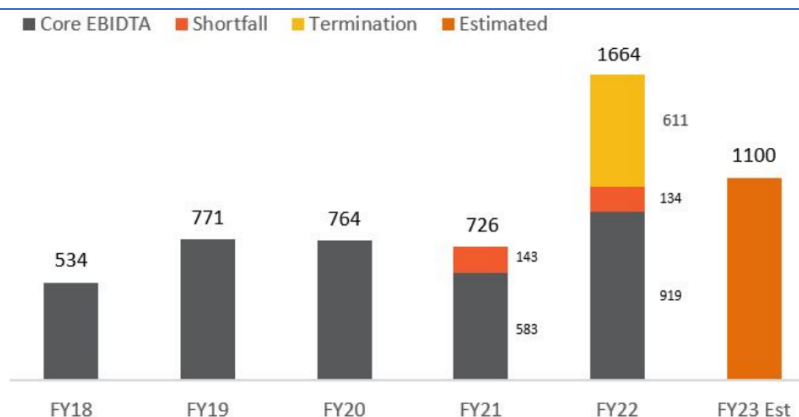
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in earnings estimates

Consolidated (Rsmn)	Old Estimates			New estimates			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	66,177	81,090	96,671	66,177	78,399	97,082	0%	-3%	0%
EBITDA	11,521	14,117	19,516	11,521	13,338	17,769	0%	-6%	-9%
EBITDA margin	17.4%	17.4%	20.2%	17.4%	17.0%	18.3%	bps	-40bps	-189bps
APAT	5,283	6,446	10,192	5,283	5,807	8,675	0%	-10%	-15%

Source: Nirmal Bang Institutional Equities Research

Exhibit 3: Historical normalized EBITDA of Chemicals division



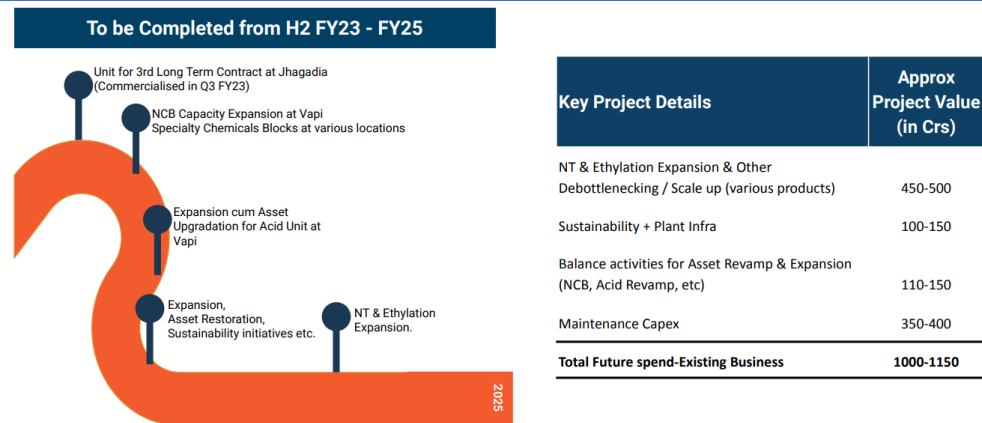
Source: Company PPT, Nirmal Bang Institutional Equities Research

Exhibit 4: Historical capex break-up



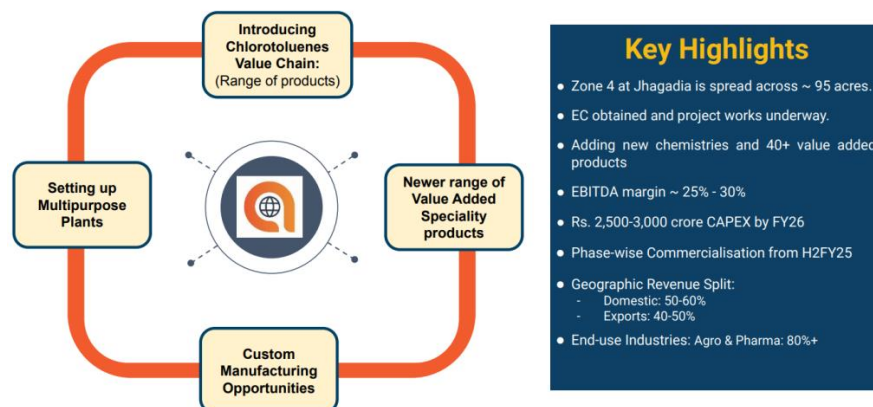
Source: Company PPT, Nirmal Bang Institutional Equities Research

Exhibit 5: Future capex at Jhagadia and Vapi (existing sites)



Source: Company PPT, Nirmal Bang Institutional Equities Research

Exhibit 6: Jhagadia Zone 4- new value chains and capex details



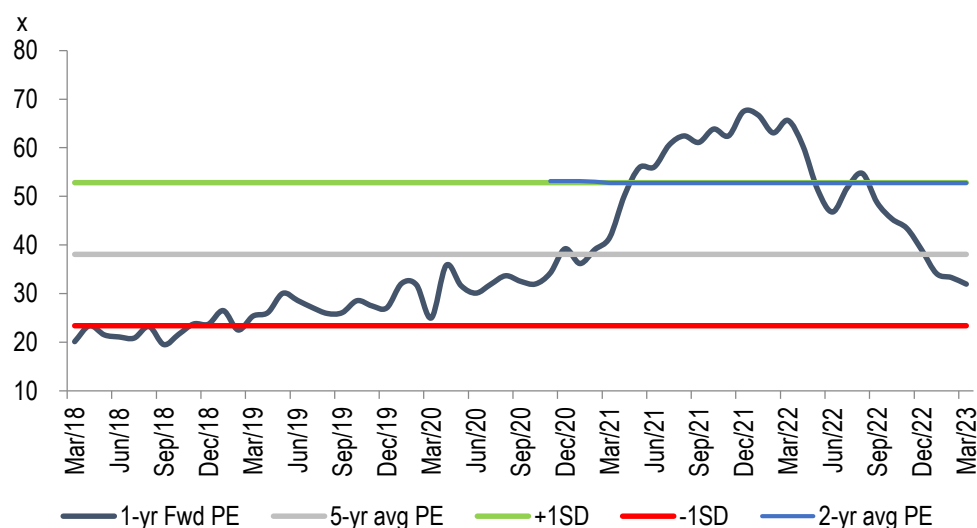
Source: Company PPT, Nirmal Bang Institutional Equities Research

Exhibit 7: Growth outlook

FY24	<ul style="list-style-type: none"> Macro Concerns on demand continuing from FY23 is expected to progressively improve in FY24.
FY25	<ul style="list-style-type: none"> Ramp-up of capacities and higher operating leverages shall lead to EBITDA of about Rs.1700 crs (~25% CAGR over FY23). Zone 4 to start gradually going onstream.
FY26 and beyond	<ul style="list-style-type: none"> EBITDA to grow by ~ 20-25% CAGR driven by <ul style="list-style-type: none"> Zone 4 ramping up. New Strategic opportunities Higher utilisation for existing capacities at Zone 1,2,3

Source: Company PPT, Nirmal Bang Institutional Equities Research

Exhibit 8: One-year forward P/E



Source: Company PPT, Nirmal Bang Institutional Equities Research

Financials (Consolidated)

(Financials before 1st July, 2021 includes Pharma segment's performance as well, which got demerged)

Exhibit 9: Income statement

Y/E March (Rsm)	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	45,061	54,745	66,177	78,399	97,082
Growth YoY%	7.6	21.5	20.9	18.5	23.8
COGS	21,286	28,545	38,290	44,193	53,765
Gross margin %	52.8	47.9	42.1	43.6	44.6
Staff costs	3,714	3,570	3,716	4,714	5,741
Other expenses	10,246	11,540	12,649	16,154	19,807
EBITDA	9,815	11,091	11,521	13,338	17,769
Growth YoY%	0.4	13.0	3.9	15.8	33.2
EBITDA margin %	21.8	20.3	17.4	17.0	18.3
Depreciation	2,313	2,464	3,261	4,138	5,015
EBIT	7,502	8,627	8,260	9,200	12,753
Interest	864	1,023	1,845	2,161	2,209
Other income	7	8	22	56	52
PBT (bei)	6,646	7,612	6,437	7,095	10,596
PBT	6,646	7,612	6,437	7,095	10,596
ETR	19.5	24.5	17.9	18.2	18.1
PAT	5,235	5,747	5,281	5,805	8,673
Adj PAT	5,352	5,749	5,283	5,807	8,675
Growth YoY%	-0.2	7.4	-8.1	9.9	49.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Cash flow

Y/E March (Rsm)	FY21	FY22	FY23E	FY24E	FY25E
PBT	6,646	15,268	6,437	7,095	10,596
Depreciation	2,313	2,885	3,261	4,138	5,015
Interest	864	1,143	1,845	2,161	2,209
Other adjustments	-57	-61	-22	-56	-52
Change in Working capital	-72	-11,858	1,673	-1,804	-4,652
Tax paid	-966	-2,670	-1,155	-1,288	-1,920
Operating cash flow	8,727	4,708	12,040	10,246	11,196
Capex	-13,148	-13,066	-11,091	-15,264	-13,723
Free cash flow	-4,421	-8,358	949	-5,018	-2,527
Other investing activities	-73	11	-752	1,551	52
Investing cash flow	-13,221	-13,055	-11,843	-13,712	-13,672
Issuance of share capital	-	11,867	-	-	-
Movement of Debt	7,459	-2,663	4,408	5,290	7,954
Dividend paid (incl DDT)	-451	-1,269	-1,571	-1,725	-3,442
Other financing activities	-864	-1,975	-590	-531	-796
Financing cash flow	6,145	5,960	2,246	3,033	3,716
Net change in cash flow	1,650	-2,387	2,443	-433	1,241
Opening C&CE	2,473	4,123	1,736	4,179	3,746
Closing C&CE	4,123	1,736	4,179	3,746	4,987

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Balance sheet

Y/E March (Rsm)	FY21	FY22	FY23E	FY24E	FY25E
Share capital	871	1,813	1,813	1,813	1,813
Reserves	34,158	43,347	47,059	51,141	56,374
Net worth	35,151	45,167	48,879	52,961	58,194
Long term debt	12,681	9,299	11,158	13,390	17,675
Short term debt	12,241	12,741	15,289	18,347	22,017
Total debt	24,921	22,040	26,448	31,737	39,691
Other non-current liabilities	4,584	4,181	5,435	7,065	8,478
Total Equity & Liabilities	64,657	71,387	80,761	91,763	1,06,363
Gross block	51,147	54,062	69,062	87,062	1,02,062
Accumulated depreciation	15,222	17,686	20,947	25,085	30,101
Net Block	35,925	36,376	48,115	61,977	71,961
CWIP	12,979	13,030	9,121	6,385	5,108
Intangible and others	1	-1	-	-	-
Other non-current assets	3,201	4,152	4,983	3,488	3,488
Investments	635	283	226	226	226
Trade receivables	7,937	10,915	11,395	13,499	16,716
Inventories	9,357	9,341	11,301	13,389	16,579
Cash & Cash equivalents	4,123	1,736	4,179	3,746	4,987
Other current assets	2,259	4,469	2,234	2,234	2,234
Total current assets	23,676	26,461	29,110	32,868	40,516
Trade payables	5,763	3,526	3,249	3,749	4,561
Other current liabilities	5,997	5,390	7,545	9,432	10,375
Total current liabilities	11,761	8,916	10,794	13,181	14,936
Total Assets	64,657	71,387	80,761	91,763	1,06,363

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Key ratios

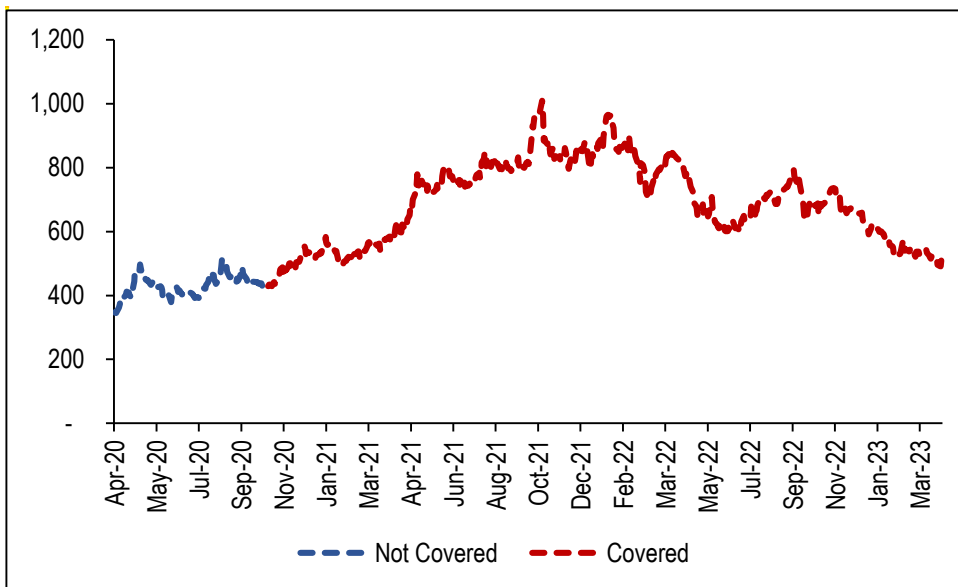
Y/E March (Rsm)	FY21	FY22	FY23E	FY24E	FY25E
Per share (Rs)					
Adj EPS	15.4	15.9	14.6	16.0	23.9
Book value	100.5	124.6	134.8	146.1	160.5
Valuation (x)					
EV/EBITDA	19.7	17.9	17.9	15.6	12.0
P/E	33.3	32.2	35.1	31.9	21.4
P/BV	5.1	4.1	3.8	3.5	3.2
Return ratios (%)					
RoCE	13.9	13.6	11.6	11.5	14.0
RoE	16.5	14.3	11.2	11.4	15.6
Profitability ratios (%)					
Gross margin	52.8	47.9	42.1	43.6	44.6
EBITDA margin	21.8	20.3	17.4	17.0	18.3
PAT margin	11.9	10.5	8.0	7.4	8.9
Liquidity ratios (%)					
Current ratio	1.0	1.2	1.1	1.0	1.1
Quick ratio	0.6	0.8	0.7	0.6	0.6
Solvency ratio (%)					
Debt to Equity ratio	0.7	0.5	0.5	0.6	0.7
Turnover ratios					
Fixed asset turnover ratio (x)	0.9	1.0	1.0	0.9	1.0
Debtor days	63	63	63	63	63
Inventory days	72	62	62	62	62
Creditor days	37	31	31	31	31
Net Working capital days	97	94	94	94	94

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
16 October 2020	BUY	489	625
12 November 2020	BUY	526	625
7 January 2021	BUY	646	750
29 January 2021	BUY	580	670
19 May 2021	ACCUMULATE	833	800
09 August 2021	ACCUMULATE	950	920
23 September 2021	ACCUMULATE	918	1,000
1 November 2021	ACCUMULATE	972	1,000
7 February 2022	ACCUMULATE	1,000	1,100
31 May 2022	ACCUMULATE	812	900
11 August 2022	ACCUMULATE	815	900
19 September 2022	ACCUMULATE	887	900
16 November 2022	ACCUMULATE	709	700
6 February 2023	ACCUMULATE	565	600
31 March 2023	ACCUMULATE	511	550

Rating Chart



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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