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BUY

Aarti Industries

Best play on demand recovery in chemicals; initiate with BUY

Specialty Chemicals ▸ Initiating Coverage ▸ **January 18, 2024**

TARGET PRICE (Rs): 750

Aarti is poised for a structural uptick in its value chains, led by i) headwinds faced by European players operating in similar value chains on high feedstock/energy costs, ii) India becoming more competitive in nitration after multiple nitric acid capacities coming on stream, and iii) a diversified end-user market. A large part of the capex spent in the last five years has not contributed to Aarti's EBITDA due to 1) cancellation of the first long-term contract, 2) spends on asset refurbishment/replacement, which are non-revenue generating, 3) availability issues in nitric acid hindering volume growth. Aarti's EBITDA has not grown materially over FY19-23, but we expect FY24-26E revenue/EBITDA/PAT CAGR at ~21%/38%/57%. We initiate coverage with a BUY recommendation and TP of Rs750/share, valuing it at 30x its Dec-25E EPS.

Aarti Industries: Financial Snapshot (Consolidated)

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	62,401	66,186	63,315	78,002	92,428
EBITDA	10,892	10,890	9,933	15,487	18,792
Adj. PAT	5,550	5,453	3,971	7,640	9,727
Adj. EPS (Rs)	18.2	15.1	11.0	21.1	26.9
EBITDA margin (%)	17.5	16.5	15.7	19.9	20.3
EBITDA growth (%)	11.0	0.0	(8.8)	55.9	21.3
Adj. EPS growth (%)	15.8	(17.1)	(27.2)	92.4	27.3
RoE (%)	13.8	11.6	7.8	13.7	15.4
RoIC (%)	12.2	11.6	8.3	12.2	13.3
P/E (x)	39.9	40.6	55.7	29.0	22.8
EV/EBITDA (x)	22.5	22.8	25.4	16.5	13.7
P/B (x)	4.9	4.5	4.2	3.7	3.3
FCFF yield (%)	0.9	(0.1)	(0.7)	(0.3)	0.6

Source: Company, Emkay Research

Mono Methyl Aniline (MMA) & Methyl Ethyl Aniline (MEA) to grow significantly

Methyl Aniline (MMA) and Methyl Ethyl Aniline (MEA) are likely to be materially large and scalable products for Aarti over the next few years. MMA is an octane booster used for converting naphtha to gasoline, and MEA is used in agrochemicals/discretionary end-uses. While the core portfolio is seeing relatively subdued demand for now, we believe the core portfolio of Para Di Chloro Benzene (PDCB), Para Nitro Chloro Benzene (PNCB) and other products within the Aniline chain will start delivering significant delta to Aarti's overall EBITDA once demand recovers. We expect sequential improvement in Aarti's EBITDA over the next few quarters, with enhancement in quality of earnings.

Aarti witnessing benefits of Europe+1 in its value chains

Post the onset of the Russia-Ukraine war, the European chemical industry is facing significant headwinds and is losing competitiveness in global chemical markets due to high energy and feedstock costs. Typically, European players are operating their plants at significantly lower utilization on account of higher feedstock costs and a relatively subdued demand environment. Further, Russia is now making divergent buying decisions from Europe, wherever there is an alternate supply chain available. Aarti is well poised for an uptick, with global leadership in the benzene, toluene, and aniline value chains, and is reaping the benefits of a structural shift in the supply chain.

India has become more competitive in nitration

Indian companies witnessed inconsistent supply of nitric acid during FY20-22 (impacting their nitration volume growth), largely due to: i) steady rise in end-use demand of nitric acid, ii) delays in capacity ramp-up by Deepak Fertilizers, and iii) limited import mechanisms to import concentrated nitric acid. This led to ~3x rise in the prices of nitric acid. However, sighting these concerns, several players announced capacity expansions in nitric acid in FY23, and prices saw sharp correction, granting Indian players more competitiveness in nitration. In this context, Aarti's decision not to backward integrate into a commodity at the peak of its cycle was the right decision in our view.

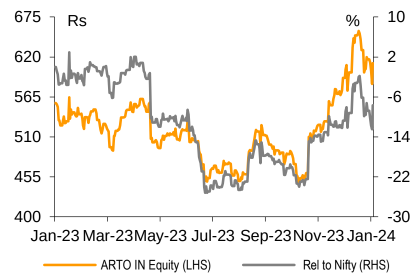
Target Price – 12M	Dec-24
Change in TP (%)	**NA**
Current Reco.	BUY
Previous Reco.	NA
Upside/(Downside) (%)	22.6
CMP (18-Jan-24) (Rs)	611.6

Stock Data	Ticker
52-week High (Rs)	662
52-week Low (Rs)	438
Shares outstanding (mn)	362.5
Market-cap (Rs bn)	222
Market-cap (USD mn)	2,667
Net-debt, FY24E (Rs mn)	30,828
ADTV-3M (mn shares)	2
ADTV-3M (Rs mn)	1,201.2
ADTV-3M (USD mn)	14.5
Free float (%)	-
Nifty-50	21,462
INR/USD	83.1
Shareholding, Dec-23	
Promoters (%)	43.6
FPIs/MFs (%)	10.8/15.8

Price Performance

(%)	1M	3M	12M
Absolute	1.5	26.0	5.7
Rel. to Nifty	1.3	15.4	(10.5)

1-Year share price trend (Rs)



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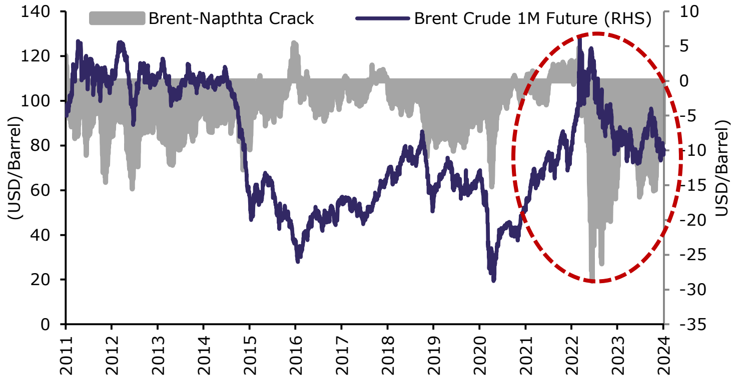
Refer to Important Disclosures at the end of this report

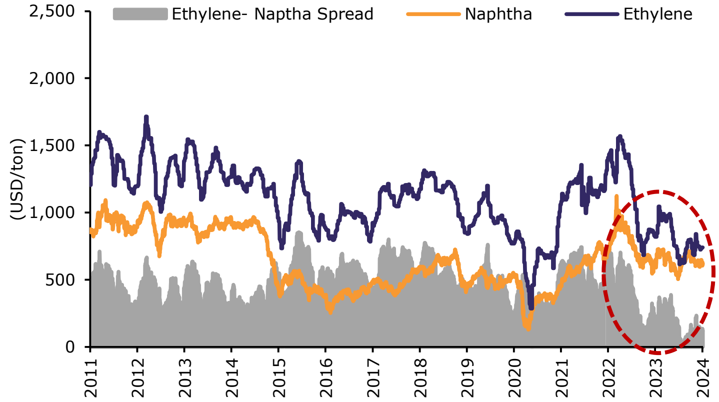
Story in Charts

Exhibit 1: Favorable Brent-Naphtha cracks diverted more naphtha towards gasoline…



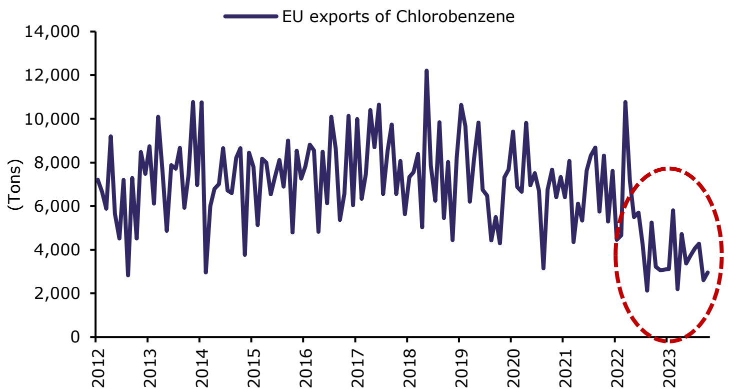
Source: Industry, Emkay Research

Exhibit 2: …supplemented by unfavorable Ethylene-Naphtha spreads



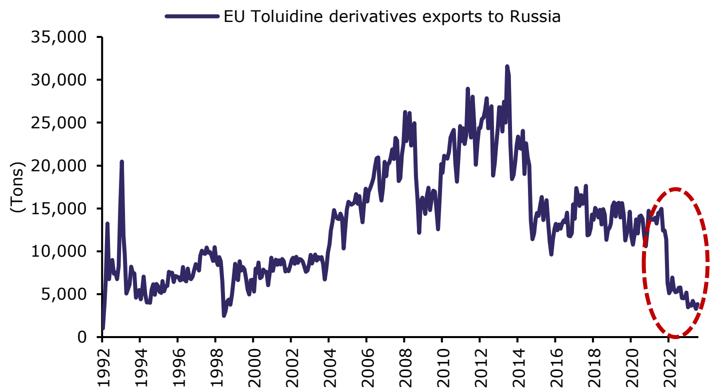
Source: Industry, Emkay Research

Exhibit 3: Chlorobenzene exports from EU on a decline globally…



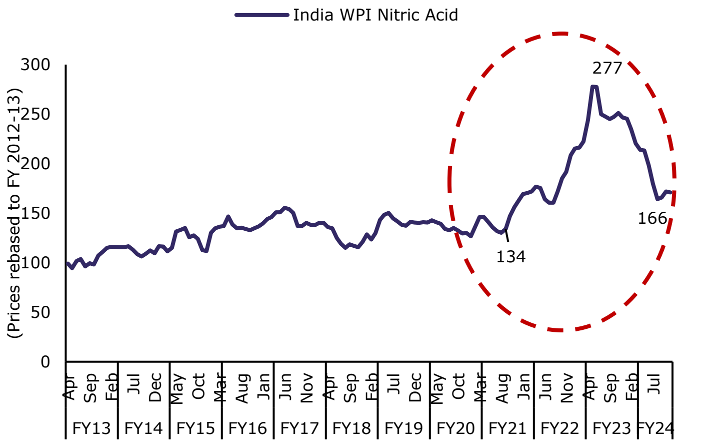
Source: Industry, Emkay Research

Exhibit 4: ..Toluidine derivatives exports to Russia too on a decline



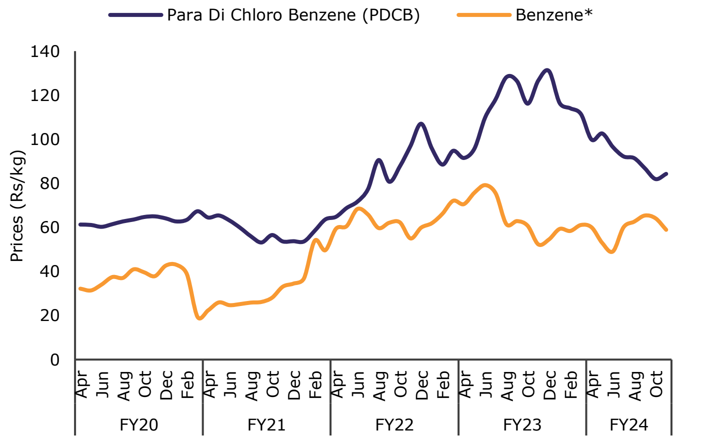
Source: Industry, Emkay Research

Exhibit 5: Nitric acid prices corrected after new capacity additions



Source: Industry, Emkay Research

Exhibit 6: Pass through model with a quarterly lag



*Source: Industry, Emkay Research, *1 unit of chlorobenzene requires 0.7 units of benzene*

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Investment Thesis

Aarti's technical capabilities, low-cost manufacturing edge, willingness to invest, and consistently strengthening relationships with customers have helped the company grow its EBITDA ~12x over FY07-23. Aarti is among the most scalable chemical companies in India given (i) its presence across a wide range of products from basic to specialty having diverse end use applications, (ii) integrated manufacturing leading to cost efficiencies and supply chains independent of China and (iii) favorable macro factors like depreciation of INR versus RMB, import substitution and 'China+1'.

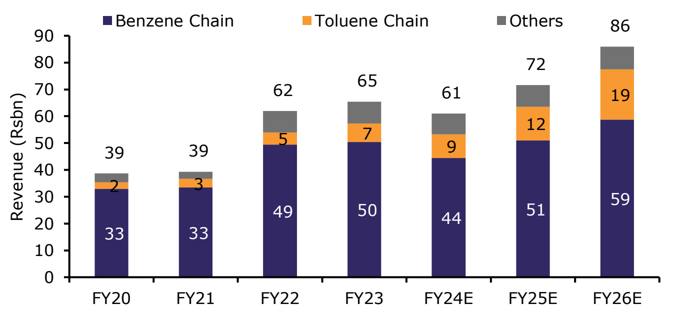
Aarti's first-generation, technocrat promoters built a global scale benzene derivatives business, and second generation is now scaling up benzene & toluene derivatives. We expect, Mono Methyl Aniline (MMA) and Methyl Ethyl Aniline (MEA) to be significantly large and scalable products for Aarti over next few years. While the core portfolio is seeing relatively subdued demand currently, once demand recovers we believe core portfolio of Para Di Chloro Benzene (PDCB), Para Nitro Chloro Benzene (PNCB) and other products within the Aniline chain will start delivering significant delta to the overall EBITDA of the company.

The company is well-positioned for growth in the coming years, supported by its low-cost manufacturing advantage and relationships with global customers. Expansion of existing value chains and entering newer value chains will aid earnings momentum. Once these value chains are established, these will largely become a cash cow and the next leg of growth will be driven by establishing Universal MPP and value-added products. Moreover, entering into more downstream products will lead to margin expansion and improve the quality of earnings.

Generally in all high-growth chemical companies, a large part of OCF is being reinvested in capex and thus there is very low FCF generation. We believe these companies are in the midst of an investment cycle seeing strong growth opportunities and thus will see sustained investments. Also, Aarti has spent ~Rs10-12bn of capex in asset replacement, refurbishment etc. as these plants were 20+ years old plants and required refurbishment to enhance their useful lives. At the same time first long term contract with a capex of Rs8bn is lying in the gross block but not contributing to the revenue. We believe, large part of this non-revenue generating capex is largely behind and because we are at the early phase of these replacement capex cycle the return ratios will optically look lower. However, going forward return ratios are expected to improve on ramp up in existing value chains and long term contracts.

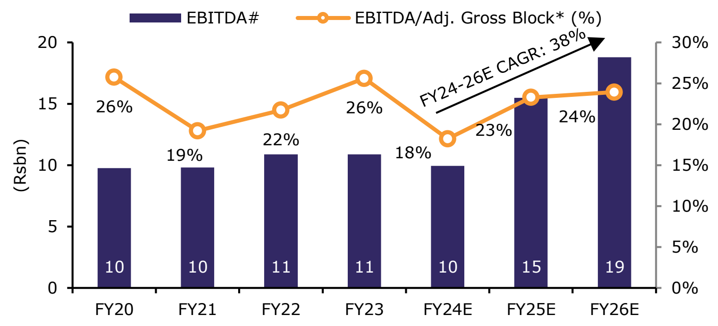
A large part of the capex spent in the last five years has not contributed to Aarti's EBITDA due to i) cancellation of the first long-term contract, ii) spends on asset refurbishment/replacement, which are non-revenue generating, and iii) availability issues in nitric acid hindering volume growth. After a stagnant EBITDA growth over FY19-23, Aarti is now poised for a sharp EBITDA growth along with RoCE improvement. We expect Aarti's revenue/EBITDA/PAT to register a ~21%/38%/57% CAGR over FY24-26E. We believe Aarti is the best play on demand recovery in the chemicals space, once inventory destocking is over with multiple tailwinds in the favor of their businesses. Also, we expect Aarti to show sequential improvement in EBITDA over next few quarters followed by contribution from chlorotoluene chain from FY26. We initiate coverage with a BUY rating and TP of Rs750/share, valuing the stock at 30x its Dec-25E EPS as the growth is largely back ended in FY26.

Exhibit 7: Toluene chain to start ramping up sequentially followed by rebound in benzene chain



Source: Company, Emkay Research

Exhibit 8: Adj. Gross Block/EBITDA to start improving once demand recovers; to reach 28-30% at peak by FY27/28



*Source: Company, Emkay Research; *Gross Block adjusted for first long term contract & replacement/refurbishment capex to the tune of Rs20bn, #FY20-22 contains pharma business EBIDTA of ~Rs1.5-2bn which has now been demerged*

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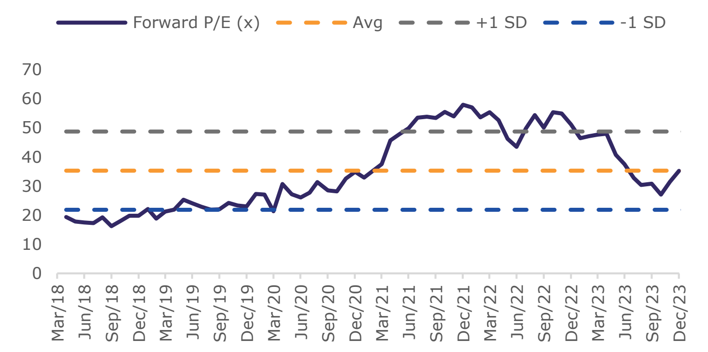
Exhibit 9: Peer valuation

Peers (Domestic)	Rating	P/E (x)			EV/E (x)			RoE (%)		
		FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
SRF	ADD	45	32	24	24	19	15	14	17	19
Gujarat Fluorochemicals	SELL	69	45	36	45	31	25	10	13	15
Deepak Nitrite	ADD	42	35	26	27	23	17	17	18	20
Aarti Industries	BUY	56	29	23	25	17	14	8	14	15
Navin Fluorine International	REDUCE	37	28	25	30	22	19	20	23	21
Anupam Rasayan India*	ADD	51	33	22	28	20	15	8	12	15
P I Industries	NR	33	29	25	24	21	18	19	19	18
Atul	NR	44	34	28	27	21	18	9	11	12
Vinati Organics	NR	46	33	24	34	24	18	16	20	22
Clean Science & Technology	NR	64	48	36	46	35	26	22	24	27
Fine Organic Industries	NR	35	35	31	25	25	21	24	20	20
Galaxy Surfactants	NR	29	25	22	18	16	14	17	17	16
Laxmi Organic Industries	NR	48	34	29	25	18	15	10	14	15
Rossari Biotech	NR	31	23	20	17	13	12	14	16	17
Neogen Chemicals	NR	60	39	34	32	23	17	10	13	13
Sudarshan Chemical Industries	NR	35	22	18	13	11	9	11	14	17
Camlin Fine Sciences	NR	33	13	12	16	9	7	4	13	16

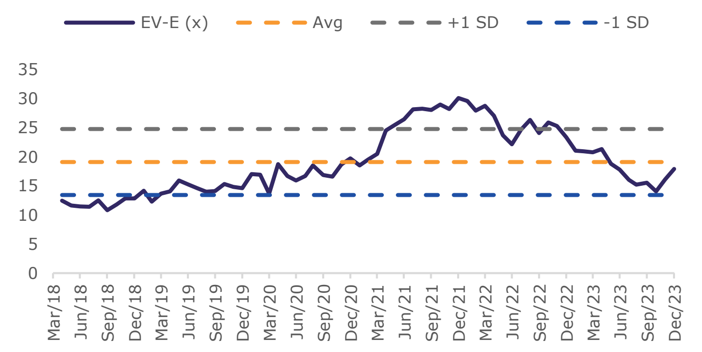
*Source: Bloomberg, Emkay Research; *Standalone business*

Exhibit 10: One-year forward P/E



Source: Bloomberg, Emkay Research

Exhibit 11: One-year forward EV/EBITDA



Source: Bloomberg, Emkay Research

Key Risks

- **Increased competition:** Aarti faces competition in its existing product range from a few small domestic businesses. Any increase in capacity expansion by these players can result in pressure on realizations and margins. Aarti's scale, forward integration into downstream products, and strong client relationships have given it a strong lead against domestic competition.
- **Prolonged demand slowdown:** Prolonged demand slowdown in any of Aarti's key customer segments can result in lower volumes and poor margins. Due to the nature of its product portfolio, Aarti gets multiple products having different applications. Despite poor demand for any of these products, Aarti would be forced to manufacture these products and sell them off at lower realizations.
- **Delay in project execution:** Aarti has been going through a massive capex phase. Any delay or poor execution in these projects can derail the current growth plans. In the past, Aarti has also experienced termination of one of its long-term contracts (for which the company was compensated with shortfall fees). If Aarti can replicate the benzene chain's success in the toluene chain, it will see good earnings momentum over the next few years.

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Mono Methyl Aniline (MMA) to grow significantly, here to stay till Brent-naphtha cracks remain favorable

Major crude oil refineries across the globe are producing crude derivatives based on distillation techniques. This produces gasoline (petrol), LPG, FBRN (full-boiling-range naphtha), aviation fuels, kerosene, diesel, furnace fuel oil, lube oils, and Bitumen grades. These are then further processed for intended use (or direct use). Certain refineries are not equipped to make gasoline from naphtha using the reformer process (in which MMA acts as an octane booster) and, thus, they sell naphtha in the open market on a spot price or make ethylene and sell it based on spreads. This reformer process is majorly patented in Russia, Ukraine, UAE, and some other countries where the industry does not provide sufficient production of high gasoline fractions.

Naphtha is a feedstock along with ethanol (20% of naphtha) to manufacture gasoline blends that have a lower octane number ranging from 60 to 67. Because of a lower octane number, direct blends are not suitable for use in IC engines, which should ideally be above 90 (normal unleaded fuel sold through any company in any city in India should have an octane rating of 91 or more).

Octane number is directly correlated with the power and fuel consumption of the engines in which gasoline is used (more the better). A high octane number gasoline allows to design engines with better performances. The major impact on the quality of gasoline is its improved stability during transportation, filling and storage, reduction in vapor pressure of the final blend, reduction in fuel consumption and good mileage, reduced exhaust emissions, and lower maintenance of the car.

There are two types of commonly used non-metallic anti-knock (octane-improving) additives – MMA and MTBE (Methyl tert-butyl ether). The largest producer of MTBE is Saudi Aramco with a capacity of ~2,500 KTPA and a worldwide capacity of ~40,000 KTPA. MTBE is banned in the USA and experts suggest the European Protection Agency has hinted at the use of other fuel derivatives.

Mono Methyl Aniline (MMA/NMA) is an aniline derivate used to increase the octane number of gasoline by petroleum refiners and fuel distributors/traders around the world as well as an intermediate to agrochemicals. Based on industry reports, MMA's global market demand was at ~1750 KTPA as of CY20 and it is expected to report a CAGR of 4% over CY30. Aarti has increased its MMA capacity to 144 KTPA from 78 KTPA. In regions where petrol production falls short of meeting demand, MMA steps in. Less technologically advanced countries resort to creating gasoline through blending methods or by incorporating diverse additives. In nations like Kazakhstan, Belarus, UAE, and Russia, MMA is utilized in the manufacturing of gasoline.

What changed structurally?

Post the onset of the Russia-Ukraine war, Brent crude skyrocketed from USD80 per barrel in Jan-22 to USD127 in Mar-22, which was its peak. This structurally changed two things - i) Brent-Naphtha crack realizations went to negative USD30 per barrel at the peak, implying the use of more Naphtha to make gasoline for better profits; and ii) Ethylene-naphtha spread started contracting due to falling demand and prices for ethylene and its end-products.

In Apr-23, OPEC+ introduced additional supply cuts, ~3% of global oil demand, followed by Saudi's commitment to further cuts in Jul-23 leading to an uptick in crude prices. This led to a surge in naphtha prices (but ethylene prices did not improve due to destocking in downstream chemicals) and have remained range-bound for the last six months.

All in all, refineries were not able to make and sell ethylene, which led to naphtha stock piling up and Brent-naphtha cracks improving in favor of making gasoline from naphtha. This led to heavy export demand/domestic demand for naphtha to produce gasoline. Ethylene oversupply in CY24 is here to stay and Brent-naphtha cracks are expected to improve further due to lower crude oil prices. Even if ethylene prices start improving, the reformer process for making gasoline from naphtha will structurally stay till Brent-naphtha cracks are favorable.

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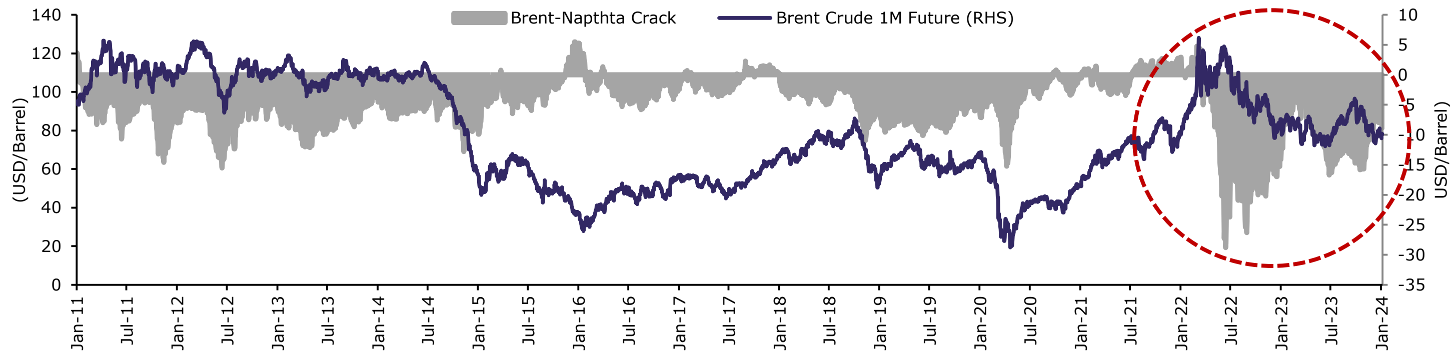
Aarti started exporting MMA to Russia in Apr-23 and the same was invoiced in INR. This spurge in MMA demand from Russia was due to MTBE premiums over Euro Gasoline swap reaching record highs till Sep-23 end amid robust buying interest in a tight European market and favorable blending margins. Some market players were examining the potential of shifting from MTBE to alternative blending components due to very high values. However, the MTBE premiums started becoming favorable with a sudden fall of 35-40% in mid-Oct 2023. Post Oct-23, there has been no export of MMA possibly due to the easing in MTBE realizations and the typical seasonality after the switch to winter gasoline specifications.

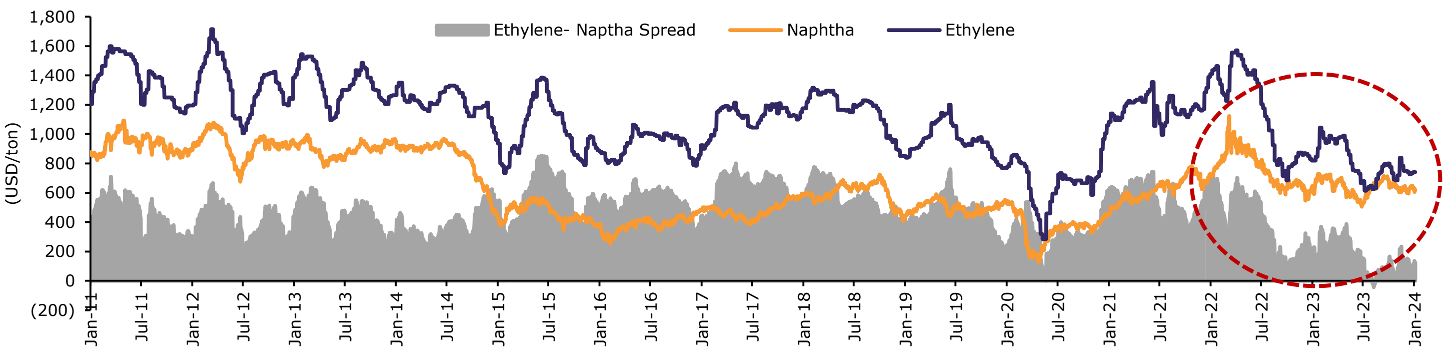
We expect demand for high-octane blending additives like MMA/MTBE to remain till this favorable environment persists. MMA business, which has grown sharply, can further give a significant tailwind to Aarti's portfolio once the demand for core value chains improves. Even if volumes in Russia are going down, Aarti can see those volumes in Persian Gulf (like UAE and Oman) sighting a structural shift towards naphtha to gasoline conversion. Based on overall capacity, we believe MMA can generate a peak potential revenue of ~Rs20bn per year.

Exhibit 12: Favorable Brent-Naphtha cracks diverted more naphtha towards gasoline…



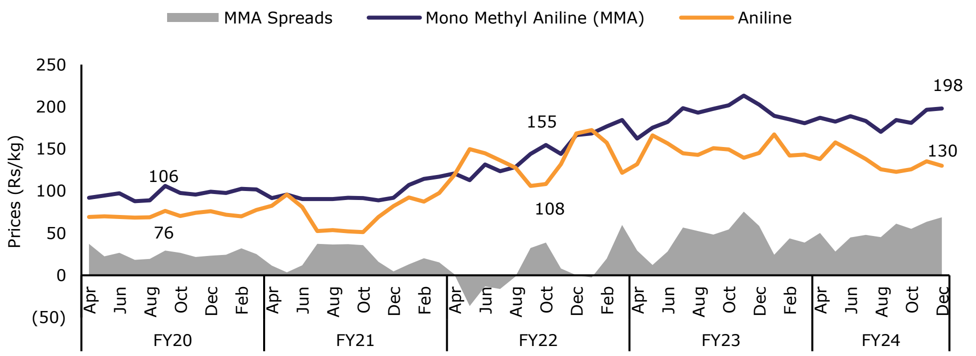
Source: Bloomberg, Emkay Research

Exhibit 13: …supplemented by unfavorable Ethylene-Naphtha spreads



Source: Bloomberg, Emkay Research

Exhibit 14: MMA-Aniline spreads



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Fourth long term contract for Methyl Ethyl Aniline (MEA)

Aarti entered into a 9-year long-term supply contract for the supply of a niche agrochemical intermediate (an integral component of Aarti's existing integrated product portfolio) with a global agrochemical products and solutions company having a revenue potential of over Rs30bn. The supplies will commence starting CY24. This agrochemical intermediate serves as a crucial input component for a widely used herbicide applied in diverse food and cash crops (such as corn, soybean, cotton, sugarcane, sunflower, etc). The global market for this herbicide is large and steadily growing. Aarti's current capex plans, across its existing manufacturing locations, are sufficient to meet this contract requirement and the company does not anticipate any additional capex for this contract.

We believe, this contract with global agrochemical company is for MEA (2-Ethyl-6-methylaniline) which is used as an intermediate to synthesize herbicide called S-metolachlor (~50% of MEA demand) and having a global market size of USD800mn (growing at a CAGR of 4-5%). This contract is in line with Aarti's plan to expand its Nitrotoluene capacity by 50% and MEA capacity by 3x. Based on overall capacity, we believe this product can generate a peak potential revenue of ~Rs9bn per year (including spot and contracted volumes for S-metolachlor & other demand) making it the second largest product after MMA for Aarti over next few years.

S-metolachlor maintains considerable growth potential and holds a crucial position in the global market. However, recent announcement by the EU regarding discontinuation of S-metolachlor registration renewal poses some demand risk. We believe, demand of S-metolachlor in EU will be ~8-10% of global demand and pose insignificant risk to Aarti's MEA volumes (~3-4% of overall volumes) which has other pockets of demand to serve.

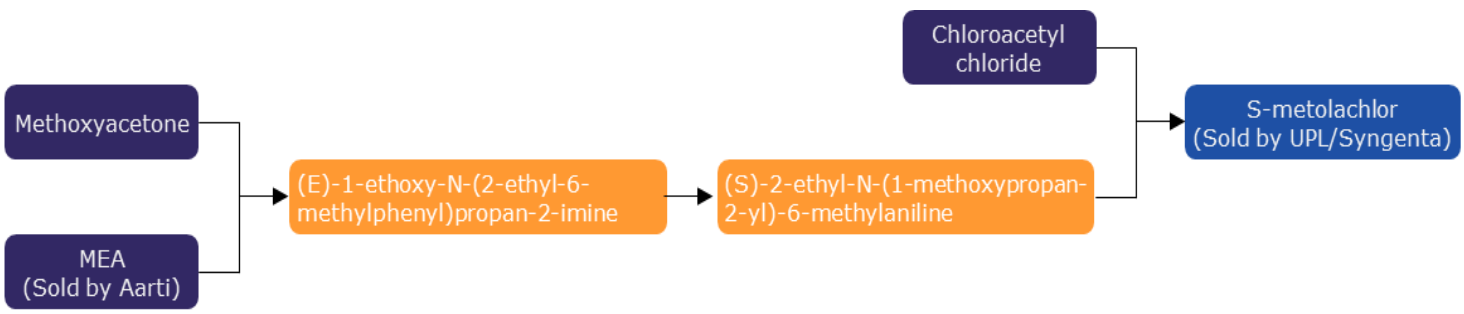
S-metolachlor players and trade flow

Currently, major global manufacturers of S-metolachlor include Syngenta, Zhongshan Chemical, Binnong Technology, Nutrichem, Jiangshan Agrochemical, Changqing Agrochemical, and UPL. Syngenta and UPL primarily target markets in the US and Argentina, among others. Zhongshan Chemical expanded its S-metolachlor production capacity to more than 20,000 tons/year and largely serves markets in the US, Argentina, Russia, Ukraine, and Australia. Binnong Technology serves markets such as Australia, Africa, Europe, and LATM.

As a leading S-metolachlor manufacturer in India, UPL maintains a consistent production output. UPL's current S-metolachlor production capacity stands at 2,000 tons per month, with an ongoing expansion plan to add 5,000 tons annually. Top 3 destinations for UPL's S-metolachlor export in 2023 were Argentina (5,000+ tons), the US (1,200+ tons), and South Africa (1,000+ tons). In terms of formulation exports, top 3 destinations are the US (3,000+ tons), Russia (~200 tons), and Australia (~200 tons). In summary, whether in formulation or technical exports, the US stands out as a pivotal export destination for UPL.

Based on US market data, S-metolachlor technical imports totaled ~150,000 tons from 2021 to 2023 (the market is currently stable), primarily sourced from Syngenta and UPL. Global sales of acetochlor (including S-metolachlor) have consistently shown stable growth at a CAGR of ~8% over FY03-13. In 2014, its global sales slightly declined to USD585mn, primarily attributed to the gradual replacement of acetochlor by other active ingredients and rebounded to ~USD762mn in 2018. The global market for S-metolachlor is predominantly concentrated in North America and Europe, with the US emerging as the largest market at USD333mn, constituting ~45% of the total. The European market holds the second-largest position, accounting for ~8-10% of the overall market.

Exhibit 15: S-Metolachlor value chain



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New production capacity for S-metolachlor in China in 2023

In Jan'23, Jiangsu Changqing Agrochemical Nantong Co., Ltd. ("Changqing Chemical") announced a social stability risk assessment for its new project titled Expansion Project for 5,000 TPA S-metolachlor Technical (Including 4,022 TPA MEA and 1,380 TPA Hydrochloric Acid by-product (for self-use) and 310 TPA Sodium Chloride.

In Nov'23, Hangzhou Nutrichem Biotechnology Co., Ltd. published the environmental protection acceptance results for its 15,000 TPA S-metolachlor upgrade project on its official website. Through technological upgrades, the company will form a total production capacity of 15,000 tons of S-metolachlor per year.

On Dec'23, Nantong Jiangshan Agrochemical & Chemicals Co., Ltd raised funds up to RMB1.2bn (inclusive) for projects such as novel, environmentally friendly herbicide technicals and formulations, including 10,000 TPA green and efficient chiral pesticide, S-metolachlor technical.

New S-metolachlor products introduced in 2023

In July'23, Syngenta launched its latest residual corn herbicide Storen™ (active ingredients: bicyclopyrone, mesotrione, S-metolachlor and pyroxasulfone). The product has been registered by the U.S. EPA and will be available for use in CY24, subject to state approvals. Storen is labeled for pre-emergence and post-emergence in field corn and seed corn and has partial control, or control, of 74+ weed species. Its residual efficacy extends three weeks longer than leading corn herbicides.

In Nov'23, ADAMA launched Apresa® in Argentina, a dispersible oil suspension herbicide with active ingredients comprising 4.2% flumioxazin + 84% S-metolachlor. With high concentration of active ingredients, the product eliminates hard-to-control grass and broadleaf weeds while providing a strong residual effect for soybeans, corn and other crops in a simple and safe application for pre-emergence uses by farmers. Apresa® uses ADAMA's proprietary TOV oil dispersion formulation technology, which maximizes the potential of its dual active ingredients.

In Dec'23, the Portuguese multinational, Ascenza, launched the herbicide Deflexo (active ingredient: S-metolachlor) in Brazil. Deflexo is a pre-emergent herbicide that uses an emulsifiable concentrate (EC) formulation and a selective mode of action. It is recommended for controlling narrow-leaved weeds.

Technological innovations in S-metolachlor in 2023

In Mar'23, after comprehensive evaluation organized by China Crop Protection Industry Association and subsequent public announcement, PILARGOLD® (45% S-metolachlor microencapsulated suspension) from PilarBio was selected as a high-quality green pesticide product. UPL plans to launch an innovative S-metolachlor microencapsulated suspension+ in the future.

In Dec'23, Zhongshan Chemical's 960g/L S-metolachlor EC product obtained the national certification for green food production materials, making it the second company in China, after Syngenta's Dual Gold, to receive this honor. The company has successfully developed various combinations with other agrochemicals for corn fields.

Restrictions and bans of S-metolachlor in 2023

On January 3, 2024, the European Commission (EC) issued a formal decision: based on the EU Plant Protection Products PPP (REGULATION (EC) No 1107/2009), the active substance S-metolachlor is no longer approved for the EU register of plant protection products. The draft resolution was issued by the EU to the WTO in May 2023, and this formal resolution is largely in line with the previous draft.

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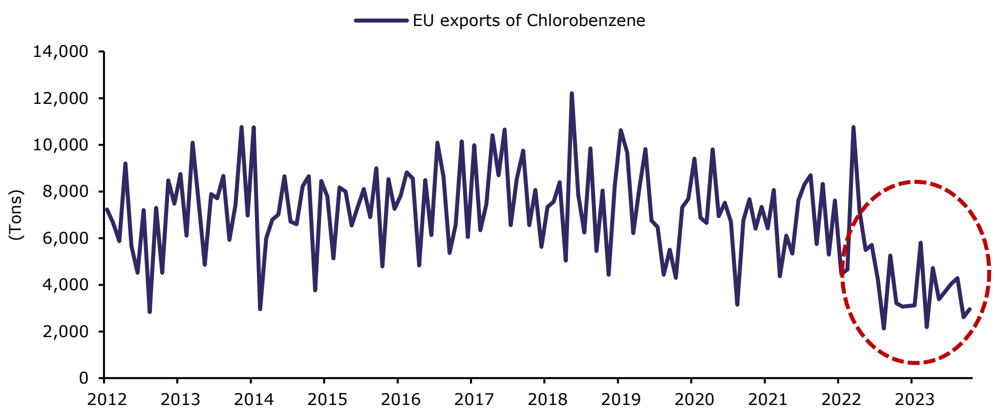
Aarti witnessing benefits of Europe+1 in its value chains

Post the onset of the Russia-Ukraine war, the European chemical industry is facing significant headwinds and losing competitiveness in global chemical markets due to high energy and feedstock costs. The European chemical industry started CY23 on a considerably weak note, with both domestic and export demand remaining muted and H1CY23 production declining sharply by ~12% YoY (overall, in CY23, export and import volumes are materially deteriorating). This points to increasing pressure on the European chemical sector amid intense competition in global chemical markets, in times of weak universal demand and low-capacity utilization. Given this backdrop, European players are losing their market share to Indian and Chinese companies in some value chains.

Typically, European players are operating their plants at significantly lower utilization on account of higher feedstock costs and a relatively subdued demand environment. Further, Russia is now differing its buying decisions away from Europe wherever there is an alternate supply chain available. These tailwinds are favoring Indian and Chinese players present in these value chains. Aarti is well poised with global leadership in benzene, toluene, and aniline value chains and is reaping the benefit of a structural shift in the supply chain.

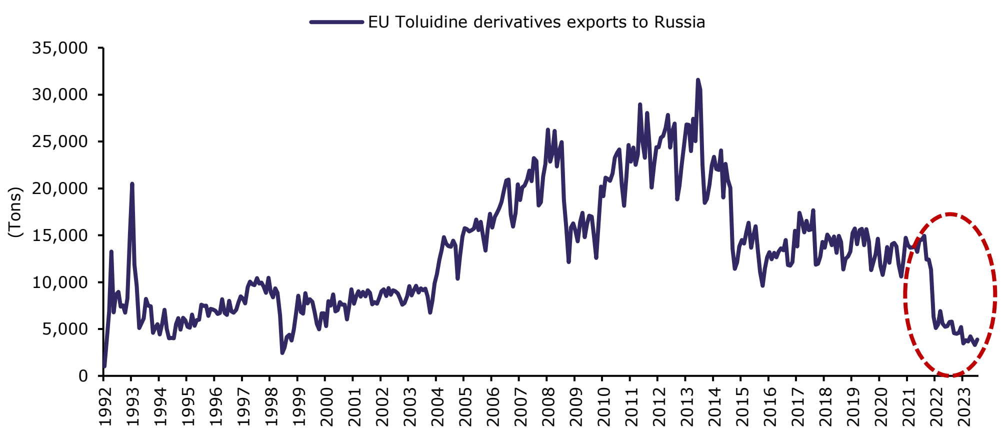
Exhibit 16: Chlorobenzene exports from the EU on a sharp decline globally



Source: Industry, Emkay Research

Chlorobenzene exports from Europe have been falling post the onset of the war (on account of shutdown in companies in France, Belgium & Germany), benefiting Aarti to gain market share in Russian and other markets. Toluidine and its derivatives are other major chains where we are seeing falling exports from Europe. We believe this shift in the supply chain is sustainable and will benefit players present in nitrobenzene, nitrotoluene, chlorobenzene, and chlorotoluene chains with relatively better operating environments.

Exhibit 17: Toluidine derivatives exports from the EU to Russia on a sharp decline



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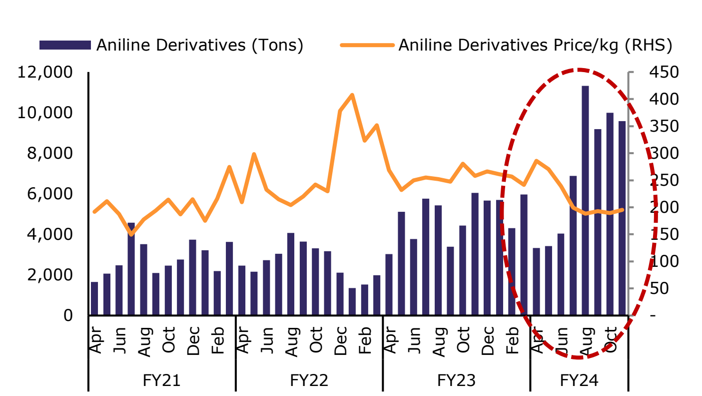
De-risking of the European supply chain by Russia is confirmed by fresh exports of aniline derivatives and ortho toluidine starting in early FY23. These products were not exported to Russia in FY22, but in H1FY24, they saw a sharp increase. This increase is more structural in nature and is also a result of the shutdown or significantly lower utilization of major capacities in Europe. We believe products within these value chains will see a sustainable shift towards Indian players.

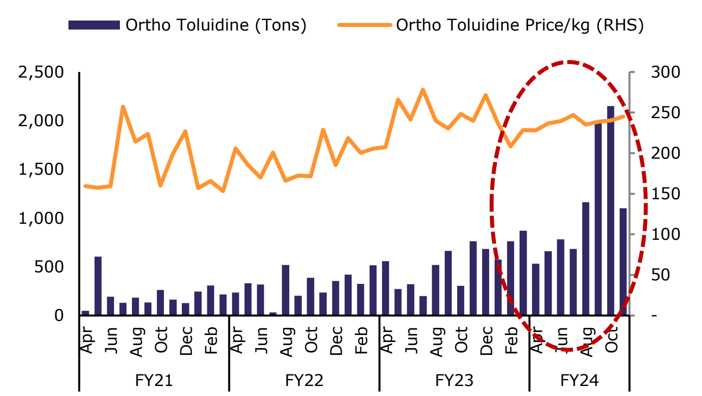
Mono Methyl Aniline (MMA), an aniline derivate is used to increase the octane number of gasoline petrol by petroleum refiners and fuel distributors around the world and Ortho Toluidine, a nitro-toluene derivative used across multiple industries viz. pesticides (Tricyclazole and Alanycarb), pharma (Chloromycin and Bisolvon), dyes (Sulphur Blue and Red Radical), and rubber chemicals. These products which are a part of Aarti's Aniline and Toluene value chains are seeing significantly high demand.

Exhibit 18: India Aniline derivatives exports show a sharp increase…



Source: Industry, Emkay Research

Exhibit 19: …Ortho Toluidine exports also saw a sharp up move



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Right decision not to backward integrate in Nitric Acid

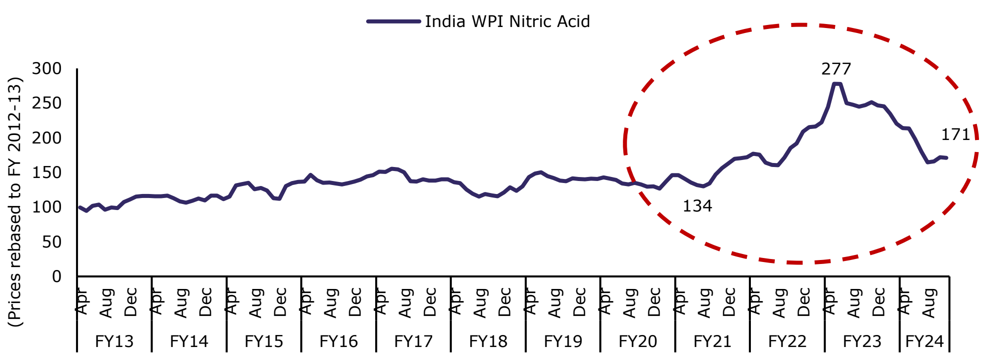
Nitric acid is the second largest raw material (after Benzene, in volume terms) for Aarti and is used in more than two-thirds of its overall products. It sources most of its nitric acid demand from Deepak Fertilizers and Petrochemicals Corporation Limited (DFCPL; contracted volumes), which is the largest producer in India and the only player selling in the open market, largely captive consumption by players like RCF and GNFC.

Aarti had witnessed inconsistent supply of nitric acid between FY21-22 (impacting its volume growth), largely due to demand-supply mismatch given (a) steady rise in end-use demand of nitric acid (fertilizers, ammonium nitrate, and other downstream products), (b) delays in capacity ramp up at DFCPL, and (c) limited import mechanisms to import concentrated nitric acid. This led to a ~3x rise in nitric acid prices over FY21-23.

To address these supply constraints, Aarti had plans to commission a concentration plant, wherein it will be able to convert weak nitric acid (imported) to concentrated nitric acid, reducing its dependence on third-party sourcing. Further, Aarti was also evaluating a dedicated backward-integrated nitric acid plant (from ammonia), which would ease its long-term requirements. But later management re-evaluated and decided to sign a binding term sheet for the offtake and supply of nitric acid with DFPCL for 20 years with a value of more than Rs80bn on a take or pay basis.

However, looking at the demand surge and availability issues, several other players like Deepak Nitrite, Panoli Intermediates (Kutch Chemicals), and GNFC stepped up and commissioned a nitric acid plant/concentration plant in India. In addition, DFPCL also announced plans to nearly double its concentrated nitric acid capacity to meet the contractual requirements of Aarti. These developments have led to a surplus availability of nitric acid in the county and prices have cooled off to historical averages.

Exhibit 20: Nitric acid prices have cooled off after surplus capacity additions



Source: Bloomberg, Emkay Research

We believe India will not have any shortage of nitric acid at least for the next decade and players using nitric acid are now better placed. Aarti made the right decision of not backward integrating into a pure commodity, which would have been margin dilutive to the overall business. Moreover, nitric acid availability issues being resolved will aid Aarti in ramping up its nitrotoluene chain as well.

India has become competitive in nitration vs. China

New capacities in nitric acid were announced over the last few quarters and because of massive imports prices fell; now India has become competitive compared with China in the nitration business. Due to cheap nitric acid availability, which is expected to go down further once some of these capacities go online over the next few quarters, India's nitration business is well poised with market tailwinds to gain market share.

Within the nitration business, players doing nitration at a large scale on benzene, toluene, and other petrochemicals will be the key beneficiaries. Lower operating rates in Europe will further strengthen this tailwind and aid the structural transition for the world's lowest-cost producers. Aarti Industries, Deepak Nitrite, and Panoli Intermediates (Kutch Chemicals) are the leading companies in this market.

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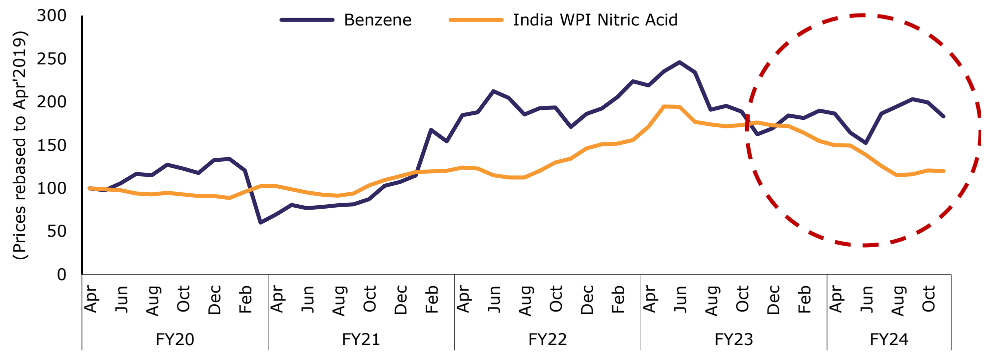
Pass through business model – With a quarter's lag

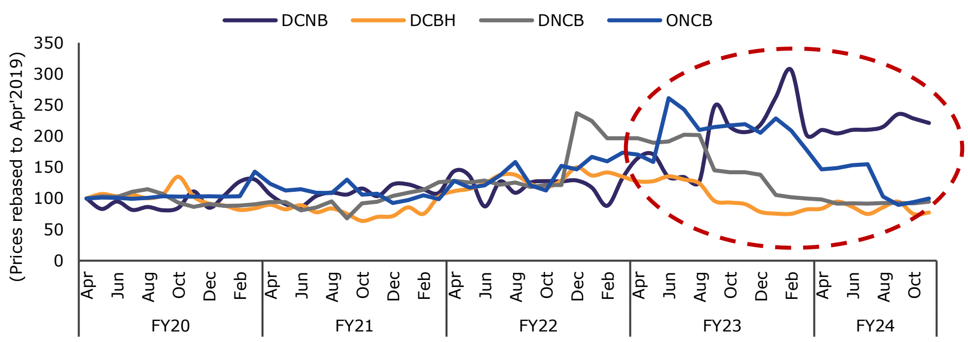
Aarti's business model operates on full pass-through of raw-material inflation (with a quarter's lag, subject to client contracts). As benzene, toluene (both linked to crude), and nitric acid are global commodities, any raw-material inflation will be passed on to the customers. Owing to volatility in crude oil price, revenue/realization for end-products may see volatility in the short term. However, the pass-through model insulates Aarti from any absolute earnings impact over the medium term as it earns margin on Rs/kg basis (and not % margin). So, in an inflationary environment, its % EBITDA margin would decline and vice-versa in a deflationary scenario.

Exhibit 21: Inflationary trend in its key raw material…



Source: Industry, Emkay Research

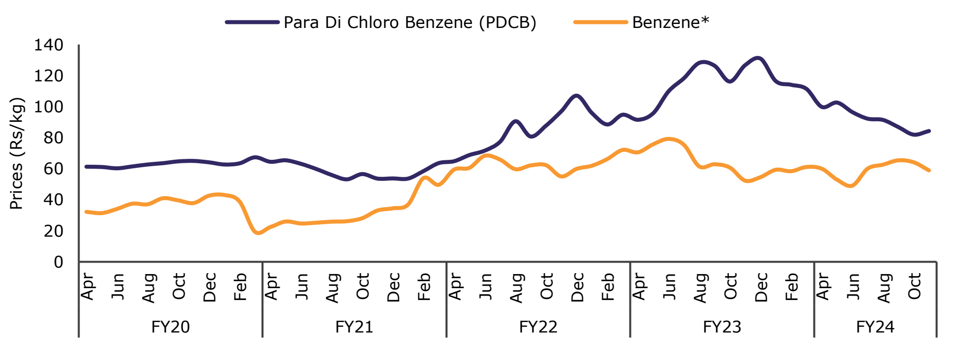
Exhibit 22: …has been passed through, as visible in higher end-product prices



Source: Industry, Emkay Research; DCNB - Di Chloro Nitro Benzene, DCBH - Di Chloro Benzedine, DNCB - Di Nitro Chloro Benzene, ONCB - Ortho Nitro Chloro Benzene

Aarti has historically managed PDCB-benzene spreads by implementing quarterly adjustments; but, disruptions due to the Covid pandemic led to a contraction in spreads during H1CY22. However, it is clearly evident that the company tries to maintain absolute spread by passing through raw-material inflation/deflation over a period of time. Aarti's strategy revolves around maintaining its margin (Rs/kg), adjusting prices to align with market dynamics while ensuring consistent profitability and EBITDA % expansion.

Exhibit 23: PDCB-Benzene spreads remain largely intact (quarterly pass-through)



*Source: Industry, Emkay Research; *1 unit of chlorobenzene requires 0.7 units of benzene*

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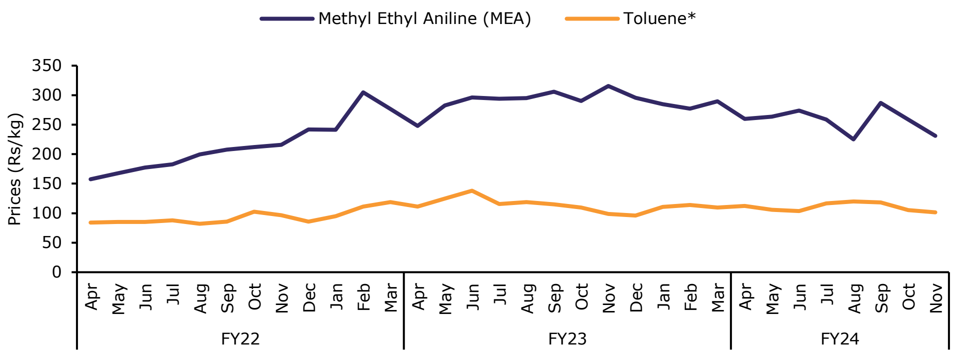
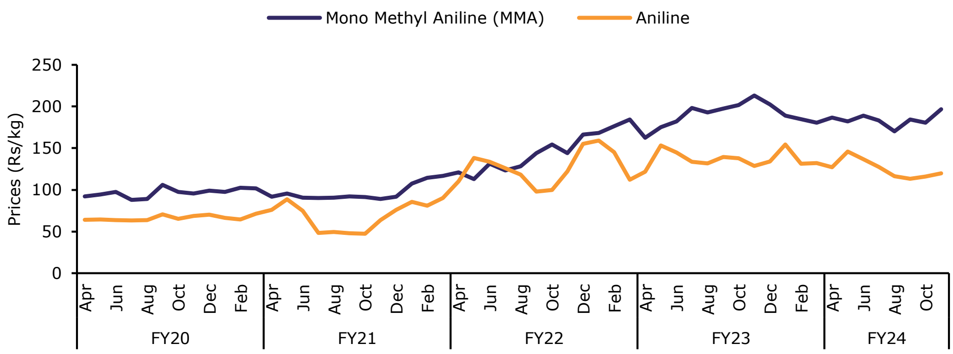
Exhibit 24: MEA-Toluene spread has largely moved in tandem with toluene prices



*Source: Industry, Emkay Research; *1 unit of MEA requires 1.22 units of toluene*

Aarti maintains absolute value margin (Rs/kg) on its products and, thus, % margin may look depressed in an inflationary pricing environment. However, absolute EBITDA growth is the correct evaluation measure for Aarti's business.

Exhibit 25: MMA-Aniline spread showing a quarterly lag



Source: Industry, Emkay Research

Expanding into the chlorotoluene value chain

Aarti is expanding into the chlorotoluene value chain in addition to its steady expansion in value-added products (>75% share currently) across current value chains. The company plans to introduce other downstream chemistries like photochlorination, oxidation, hydrolysis, bromination, Balz-Schiemann Reaction, and HG Fluorination. Most of the downstream products under the chlorotoluene chain are imported in India (Rs15bn currently) and, hence, offer a strong import substitution-led growth opportunity. Management expects market share gains at a fast pace; expected to reach full potential within 3-4 years of introduction of the chlorotoluene chain (FY26 onwards).

Aarti will benefit from leveraging its existing customer relationships for a faster ramp-up of chlorotoluene-based products as customers are largely likely to remain the same. Further, in chlorotoluene, Aarti will sell higher value-added products instead of 1-2 step reaction products as it currently does in benzene – this will be margin accretive.

Expansion through Universal Multi-Purpose Plants (UMPP)

The company is setting up UMPP for exploring additional custom manufacturing opportunities. UMPP is designed to facilitate distinct products with different chemistries enabling much faster commercialization of end-products. This will help Aarti to address demand from multiple customers across various products. The main purpose of introducing UMPP is to expand into other value-added products by customizing requirements. Once Aarti establishes its existing value chains, which will largely become a cash cow, it will focus on growth through UMPPs.

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Long-term contracts offer strong revenue visibility

Backed by its backward integration and cost efficiencies, Aarti is globally competitive in its key product value chain. Hence, it has been able to attract global players and enter into take-or-pay contracts to source its intermediates/specialty chemical requirements; signed four long-term contracts till date. Aarti is evaluating opportunities in this space and may enter into new contracts with global players as and when an attractive proposition is seen.

- Contract 1 with Bayer for Dicamba intermediate – The contract has terminated now because of the change in Bayer's business strategy. Aarti has received a termination fee of ~Rs9bn (over FY21 and FY22), covering up its full capex for the project. Aarti has commercialized this plant and will be looking to sell this intermediate in the open market to other customers (currently subdued demand). The company is further working towards selling N-1/N+1 stage of this intermediate once demand recovers.
- Contract 2 with SABIC; commissioned in FY22. The contract is structured in a take-or-pay arrangement, where EBITDA generation is more or less capacity-agnostic.
- Contract 3 with an MNC (name undisclosed); commissioned in FY24 and is under the product stabilization stage – management expects to reach full EBITDA run rate by FY25.
- Contract 4 with an MNC (name undisclosed) for the supply of herbicide intermediate; contract supplies are commencing from FY24. Revenue potential of this contract is Rs30bn for nine years.
- Contract 5 with an MNC (name undisclosed) for supply of a niche specialty chemical; Supplies already commenced from CY24 and revenue is expected to double over CY23. No additional capex required.

Exhibit 26: Details of long-term contracts

	Total amount (Rs bn)	Contract terms (years)	Details	Current status
Long-term contract - 1	40	10	Supply of intermediate for Dicamba Active Ingredient to Bayer.	Contract terminated; Aarti has received termination fees of USD120-130mn (USD20mn in FY2021 and the balance in FY2022). The plant has been commissioned in FY22. Aarti will utilize the plant for selling the intermediate to other customers and is evaluating selling N-1/N+1 stage of this product once overall demand recovers.
Long-term contract - 2	100	20	Supply of specialty chemicals intermediate to SABIC. The customer provided basic technology and gave USD42mn to Aarti for capex.	Commissioned in FY22; the way it is structured is capacity agnostic with a take-or-pay arrangement. It is currently contributing entirely to the EBITDA.
Long-term contract - 3	10	10		The project commissioned in FY24; the product is under the stabilization phase and will see a full ramp-up starting from FY25.
Long-term contract - 4	30	9	Supply of agrochemical intermediate, which serves as a crucial input component for a widely used herbicide.	Supplies are to commence from FY24; contract revenue potential is Rs30bn for nine years. No new capex is required for this product. The global market for this herbicide is large and steadily growing.
Long-term contract - 5	60	4	Supply of a niche specialty chemical	Supplies already commenced from CY24 and revenue is expected to double over CY23. No additional capex required.

Source: Company, Emkay Research

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Largest player in Benzene Value Chain

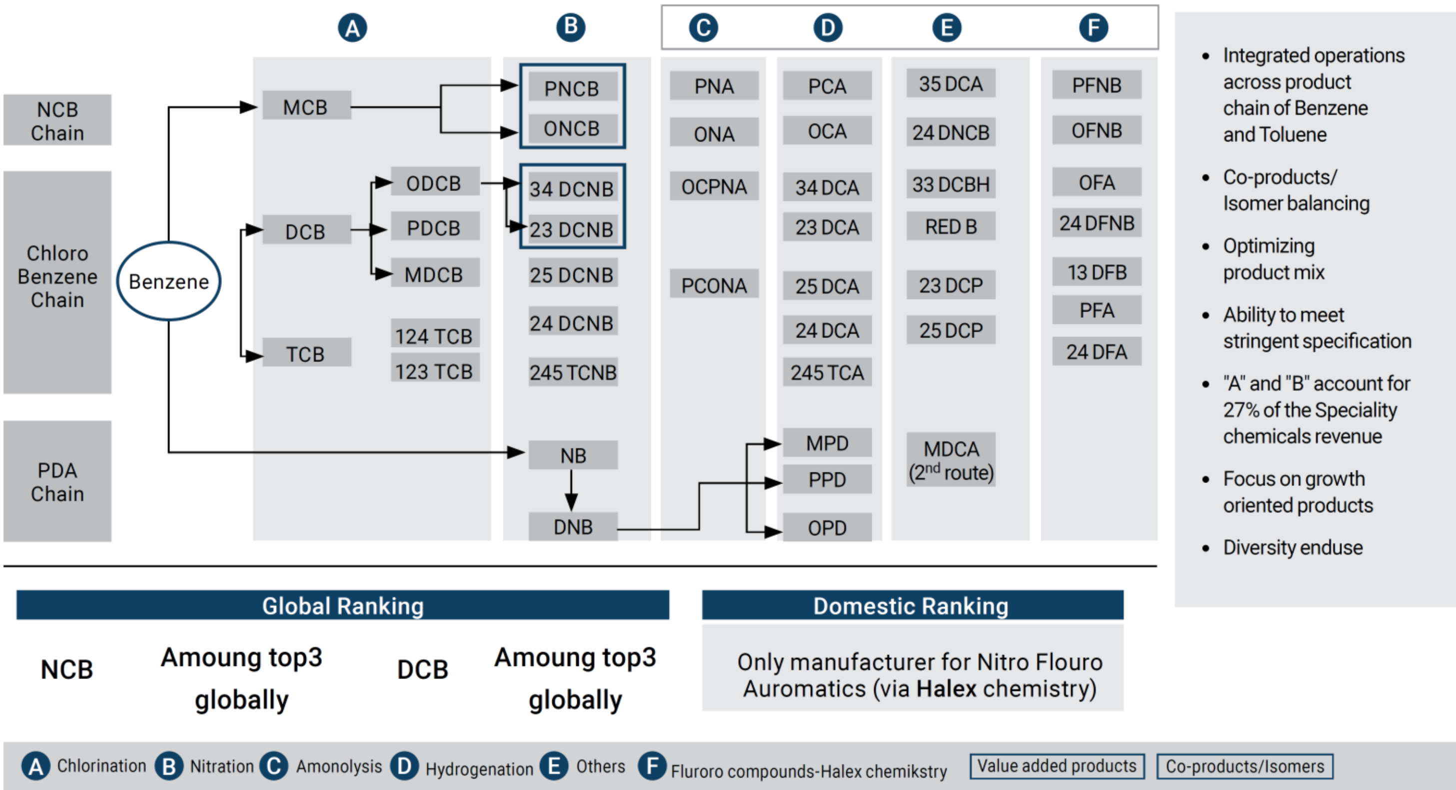
In specialty chemicals, Aarti's products are spread across three value chains (1) benzene, (2) toluene and (3) sulphuric acid. Besides these, Aarti manufactures single super phosphate (SSP), export grade calcium chloride granules, fuel additives and phthalates, which are more of by-products.

Benzene value chain

Aarti is among a few players globally who are completely integrated in the benzene value chain, where it applies chemistries like chlorination, nitration, ammonolysis, and hydrogenation on benzene to manufacture products under 3 chains – Nitro Chloro Benzene (NCB) chain, Di Chloro Benzene (DCB) chain, and Nitro Benzene (PDA) chain.

Over the years, Aarti has expanded its product portfolio in the benzene value chain by entering newer chemistries and manufacturing more value-added products (>70% revenue share, as per management). This has helped it become a preferred source for benzene-based products globally due to cost leadership and technical capabilities. It commands a 25-40% market share globally and holds the top four positions for 75% of its product portfolio.

Exhibit 27: Benzene product chain



Source: Company, Emkay Research

Toluene value chain

Aarti manufactures products under the toluene value chain by applying chemistries like nitration, hydrogenation, and some other downstream chemistries. These products are used in agrochemicals, pharmaceuticals, polymers etc. Aarti started manufacturing products under the toluene value chain in FY18; however, this value chain is still relatively small in its specialty chemical revenue (8-10%).

The company had not been able to ramp up its toluene value chain as it had done in benzene, primarily due to inadequate availability of nitric acid. However, once the availability issue was resolved, it reached nearly full capacity utilization in Q1FY24. Aarti has announced capacity expansions in nitro-toluene, increasing its total capacity by 50% to 45,000 TPA from 30,000 TPA. Nitro-toluene is used in pharmaceuticals, agrochemicals, cosmetic nail products, dyes, and organic chemicals.

In addition to doubling the nitro-toluene capacity, Aarti is tripling its Methyl Ethyl Aniline (MEA) capacity to 30,000 TPA from 10,000 TPA on significant demand visibility in this product. We believe the toluene chain will be the next key growth driver for the company.

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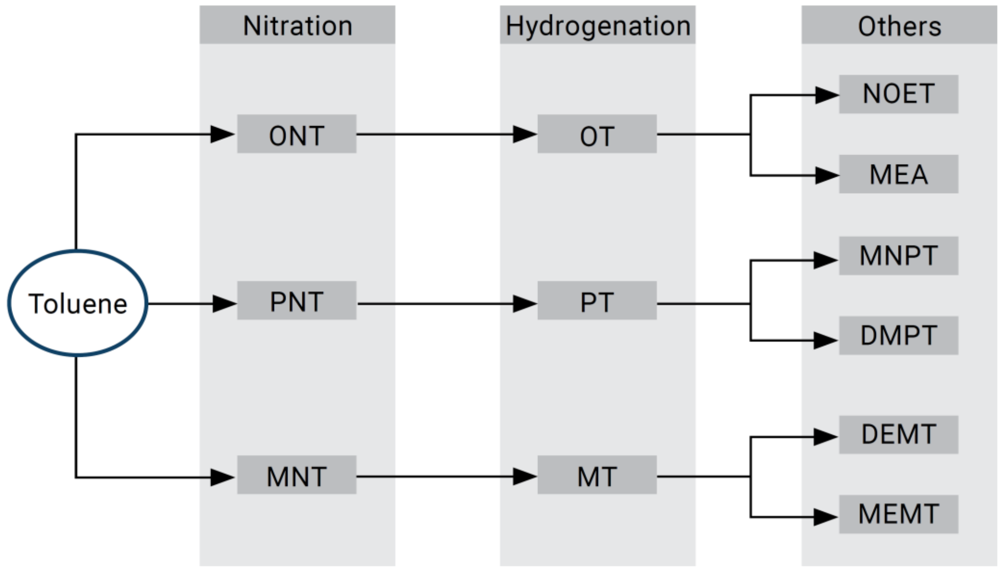
Exhibit 28: Toluene product chain

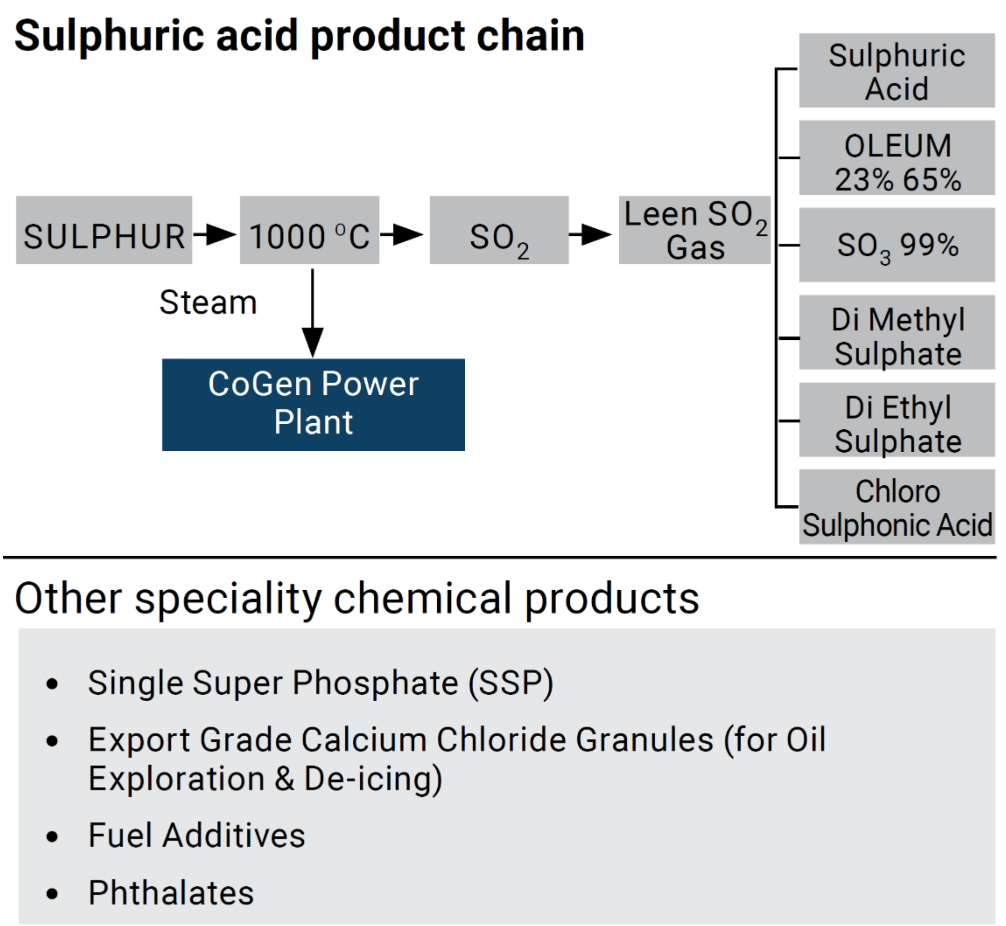


Source: Company, Emkay Research

Sulphuric acid value chain

In the sulphuric acid value chain, Aarti manufactures oleum, dimethyl sulphate, diethyl sulphate, chloro sulphonic acid, and other products. It is backward integrated, starting from sulphur, in this value chain.

Exhibit 29: Sulphuric acid value chain and other products



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Aarti's right to win in Nitro Chloro Benzene (NCB)

Aarti has a competitive advantage in the NCB value chain given its (a) Backward integration driving cost efficiencies, (b) Limited dependence on China for its raw-material procurement, and (c) Thrust on value-added products across multiple chemistries as the company has been increasing its chemistry skills and handling multi-step/high-end reactions. Rising share from value-added products coupled with the pass-through business model for raw-material inflation cushions Aarti's absolute margin (on Rs/kg basis), despite global volatility.

Lowest-cost producer due to complete backward integration

Aarti is among the lowest cost producers globally in the benzene value chain, as it is completely backward integrated, right from benzene (basic crude derivative) to end products. This enables it to have a strict control over its costs and overheads. Such cost advantage has enabled it to gain 25-40% market share globally in these products. Continuous addition of chemistries and scaling up the value chain (value-added products with 7-10 steps) have enhanced Aarti's competitive positioning and client stickiness.

Limited dependence on China for raw-material procurement

A large portion of Aarti's raw materials is petrochemical derivatives like benzene and toluene, which are available from domestic refineries (India being a net refining surplus country). Other feedstock like chlorine and nitric acid required for chemistries are also procured locally. Aarti is, thus, largely independent of China for its specialty chemical business, making it a prominent choice for global customers who want to de-risk their global supply chain.

Competitive intensity is on the rise, but well-positioned

Select players like Bodal Chemicals and Meghmani Finechem have announced capex in benzene downstream and chlorotoluene where Aarti operates or is planning to operate. Other players like ChemieOrganic Chemicals and Panoli Intermediates are already operating in the benzene chain. However, we believe Aarti's cost-competitive positioning (backward integrated) and strong product offering will be difficult to replicate for competition.

Exhibit 30: Key industry players in Aarti's product value chain

Products	Players	Comments
Benzene value chain	Chemieorganic Chemicals	Chlorobenzene, Chloroaniline, and Dinitrochlorobenzene.
	Panoli Intermediates	Chlorination, Nitration and Hydrogenation chemistries on benzene
	Bodal Chemicals	Has announced a 55,000MT capacity expansion in benzene downstream and a 3,40,000 MT capacity expansion for sulphuric acid derivatives at a total capex of Rs3bn and a combined revenue expectation of Rs4bn
Toluene value chain	Deepak Nitrite	Nitration on toluene
	Panoli Intermediates	Nitration and Hydrogenation on toluene
Chlorotoluene	Epigral (Meghmani Finechem)	Has announced a capex of Rs1.8bn with a revenue expectation of Rs3bn for chlorotoluene to be commissioned by FY24

Source: Industry, Emkay Research

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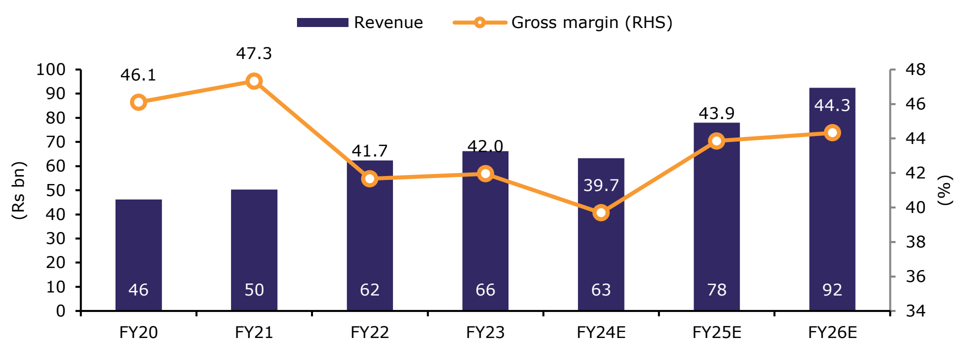
Financial Analysis

We expect Aarti's revenue to report a CAGR of ~21% over FY24-26E, led by (a) contribution from nitro-toluene expansion, (b) ramp-up of the existing benzene value chain, (c) demand recovery in existing discretionary/non-discretionary spends, and (d) contribution from the chlorotoluene chain in FY26. This growth will largely be volume-led, as the inflationary pricing environment in these chains has now normalized. Gross margins will improve on moving up the value chain and entering more downstream products, which are margin accretive.

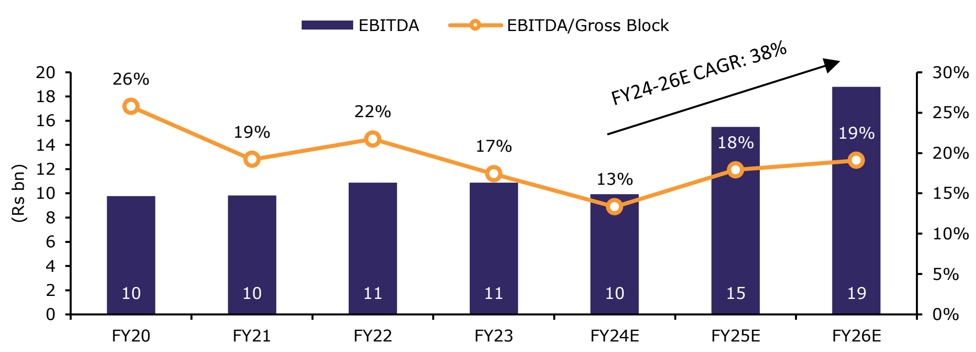
Exhibit 31: Revenue to post a ~21% CAGR over FY24-26E with steady rise in gross margin



Source: Company, Emkay Research

Since companies like Aarti maintain absolute EBITDA/kg and pass on their raw-material inflation/deflation, we evaluate them on absolute EBITDA growth rather than % margin. We expect EBITDA to register a CAGR of ~38% over FY24-26E, led by (a) demand recovery, (b) ramp-up across existing and newer value chains, and (c) contribution from long-term contracts. We further expect Aarti's EBITDA to improve sequentially over the next few quarters. EBITDA/gross block is expected to rebound gradually from FY25 on ramp-up in utilization across chains and stabilize at those levels.

Exhibit 32: EBITDA to register a CAGR of 38% over FY24-26E



Source: Company, Emkay Research

With an improving business environment backed by QoQ improvement in EBIT margins, we expect margins to replicate its ex-pharma EBIT margins of 14% over FY25-26E. This improvement is in line with the shift in the portfolio mix towards more margin-accretive/downstream products within the existing and newer value chains.

Aarti's EBIT/PAT is likely to register a CAGR of ~49%/57% over FY24-26E, in line with the higher EBITDA growth expected by us. Higher operating leverage on increased capacity utilization will aid the earnings momentum over FY24-26E. Contribution from long-term contracts is expected to further aid earnings growth over FY24-26E; the chlorotoluene chain is expected to start contributing from FY26.

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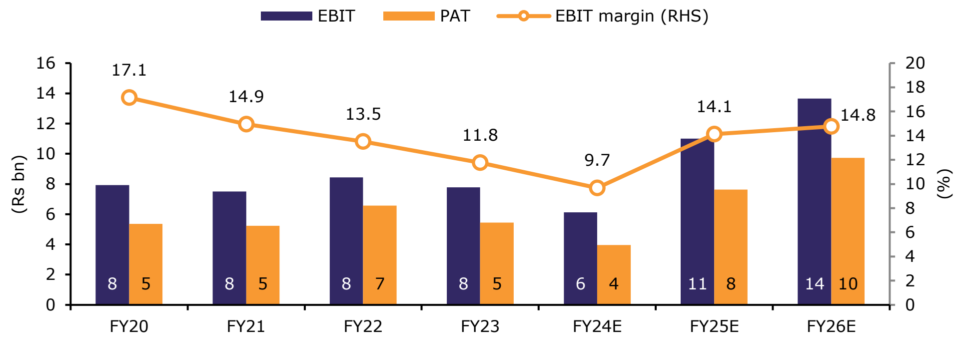
Exhibit 33: EBIT/PAT to post a CAGR of ~49%/57% over FY24E-26E with improving margins



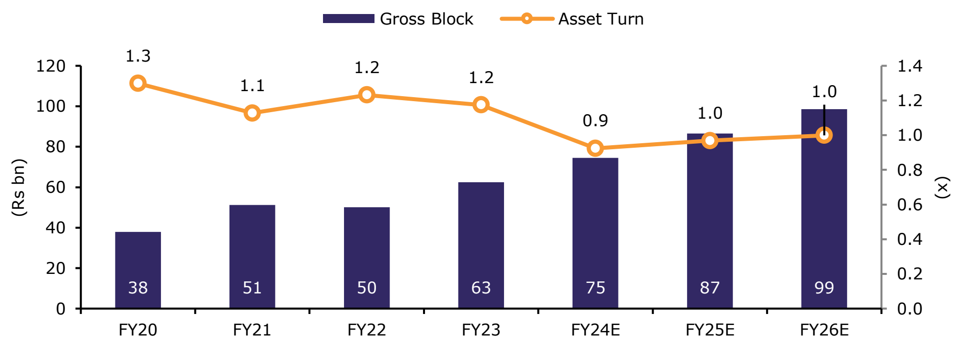
Source: Company, Emkay Research

Aarti's capex spend of ~Rs48bn (including CWIP) over the last five years has not contributed to revenue. This is due to spending on asset restoration, debottlenecking, sustainability, plant infrastructure, and cancellation of the first long-term contract.

The company has completed its asset restoration, which led to the increase in the life of assets and with minimal intervention to existing operations. Approximately, 75-80% of the total assets were revamped across all manufacturing sites. Assets older than two decades required replacement or revamping. The company has cumulatively invested Rs6.2bn in asset restoration and debottlenecking and Rs5.2bn on sustainability and plant infrastructure in the last five years.

Further, the cancellation of the first long-term contract added to the gross block but not to the EBITDA, leading to lower asset turns. We expect asset turns to improve over FY24 but remain lower compared with historical asset turns on account of non-contributing assets being added to the gross block.

Exhibit 34: Asset turns to improve over FY24 but remain lower compared with historical levels



Source: Company, Emkay Research

Aarti will fund its capex initiatives through a mix of internal accruals and debt. OCF will be largely sufficient to fund the capex from FY26 and accordingly debt should peak in FY26. Capex will largely be spent on nitro-toluene expansion and chlorotoluene chain.

Generally in all high-growth chemical companies, a large part of OCF is being reinvested in capex and thus there is very low FCF generation. We believe these companies are in the midst of an investment cycle seeing strong growth opportunities and thus will see sustained investments. Also, Aarti has spent ~Rs10-12bn of capex in asset replacement, refurbishment etc. as these plants were 20+ years old plants and required refurbishment to enhance their useful lives. We believe, large part of this non-revenue generating capex is largely behind and because we are at the early phase of these replacement capex cycle the return ratios will optically look lower. However, going forward return ratios are expected to improve on ramp up in existing value chains and long term contracts.

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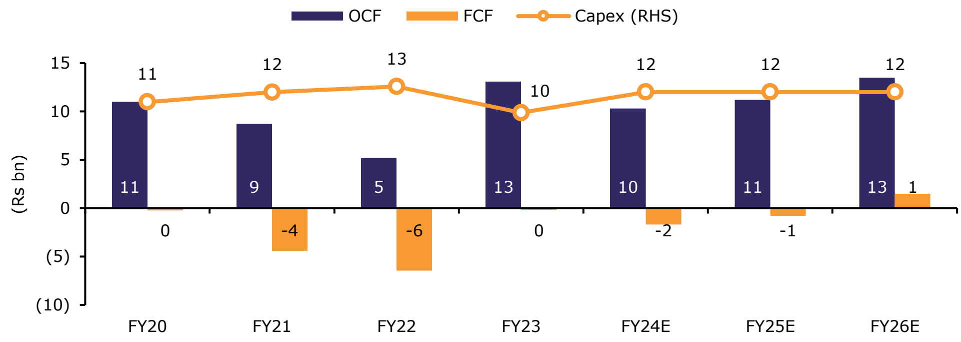
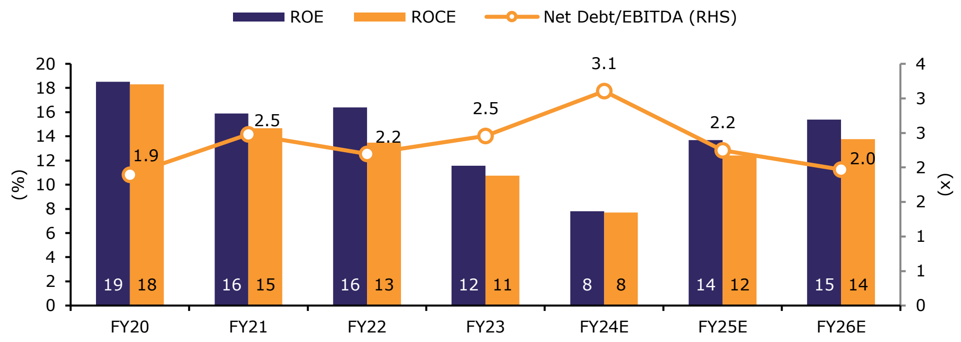
Exhibit 35: OCF will be largely sufficient to fund the capex from FY26



Source: Company, Emkay Research

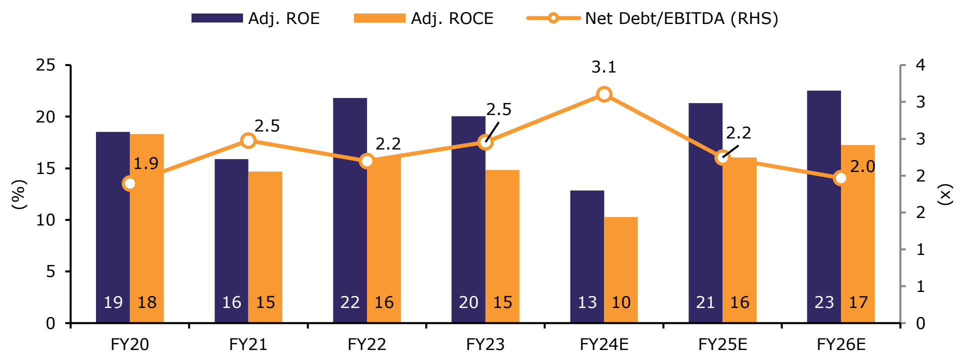
Return ratios would taper in FY24 on high capex and relatively slow earnings growth, but the same is expected to improve from FY25. Blended RoE and RoCE are expected to largely bottom out in FY24 and improve from FY25 on the ramp up in current value chains, increase in the utilization of existing assets, and contribution from long-term contracts. Net debt/EBITDA would increase in FY24 and normalize by FY26. Adjusted RoCE (adjusting for Rs20bn of non-revenue generating assets and 1st long term contract) to rebound to 18%+ by FY26/27.

Exhibit 36: Return ratios to rebound (though optically look lower on non-revenue generating capex sitting in gross block)



Source: Company, Emkay Research

Exhibit 37: Adjusted return ratios to rebound (adjusted capital employed & networth for non-revenue generating assets and 1st long term contract to the tune of Rs20bn)



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Business Overview

Founded in 1984 by pioneering technocrats, Aarti stands as a prominent Indian entity specializing in the production of specialty chemicals and pharmaceuticals (demerged in 2022). With a robust global presence spanning across >60 countries, the company commands a significant market share for Nitro Chloro Benzene and Di Chloro Benzene, holding the top four positions for 75% of its product lineup. Aarti is widely recognized as the preferred collaborator for numerous major international and domestic clients, solidifying its reputation as a trusted and preferred partner in the industry.

Since its inception, with only two products and a single manufacturing unit, Aarti has undergone significant expansion to emerge as a top-tier integrated specialty chemicals enterprise. At present, it boasts of a diverse portfolio of over >100 products and operates across 16 manufacturing facilities. With this portfolio, it caters to >400 international and >700 domestic customers across the world with a major presence in the USA, Europe, Japan, China, and India. The company's rich clientele includes BASF, Solvay, Sabic, Syngenta, Bayer, and Dupont, while some Indian names include Atul, UPL, India Oil, and Sudarshan.

Aarti's operations have been now limited to specialty chemicals. There are no other segments. Within specialty chemicals, it skillfully uses basic building blocks like benzene, toluene, nitric acid, chlorine, methanol, aniline, and sulphur and other value chains along with a wide range of reactions to manufacture products from agrochemicals to polymers, pigments and dyes, printing ink, aromatics, surfactants, and various other specialty chemicals, across the globe.

Exhibit 38: Aarti's manufacturing facilities

Manufacturing facilities
Vapi (Gujarat)
Jhagadia (Gujarat)
Dahej (Gujarat)
Kutch (Gujarat)
Tarapur (Maharashtra)

Source: Company, Emkay Research

Exhibit 39: Geographical mix shifting towards higher exports

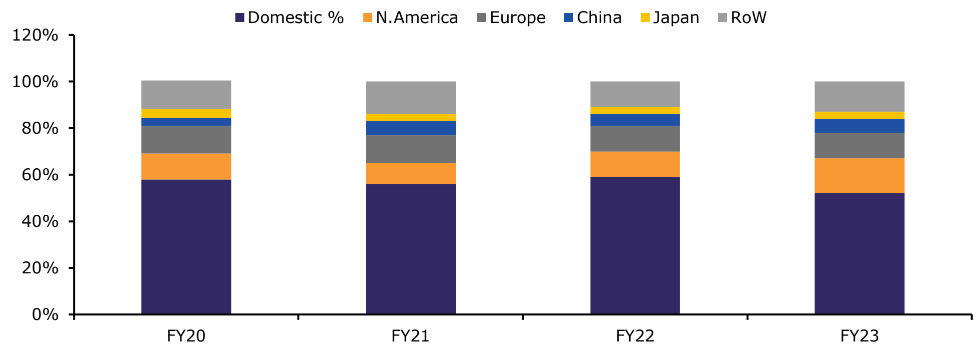

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Exhibit 40: Aarti's timeline

1984	•Incorporated **Aarti Organics Private Limited**
1986	•Commenced **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)
2005-08	•Expanded the **NCB and sulphuric acid capacity** •Set up a **large-scale speciality chemical** unit in Kutch, Gujarat •Received **US FDA** approval for an Active Pharmaceutical Ingredient unit in Tarapur, Maharashtra
2011	•Upgraded the **hydrogenation unit** from batch to continuous •Received **US FDA** approval for the custom synthesis division at Vapi •Commenced bulk shipment for **global markets**
2013	•**Merged manufacturing division** of Anushakti Chemicals and Drugs Ltd. •Total income crossed 2000cr; **exports crossed 1000cr**
2014	•First time **concentration plant** in India
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**
2018	•Commissioned the **Nitro Toulene plant** •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** at Mahape, Navi Mumbai, Maharashtra •**Commissioned two units** at Dahej SEZ for high-value speciality chemicals
2021	•Operationalized **Phase 2 Unit at Dahej SEZ** for agrochemical intermediates •Operationalized New Chlorination Unit at Jhagadia, capacity enhanced to 175 KTPA
2022	•**Commercialized** the unit at Dahej SEZ for the project related to **2nd Long-Term Contract** •Completed Phase I of **NCB capacity expansion** •**Demerger** of **Pharmaceutical Business**
2023	•**Commercialized** a manufacturing facility at Jhagadia for **3rd Long-term Contract** •**Commercialized speciality chlorination block** at Jhagadia

Source: Company, Emkay Research

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Exhibit 41: Current board of directors

Name of Director	Designation	Qualification	Experience/Expertise
Chandrakant V. Gogri	Chairman Emeritus	Chemical Engineering Degree (UDCT)	Experienced in the areas of projects, operations, process development, and local and international marketing
Rajendra V. Gogri	Chairman & MD	UDCT (Rank Holder); Masters in Chemical Engineering, USA	Expertise in technical aspects as well as financial and commercial aspects of the chemical industry
Rashesh C. Gogri	Vice Chairman & MD	Production engineer from Mumbai University	Expertise in chemical, pharma, and personal care segments
Parimal H. Desai	WTD	Chemical Engineering degree (UDCT)	34 years of experience in the development and project implementation in the chemical industry
Manoj M. Chheda	WTD	Commerce graduate from Mumbai University	25 years in the purchase and marketing of chemicals
Hetal Gogri Gala	NED	Graduate in electronics engineering from Mumbai University; MEP (IIM-A); Bachelors in Supply Chain Management	Experienced in the purchase function
Renil R. Gogri	WTD	B. Tech (Mech) (IIT Bombay)	Experienced in system development and improvement in operations and project execution
Ajay Kumar Gupta	WTD	Bachelors in Chemical Engineering	30 years of experience in the petrochemical manufacturing industry
K.V.S. Shyam Sunder	ID	CA; B. Com	31 years of experience in corporate and retail banking, risk management, credit rating, reviewing, and monitoring system and loan policies; partner in Singrodia Goyal & Co.
P.A. Sethi	ID	CAIIB; B. Com	47 years of experience in the banking sector; Ex-ED Vijaya Bank
Bhavesh R. Vora	ID	CA; B. Com	24 years of experience in the field of stock brokers' audits, compliances, derivatives, futures and options, accounting standards, and internal management audit
Lalitkumar Naik	ID	B. Tech – Chemical Engineer (IIT Kanpur); MBA (IIM-A)	25 years of rich experience in the field of chemicals and building materials and nutrition
Natasha Treasurywala	ID	LLB (Government Law College Mumbai); Solicitor (Bombay Incorporated Law Society)	47 years of experience in corporate law matters including mergers and acquisitions, private equity, and debt finance; partner at law firm Desai & Diwanji

Source: Company, Emkay Research;

MD – Managing Director, NED –Non-Executive Director, WTD – Whole-time director, ID – Independent Director, B. Tech. – Bachelors in Technology, B.Com. – Bachelors in Commerce, LLB – Bachelors of Law, CA – Chartered Accountant,

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Aarti Industries: Consolidated Financials and Valuations

Profit and Loss

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	**62,401**	**66,186**	**63,315**	**78,002**	**92,428**
Revenue growth (%)	24.2	6.1	(4.3)	23.2	18.5
EBITDA	**10,892**	**10,890**	**9,933**	**15,487**	**18,792**
EBITDA growth (%)	11.0	0.0	(8.8)	55.9	21.3
Depreciation & Amortization	2,464	3,105	3,807	4,474	5,141
EBIT	**8,428**	**7,786**	**6,126**	**11,013**	**13,651**
EBIT growth (%)	12.3	(7.6)	(21.3)	79.8	24.0
Other operating income	0	0	0	0	0
Other income	8	9	9	9	9
Financial expense	1,023	1,683	1,818	2,033	2,216
PBT	**7,413**	**6,111**	**4,317**	**8,988**	**11,444**
Extraordinary items	0	0	0	0	0
Taxes	1,863	659	345	1,348	1,717
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	**6,579**	**5,453**	**3,971**	**7,640**	**9,727**
PAT growth (%)	20.3	(17.1)	(27.2)	92.4	27.3
Adjusted PAT	**5,550**	**5,453**	**3,971**	**7,640**	**9,727**
Diluted EPS (Rs)	**18.2**	**15.1**	**11.0**	**21.1**	**26.9**
Diluted EPS growth (%)	15.8	(17.1)	(27.2)	92.4	27.3
DPS (Rs)	**3.5**	**2.5**	**1.6**	**3.2**	**4.0**
Dividend payout (%)	**19.3**	**16.6**	**15.0**	**15.0**	**15.0**
EBITDA margin (%)	17.5	16.5	15.7	19.9	20.3
EBIT margin (%)	13.5	11.8	9.7	14.1	14.8
Effective tax rate (%)	25.1	10.8	8.0	15.0	15.0
NOPLAT (pre-IndAS)	**6,310**	**6,946**	**5,636**	**9,361**	**11,603**
Shares outstanding (mn)	362.0	362.0	362.0	362.0	362.0

Source: Company, Emkay Research

Balance Sheet

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	1,810	1,813	1,810	1,810	1,810
Reserves & Surplus	43,350	47,388	50,764	57,258	65,526
Net worth	**45,160**	**49,201**	**52,574**	**59,068**	**67,336**
Minority interests	7	7	7	7	7
Deferred tax liability (net)	(277)	(528)	(528)	(528)	(528)
Total debt	**25,680**	**28,740**	**31,857**	**35,925**	**37,929**
Total liabilities & equity	**70,570**	**77,421**	**83,910**	**94,473**	**104,745**
Net tangible fixed assets	35,381	48,287	56,480	64,006	70,865
Net intangible assets	568	322	322	322	322
Net ROU assets	170	303	303	303	303
Capital WIP	13,460	10,962	10,962	10,962	10,962
Goodwill	0	0	0	0	0
Investments [JV/Associates]	281	172	172	172	172
Cash & equivalents	**1,736**	**2,007**	**1,029**	**1,126**	**958**
Current assets (ex-cash)	26,805	23,531	22,166	26,218	30,893
Current Liab. & Prov.	7,660	7,861	7,220	8,334	9,427
NWC (ex-cash)	**19,144**	**15,670**	**14,945**	**17,885**	**21,465**
Total assets	**70,570**	**77,421**	**83,910**	**94,473**	**104,745**
Net debt	23,944	26,733	30,828	34,799	36,971
Capital employed	70,570	77,421	83,910	94,473	104,745
Invested capital	**55,093**	**64,279**	**71,747**	**82,213**	**92,653**
BVPS (Rs)	124.8	135.9	145.2	163.2	186.0
Net Debt/Equity (x)	0.5	0.5	0.6	0.6	0.5
Net Debt/EBITDA (x)	2.2	2.5	3.1	2.2	2.0
Interest coverage (x)	0.1	0.2	0.3	0.2	0.2
RoCE (%)	**12.4**	**10.5**	**7.6**	**12.4**	**13.7**

Source: Company, Emkay Research

Cash Flows

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	7,413	6,111	4,317	8,988	11,444
Others (non-cash items)	0	0	0	0	0
Taxes paid	(2,458)	(909)	(345)	(1,348)	(1,717)
Change in NWC	(9,495)	3,224	725	(2,939)	(3,581)
Operating cash flow	**5,186**	**13,098**	**10,313**	**11,199**	**13,494**
Capital expenditure	(2,973)	(13,268)	(12,000)	(12,000)	(12,000)
Acquisition of business	354	109	0	0	0
Interest & dividend income	8	9	9	9	9
Investing cash flow	**(11,694)**	**(13,298)**	**(11,991)**	**(11,991)**	**(11,991)**
Equity raised/(repaid)	(6,038)	3	(3)	0	0
Debt raised/(repaid)	(2,759)	3,061	3,117	4,069	2,004
Payment of lease liabilities	0	0	0	0	0
Interest paid	(1,023)	(1,683)	(1,818)	(2,033)	(2,216)
Dividend paid (incl tax)	(1,269)	(906)	(596)	(1,146)	(1,459)
Others	15,209	(3)	0	0	0
Financing cash flow	**4,120**	**472**	**700**	**889**	**(1,671)**
Net chg in Cash	(2,388)	272	(978)	97	(168)
OCF	5,186	13,098	10,313	11,199	13,494
Adj. OCF (w/o NWC chg.)	(4,309)	16,322	11,037	8,260	9,914
FCFF	2,214	(170)	(1,687)	(801)	1,494
FCFE	1,199	(1,844)	(3,497)	(2,825)	(713)
OCF/EBITDA (%)	47.6	120.3	103.8	72.3	71.8
FCFE/PAT (%)	18.2	(33.8)	(88.1)	(37.0)	(7.3)
FCFF/NOPLAT (%)	**35.1**	**(2.4)**	**(29.9)**	**(8.6)**	**12.9**

Source: Company, Emkay Research

Valuations and Key Ratios

Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	39.9	40.6	55.7	29.0	22.8
P/CE(x)	27.6	25.9	28.5	18.3	14.9
P/B (x)	4.9	4.5	4.2	3.7	3.3
EV/Sales (x)	3.9	3.7	4.0	3.3	2.8
EV/EBITDA (x)	22.5	22.8	25.4	16.5	13.7
EV/EBIT(x)	29.1	31.9	41.2	23.3	18.9
EV/IC (x)	4.5	3.9	3.5	3.1	2.8
FCFF yield (%)	0.9	(0.1)	(0.7)	(0.3)	0.6
FCFE yield (%)	0.5	(0.8)	(1.6)	(1.3)	(0.3)
Dividend yield (%)	0.6	0.4	0.3	0.5	0.7
DuPont-RoE split					
Net profit margin (%)	8.9	8.2	6.3	9.8	10.5
Total asset turnover (x)	0.9	0.9	0.8	0.9	0.9
Assets/Equity (x)	1.7	1.6	1.6	1.6	1.6
RoE (%)	**13.8**	**11.6**	**7.8**	**13.7**	**15.4**
DuPont-RoIC					
NOPLAT margin (%)	10.1	10.5	8.9	12.0	12.6
IC turnover (x)	1.2	1.1	0.9	1.0	1.1
RoIC (%)	**12.2**	**11.6**	**8.3**	**12.2**	**13.3**
Operating metrics					
Core NWC days	112.0	86.4	86.2	83.7	84.8
Total NWC days	**112.0**	**86.4**	**86.2**	**83.7**	**84.8**
Fixed asset turnover	1.2	1.2	0.9	1.0	1.0
Opex-to-revenue (%)	24.2	25.5	24.0	24.0	24.0

Source: Company, Emkay Research

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ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	<15% downside

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