Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Aarti Industries Ltd

Strong Q1, improved outlook

Stock Update | Result Update

Specaility Chem	Sharekhan code: AARTIIND
Reco/View: Buy ↔	CMP: **Rs. 734**
	Price Target: **Rs. 848** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Company details

Market cap:	Rs. 26,641 cr
52-week high/low:	Rs. 769/438
NSE volume: (No of shares)	35.25 lakh
BSE code:	524208
NSE code:	AARTIIND
Free float: (No of shares)	20.6 cr

Shareholding (%)

Promoters	43
FII	11
DII	19
Others	28

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	4.0	9.8	10.7	58.4
Relative to Sensex	5.1	0.4	-0.5	36.6

Sharekhan Research, Bloomberg

Summary

- Revenue for Q1FY25 at Rs. 1855 crore, marking a 31% increase y-o-y and a 5% rise quarter-over-quarter, surpassing our estimates by 4%.
- The company anticipates meeting its production goals this fiscal year, operating at between 40% and 50% of its maximum capacity.
- The company's capital expenditures will reach their highest point in the fiscal year 2025, followed by a substantial decline in the subsequent year.
- With growth expected to come back in FY25 on the back of increased capex and improving external environment, we revise our rating on Aarti Industries to a Buy with a higher PT of Rs. 848.

Revenue for Q1FY25 at Rs. 1855 crore, marking a 31% increase y-o-y and a 5% rise quarter-over-quarter, surpassing our estimates by 4%. Growth was driven by a volume-led recovery in both core and contracted products. EBITDA amounted to Rs. 305 crore, up 28% y-o-y and 4% quarter-over-quarter, exceeding our estimates by 6%. This increase occurred despite significant pricing pressures, supported by volume-driven operating leverage and an improved product mix. The EBITDA margin was 16%, reflecting a 223 basis point increase y-o-y and a 48 bps rise quarter-over-quarter. PAT stood at Rs. 137 crore, up 96% y-o-y and 4% quarter-over-quarter, and was 28% above our estimates.

Key positives

- Strong recovery in exports for certain products.
- Volume recovery in both core and contracted products.
- The company is on track to achieve the revenue and volume targets for the specific contract.

Key negatives

- Dumping from China into the global market persists, leading to continued pressure on margins.
- Red Sea crisis is disrupting the global supply chain, causing longer turnaround times and affecting volumes in some cases.

Management Commentary

- The company is reluctant to provide EBITDA guidance for the year due to margin pressures and energy application volatility, preferring to observe margin trends over the next 2-3 months before making a commitment.
- The company is confident of achieving its volume targets, including reaching 40-50% capacity utilization within the current financial year.
- The company capex to peak in FY25 and then drop significantly in the following financial year.
- Margin pressures persist, primarily due to competition from China driven by their domestic overcapacity.

Revision in estimates – We have marginally tweaked earnings estimates for FY2025-FY2026 to factor in recent guidance of the company.

Our Call

Valuation – Maintain Buy rating with a higher PT of Rs. 848: Though confident of reaching a 40-50% capacity utilization, it remains cautious about meeting EBITDA and margin expectations due to ongoing pressure from China. Therefore, we are maintaining our Buy rating on Aarti Industries with a revised price target of Rs. 848. At the current market price, the stock is valued at 45x and 30x FY25 and FY26 earnings estimates, respectively.

Key Risks

1) Slowdown in demand of the end user industries 2) Delay in commissioning of facilities for multi-year contracts 3) Adverse commodity prices.

Valuation (Consolidated) Rs cr

Particulars	FY23	FY24	FY25E	FY26E
Net Sales	6,619	6,372	7,832	9242
Growth (%)	21%	-4%	23%	18%
EBITDA	1,089	976	1,253	1,664
OPM (%)	17%	15%	16%	18%
Adjusted PAT	547	416	587	878
y-o-y growth (%)	-17%	-24%	41%	32%
Adjusted EPS (Rs.)	15.1	11.5	16.23	24.25
P/E (x)	49x	64x	45x	30x
P/BV (x)	5x	5x	5x	4x
EV/EBITDA (x)	27x	30x	24x	18x
ROCE	10%	7%	8%	10%
ROE	11%	8%	10%	13%

Source: Company; Sharekhan estimates

Q1FY2025 key conference call highlights

- Despite being a cost leader, the company continues to face pressure on prices and margins due to competition from China.
- Margins would face some compression due to current pricing, which may cause profitability to be slightly lower than initially projected in the business plan.
- The company is optimistic about a near-term recovery in margins, especially within the chloroform value chains.
- The company is currently below its cycle average margins and does not anticipate normalisation within the next 1-2 quarters.
- There are early signs of demand recovery in key sectors such as pharma polymers, additives, dyes and pigments, and agrochemicals.
- There has been price volatility for key raw materials, particularly benzene and aniline, which are among the company's largest inputs. Both benzene and aniline prices have increased on a sequential and y-o-y basis.
- The company's peak debt level, projected to be between Rs. 3,500 and Rs. 3,800 crore this year, will be influenced by its working capital and raw material prices.
- The company plans to allocate Rs. 1,500-1,800 crore for capital expenditure in FY25.
- Most of the remaining capex of Rs. 1,200 crore will be allocated to the Chlorotoluene value-chain project in Zone 4.
- The company will launch a new pilot plant in Zone Four within the current quarter, which will aid in speeding up the commercialization of new products developed through their technology.

Results (Consolidated) Rs cr

Particulars	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)
Revenue	**1,855**	**1,414**	**31%**	**1,773**	**5%**
Total expenditure	1,550	1,213	28%	1,490	4%
Operating profit	**305**	**201**	**52%**	**283**	**8%**
Other Income	6				-
Depreciation	102	89	15%	98	4%
Interest	64	40	60%	59	8%
PBT	**145**	**72**	**101%**	**126**	**15%**
Tax	8	2	300%	-6	-233%
Reported PAT	**137**	**70**	**96%**	**132**	**4%**
Reported EPS (Rs)	3.77	1.93	95%	3.64	4%
Particulars (%)	**Q1FY25**	**Q1FY24**	**YoY (%)**	**Q4FY24**	**QoQ (%)**
EBITDA margin	16%	14%	223bps	16%	48bps
Net Profit	7%	5%	-155	7%	29
Tax Rate	6%	3%	561	-5%	122

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Structural growth drivers in place for specialty chemicals in medium to long term

We remain bullish on the medium to long-term growth prospects of the specialty chemicals sector, given a massive revenue opportunity from import substitution (India's total specialty chemical imports are estimated at $56 billion), a potential increase in exports given China plus One strategy by global customers and favourable government policies (such as tax incentives and production-linked incentive scheme similar to the pharmaceutical sector). In our view, conducive government policies, product innovation, a massive export opportunity and lower input costs would help the sector witness sustained high double-digit earnings growth for the next 2-3 years.

■ Company Outlook – Demand recovery; capex to drive long-term growth

The company is well-poised to benefit from improved demand from discretionary segment and recovery in non-discretionary segment. Despite a demand slowdown over past few quarters, the company is continuing with its capex plan and guided robust growth over long term. Company has also invested in the right areas to build capabilities and enhance client engagements. Over the long term, growth is expected to be largely driven by – i) Growth in global markets, ii) Import substitution, and iii) the China Plus One opportunity.

■ Valuation – Maintain Buy rating with a higher PT of Rs. 848

Though confident of reaching a 40-50% capacity utilization, it remains cautious about meeting EBITDA and margin expectations due to ongoing pressure from China. Therefore, we are maintaining our Buy rating on Aarti Industries with a revised price target of Rs. 848. At the current market price, the stock is valued at 45x and 30x FY25 and FY26 earnings estimates, respectively.

About the company

Aarti Industries is a leading specialty chemicals company in benzene-based derivatives with a global footprint having integrated operations and high level of cost optimisation. The company has been setup by first-generation technocrats in 1984 and its pharmaceutical business spans across APIs, intermediates, and Xanthene derivatives. The company has strong R&D capabilities, with three R&D facilities and a dedicated pool of over 170 engineers and scientists. The company has 11 plants located in western India with proximity to ports; specialty chemicals are manufactured in all plants; and four of the plants are approved as pharma-grade (2 USFDA and 2 WHO/GMP). The company is also coming up with two project sites at Dahej SEZ and the fourth R&D centre at Navi Mumbai.

Investment theme

Aarti Industries is investing in the right areas for building capabilities and richer client engagements, which would create a long-term moat in a booming industry. The company expects significant growth prospects, led by growth from discretionary end-users (65% of revenues of Aarti Industries) and recovery in the non-discretionary segment. Capex of Rs 2500 crore in the next two years and good growth in end user industries bodes well for the company.

Key Risks

- Slowdown in demand of the end user industries
- Delay in commissioning of facilities for multi-year contracts
- Adverse commodity prices

Additional Data

Key management personnel

Rajendra Vallabhaji Gogri	Chairman cum Managing Director
Rashesh Chandrakant Gogri	Vice Chairman cum Managing Director
Renil Rajendra Gogri	Executive Director
Manoj Mulji Chheda	Executive Director
Hetal Gogri Gala	Executive Director

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	6.80
2	Morgan Stanley	3.19
3	HDFC Asset Management Co Ltd	2.59
4	Vanguard Group Inc/The	1.51
5	PGIM India Asset Management Pvt Lt	1.06
6	ICICI Prudential AMC	1.05
7	Alchemie Financial Services Ltd	1.03
8	BlackRock Inc	0.97
9	Baron Capital Inc	0.81
10	Aditya Birla Sun Life Asset Manage	0.55

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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