Aarti Industries

Challenging times

We maintain our BUY recommendation on Aarti Industries (AIL), with a target price of INR 619/share. AIL’s constant focus on Capex and R&D will enable it 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. EBITDA/APAT were 20/21% below our estimates, owing to a 10% fall in revenue and higher-than-expected raw material cost, offset by lower-than-expected other expenses, finance cost and tax outgo.

- Financial performance: Revenue fell 12% YoY to INR 14bn, on account of a decline in volumes, a decline in realisations owing to a reduction in prices of key raw materials and margin contraction due to excess supply from China. Commitments with reference to long-term contracts and demand for a few products with end-use in additives are continuing to gain traction. EBITDA fell 28% YoY to INR 2bn while EBITDA margin fell by 320bps YoY to 14% in Q1, owing to lower capacity utilisation across products and reduced realisations. APAT fell 48% YoY to INR 0.7bn.

- Con call takeaways: (1) Demand weakness is continued in products with end-use industries such as dyes and pigments, agrochemicals, auto, etc. With the impact being deep, the recovery is expected to gradually come from H2FY24. (2) The company commercialised the expanded NCP capacity. (3) The company commercialised a renewable power generation unit with a capacity of 13MW, in partnership with Renew Power. (4) It has guided for INR 30bn Capex over FY24-25.

- Change in estimates: We cut our FY24/25 EPS estimates by 52.5/20.3% to INR 8.4/19.6/sh, to factor in the slowdown in the end-user industries, reduced realisations owing to Chinese dumping of goods at aggressive prices, and management guidance in Q1FY24.

- DCF-based valuation: Our target price is INR 619 (WACC 11%, terminal growth 4%). The stock is currently trading at 24x FY25E EPS.

Financial summary (consolidated)

<table>
<thead>
<tr>
<th>INR mn</th>
<th>Q1 FY24</th>
<th>Q4 FY24 QoQ (%)</th>
<th>Q1 FY23 YoY (%)</th>
<th>FY22</th>
<th>FY23</th>
<th>FY24E</th>
<th>FY25E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>14,140</td>
<td>16,550 (14.6)</td>
<td>16,105 (12.2)</td>
<td>60,855</td>
<td>66,186</td>
<td>59,735</td>
<td>70,265</td>
</tr>
<tr>
<td>EBITDA</td>
<td>2,020</td>
<td>2,510 (19.5)</td>
<td>2,815 (28.2)</td>
<td>17,201</td>
<td>10,890</td>
<td>9,239</td>
<td>14,352</td>
</tr>
<tr>
<td>APAT</td>
<td>710</td>
<td>1,490 (52.3)</td>
<td>1,335 (47.6)</td>
<td>11,857</td>
<td>5,452</td>
<td>3,040</td>
<td>7,096</td>
</tr>
<tr>
<td>AEPS (INR)</td>
<td>2.0</td>
<td>4.1 (52.3)</td>
<td>3.7 (47.6)</td>
<td>32.7</td>
<td>15.0</td>
<td>8.4</td>
<td>19.6</td>
</tr>
<tr>
<td>P/E (x)</td>
<td>14.5</td>
<td>31.5</td>
<td>56.5</td>
<td>24.2</td>
<td>17.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EV/EBITDA(x)</td>
<td>11.4</td>
<td>18.2</td>
<td>22.2</td>
<td>14.7</td>
<td>11.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RoE (%)</td>
<td>29.6</td>
<td>11.6</td>
<td>6.0</td>
<td>13.0</td>
<td>15.8</td>
<td></td>
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</tbody>
</table>

Source: Company, HSIE Research

Change in estimates (consolidated)

<table>
<thead>
<tr>
<th>Y/E Mar</th>
<th>FY24E Old</th>
<th>FY24E New</th>
<th>% Ch</th>
<th>FY25E Old</th>
<th>FY25E New</th>
<th>% Ch</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA (INR mn)</td>
<td>12,929</td>
<td>9,239 (28.5)</td>
<td>17,315</td>
<td>14,352 (17.1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. EPS (INR/sh)</td>
<td>17.7</td>
<td>8.4 (52.5)</td>
<td>24.6</td>
<td>19.6 (20.3)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Company, HSIE Research

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