

Strong Growth Outlook Backed By Aggressive Expansion Plans

Aarti Industries (AIL) Q1FY22 revenue was in line with estimates while operating profitability was higher than expected. Consolidated Revenues stood at Rs 1,317 Cr, up by 40% YoY and 9% QoQ aided by 10% volume growth with demand returning to the pre-Covid levels from both established and domestic markets. The EBITDA came in at Rs 314 Cr (higher than our estimate of Rs 288 Cr) which grew by 72% on a YoY basis and 20% QoQ. This resulted in EBITDA Margins of 23.8% (our estimate 21.8%) expanding by 440bps on a YoY basis and 228bps QoQ on account of higher capacity utilization and better product mix. Recurring PAT (consol basis) was at Rs 165 Cr (our estimate Rs 151 Cr) growing by 98% on a YoY basis and 18% QoQ. The exports rose by 29%/16% on a YoY and QoQ basis, resulting in the contribution to the top-line at 41% falling by 600bps on a YoY basis, as the domestic demand has now started to pick up.

Segment revenue from the Specialty Chemical was recorded at Rs 1,263 Cr, growing 28% QoQ on the back of high volume growth as well as pass-on of higher input and logistics cost. The EBIT Margins expanded 336bps/128bps on YoY/QoQ basis to 18.8% on account of demand revival in the established markets. The Pharma segment revenue came in at Rs 240 Cr, registering a growth of 24%/16% on a YoY/QoQ basis on the back of higher volume from regulated markets, value-added products and introduction of new intermediates. The EBIT Margins grew by 247bps QoQ to 19.8% but was down 349bps on a YoY basis. The margin was lower on account of the higher inventory of finished products which could not be shipped due to logistical issues.

Owing to strong growth guidance over FY21-24E, we introduce FY24 estimates and revise estimates upward leading to a revised TP to Rs 925/share (Rs 877 earlier) and multiple of 30x to its FY24E EPS. We maintain our HOLD rating and await lower levels to enter into the stock. 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, c) COVID-led uncertainties.

Our Take on 1FY22 Results Concall

- Strong Operational Performance:** AIL reported an impressive set of numbers during the quarter with top-line growing by 9% QoQ aided by significant growth in both specialty chemical and pharmaceutical business. The company managed to sustain the strong momentum of H2FY21 in the current quarter, driven by rising demand across various products, higher capacity utilization as well as 70% contribution from the value-added products.
- Capex Update:** The management has guided for Rs 1,500 Cr Capex in FY22 to include investments for the Long term contract (LTC) 2 and 3, NCB capacity, USFDA capacity expansion in API unit at Tarapur, AIL acquired more than 100 acres land in Gujarat for further expansion and new project initiatives for both segments. The second long-term contract is expected to be commercialized in H2FY22 and the third long-term contract is by Q4FY22.
- Maintained guidance:** The management has re-iterated its top-line guidance of 25-35% for FY22 with higher capacity utilization, better product mix, and improving throughput from recently commissioned facilities supporting the growth.

Key Financials (Consolidated)

(Rs. Cr)	FY21	FY22E	FY23E	FY24E
Net Sales	4,506	5,790	7,139	8508
EBITDA	982	1,297	1,642	1,999
Net Profit	535	676	877	1,072
EPS (Rs.)	15.4	19.4	25.2	30.8
PER (x)	61.9	49.0	37.8	30.9
EV/EBITDA (x)	19.0	13.8	10.7	9.0
P/BV (x)	9.5	6.2	5.3	4.5
ROE (%)	16.3	15.1	14.9	15.7

Source: Company, Axis Research

(CMP as of Aug 9th, 2021)

CMP (Rs)	951
Upside /Downside (%)	-3%
High/Low (Rs)	988/483
Market cap (Cr)	34,483
Avg. daily vol. (6m) Shrs.	816,717
No. of shares (Cr)	36

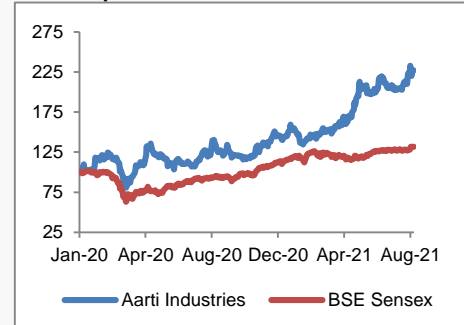
Shareholding (%)

	Dec-20	Sept-20	Jun-20
Promoter	46.8	44.9	46.7
FIs	8.6	11.9	9.6
MFs / UTI	10.9	8.8	8.8
Banks / FIs	0.0	0.0	0.0
Others	33.6	34.4	34.9

Financial & Valuations

Y/E Mar (Rs. Cr)	2022E	2023E	2024E
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Relative performance



Source: Capitaline, Axis Securities

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Other Key Concall Takeaways

- 1) **Demand Outlook:** For FY22, the management has reiterated 25-35% top-line growth.
- 2) **Production Volumes for Specialty Chemicals:** For Q1 volumes across product segments were NCB -18,155 MT vs19,100MT in Q4FY20, Hydrogenation – 2,920tonnes/month (1,935tons/month in QFY20), PDA – 570tons/month.
- 3) **Specialty Chemicals top-line:** Spl chemicals volume growth is 10% qoq based on a weighted volume basis. Growth supported by higher capacity utilization which is at 80-85% & demand revival in key discretionary categories.
- 4) **Pharma division resilient performance continues:** AIL management indicates that Pharma margins of 25% could be sustained owing to increased capacity utilization leading to higher volumes, focus on speciality therapies like oncology and regulated markets.
- 5) **FY21 Capex:** In Q1FY22, AIL incurred a Capex of Rs 295cr and in FY22 it was Rs 1500 Cr.
CWIP in FY21 includes
 - Expansion of NCB (phase 2)
 - USFDA pharma facility
 - Facility for 2 and 3rd long term contract, some specialty intermediates revamp
- 6) **New Capex and expansion plans:**
 - The management has also guided for a Capex of Rs 5000 Cr for the next 4-5 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.
 - 20-25% of the Capex will be for the pharma segment, while the remaining for the specialty chemical segment.
 - The annual maintenance Capex will be ~Rs 300 C.
 - Asset Turnover will be in the range of 1x-1.5x for the next few years until the capacity utilization reaches the optimum level.
- 7) **Update on Shortfall Fees:** The specialty Chemical Business Top-line includes income recognition of ~US\$4.5 Mn towards the shortfall fees in respect of the first long term contract. The shortfall fees are higher than the cost incurred for the plant construction of the first long term contract.
- 8) In a bid to reward the shareholders, the board of directors has approved the bonus issue in the ratio of 1:1 subject to shareholders' approval. They have also recommended a final dividend of Rs 3 per equity share (Pre-Bonus) or Rs 1.5 per equity share (Ex-Bonus), as may be applicable.
- 9) **Dicamba situation** has improved. The company has spoken to few customers and expects major volume to come in from FY23 onwards.
- 10) **Chlorination Plant:** The plant with a capacity of 65k was ideally for the first long term contract which was cancelled, however, the company has seen strong demand for the product and the capacity is being used from H2FY21 onwards and the momentum is expected to continue during FY22 as well. The company is planning to come up with more downstream products for which the commissioning will be done in FY23.
- 11) **Long Term Contract:** The second long term contract which was to be commercialized by Q1FY21, will now be commissioned in H2FY22 and ramp-up in FY23. The delay was on account of the COVID-19 impact and there is no significant cost escalation wrt the budget.
- 12) **Logistics Issue:** The logistics issue is two-fold in nature; One is the increase in freight rates and the second is the actual availability of containers for exporting. It has passed on the incremental ocean freight to the customer; in some cases, it has absorbed it.

Q1FY22 Financials (Consolidated)

(Rs.Cr.)	Quarterly Performance						
	Q1FY22	Axis Sec Estm (Rs. cr)	Variance (%)	Q1FY21	% Change (YoY)	Q4FY21	% Change (QoQ)
Net Operating Revenue	1,317	1,323	-	938	40	1210	9
Expenditure							
Net Raw Material	610			447	36	559	9
Personnel	99			90	11	98	2
Other Exp	293			219	34	293	0
Total Expenditure	1003	1035		755	33	949	6
EBIDTA	314	288	9	182	72	261	20
EBITDA Margin (%)	23.8%	21.8%	204bps	19.4%	440bps	21.6%	288bps
Interest	38			25	51	22	77
Depreciation	69			52	32	66	4
PBT	207	186	11	105	97	173	19
Tax	42			21.7	93	34	24
PAT	165	151	10	83	98	140	18
EPS (Rs.)	9.5	8.7	--	4.8	--	8.0	--

Source: Company; Axis Securities

(Rs. Cr.)	Q1FY22	Q1FY21	% Change (YoY)	Q4FY21	% Change (QoQ)
Revenue Contribution					
Specialty Chemicals	1,263	841	50	984	28
Pharmaceuticals	240	194	24	206	16
Total Revenues	1,503	1,035	45	1,190	26
EBIT					
Specialty Chemicals	237	120	83	172	38
Pharmaceuticals	48	45	5	36	33
Total EBIT	285	175	63	208	37
EBIT Margin (%)					
Specialty Chemicals	19	15	336	18	128
Pharmaceuticals	20	23	-349bps	17	247

Source: Company; Axis Securities

Valuation & Outlook

Currently AILs plants are running at high utilization levels with demand in domestic market for discretionary products has already reached pre-COVID levels while export markets will resume normalcy by the end of FY2021. The Specialty Chemicals segment margins showed healthy improvement on QoQ basis owing to return of demand from established markets. Going forward, focus on value added products, production of more downstream products and better operating leverage is expected to drive the margin and profitability for the company. While, from a medium to long term perspective the earnings growth visibility appears fair driven 1) Capex coming on stream, 2) commercialization of its key long term contracts albeit delayed due to COVID disruption, 3) growing contribution from value added products and 4) structural shift in global supply chains that are independent of China. Owing to strong growth guidance over FY21-24E, we introduce FY24 estimates and revise estimates upward leading to a revised TP to Rs 925/share (Rs 877 earlier) and multiple of 30x to its FY24E EPS. We maintain our HOLD rating and await lower levels to enter into the stock.

Financials (consolidated)
Profit & Loss
(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Net sales	4,506	5,790	7,139	8,508
Other operating income	1	0	0	0
Total income	4,507	5,790	7,139	8,508
Cost of goods sold	3,525	4,114	5,028	5,962
Contribution (%)	21.8%	28.9%	29.6%	29.9%
EBITDA	982	1,297	1,642	1,999
Depreciation	231	362	458	574
Interest & Fin Chg.	86	100	102	103
Pre-tax profit	665	835	1,083	1,323
Tax provision	129	159	206	251
Adjusted PAT	535	676	877	1,072

Source: Company, Axis Securities

Balance Sheet
(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Total assets	56,466	8,362	9,274	10,365
Net Block	3,592	4,692	5,392	6,292
CWIP	1,298	825	525	675
Investments	64	87	107	128
Wkg. cap. (excl cash)	1,099	1,529	1,758	2,105
Cash / Bank balance	412	1,228	1,491	1,165
Misc. Assets	0	0	0	0
Capital employed	6,466	8,362	9,274	10,365
Equity capital	87	87	87	87
Reserves	3,416	5,292	6,169	7,241
Pref. Share Capital	0	0	0	0
Minority Interests	12.2	12.2	12.2	12.2
Borrowings	2,717	2,737	2,772	2,792
Def tax Liabilities	234	234	234	234

Source: Company, Axis Securities

Cash Flow
(Rs Cr)

Y/E March	FY21	FY22	FY23E	FY24E
Profit Before Tax	665	835	1,083	1,323
Finance Cost	86	100	102	103
Depreciation	231	362	458	574
Inc/Dec in Working Capital	-7	-410	-193	-237
Tax Paid	-97	-159	-206	-251
Cash Flow from Operations	873	728	1,234	1,420
Change in Gross Block	-1,314	-1,462	-1,158	-1,474
Inc/Dec in Investments	-8	-23	-20	-21
Cash Flow from Investing	-1,322	-1,012	-878	-1,644
Inc/Dec in Loans	746	20	35	20
Finance Cost	-86	-101	-102	-103
Cash Flow from Financing	615	1,099	-102	-103
Net Inc/Dec in Cash	165	816	263	-326
Opening Cash	247	412	1,228	1491
Closing Cash	412	1,228	1,491	1,165

Source: Company, Axis Securities

Ratio Analysis
(%)

Y/E March	FY21	FY22	FY23E	FY24E
Sales growth (%)	7.6	28.5	23.3	19.2
OPM	21.8	22.4	23.0	23.5
Oper. profit growth (%)	-0.4	32.0	26.6	21.8
COGS / Net sales (%)	78.2	71.1	70.4	70.1
Depreciation / G. block (%)	4.5	5.0	5.0	6.0
Effective interest rate (%)	4.0	4.0	4.0	4.0
Net wkg.cap / Net sales (x)	0.21	0.17	0.19	0.19
Net sales / Gr block (x)	0.9	0.8	0.8	0.7
RoCE (%)	12.4	12.6	13.4	14.5
Debt / equity (x)	0.7	0.5	0.4	0.4
Effective tax rate (%)	19.5	19.0	19.0	19.0
RoE (%)	16.3	15.1	14.9	15.7
Payout ratio (Div/NP) (%)	18.0	14.2	11.0	9.0
EPS (Rs.)	15.4	19.4	25.2	30.8
EPS Growth	--	26.3	29.7	22.2
CEPS (Rs.)	22.0	29.8	38.3	47.2
DPS (Rs.)	2.5	2.5	2.5	2.5
Valuation (x)				
P/E	61.9	49.0	37.8	30.9
P/BV	9.5	6.2	5.3	4.5
EV/EBITDA	19.0	13.8	10.7	9.0
Mcap/Sales	3.7	2.9	2.3	1.9

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
1-Jun-21	HOLD	877	Result Update
10-Aug-21	HOLD	925	Result Update

Source: Axis Securities

About the analyst**Analyst:** Suvarna Joshi**Contact Details:** suvarna.joshi@axissecurities.in**Sector:** FMCG, Consumption sector, Sp. Chemicals, Mid-Caps**Analyst Bio:** Suvarna Joshi is MBA (Finance) from Mumbai University with about 10 years of experience in Equity market and research.**About the analyst****Analyst:** Darshita Shah**Contact Details:** darshita.shah@axissecurities.in**Sector:** Specialty Chemicals, Mid-Caps**Analyst Bio:** Darshita Shah is CFA Level III candidate and has over a year experience in Equity Market and Research.**Disclosures:**

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