

Stable Growth Outlook & Expansion Plans in Value-Added Products

Aarti Industries Ltd (AIL) reported Q1FY23 revenue at Rs 1,972 Cr, up 12%/5 YoY/QoQ. The growth was led by price hikes undertaken by the company to pass on elevated RM prices and volume increase with new projects and increasing utilisation level in the existing projects. The EBITDA came in at Rs 369 Cr (lower than our estimate of Rs 433 Cr) up 18%/9% on YoY/QoQ basis. The EBITDA Margins contracted by 60bps QoQ on account of the RM price increase and utility expenses. PAT was Rs 189 Cr (our estimate: Rs 205 Cr), up 6% on a YoY basis.

AIL expects to increase its top line with ramp up in 1st and 2nd long-term contract to the level of 70-80% by FY24 and increased capacity utilization levels across various plants commissioned till FY22. The company expects its Exports share to increase and the capacity expansion of existing and new products would be towards value-added products going forward. These products would be addressed to multiple end users in Pharma and Agro as import substitutes. AIL has 90+ products in the pipeline beyond FY24 with products having a high margin profile of 25%. With this in mind, **we maintain our estimates and value the stock at 20x FY24E EPS and change our recommendation of BUY to HOLD with an unchanged TP of Rs 875, implying an upside potential of 7.3% from the CMP.** **Key risks – a) Slower-than-expected ramp-up in commissioning of multi-year deals and other Capex projects, b) Volatility in RM prices and Forex and availability.**

Key Concall Highlights

- **Weak demand from Textile & FMCG (dyes & pigments)**
- **Ramp up in the Long-term Contracts**
- **Expansion Led Growth:** The management has also guided for a Capex of Rs 3,000 Cr for the next 2 years. The Capex will be majorly for adding more downstream products in the current benzene chain, new Chloro Toluene chain, and debottlenecking of the existing products. All capacities set up during FY22 should ramp up and clock utilisation of ~70-90% by the end of FY24. Incremental Capex would be mainly utilized for high-value products. 50% of the Capex will be for the existing products and contracts while the remaining would be for the new product development. A large part of the Capex would be towards chemical products (2,500-3000 Cr), whereas it would be in the range of 350-500 Cr for Pharma. Site development work to commence on 100+ acre land at Jhagadia. AIL also acquired over 120 acres of land at Atali, Gujarat. Environmental Clearances are obtained/in process and the construction span is expected to be FY22–FY24

Valuation & Outlook

AIL is witnessing strong demand from its key consumer segments, i.e., Pharma & Agro Chemicals which has led to a revised product mix of more value-added and margin-accretive products in the Specialty Chemicals segment. Going forward, it would focus on value-added products, production of more downstream products, and better operating leverage as it increases capacity utilisation across various commissioned plants. This will drive the margin and profitability over other companies. While from a medium to long term perspective, the earnings growth visibility appears fair driven by 1) Capex coming on stream, 2) ramp up and commercialization of its key long-term contracts, 3) Growing contribution from the value-added products, and 4) Structural shift in the global supply chains that are independent of China. Owing to growth visibility, **we maintain our estimates and TP of Rs 875/share, valuing the company at 20x its FY24E EPS and change our recommendation from BUY to Hold. The TP implies an upside of 7.3% from the CMP.**

Key Financials (Consolidated)

(Rs Cr)	FY21	FY22E	FY23E	FY24E
Net Sales	4,506	7,000	7,770	9,257
Gross Profit	2,129	3,294	3,652	4,351
Gross Margin	53%	53%	53%	53%
EBITDA	981.5	1,928.8	2,105.6	2,509
EBITDA Margin	21.8%	27.6%	27.1%	27.1%
Net Profit	535.2	1,307.4	1,368.3	1585
EPS (Rs.)	15.4	36.1	37.7	43.7

Source: Company, Axis Research

(CMP as of 11th August, 2022)

CMP (Rs)	815
Upside /Downside (%)	7.3%
High/Low (Rs)	1168/669
Market cap (Cr)	29,537
Avg. daily vol. (6m) Shrs.	3,81,305
No. of shares (Cr)	36

Shareholding (%)

	Dec-20	Mar-21	Jun-22
Promoter	44.2	44.2	44.2
FIIs	12.3	12.5	11.8
MFs / UTI	7.4	7.3	6.7
Banks/ FIIs	0.0	0.0	0.0
Others	36.1	36.1	37.3

Financial & Valuations

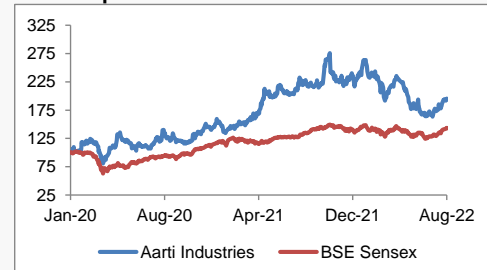
Y/E Mar (RsCr)	2022E	2023E	2024E
Net Sales	7,000	7,770	9,257
EBITDA	1,929	2,106	2,509
Net Profit	1,307	1,368	1,585
EPS (Rs)	36.1	37.7	43.7
PER (x)	25.9	24.7	15.8
EV/EBITDA (x)	1.0	0.7	0.7
P/BV (x)	5.7	4.6	3.8
ROE (%)	27.5	20.6	19.5

ESG disclosure Score**

Environmental Disclosure	N/A
Social Disclosure Score	N/A
Governance Disclosure Score	N/A
Total ESG Disclosure Score	N/A

Source: Bloomberg, Scale: 0.1-100
 **Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: Capitaline, Axis Securities

Prathamesh Sawant, CFA
 Analyst

Email: prathamesh.sawant@axissecurities.in

Other Key Concall Takeaways

- 1) **Demand Outlook: Although AIL has slightly outperformed in the current quarter in terms of topline guidance company has maintained its guidance for FY23**, of 10% top-line growth & 8-9% EBITDA growth as management witnesses little turbulence in demand from Textile and FMCG (dyes & pigments segment) & raw material costs pressure from core products like benzene & higher utility prices.
- 2) **Production Volumes for Specialty Chemicals:** For Q1FY23 volumes across product segments were:
 - NCB - 20515 MT in
 - Hydrogenation – 3295 tonnes/month
 - Nitro Toulene – 5252 MT
- 3) **Specialty Chemicals top-line:** Specialty chemicals grew 44% YoY, with about 75% share of the revenue from value-added products during the quarter. Growth came in from increased realisations from value-added products & the price hikes taken to pass on the increase in cost. The pass-on of cost increase happens in a month in the domestic market, whereas in the export market, the lag is of 2-3 months.
- 4) **Pharma Division:** The segment reported 48% growth on a YoY basis & 5% growth on a QoQ basis. Robust growth in topline performance was attributable to a positive demand landscape for key products. Higher uptake from Generic Pharma companies aiding topline growth and strong revenue visibility. The expansion of capacity for the USDA-approved API facility is in the final stages and is expected to commercialize in Q1 FY23.
- 5) **New Capex and Expansion plans:**
 - The management has also guided for a Capex of Rs 3000 Cr for the next 2 years. Out of the projected Capex company has spent 200 Cr in the current quarter.
 - The Capex will be majorly for adding more downstream products in the current benzene chain, new Chloro Toluene chain and debottlenecking of the existing products.
 - All the capacities set up during FY22 should ramp up and clock utilisation of ~70-90% by FY24-end. Incremental Capex would be mainly utilized for high-value products.
 - 50% of the Capex will be for the existing products and contracts, while the remaining for the new product development. A large part of the Capex would be towards chemical products 2500-3000 Cr, whereas for Pharma it would be in the range of 350-500 Cr. Site development work to commence on 100+ acre land at Jhagadia. AIL also acquired over 120 acres of land at Atali, Gujarat. Environmental Clearances obtained / in-process. Construction from FY22 – FY24
 - The company will be coming up Concentrated Nitric Acid plant by FY24 to take care of Nitric Acid requirements, the company is evaluating the feasibility of going for a Weak Nitric Acid integrated plant to be completely self-sufficient, the management has a project cost of 150-200 cr for CNA plant whereas Capex of 500CR + for WNA & CNA plant.
- 6) **Long-term Contracts:**
 - Capacity created for 1st long-term contract should ramp up utilization levels to the tune of 70-80% by FY24-end
 - The company commissioned a second long-term contract during Q1FY23 and is expected to contribute to revenue starting from Q1FY23. The annual contracted sales for this contract are 500 Cr and shall be seen adding to the topline with a ramp-up in utilization over FY23.
 - The 3rd contract should start by Q2 FY23 and ramp up over the next two years FY23-24.
- 7) **RM Availability: Nitric acid shortage** continues to affect the production of a few linked products. Management is planning a Capex for Concentrated Nitric Acid to the tune of 150-200 Cr with a capacity of 60,000 MTPA. The plant will commission by the end of FY24 as a backup to reduce the company's dependency on local players. In the near-term company expects supply to resume from H2FY23 onwards as new capacity in India will be ready.

Q1FY23 Financials (Consolidated)

(RsCr.)	Quarterly Performance						
	Q1FY23	Axis Sec Estm (Rs. cr)	Variance (%)	Q1FY22	% Change (YoY)	Q4FY22	% Change (QoQ)
Sales	1,972.0	1,877.0	5.1%	1,316.8	49.8%	1,755.6	12.3%
Expenditure							
COGS	1098	939	16.9%	610	80.0%	922	19.1%
Employee Expenses	121	125	-2.9%	99	22.0%	120	1.1%
Other Exp	383	380	0.8%	293	30.6%	375	2.3%
Total Expenditure	1603	1444	11.0%	1003	59.8%	1417	13.1%
EBITDA	369.3	433	-14.7%	313.8	17.7%	339.1	8.9%
EBITDA Margin (%)	18.7%	23.1%	<i>-434 bps</i>	23.8%	<i>-510 bps</i>	19.3%	<i>-59 bps</i>
Depreciation	86.5	80.0	8.1%	68.6	26.1%	77.2	12.0%
Other Income	0.4	0.3	26.7%	0.1	660.0%	0.2	123.5%
EBIT	283.2	353.3	-19.8%	245.3	15.5%	262.1	8.1%
Interest	49.8	33.0	50.9%	38.3	30.1%	30.6	62.7%
Exceptional Item	0.0	0.0		0.0		0.0	
PBT	233.4	320	-27.1%	207	12.8%	231	0.9%
Tax	44.3	115.3	-61.6%	41.9	5.7%	37.7	17.6%
PAT	189.1	205.0	-7.8%	165.0	14.6%	193.6	-2.3%
EPS (Rs.)	5.22	5.9	-11.6%	4.73	10.3%	5.34	-2.4%

Source: Company; Axis Securities

(Rs Cr.)	Q1FY23	Q1FY22	Change YoY (%)	Q4FY22	Change QoQ (%)
Revenue Contribution					
Specialty Chemicals	1,766	1,228	43.8%	1,629	8.4%
Pharmaceuticals	407	276	47.6%	388	4.8%
Total Revenues	2,173	1,504	44.5%	2,018	7.7%
EBIT					
Specialty Chemicals	250	232	8.0%	246	2.0%
Pharmaceuticals	76	52	46.6%	67	14.2%
Total EBIT	327	284	15.0%	312	4.6%
EBIT Margin (%)					
Specialty Chemicals	14.2	18.9	-470 bps	15.1	- 88 bps
Pharmaceuticals	18.7	18.8	-10 bps	17.2	150 bps
Total	16.6	18.9	-231 bps	17.8	-120 bps

Source: Company; Axis Securities

Financials (consolidated)
Profit & Loss
(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Net sales	4,506	7,000	7,770	9,257
Cost of goods sold	2,129	3,294	3,729	4,351
Contribution (%)	52.8%	52.9%	52.0%	53.0%
Employee Costs	371	442	536	639
Other Expenses	1,025	1,335	1,476	1,759
Operating Profit	982	1,929	2,028	2,509
EBITDA Growth %	0.4%	96.5%	5.1%	23.7%
Other income	1	1	0	0
Depreciation	231	289	348	486
EBIT	751	1,641	1,680	2,022
Interest & Fin Chg.	86	114	88	89
E/o income / (Expense)	0	0	0	0
Pre-tax profit	433	1,238	1,243	1,447
Tax provision	129	219	287	348
Reported PAT	304	1,019	956	1,099

Source: Company, Axis Securities

Balance Sheet
(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Total assets	6,466	8,623	9,919	11,524
Net Block	3,592	4,418	5,918	7,418
CWIP	1,297.9	1,490.4	1,125.0	1,125.0
Investments	63.5	73.1	116.5	138.9
Wkg. cap. (excl cash)	1,099	2,385	2,049	2,413
Cash / Bank balance	412	257	711	430
Misc. Assets	0.0	0.0	0.0	0.0
Capital employed	6,466	8,623	9,919	11,524
Equity capital	87.1	181.3	181.3	181.3
Reserves	3,416	5,733	7,038	8,623
Pref. Share Capital	0.0	0.0	0.0	0.0
Minority Interests	12.2	0.7	0.5	0.5
Borrowings	2,717	2,458	2,450	2,470
Def Tax Liabilities	233.9	250.2	250.2	250.2

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Profit Before Tax	665	1,527	1,591	1,933
Finance Cost	86	114	88	89
Depreciation	231	289	348	486
Inc/Dec in Working Capital	-7	-1,186	327	-344
Tax Paid	(96.6)	(267.0)	(286.6)	(348.1)
Cash Flow from Operations	872.7	470.8	2,068.6	1,816.9
Change in Gross Block	-1,314	-1,307	-1,848	-1,986
Inc/Dec in Investments	-8	0	-43	-22
Cash Flow from Investing	-1,322	-1,305	-1,526	-2,009
Inc/Dec in Loans	745.9	(329.4)	0.0	0.0
Finance Cost	(86.4)	(114.3)	(88.4)	(89.2)
Cash Flow from Financing	614.5	679.2	(88.4)	(89.2)
Net Inc/Dec in Cash	165	-155	454	-281
Opening Cash	247	412	257	711
Closing Cash	412	257	711	430

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E March	FY21	FY22	FY23E	FY24E
Sales growth	7.6	55.3	11.0	19.1
OPM	21.8	27.6	26.1	27.1
Oper. profit growth	0.4	96.5	5.1	23.7
COGS / Net sales	47.2	47.1	48.0	47.0
Overheads/Net sales	8.2	6.3	6.9	6.9
Depreciation / G. block	4.5	3.9	3.5	3.9
Effective interest rate	4.0	4.9	4.0	4.0
Net wkg.cap / Net sales (x)	0.21	0.20	0.23	0.20
Net sales / Gr block (x)	0.9	0.9	0.8	0.7
RoCE	12.3	21.8	18.1	18.9
Debt / equity (x)	0.7	0.4	0.3	0.3
Effective tax rate	19.5	14.4	18.0	18.0
RoE	16.0	27.5	19.7	19.7
Payout ratio (Div/NP)	18.0	7.4	7.4	6.1
EPS (Rs.)	15.4	36.1	36.0	43.7
EPS Growth	(0.2)	134.8	(0.2)	21.5
CEPS (Rs.)	22.0	44.0	45.6	57.1
DPS (Rs.)	2.5	2.5	2.4	2.4
Valuation (x)				
P/E	60.8	25.9	26.0	21.4
P/BV	9.3	5.7	4.7	3.8
EV/EBITDA	18.7	1.0	0.7	0.7
Mcap/Sales	3.6	0.0	0.0	0.0

Source: Company, Axis Securities

Aarti Industries Price Chart and Recommendation History



Date	Reco	TP	Research
05-Mar-20	BUY	444	Pick of the week
05-Mar-20	BUY	541	Event update Corona
06-May-20	BUY	627	Top Picks
27-May-20	HOLD	484	Result Update
01-Jun-20	BUY	565	Top Picks
15-Jun-20	HOLD	484	Event Update
14-Aug-20	BUY	548	Result Update
06-Nov-20	BUY	632	Diwali Picks
11-Nov-20	BUY	632	Result Update
02-Feb-21	BUY	649	Result Update
10-Aug-21	HOLD	925	Result Update
28-Sep-21	HOLD	925	AAA
02-Nov-21	BUY	1,080	Result Update
02-Jun-22	BUY	875	Result Update
12-Aug-22	HOLD	875	Result Update

Source: Axis Securities

About the analyst

Analyst: Prathamesh Sawant

Email: Prathamesh.sawant@axissecurities.in

Sector: Chemicals, Textile & Mid-Cap Opportunities

Analyst Bio: Prathamesh is a CFA charterholder with 5 years of experience in Equity Research.

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, Prathamesh Sawant, CFA, author/s and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We (Research Analyst) also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associate does not have any material conflict of interest. I/we have not served as director / officer, etc. in the subject company in the last 12-month period. Any holding in stock – No
5. ASL has not received any compensation from the subject company in the past twelve months. ASL has not been engaged in market making activity for the subject company.
6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;

Managed or co-managed public offering of the securities from the subject company of this research report and / or;

Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report.

Term & Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation
UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NO STANCE	We do not have any forward looking estimates, valuation or recommendation for the stock

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. The Research reports are also available & published on AxisDirect website.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Copyright in this document vests with Axis Securities Limited.

Axis Securities Limited, Dealing office: 1st Floor, I-Rise Building, Q Parc, Loma Park, Thane, Ghansoli, Navi Mumbai-400701, Regd. off.- Axis House,8th Floor, Wadia International Centre, Pandurang Budhkar Marg, Worli, Mumbai – 400 025. Compliance Officer: Anand Shaha, Email: compliance.officer@axisdirect.in, Tel No: 022-4921270