Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

Aarti Industries (ARTO IN)

Rating: BUY | CMP: Rs1,475 | TP: Rs1,980

Chemistry for growth

Avishek Datta avishekdatta@plindia.com | 91-22-66322254

Contents

August 22, 2019

Company Initiation

Aarti Industries (ARTO IN)

Rating: BUY| CMP: Rs1,475 | TP: Rs1,980

Chemistry for growth

We are initiating coverage on Aarti Industries (AIL) with BUY rating given fully integrated operations and its ability to cater to diverse set of industries which makes it a partner of choice for domestic and MNCs alike. AIL, a global leader in benzene based intermediates is at an inflection point led by 1) increased opportunities from China's tightening environmental norms and 2) healthy downstream domestic demand from dyes, paints, pigments and agro chemicals. AIL has signed 3 multi-year long projects with MNCs worth USD2.3bn, which reiterates AIL's dominance in global chemical space. Led by timely capex to capitalize on opportunities, we expect AIL's earnings to grow by 21% CAGR over FY19-22E, despite near term weakness in agro chemicals and auto segment. Initiate with a BUY and PT of Rs 1,980, based on PER of 22x Sept21 EPS of Rs90.

Unique one stop solution provider: AIL is a global leader in benzene based speciality space with a portfolio of over 200 products and has built deep relationship with over 400 global and 700 domestic customers. The company shares a symbiotic relationship with its customers and ranks globally among top five suppliers for 75% of its product portfolio. A strong focus on manufacturing integrated derivatives and significant scale has helped AIL to lower its cost and gain traction with clients. Also, regular investments (Rs22bn over FY14-18) in creating newer capacities and fresh product offerings has helped AIL to be a one-stop solution provider.

Well placed to capitalize on opportunities in both domestic and export markets: AIL is well placed to capitalize on multiple growth opportunities in the domestic and global markets. Tightening environmental norms in China has disrupted the global supply chain and opened up opportunities for AIL. Also rising capex by domestic players in downstream industries like paints, dyes, agrochemicals etc. will add to growth. AIL plays the value/volume game smartly (depending on market conditions), for eg: FY19 EBIDTA growth of 39%, despite 8% volume growth was due to higher share of value added products. With domestic specialty chemicals market likely to rise at ~13%CAGR to ~USD58bn by FY22E, AIL (with a deep client relation) is well placed to capitalize on growth opportunities.

Multi-decade contracts-the way forward: Tightening environment norms in China has led global players eye for an alternate supply source of raw material. AIL's deep technical knowledge is well placed to capitalize on such opportunities. Accordingly, AIL has recently signed 3 multi-decade contracts worth ~Rs150bn with MNCs. We believe creation of new capacities will help garner more long term deals, which will add earnings visibility to AIL.

Healthy earnings growth ahead: AIL's earnings are expected to increase at 21% CAGR over FY19-22E as the company capitalizes on evolving global growth opportunities, despite near term weakness due to unfavorable weather condition in US and deceleration in the auto sales. The stock has corrected post Q1 results due to muted commentary. However, we believe this offers a good entry point to the company as we like its long-term prospects.

Key Financials - Standalone

Y/e Mar	FY19	FY20E	FY21E	FY22E
Sales (Rs. m)	48,576	51,841	63,455	71,047
EBITDA (Rs. m)	9,138	10,811	13,750	15,500
Margin (%)	*18.8*	*20.9*	*21.7*	*21.8*
PAT (Rs. m)	4,693	5,486	7,302	8,299
EPS (Rs.)	54.2	63.3	84.3	95.8
Gr. (%)	*39.0*	*16.9*	*33.1*	*13.7*
DPS (Rs.)	7.0	9.5	12.6	19.2
Yield (%)	*0.5*	*0.6*	*0.9*	*1.3*
RoE (%)	*22.3*	*18.8*	*21.1*	*20.2*
RoCE (%)	*18.4*	*17.4*	*19.5*	*19.4*
EV/Sales (x)	2.9	2.8	2.3	2.0
EV/EBITDA (x)	15.4	13.3	10.6	9.3
PE (x)	27.2	23.3	17.5	15.4
P/BV (x)	4.8	4.1	3.4	2.9

Key Data	ARTI.BO | ARTO IN
52-W High / Low	Rs. 1,877 / Rs. 1,087
Sensex / Nifty	37,060 / 10,919
Market Cap	Rs. 128 bn/ $ 1,797 m
Shares Outstanding	87m
3M Avg. Daily Value	Rs. 279.93m

Shareholding Pattern (%)

Promoter's	48.71
Foreign	7.70
Domestic Institution	15.76
Public & Others	27.82
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	(10.0)	8.0	6.8
Relative	(6.9)	4.6	10.4

Avishek Datta
avishekdatta@plindia.com | 91-22-66322254

Aarti Inds- Unique play in specialty chemicals

Aarti Industries (AIL) is a global leader in benzene based speciality chemicals with diversified end-uses into agrochemicals, pharmaceuticals, paints, pigments, printing inks, rubber chemicals, etc. and has an integrated operation across product chain of Benzene, Toluene and Sulphur. With a strong focus on cost and scale, the company has leveraged its deep chemistry knowhow to emerge as a partner of choice for global and domestic companies. The company ranks among top four players globally for 75% of its products portfolio. AIL has a wide basket of over 200 products which are marketed to 400 global and 700 domestic customers. AIL's businesses are segregated into three different segments:

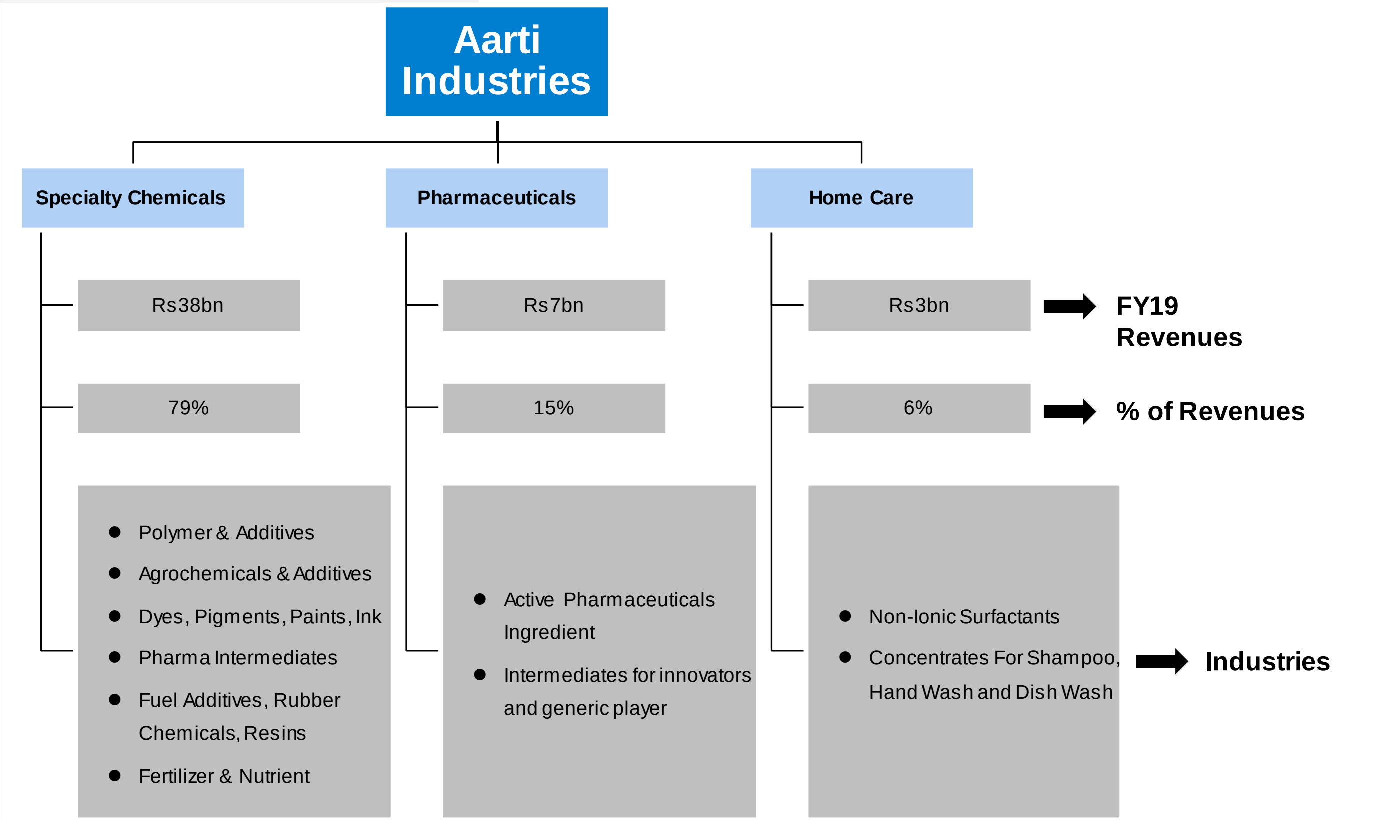
a) Specialty chemicals (80% of sales)

b) Pharmaceuticals (14% of sales)

c) Home and personal care (6% of sales)

AIL has decided to demerge the HPC division by FY19 end into a separate entity called Aarti Surfactants Ltd (ASL). All shareholders will have option for Equity or redeemable preference shares of ASL and the same will be listed on Stock exchanges in India. The company plans to hive off the Home and Personal care business by FY19 to focus on its core businesses. Factors like- huge opportunity following environmental issues in China, established global clientele, Rs22bn investments over FY14-18 and 21% PAT CAGR makes AIL one of the best stocks to play an outsourcing story in specialty chemicals.

Exhibit 1: Speciality chemicals accounts for 79% of AIL revenues

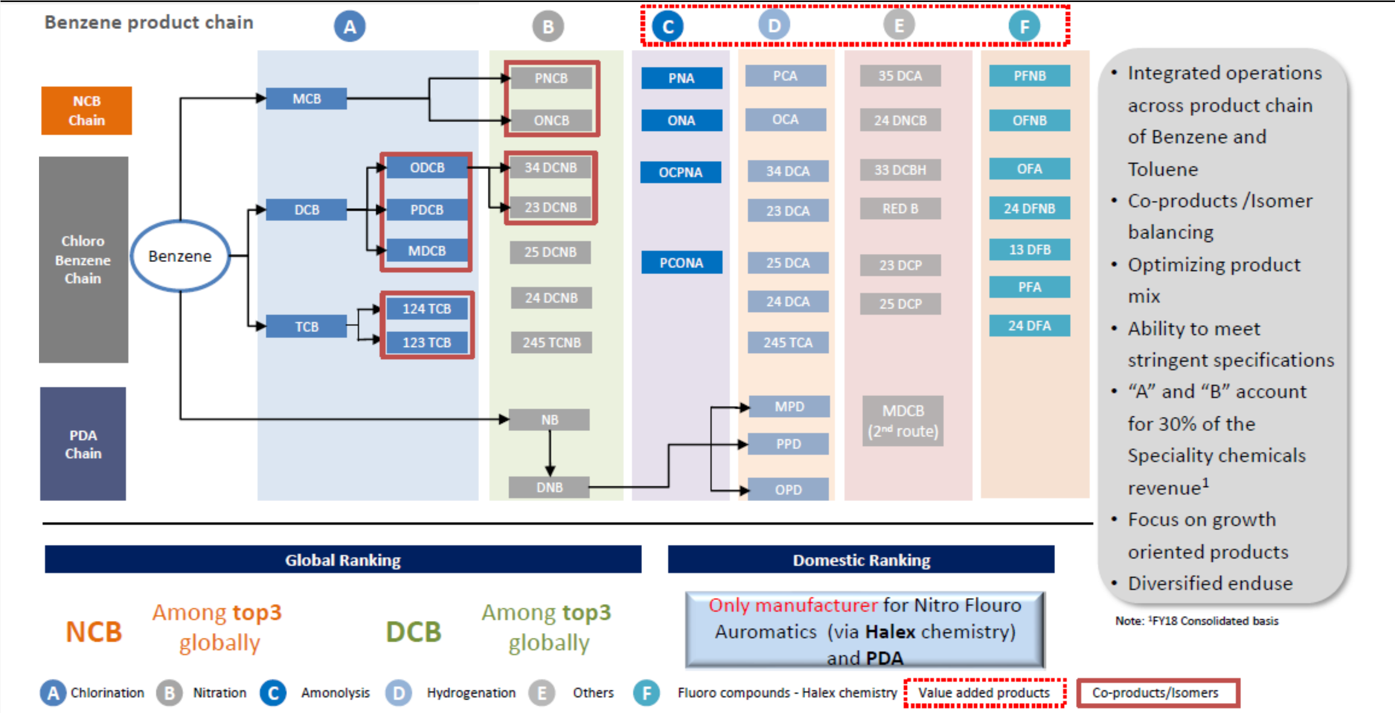


Source: Company, PL

Leading player in global benzene derivatives

AIL is a leading specialty chemical manufacturing player globally for benzene based derivatives. The global benzene derivative chain is dominated by few large players like Lanxess, Dupont, Sumitomo chemicals, Honeywell, etc. along with significant smaller players too. AIL ranks amongst top three global players for manufacturing NCB and DCB.

Exhibit 2: AIL's benzene product chain



Source: Company, PL

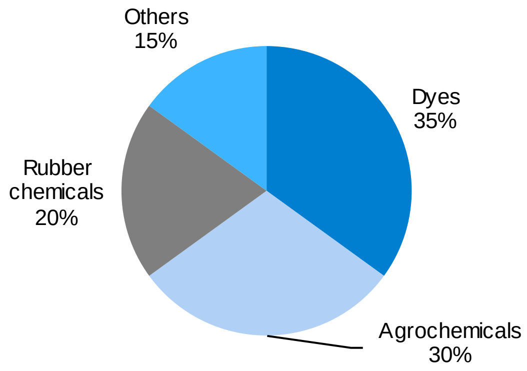
Market assessment of key benzene derivative products (NCB & DCB):

Nitrochlorobenzene (NCB)

NCB is produced by the reaction of nitric acid with chlorobenzene. The global NCB consumption was 322KTPA in CY18 and grew 3%CAGR over CY14-18. In terms of revenues, NCB market was at USD400m in CY18. Largely, the global NCB demand is met by 5-6 major players like Dupont, Lanxess and few Chinese players which accounts for 65% of market.

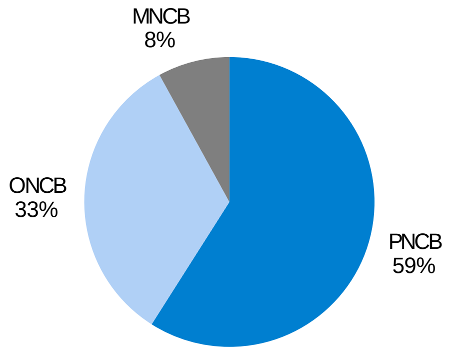
The market is expected to grow 3-3.5% CAGR between 2019 and 2023 driven by rising demand from various end-use segments to USD468m. Demand for dye products such as printing ink and increase in end-user preference for environment-friendly products is likely to drive growth & push demand for NCB. Additionally, rising crop protection measures will drive NCB demand for pesticides over the coming years.

Exhibit 3: Global NCB market by use



Source: Company, PL

Exhibit 4: Global NCB market by form



Source: Company, PL

NCB classification by form:

In terms of form, para nitrochlorobenzene (PNCB) dominates the market with ~59% of the market share (in 2018). It acts as an intermediate to produce fine chemicals particularly dyes, pigments, pesticides, herbicides and several pharmaceutical products.

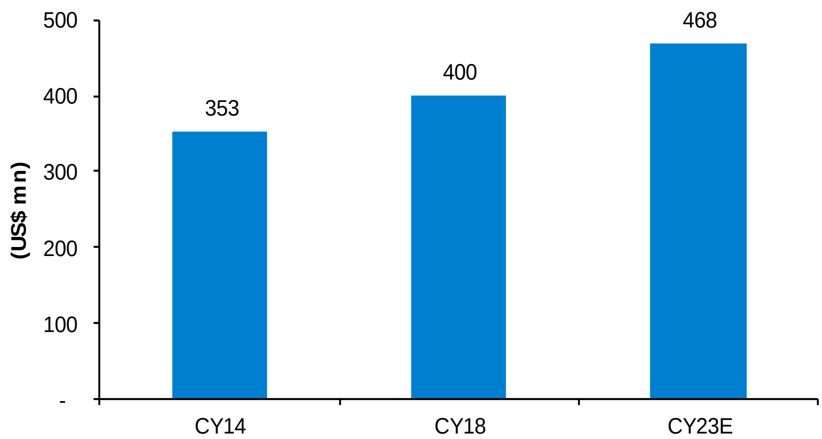
Ortho nitrochlorobenzene (ONCB) has the second largest market with a share of 33%. Rising importance of rust protection in manufacturing industry to reduce maintenance cost is expected to fuel the demand for ONCB to produce corrosion inhibitors. This chemical also has application in dyes, pesticides, agrochemicals.

Meta nitrochlorobenzene (MNCB)- Accounting the remaining market share is an important intermediate for dyes and pharmaceuticals. It is used to produce chloroaniline, azo dyes, pigments, drugs, pesticides etc.

Asia Pacific to lead NCB growth

In terms of regional growth, Asia Pacific is expected to lead NCB growth during the forecast period (with India and China leading the race) due to rapid growth in pharmaceuticals, pesticides dyes, rubber and chemical industries.

Exhibit 5: Global NCB revenues to grow at CAGR of 3.5% to USD468m

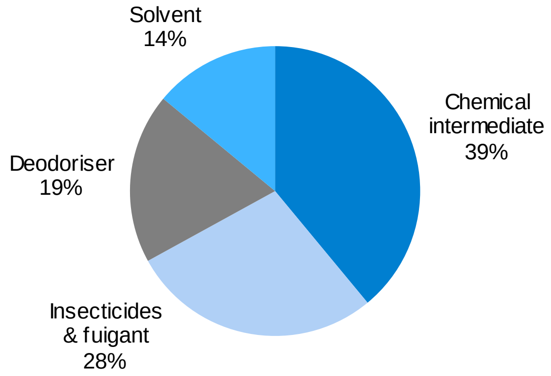


Source: Company, PL

Dichlorobenzene (DCB)

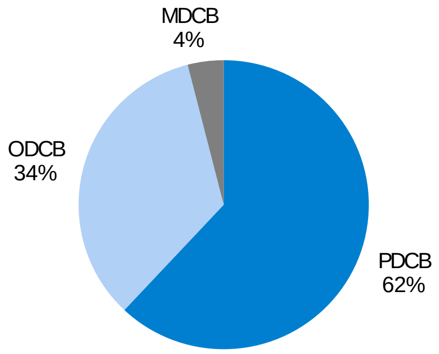
DCB finds significant application in agrochemicals and intermediates to other chemical products, solvents and deodorizers. Its overall market is estimated to be ~454 kilo tonnes in 2018, primarily dominated by chemical intermediates. AIL accounts for 10% of global production at ~40ktpa and ranks third globally. Global DCB market grew at 4%CAGR over CY14-18 to USD586m. The market is expected to grow at 4-5% CAGR over CY19-23 led by rising application from solvents and agrochemcials industry.

Exhibit 6: Global DCB market by useage



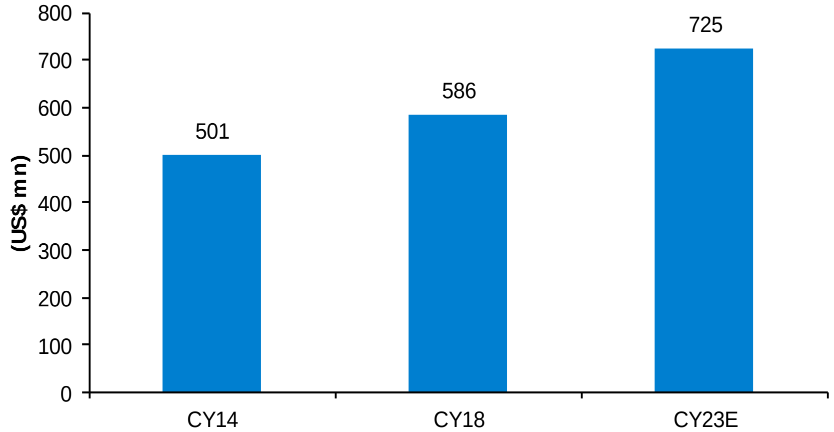
Source: Company, PL

Exhibit 7: Global DCB market by form



Source: Company, PL

Exhibit 8: Global DCB revenues are set to grow at CAGR 5% to USD725m



Source: Company, PL

Apart from chlorination and nitration, benzene is utilized to develop derivatives through amonolysis, hydrogenation and Halex chemistry. These derivatives constitute value added products like anilines (through hydrogenation), Nitro Fluoro Aromatics via Halex chemistry and PDA value chain.

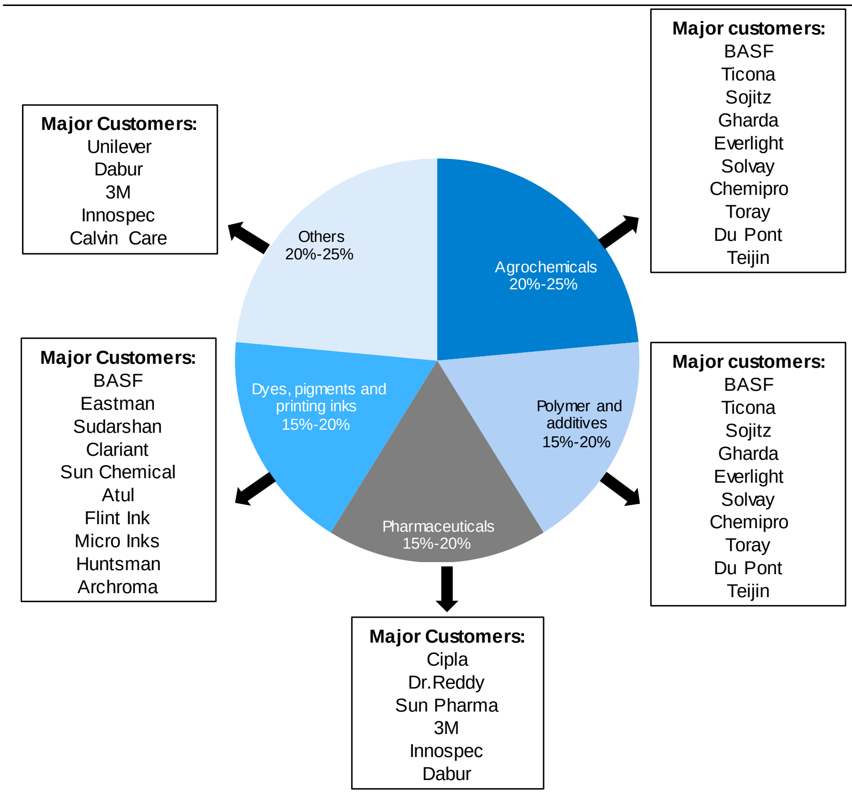
Structural tailwind in end use demand

A strong focus on niche chemistry has helped AIL escape high competitive segments. AIL continues to add new and high value added products which helps it garner a greater share in customer's product line. Hence, AIL is now one of a few chemical companies that exports to China.

Also, AIL's end products find usage in our daily lives across different sectors, for eg: polymer and additives are used in automobiles, aircrafts and electronic gadgets etc. Besides some products are also used in agro chemicals, pharmaceuticals, dyes and non-ionic surfactants used in shampoos, handwash etc.

The company has marquee clients across different sectors which has reduced its earnings volatility and de-risked its portfolio. AIL derives over 80% of revenues from customers who are more than five years old, given their strong relationship with them. Also, continuous product innovation means that AIL is best placed to capitalize on any new demand opportunities from existing and new customers.

Exhibit 9: AIL's business is well diversified with Marquee clients



Source: Company, PL

Exhibit 10: Downstream user industries growth trajectory likely to remain healthy

Segments	End usage industries	Product cycle	Growth FY18-23 CAGR
Agrochem	Pesticides, insecticides, fungicides, herbicides, Nutrients	Agrochemical cycle	7-9%
Dyes & pigments	Printing inks	Normal business cycle	10-12%
Polymer & additives	Aircrafts, automobiles, cruise liners, bullet proof jackets, electronic products	Normal business cycle	7-11%*
Pharma	Intermediates used in drugs catering to anticancer, antiasthma, anti-hypertensive drugs, oncology therapies	Non-cyclical	12-13%
Others	Fuel additives, rubber chemicals		

*Source: Company, Crisil report; * Polymers-7-9% and Polymer additives 10-11%*

AIL's revenue growth on firm footing

AIL's has reported a sales CAGR of 13% over past five years led by strong demand traction from user industries. Future outlook looks promising as the company is well placed to capitalize on multiple growth opportunities from domestic and global markets. Accordingly, the company is aggressively expanding capacities via:

a) Multiple long term contracts from global players

b) Entry into new chemistry –the toluene chain and

c) Extending into more downstream product offerings

Opening a new chapter with long term MNC contracts

AIL has recently signed three multi- year long contracts with global majors worth Rs150bn for the first time. Long term contract with global players ensures revenue visibility and also showcases AIL's deep chemistry knowhow. Below are the details:

Long-term contract 1: AIL has signed a ten-year contract with a global agriculture major to supply high value agrochemical intermediary for Rs40bn. The company will invest Rs4bn towards capex and the contract will start from H2FY20E. The contract is likely to provide annual sales of Rs1bn in the year 1, which can increase, to Rs4bn at the peak. With EBIDTA margins of ~40%, we calculate project ROCE of 35%.

Long-term contract 2: The second contract of Rs100bn is for twenty years to supply high value speciality chemical intermediate to a global chemical major. The supplies are likely to start from Q1FY21 and will help AIL enter a new chemistry range. The customers would advance ~USD42m towards plant capex and the same will be adjusted against future supplies. With project funded via advances from customer, we expect ROCE of ~30% from the contract. The contract is likely to provide annual sales of Rs2.5bn in the first year, which can increase to Rs5bn at its peak.

Long-term contract 3: Latest contract is with a global chemical conglomerate to develop and supply high value specialty chemical intermediate worth Rs9bn for a period of ten years. The project is set to start from Q4FY21 and AIL will invest USD15m for setting up the plant. AIL has jointly developed the product with the customers over the last four years. In line with other multi-year contracts, we expect project ROCE to be ~20%. The contract is likely to provide annual sales of Rs900mn.

While ensuring high earnings visibility, these multi-year contracts also highlight AIL's position in the global chemical space. We believe that successful execution of these orders can open more opportunities with global majors and help the company gain a share, given that environment issues have changed the landscape in China.

Diversifying into toluene chemistry

AIL has recently commercialized its toluene plant to cross sell among its existing customers in agrochemicals, pigments, pharmaceuticals and optical brighteners etc. Toluene derivatives have significant demand opportunities in the Indian and global markets. Aarti industries and Deepak nitrite are the only major manufacturers of toluene based derivatives in India. With large part of domestic demand met through imports, there is a scope of import substitution.

Anticipated growth in the toluene market can be attributed to increasing applications of its derivatives in different industries like construction industry, cosmetics and agriculture.

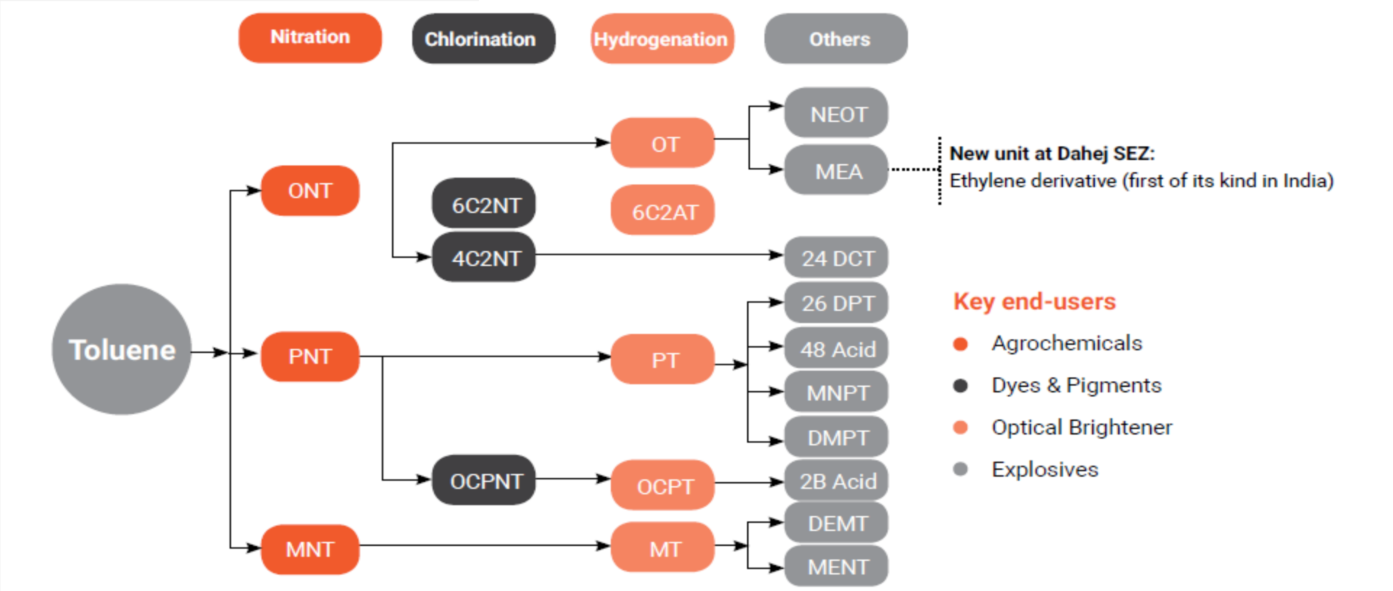
Toluene, is an aromatic hydrocarbon that is used as an industrial feedstock as well as a solvent. Based on derivatives types, global toluene market is classified into benzene & xylene, toluene diisocyanate (TDI), solvent, gasoline additives and tri-nitro toluene (TNT).

Benzene & xylene is the dominating segment is used in blending of petrol and occurs as a by-product in the manufacturing of styrene. TDI segment is expected to be the fastest growing market for toluene as it is majorly used in the production of PU foams, which are widely used in industries such as, oil & gas, building & construction, and automotive for insulating applications.

Furthermore, solvent accounted for the second largest share in global toluene market, owing to its higher demand in manufacturing of cosmetics and paints & coatings industry.

AIL has set up a 30,000 ton toluene facility with capex of Rs600m in Jhagadia and utilization rate at 53% in FY19 end. The company expects to reach potential revenue of Rs3.5-4bn over next four years.

Exhibit 11: AIL is venturing into Toluene- A new chemistry to offer more products



Source: Company, PL

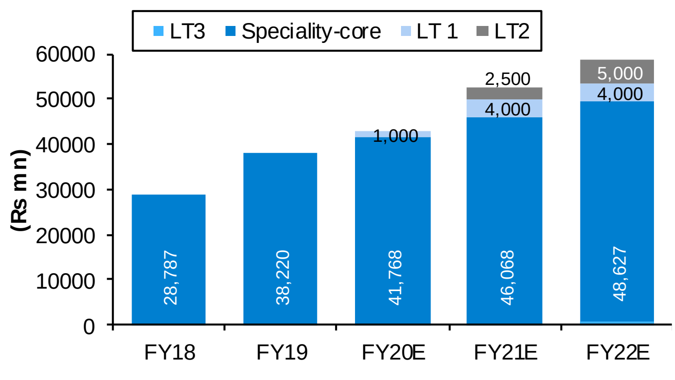
Moving downstream to garner bigger pie of wallet share

AIL has long focused on maximizing downstream value and creating economies of scale. The company is the only Indian player developing benzene base fluoro compounds and is also amongst a few producers of toluene-based products. AIL has consciously moved downstream- amonolysis, hydrogenation, fluro compound etc- and now they account for 70% of AIL's specialty revenues.

Phenylene Diamines (PDA) chain- AIL is the only Indian company involved in manufacture of PDA with capacity of 12,000TPA. PDA caters to high growth markets of engineering polymers and speciality additives, which is an import substitution.

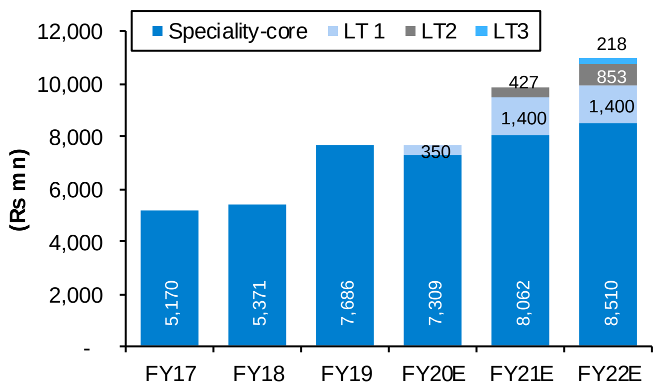
Nitro-Chloro benzene (NCB) chain- AIL is the largest NCB player with presence across value chain. Being the building block in chemical process, the company has steadily increased NCB capacity to 75,000 tons. With utilization levels of over 90%, the company plans to increase its capacity further to 108,000 tons in two stages by FY21E. The expanded capacity will also help to increase the production of ONCB and PNCB which have high demand in agrochemicals and Pharma respectively.

Exhibit 12: Multi-year contracts will lift specialty revenues



Source: Company, PL

Exhibit 13: High margin contracts will also boost EBIT



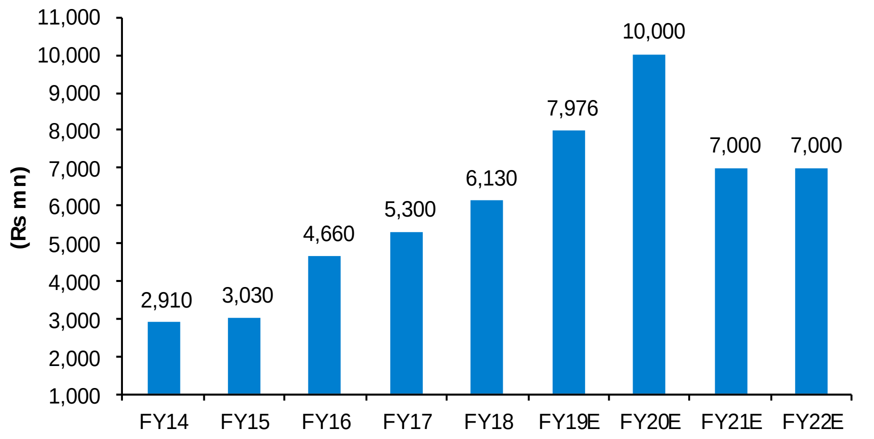
Source: Company, PL

High capex to add capacities, fuel growth

AIL has been on a capex spree to expand existing capacities and enter into new verticals to capitalize on rising opportunities in both exports and domestic markets. This expansion is done to 1) expand product portfolio and production capacity for existing products; 2) identifying niche opportunities in relatively less crowded markets to gain rapid market share 3) to further expand product basket with related products that are bi-products of existing products; 4) downstream integration to manufacture more value added products; and 5) improve market position across isomers.

Over last five years AIL has spent Rs22bn to expand capacities. Going forward, we expect the capex intensity to reduce post FY20 peak levels of Rs10bn. The company has recently raised Rs7.5bn by way of fund raising at Rs1,397/share to part fund capex.

Exhibit 14: AIL has lined up aggressive capex



Source: Company, PL

Exhibit 15: Key expansion projects undertaken recently

Project	Location	Capacity Details	Commissioning	FY19 Utilization	Objective of Capex
Nitro-Chloro Benzene	Vapi	Expanded from 57 to 75 ktpa and expanding to 108 ktpa	FY16	90%	Diversifying further in Benzene Value chain
Phenylene Diamines	Jhagadia	Expanded from 5 to 12ktpa	FY17	40%	Strengthen presence in high end polymer
Ethylation	Dahej	Set up a 8 to 10ktpa plant	FY17	80%	Increase of Agrochemicals Intermediates
Nitro-Toluene	Jhagadia	Set up a 30ktpa plant	FY18	53%	Foray in Toluene chain

Source: Company, PL

Exhibit 16: Key projects being setup

Location	Details
Vapi, Kutch & Tarapur	Various Speciality Chemicals, API & Pharma Intermediates. Debottlenecking and Expansions.
Jhagadia	Chlorination & Speciality Chemical Complex, Nitration of Chloro Benzenes
Dahej	Capex for new long-term contracts.
Navi Mumbai	New R&D Centre

Source: Company, PL

Margins to stay healthy

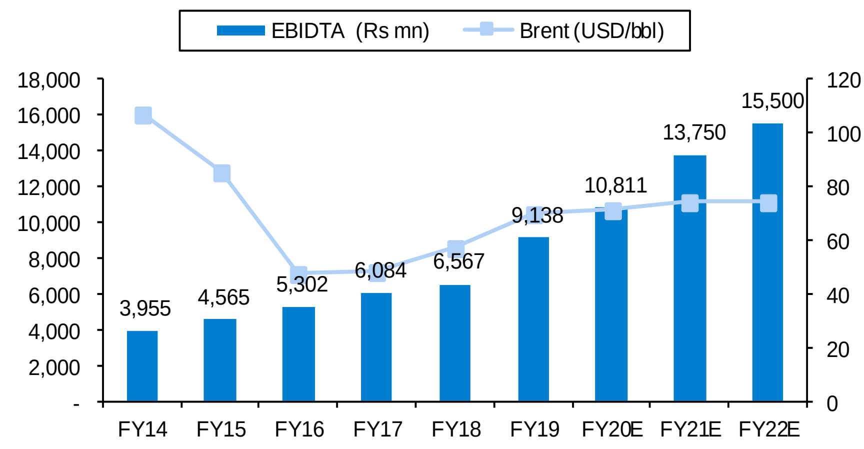
AIL's EBIDTA margins for FY19 have improved to 18.8% (Q1FY20- 21.8%) against 15% in FY14. Margin expansion was led by **1)** high share of value added products **2)** opportunistic product placement from China plant closure and **3)** recovery in Pharma business. We expect the trend to continue and expect margins to improve to 21.9% by FY22E given **1)** start of high margin long-term contracts **2)** large scale integrated operations and **3)** cost plus pricing model.

Start of high margin contract business: AIL has signed US$2.28bn long term contracts across speciality chemicals and herbicides segments. The contracts (which are high margin businesses) to start in stages by H2FY20. Start of multiyear contracts may potentially open up new opportunities for AIL. Accordingly, AIL is investing in setting capacities to capitalize on these opportunities.

Integrated operations with scale benefits drive margins: AIL is a key player in the Indian specialty chemicals space. It's focus on manufacturing integrated derivatives has helped to garner higher share of customer's wallet. While most companies focus on limited number of products, AIL's global scale capacities of over 200 products has helped garner customers across different industries.

Cost plus model shields AIL from raw material price shocks: AIL follows a cost plus business model which helps it beat raw material price volatility. While the company has contracts of varying duration ranging from quarterly to five years, the raw material prices are adjusted quarterly. For the non-contracted volumes, raw material prices are passed to domestic markets (on a monthly basis). Accordingly, while revenues might swing with higher input prices, the core profitability is not impacted. So EBIT growth is the key determinants of profitability for the company.

Exhibit 17: Cost plus model means no correlation to crude oil prices

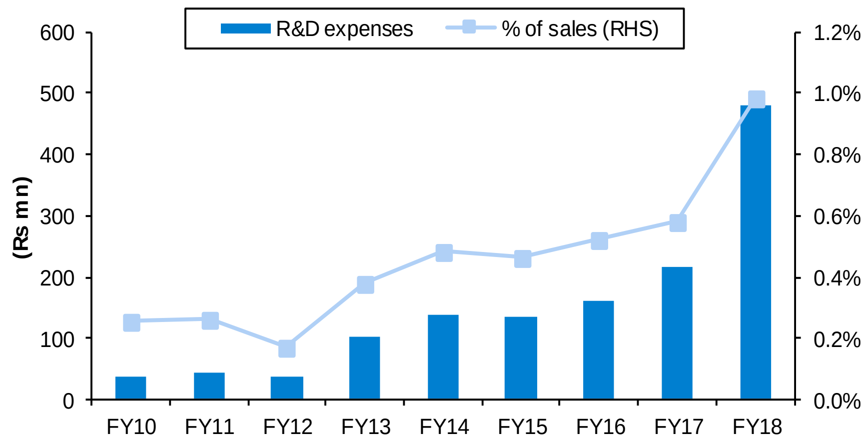


Source: Company, PL

World-class safety standards

AIL is a big proponent of Safety, Health and Environmental practices and has spent over Rs2.4bn over last five years. The company has seven zero liquid discharge plants and plans to convert two more units in FY19. AIL is also REACH compliant since 2012, which has helped entry into new geography (that have stringent environment norms).

Exhibit 18: AIL's R&D expense have increased over time



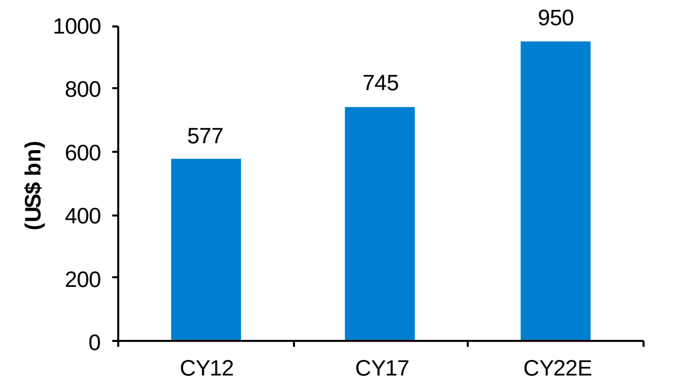
Source: Company, PL

Specialty chemicals – on a roll

Global specialty chemicals market (USD745bn) has shown a CAGR of 5% over CY12-17 led by increasing Chinese demand, availability of cheap US shale gas and higher Agri commodity prices. China has garnered higher share in specialty chemical market on account of 1) availability of cheap labour and capital 2) sizeable end use market 3) availability of feedstock and 4) supportive government policies.

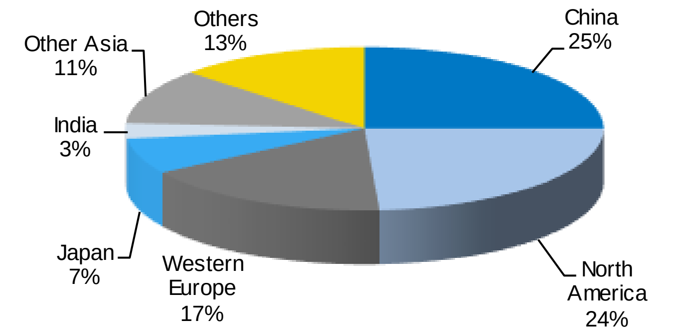
Led by trends of rising urbanization, and in turn higher demand for agro chemicals, water management chemicals etc. the global speciality chemicals market is likely to rise to USD900-1000bn by CY22F (Source: CRISIL report). Additionally, tightening environmental norms in China along with appreciation of Chinese currency, higher labour cost and reduction in government subsidies- global companies are considering diversification of their supply base. This offers great opportunity to the Indian chemical companies- A requisite technology, experience and scale for expansion. The Indian specialty chemicals market stands at USD32bn as on FY18E and has registered ~11% CAGR growth over last five years. Led by rising demand traction in agrochemicals, paints, coating, dyes and pigments domestic market is likely to grow to USD58bn by FY23E with CAGR of 12-13%, highest growth rate among all players.

Exhibit 19: Global specialty chemicals market size



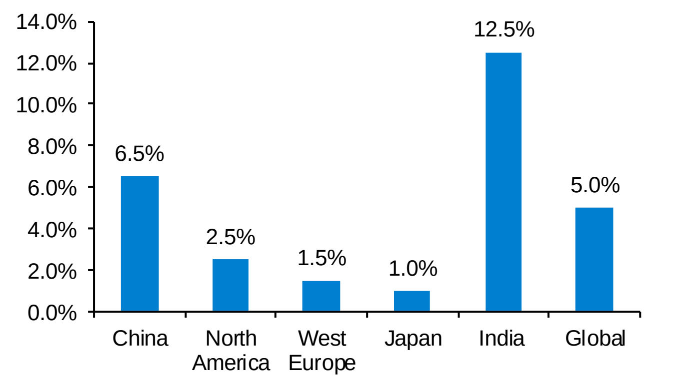
Source: Company, PL

Exhibit 20: Region wise breakup of speciality market



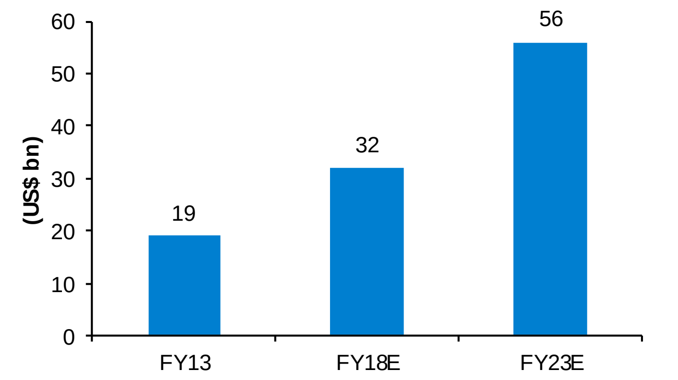
Source: Company, PL

Exhibit 21: India has just 12.5% share in specialty chemicals



Source: Company, PL

Exhibit 22: Indian speciality market size

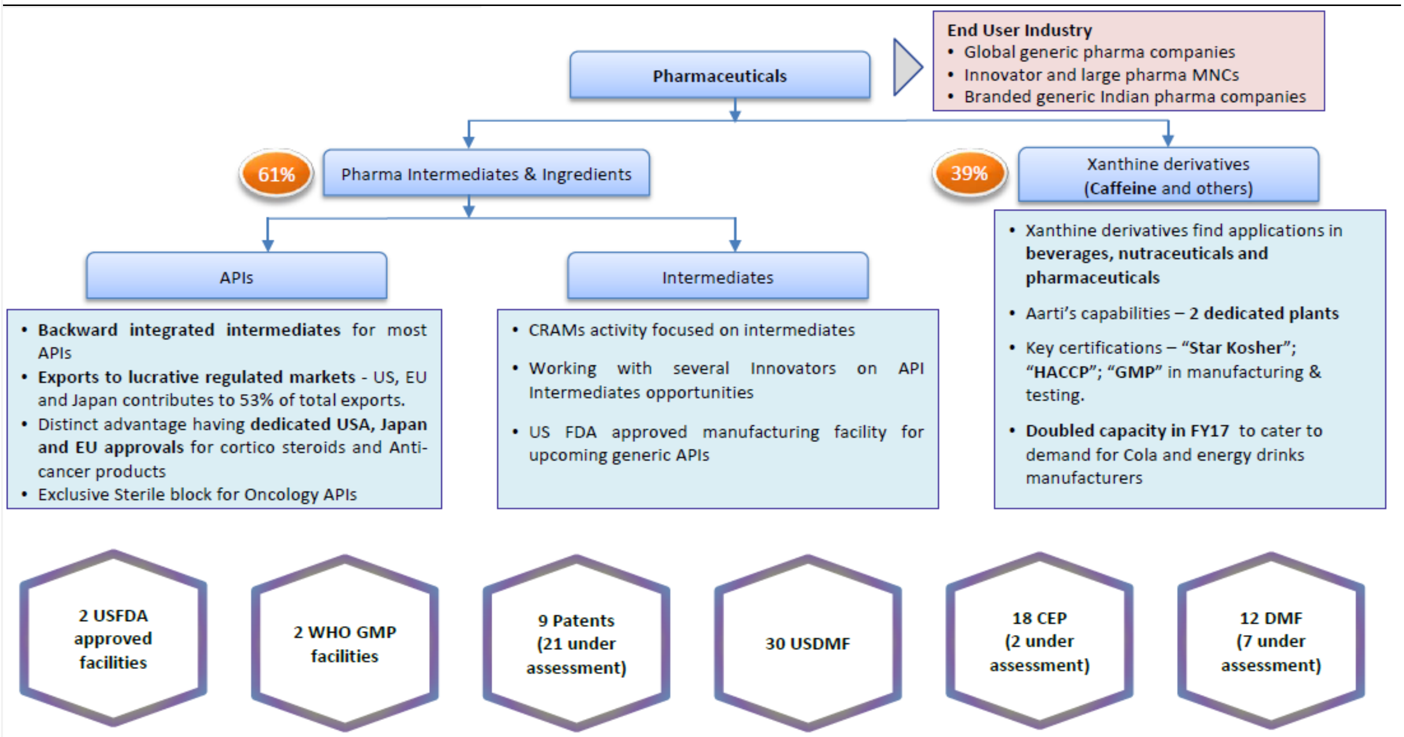


Source: Company, PL

Pharma business - on recovery mode

AIL has over time extended its deep technical chemistry knowhow to manufacture intermediates for pharma sector. The company has four plants for pharma segment-two for USFDA and two for WHO/GMP approved. The pharma division makes Active Pharmaceutical Ingredients (API), Intermediates (61% of FY19 pharma segment revenues), Xanthine based derivatives and off-patented generics (39% of sales), which are supplied to regulated markets.

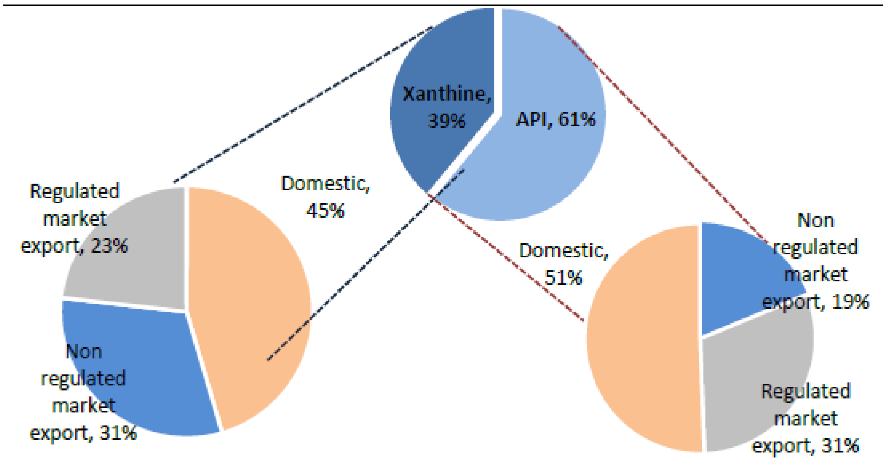
Exhibit 23: AIL pharma segment exposure across APIs, intermediates and Xanthine derivatives



Source: Company, PL

Within AIL's API sales, 51% were for domestic market and balance for regulated and non-regulated export markets. Similarly, Xanthine has 55% sales from export market.

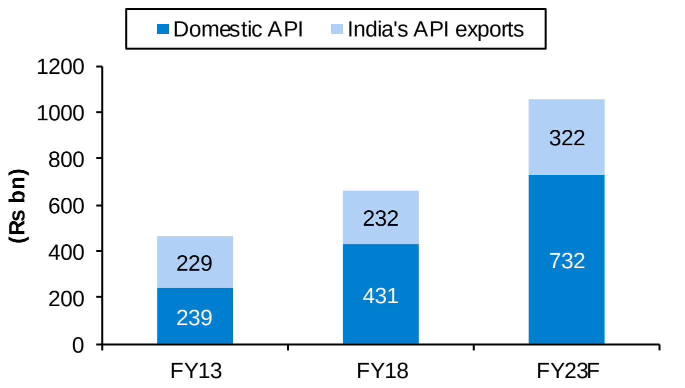
Exhibit 24: API and Xanthine sales by geography



Source: Company, PL

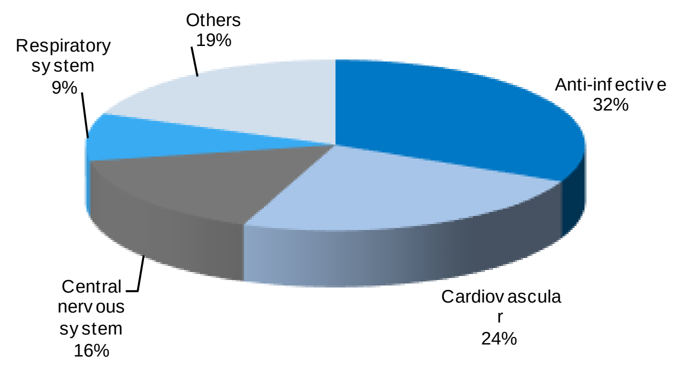
Indian API domestic and export market is expected to witness healthy growth led by supply disruption in China and transition to Specialty products and high value APIs. In addition, bulk drug manufacturers are expected to register healthy growth on the back of strong domestic sales.

Exhibit 25: India's API growth to accelerate



Source: Company, PL

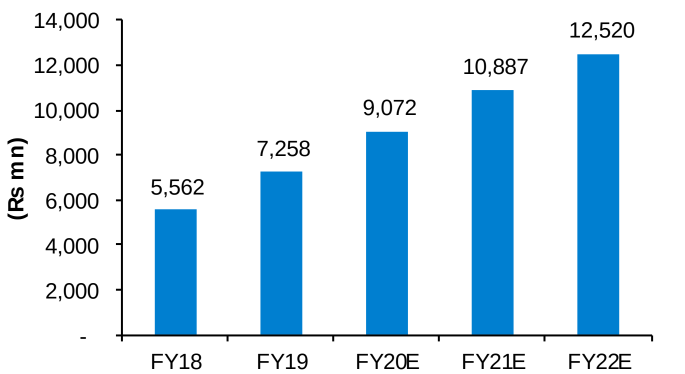
Exhibit 26: API share by application



Source: Company, PL

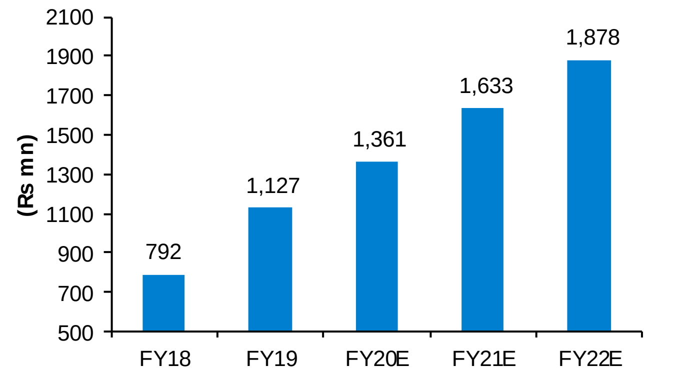
AIL's pharma profitability has steadily improved with EBIT of Rs1.1bn and margins of 15.5% in FY19 against FY16 levels of 9%. We expect EBIT margins to remain steady at 16% led by new capacity expansion of API business and monetization of intermediates. We estimate a CAGR of 20% in sales and 19% in EBIT over FY19-22E. Our estimates are conservative and offer upside risk from operating leverage and scale.

Exhibit 27: Pharma revenues on a steady growth phase



Source: Company, PL

Exhibit 28: EBIT will track rising revenues

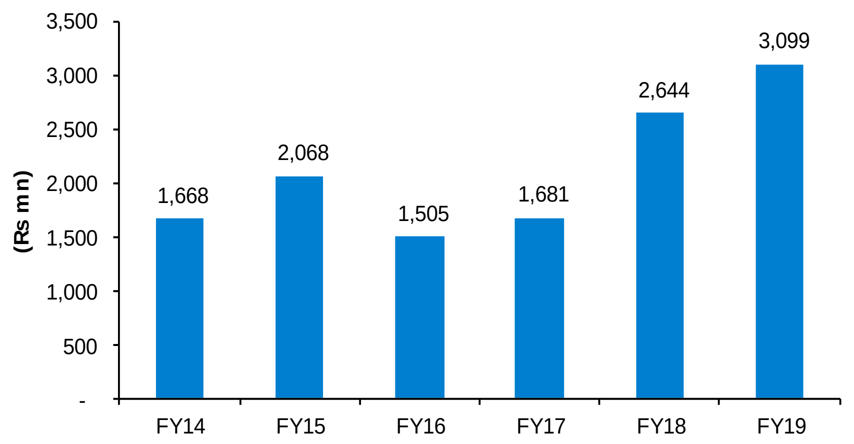


Source: Company, PL

Home and personal care-set to be demerged

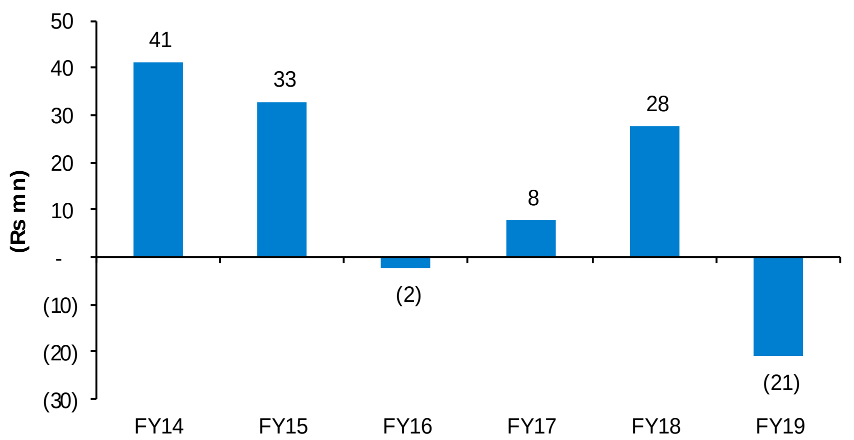
AIL is a leading surfactant player which caters to high growth industries like personal, oral, home care industries etc. However, despite best endeavor of the company, HPC segment has been a drag. HPC segment revenues have been largely stagnant over FY12-17 at Rs1.5bn. However, the revenues have staged a smart recovery in last two years to Rs3bn in FY19. Profitability trend continues to be a lackluster. To focus on core operations more effectively, AIL has decided to demerge the HPC division by FY19 end into a separate entity called Aarti Surfactants Ltd (ASL). All shareholders will have option for Equity or redeemable preference shares of ASL and the same will be listed on Stock exchanges in India.

Exhibit 29: HPC revenues have inched up smartly over last two years



Source: Company, PL

Exhibit 30: HPC segment EBIT performance is uninspiring



Source: Company, PL

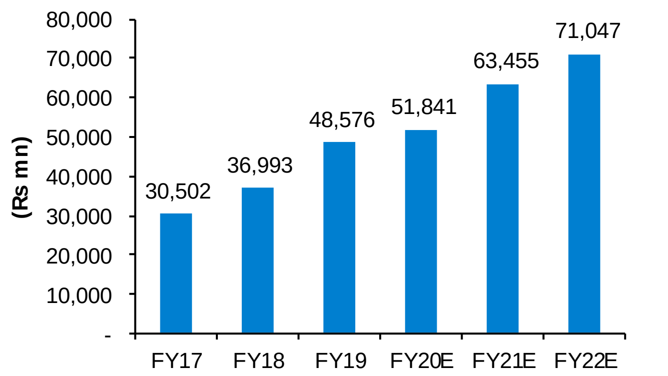
Financial Analysis

AIL's earnings are likely to grow at 21% CAGR over FY19-22E led by ~9% volume growth and margin expansion by 310bps of existing business along with benefits of three multi-year contracts in specialty chemicals. Its global positioning as "one of the largest benzene based chemical intermediary" are expected to drive earnings.

New projects to help accelerate revenue traction

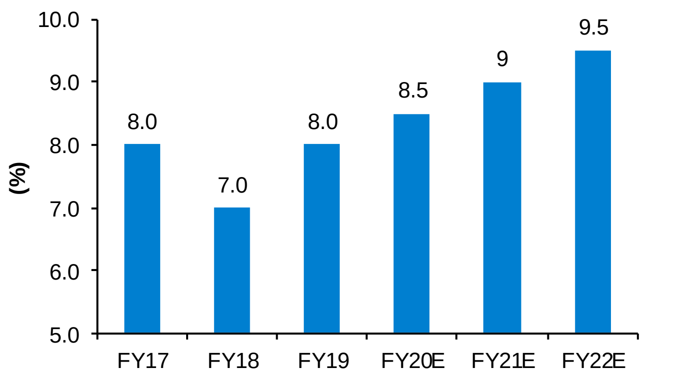
AIL's revenue growth has averaged 9% over last five years. However, start of the new capacity expansions and multi-year contracts will support revenue traction and drive a 13% CAGR over FY19-22E. Crude oil prices also impacts the revenues of the company as it follows cost plus business model.

Exhibit 31: AIL has multiple growth drivers



Source: Company, PL Research

Exhibit 32: AIL's volume is likely to pick up

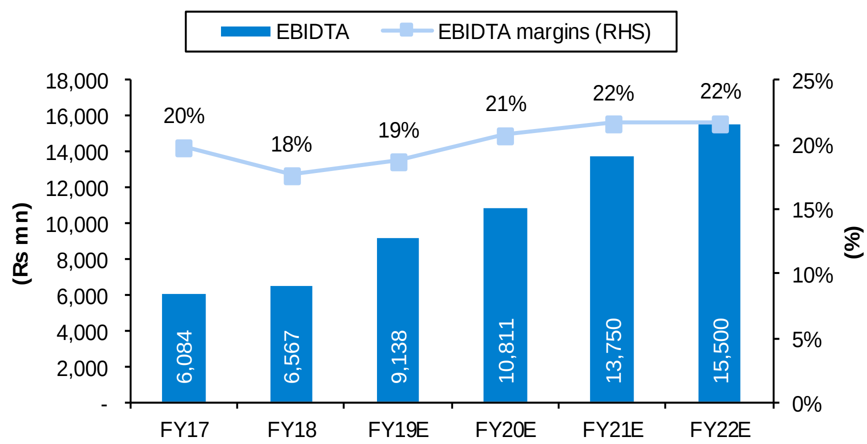


Source: Company, PL Research

High value added product share to drive margins

AIL's operating profit margins have improved to 18.8% in FY19 against 14% in FY14 led by higher share of value added products and closure of Chinese capacities. With high-margin multi-year contracts set to kick start from H2FY20E, we expect margins to remain healthy (despite some capacities coming back on stream in China). We have factored in EBIDTA margins of 19% over FY19-22E and we estimate EBIDTA CAGR of 19% during the same period.

Exhibit 33: Operating profits to increase at steady pace

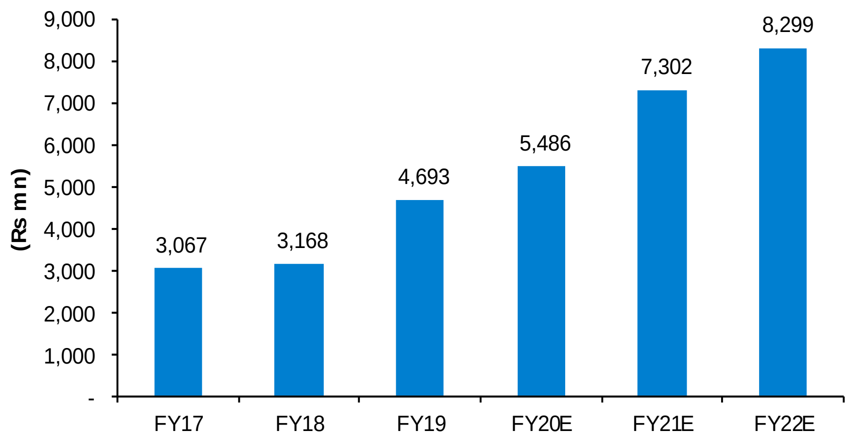


Source: Company, Company, PL

Earnings growth on a fast track

AIL is in a sweet spot as they benefit from tailwinds of healthy demand growth, new opportunities from multi-year contract and elevated margins. We expect 21% CAGR earnings growth over FY19-22E.

Exhibit 34: Capacity expansion, new projects to drive 21%CAGR PAT growth



Source: Company, PL

Exhibit 35: Concise P/L table for AIL

	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenues	30,502	36,993	48,576	51,841	63,455	71,047
EBIDTA	6,084	6,567	9,138	10,811	13,750	15,573
EBIT	4,936	5,214	7,542	9,020	11,521	12,858
PBT	3,787	3,927	5,778	7,033	9,361	10,640
PAT	3,067	3,168	4,693	5,486	7,302	8,299

Source: Company, PL

Exhibit 36: Key assumptions for AIL – Brief snapshot of AIL's revenue and EBIT breakup

	FY17	FY18	FY19	FY20E	FY21E	FY22E
Brent (USD/bbl)	48.8	57.6	70	72	75	75
Volume growth (%)	8	7	8	8.5	9.0	9.5
Segment Revenue:						
Speciality Chemicals	24,561	28,787	38,220	41,768	46,068	48,627
10 year agro chem contract-Rs 40bn				1,000	4,000	4,000
20 year SABIC contract-Rs100bn					2,500	5,000
10 year new product contract-Rs9bn						900
Pharmaceuticals	4,261	5,562	7,258	9,072	10,887	12,520
Home & Personal Care Chemicals	1,681	2,644	3,099			
Total	**30,502**	**36,993**	**48,576**	**51,841**	**63,455**	**71,047**
Segment EBIT						
Speciality Chemicals	5,170	5,371	7,686	7,309	8,062	8,510
LT-1				350	1,400	1,400
LT-2				-	427	853
LT-3					-	218
Pharmaceuticals	481	792	1,127	1,361	1,633	1,878
Home & Personal Care Chemicals	8	28	-21	-	-	
Segment EBIT	**5,659**	**6,190**	**8,791**	**9,020**	**11,521**	**12,858**
EBIT Margin						
Speciality Chemicals	21.1%	18.7%	20.1%	18%	18%	18%
LT-1						
LT-2						
Pharmaceuticals	11.3%	14.2%	15.5%	15%	15%	15%
Home & Personal Care Chemicals	0.5%	1.0%				

Source: Company, PL

Valuation

AIL is expected to report 21% CAGR in earnings growth over FY19-22E led by 1) higher volumes post commissioning of new capacity 2) start of multi-year contracts and 3) benign raw material pricing.

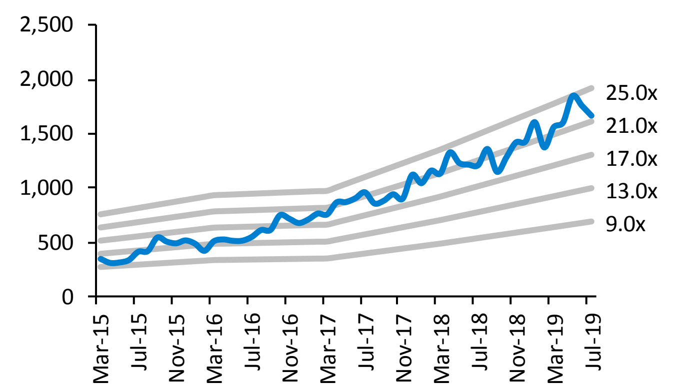
AIL's valuation band has consistently inched up led by strong earnings growth as also due to sector rerating in light of ever rising growth opportunities due to Chinese clampdown on polluting industries. AIL is expected to report one of the highest earnings growth rate among peers with an improving ROE trajectory. We have valued AIL at PER of 22x Sept21 EPS of Rs90. Initiate with a BUY and PT of Rs 1,980.

Exhibit 37: Sector comparative valuation

	PRICE	Mcap (US$ mn)	P/E			EV/EBIDTA			ROE		
			FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AARTI INDUSTRIES LIMITED	1,475	1,800	23.3	17.5	15.4	13.3	10.6	9.3	18.8	21.1	20.2
ATUL LTD	3,505	1,415	19.6	16.8	13.5	11.5	9.8	8.1	17.3	17.2	18.6
SRF LTD	2,835	2,274	20.2	16.3	13.7	11.9	10.0	8.7	17.9	19.0	19.1
VINATI ORGANICS LTD	2,057	1,472	32.1	26.3	19.6	20.6	17.3	13.3	27.8	25.8	25.2
NAVIN FLUORINE	670	462.1	18.9	16.3	13.7	12.1	10.4	8.8	15.3	15.8	16.8
SUMITOMO CHEMICALS	464	7,218	7.8	7.3	7.0	5.5	5.3	5.0	9.5	9.4	9.5
DUPONT	68	50,514	18.3	15.9	14.8	11.7	10.9	10.3	5.9	7.5	8.0
Eastman	66	8,987	8.5	7.7	6.9	7.3	7.0	6.8	17.4	17.8	18.5
Lanxess AG	52	5,086	12.9	12.0	10.9	6.3	6.0	5.7	12.1	13.3	12.3

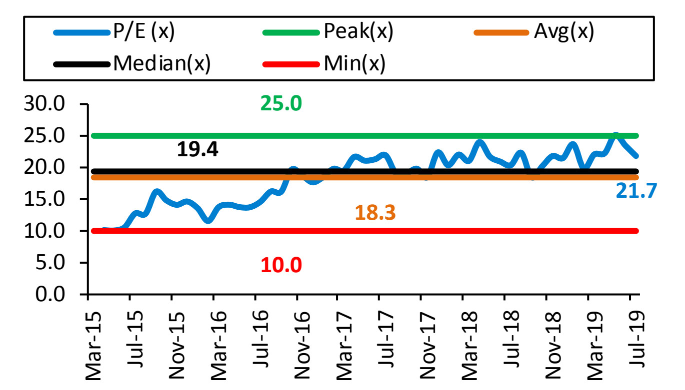
Source: Bloomberg, PL

Exhibit 38: One year forward Price/Earnings Band



Source: Company, PL, Bloomberg

Exhibit 39: One year forward Price / Earnings



Source: Company, PL, Bloomberg

Key risk and sensitivity

Significant slowdown in demand: AIL supplies intermediates to different user industries. Significant slowdown in global demand could result in downturn of product demand. However, with a diversified product base catering to wide range of customers, AIL will better withstand demand slowdown.

China comeback: AIL has benefitted from tighter environment norms, which has resulted in closure of multiple production facilities. However, some capacities are likely to come on stream post technology upgradation. Accordingly, start of capacities in China will result in softening of margins. In FY19 the company benefitted by Rs500m from higher margins, due to disruption in China.

Exhibit 40: FY21E earnings sensitivity to lower margins and sales

	Base case	Sensitivity	Base case EPS	Revised EPS	(%) chg
FY21E EBIDTA margins	21.7%	20%	84.3	75.5	-10.4%
FY21E sales growth	22.4%	11%	84.3	75.0	-11.0%

Source: Company, PL

Key highlights of Q1FY20 - Healthy quarter but cautious near term outlook

- On constant raw material prices, volume growth for Q1 was at 9.4%. Management expects volume growth to decelerate in H2 led by weakening agro-chemicals and auto sector demand. Agro-chemicals demand has been hit due to unfavorable weather conditions in the US.
- Demand momentum looks intact in the medium to long term since India has emerged as a strong viable alternative to China, where cost pressures have increased.
- Share of value added products has increased overtime for the company. Base chemistry like nitration and chlorination accounts for 28% in Q1FY20 vis-à-vis 30% in FY19 and 50% ten years ago.
- AIL has identified 15-20 products (currently in R&D phase) for import substitution in speciality chemicals space. As per the management with improved availability of these intermediates, consumption is likely to increase.

Exhibit 41: Q1FY20 Result Overview (Rs mn)

Y/e March	Q1FY20	Q1FY19	*YoY gr.*	Q4FY19	*QoQ gr.*
Income From Operations	**10,861**	**10,785**	***0.7%***	**12,114**	***-10.3%***
Total Expenditure					
Cost of Material Consumed	5,424	6,646	*-18.4%*	6,357	*-14.7%*
Purchase of stock in trade	343	332	*3.4%*	336	*1.9%*
Change in inventory of FG, WIP and SIT	50	(381)	*-113.0%*	230	*-78.4%*
Employee Cost	668	513	*30.4%*	716	*-6.7%*
Power & Fuel					
Other Expense	2,007	1,798	*11.7%*	2,106	*-4.7%*
Total Expenditure	8,492	8,906	*-4.6%*	9,745	*-12.9%*
EBIDTA	**2,369**	**1,879**	***26.1%***	**2,369**	***0.0%***
% of NS	*21.8%*	*17.4%*		*19.6%*	
Depreciation	401	377	*6.3%*	425	*-5.6%*
EBIT	**1,968**	**1,502**	***31.1%***	**1,945**	***1.2%***
Interest	303	461	*-34.3%*	412	*-26.5%*
Other Income	43	34	*27.4%*	7	*546.3%*
Exceptional Items					
PBT	**1,709**	**1,075**	***59.0%***	**1,540**	***11.0%***
Tax	335	182	*84.1%*	295	*13.6%*
Tax rate %	*19.6%*	*16.9%*	*15.8%*	*19.2%*	
Profit After Tax	**1,374**	**893**	***53.9%***	**1,245**	***10.4%***
Extraordinary Items		-			
Net Profit (after Extraordinary Items)	**1,374**	**893**	***53.9%***	**1,245**	***10.4%***

Source: Company, PL

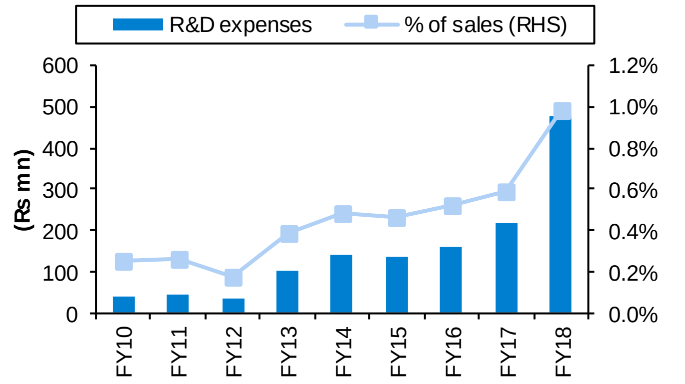
Exhibit 42: Segment revenue breakup

Y/e March	Q1FY20	Q1FY19	*YoY gr.*	Q4FY19	*QoQ gr.*
Segment revenue					
Specialty chemicals	8,950	8,485	*5.5%*	9,202	*-2.7%*
Pharma	1,911	1,497	*27.7%*	2,128	*-10.2%*
Home &personal care	-	803	*NA*	785	*NA*
EBIT					
Speciality chemicals	2,015	1,483	*35.9%*	2,006	*0.5%*
Pharma	320	260	*23.1%*	276	*16.0%*
Home &personal care	-	20	*NA*	2	*NA*
Total	**2,335**	**1,763**	*32.4%*	**2,283**	*2.3%*

Source: Company, PL

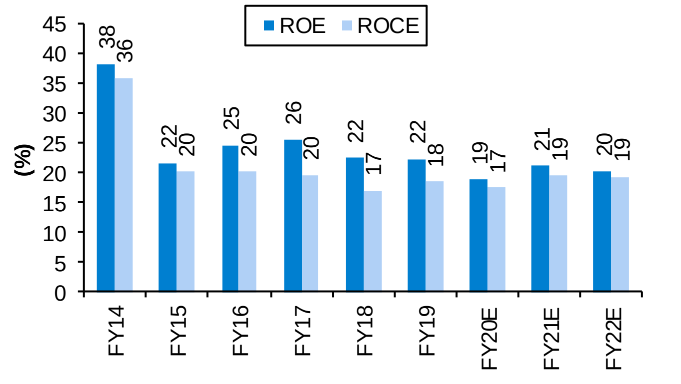
Story in Charts

Exhibit 43: R&D expense has increased over time



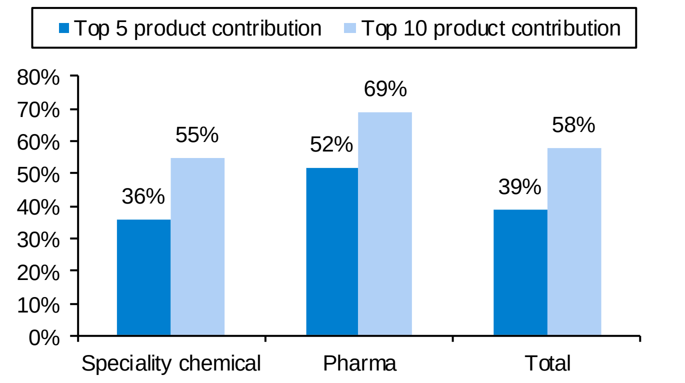
Source: Company, PL

Exhibit 44: Return ratios are likely to remain steady



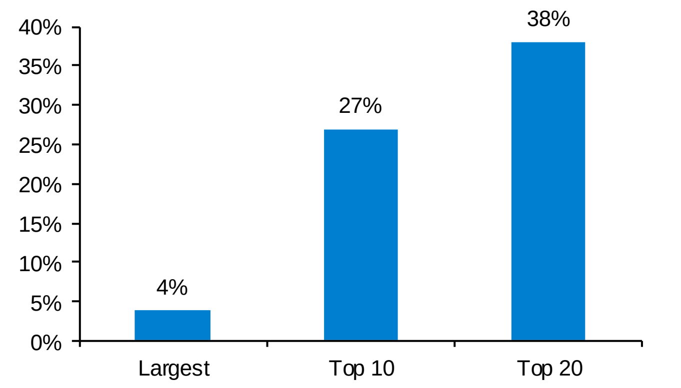
Source: Company, PL

Exhibit 45: AIL's low customer concentration…



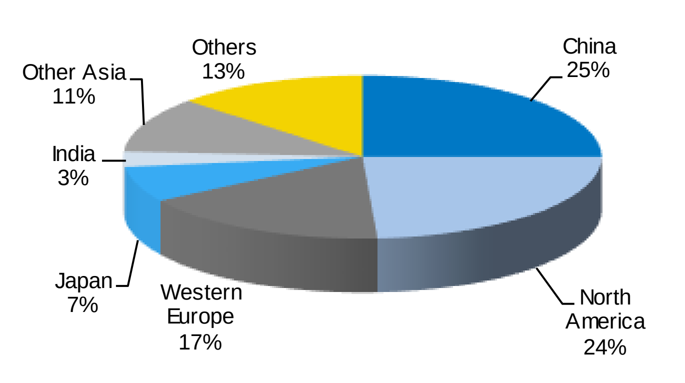
Source: Company, PL

Exhibit 46: …Largest customer accounts for less than 5%



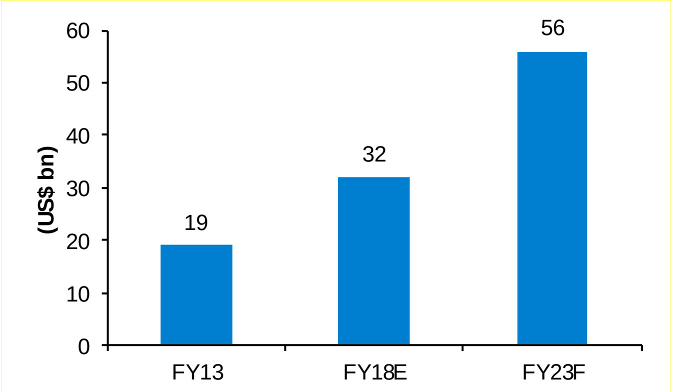
Source: Company, PL

Exhibit 47: Breakup of USD745bn global speciality market



Source: Company, PL

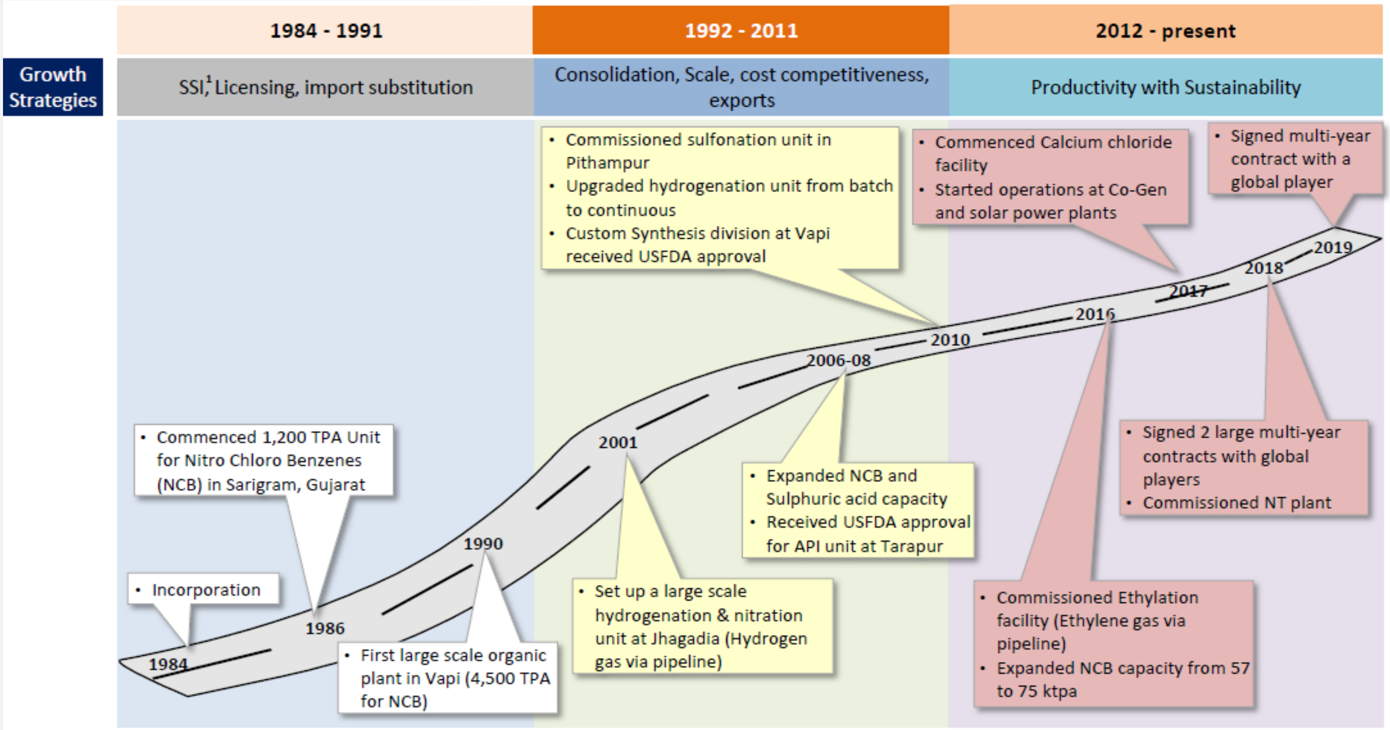
Exhibit 48: Indian speciality mkt to grow at 13%CAGR



Source: CRISIL, Company presentation

Company background

Aarti Industries Ltd (AIL) was started by first generation technocrats in 1984 and three of the four directors are chemical engineers from ICT (formerly UDCT). Over the years the company has transformed into one of the leading specialty chemical company in benzene based derivatives with fully integrated operations. AIL has three business segments-speciality chemicals, pharma and home and personal care. The company has 17 plants located in high growth western India with proximity to ports of which- 11 are dedicated to speciality chemicals, 4 for pharma (2 USFDA and 2 WHO/GMP) and 2 for HPC. AIL is on track to launch its fourth R&D facility at Navi Mumbai.



Note:[1]Small scale industries

Financials

Income Statement (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Net Revenues	**48,576**	**51,841**	**63,455**	**71,047**
YoY gr. (%)	*31.3*	*6.7*	*22.4*	*12.0*
Cost of Goods Sold	28,930	29,676	35,807	39,986
Gross Profit	19,646	22,165	27,648	31,061
Margin (%)	*40.4*	*42.8*	*43.6*	*43.7*
Employee Cost	2,381	2,541	3,111	3,483
Other Expenses	-	-	-	-
EBITDA	**9,138**	**10,811**	**13,750**	**15,500**
YoY gr. (%)	*39.1*	*18.3*	*27.2*	*12.7*
Margin (%)	*18.8*	*20.9*	*21.7*	*21.8*
Depreciation and Amortization	1,596	1,791	2,229	2,642
EBIT	**7,542**	**9,020**	**11,521**	**12,858**
Margin (%)	*15.5*	*17.4*	*18.2*	*18.1*
Net Interest	1,810	2,037	2,215	2,279
Other Income	46	50	55	61
Profit Before Tax	**5,778**	**7,033**	**9,361**	**10,640**
Margin (%)	*11.9*	*13.6*	*14.8*	*15.0*
Total Tax	1,085	1,547	2,060	2,341
Effective tax rate (%)	*18.8*	*22.0*	*22.0*	*22.0*
Profit after tax	**4,693**	**5,486**	**7,302**	**8,299**
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	**4,693**	**5,486**	**7,302**	**8,299**
YoY gr. (%)	*48.1*	*16.9*	*33.1*	*13.7*
Margin (%)	*9.7*	*10.6*	*11.5*	*11.7*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**4,693**	**5,486**	**7,302**	**8,299**
YoY gr. (%)	*48.1*	*16.9*	*33.1*	*13.7*
Margin (%)	*9.7*	*10.6*	*11.5*	*11.7*
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	4,693	5,486	7,302	8,299
Equity Shares O/s (m)	**87**	**87**	**87**	**87**
EPS (Rs)	**54.2**	**63.3**	**84.3**	**95.8**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
Non-Current Assets				
Gross Block	**32,792**	**40,792**	**50,792**	**57,792**
Tangibles	32,792	40,792	50,792	57,792
Intangibles	-	-	-	-
Acc: Dep / Amortization	**11,657**	**13,448**	**15,676**	**18,318**
Tangibles	11,657	13,448	15,676	18,318
Intangibles	-	-	-	-
Net fixed assets	**21,135**	**27,344**	**35,116**	**39,473**
Tangibles	21,135	27,344	35,116	39,473
Intangibles	-	-	-	-
Capital Work In Progress	7,990	10,000	7,000	7,000
Goodwill	9	-	-	-
Non-Current Investments	649	649	649	649
Net Deferred tax assets	(1,782)	(1,923)	(2,110)	(2,323)
Other Non-Current Assets	2,974	-	-	-
Current Assets				
Investments	-	-	-	-
Inventories	7,536	8,043	9,844	11,022
Trade receivables	8,366	8,928	10,929	12,236
Cash & Bank Balance	7,946	8,010	7,385	8,780
Other Current Assets	337	387	446	512
Total Assets	**58,353**	**64,914**	**73,075**	**81,552**
Equity				
Equity Share Capital	433	433	433	433
Other Equity	26,416	31,079	37,286	43,925
Total Networth	**26,849**	**31,512**	**37,719**	**44,358**
Non-Current Liabilities				
Long Term borrowings	8,378	10,378	10,378	10,378
Provisions	-	-	-	-
Other non current liabilities	2,032	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	12,625	13,888	14,582	15,311
Trade payables	3,131	3,303	3,985	4,450
Other current liabilities	3,555	3,911	4,302	4,732
Total Equity & Liabilities	**58,353**	**64,914**	**73,075**	**81,552**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY19	FY20E	FY21E	FY22E
PBT	5,778	7,033	9,361	10,640
Add. Depreciation	1,596	1,791	2,229	2,642
Add. Interest	1,810	2,037	2,215	2,279
Less Financial Other Income	46	50	55	61
Add. Other	778	1,083	188	213
Op. profit before WC changes	9,961	11,944	13,993	15,774
Net Changes-WC	(459)	(733)	(2,942)	(1,828)
Direct tax	(1,085)	(1,547)	(2,060)	(2,341)
Net cash from Op. activities	**8,418**	**9,663**	**8,991**	**11,606**
Capital expenditures	(7,976)	(10,001)	(7,000)	(7,000)
Interest / Dividend Income	-	-	-	-
Others	(90)	-	-	-
Net Cash from Invt. activities	**(8,066)**	**(10,001)**	**(7,000)**	**(7,000)**
Issue of share cap. / premium	7,734	167	222	337
Debt changes	2,160	3,263	694	729
Dividend paid	(730)	(990)	(1,318)	(1,997)
Interest paid	(1,810)	(2,037)	(2,215)	(2,279)
Others	-	-	-	-
Net cash from Fin. activities	**7,354**	**402**	**(2,617)**	**(3,210)**
Net change in cash	**7,706**	**65**	**(625)**	**1,395**
Free Cash Flow	442	(337)	1,991	4,606

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY19	FY20E	FY21E	FY22E
Per Share(Rs)				
EPS	54.2	63.3	84.3	95.8
CEPS	72.6	84.0	110.0	126.3
BVPS	309.8	363.6	435.3	511.9
FCF	5.1	(3.9)	23.0	53.1
DPS	7.0	9.5	12.6	19.2
Return Ratio(%)				
RoCE	18.4	17.4	19.5	19.4
ROIC	18.6	16.1	17.3	17.4
RoE	22.3	18.8	21.1	20.2
Balance Sheet				
Net Debt : Equity (x)	0.5	0.5	0.5	0.4
Net Working Capital (Days)	96	96	97	97
Valuation(x)				
PER	27.2	23.3	17.5	15.4
P/B	4.8	4.1	3.4	2.9
P/CEPS	20.3	17.6	13.4	11.7
EV/EBITDA	15.4	13.3	10.6	9.3
EV/Sales	2.9	2.8	2.3	2.0
Dividend Yield (%)	0.5	0.6	0.9	1.3

Source: Company Data, PL Research

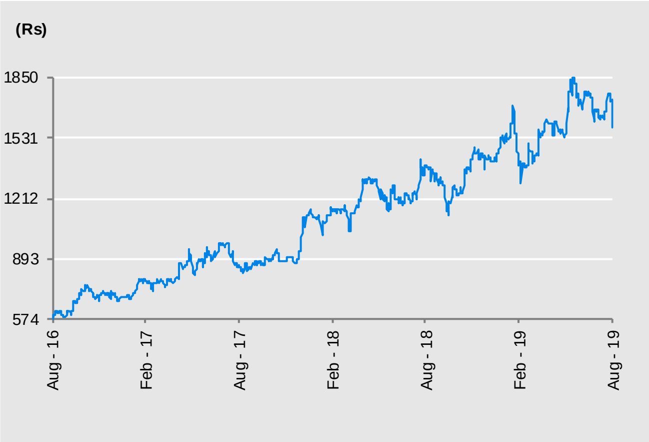
Quarterly Financials (Rs m)

Y/e Mar	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Net Revenue	**12,995**	**12,682**	**12,114**	**10,861**
YoY gr. (%)	*46.4*	*28.1*	*17.7*	*0.7*
Raw Material Expenses	7,942	7,468	6,923	5,817
Gross Profit	5,053	5,213	5,191	5,045
Margin (%)	*38.9*	*41.1*	*42.8*	*46.4*
EBITDA	**2,421**	**2,469**	**2,369**	**2,369**
YoY gr. (%)	*51.0*	*38.8*	*31.4*	*26.1*
Margin (%)	*18.6*	*19.5*	*19.6*	*21.8*
Depreciation / Depletion	389	406	425	401
EBIT	**2,032**	**2,063**	**1,945**	**1,968**
Margin (%)	*15.6*	*16.3*	*16.1*	*18.1*
Net Interest	513	424	412	303
Other Income	2	2	7	43
Profit before Tax	**1,522**	**1,642**	**1,540**	**1,709**
Margin (%)	*11.7*	*12.9*	*12.7*	*15.7*
Total Tax	293	315	295	335
Effective tax rate (%)	*19.2*	*19.2*	*19.2*	*19.6*
Profit after Tax	**1,229**	**1,327**	**1,245**	**1,374**
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	**1,229**	**1,327**	**1,245**	**1,374**
YoY gr. (%)	*56.5*	*47.1*	*46.9*	*53.9*
Margin (%)	*9.5*	*10.5*	*10.3*	*12.6*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**1,229**	**1,327**	**1,245**	**1,374**
YoY gr. (%)	*56.5*	*47.1*	*46.9*	*53.9*
Margin (%)	*9.5*	*10.5*	*10.3*	*12.6*
Other Comprehensive Income	**-**	**-**	**-**	**-**
Total Comprehensive Income	**1,229**	**1,327**	**1,245**	**1,374**
Avg. Shares O/s (m)	**-**	**-**	**-**	**-**
EPS (Rs)	**-**	**-**	**-**	**-**

Source: Company Data, PL Research

Notes:

Price Chart



Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Bharat Petroleum Corporation	BUY	499	380
2	GAIL (India)	BUY	207	124
3	Hindustan Petroleum Corporation	BUY	354	244
4	I.G. Petrochemicals	BUY	477	257
5	Indian Oil Corporation	BUY	168	137
6	Indraprastha Gas	BUY	378	312
7	Mahanagar Gas	BUY	1,179	783
8	NOCIL	BUY	199	89
9	Oil & Natural Gas Corporation	BUY	223	167
10	Oil India	Accumulate	236	178
11	Petronet LNG	BUY	306	236
12	Reliance Industries	Accumulate	1,363	1,249

PL's Recommendation Nomenclature

Buy	:	>15%
Accumulate	:	5% to 15%
Hold	:	+5% to -5%
Reduce	:	-5% to -15%
Sell	:	< -15%
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

ANALYST CERTIFICATION

(Indian Clients)

We/I, Mr. Avishek Datta- MBA Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

(US Clients)

The research analysts, with respect to each issuer and its securities covered by them in this research report, certify that: All of the views expressed in this research report accurately reflect his or her or their personal views about all of the issuers and their securities; and No part of his or her or their compensation was, is or will be directly related to the specific recommendation or views expressed in this research report.

DISCLAIMER

Indian Clients

Prabhudas Lilladher Pvt. Ltd, Mumbai, India (hereinafter referred to as “PL”) is engaged in the business of Stock Broking, Portfolio Manager, Depository Participant and distribution for third party financial products. PL is a subsidiary of Prabhudas Lilladher Advisory Services Pvt Ltd. which has its various subsidiaries engaged in business of commodity broking, investment banking, financial services (margin funding) and distribution of third party financial/other products, details in respect of which are available at www.plindia.com.

This document has been prepared by the Research Division of PL and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accepts any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its employees or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

PL may from time to time solicit or perform investment banking or other services for any company mentioned in this document.

PL is in the process of applying for certificate of registration as Research Analyst under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

PL submits that no material disciplinary action has been taken on us by any Regulatory Authority impacting Equity Research Analysis activities.

PL or its research analysts or its associates or his relatives do not have any financial interest in the subject company.

PL or its research analysts or its associates or his relatives do not have actual/beneficial ownership of one per cent or more securities of the subject company at the end of the month immediately preceding the date of publication of the research report.

PL or its research analysts or its associates or his relatives do not have any material conflict of interest at the time of publication of the research report.

PL or its associates might have received compensation from the subject company in the past twelve months.

PL or its associates might have managed or co-managed public offering of securities for the subject company in the past twelve months or mandated by the subject company for any other assignment in the past twelve months.

PL or its associates might have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.

PL or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months

PL or its associates might have received any compensation or other benefits from the subject company or third party in connection with the research report.

PL encourages independence in research report preparation and strives to minimize conflict in preparation of research report. PL or its analysts did not receive any compensation or other benefits from the subject Company or third party in connection with the preparation of the research report. PL or its Research Analysts do not have any material conflict of interest at the time of publication of this report.

It is confirmed that Mr. Avishek Datta- MBA Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

The Research analysts for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

The research analysts for this report has not served as an officer, director or employee of the subject company PL or its research analysts have not engaged in market making activity for the subject company

Our sales people, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all o the foregoing, among other things, may give rise to real or potential conflicts of interest.

PL and its associates, their directors and employees may (a) from time to time, have a long or short position in, and buy or sell the securities of the subject company or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company or act as an advisor or lender/borrower to the subject company or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

US Clients

This research report is a product of Prabhudas Lilladher Pvt. Ltd., which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Prabhudas Lilladher Pvt. Ltd. only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Prabhudas Lilladher Pvt. Ltd. has entered into an agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

Transactions in securities discussed in this research report should be effected through Marco Polo or another U.S. registered broker dealer.

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India | Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

www.plindia.com | Bloomberg Research Page: PRLD <GO>