

Pick of the Week

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- **In an ever-changing business environment, some of our investment ideas seem more convincing than others due to better earning visibility and/or attractive valuation. Every Monday, we bring you such fundamental stock ideas through our “Pick of the Week” report.**
 - **Investment Horizon:** Though the ideal investment horizon for such ideas remain 6-9 months, our picks may provide some profit-making opportunities even to short-term investors.
 - **Risk-Return Profile:** Pick of the week ideas are the best high return research ideas at this point in time.

Scrip	Mcap (Rs Cr)	CMP (Rs)	Target Price *	Potential Upside (%)	Reco
Aarti Industries	13,866	793	888	12%	BUY

* Note: Investment horizon Approx. 6-9 months., CMP as on 3rd April, 2020

Aarti Industries

Aarti Industries Ltd. (AIL) is the largest producers of Benzene based basic and intermediate chemicals in India. It has 17 manufacturing plants and 3 R&D centres in India and over 200 products. These put AIL ahead of the peers in the Benzene chemistry in India. AIL is a preferred partner of choice for more than 1000 customers globally. Q3FY20 Revenues mix was Specialty Chemicals (85%) and Pharma (15%).

Investment Rationale

- ❑ **Specialty Chemicals (SC) segment to benefit in near term due to COVID-19 led supply disruptions:** With outbreak of coronavirus causing prices of some chemical to move upwards due to short supply that could be positive for Aarti Industries SC division in the near term. We note that AIL does not have any significant imports or exports to and from China. We see that coronavirus led outbreak and ensuing disruptions could become a structural advantage for AIL as leading global players would look to accelerate shifting their supply chain to India thus benefitting AIL's SC division
- ❑ **Lower crude prices to support Margin performance:** Lower crude prices driven by covid-19 led correction would benefit ARTO to maintain margins in FY21E/22E although dip in absolute revenues could be seen. In Q3FY20, AIL reported EBITDA Margin of 20.6% versus 19.5% in Q3FY19. Further, we believe long term margin drivers like 1) favourable product mix change (75% contribution from value added downstream products); 2) operating leverage continue to be in place
- ❑ **Pharma segment resilient in long term, near term impacted:** ~20% APIs are imported from China. While, Chinese economy came out of lockdown, we witnessed nationwide lockdown in India that could impact overall business. However, we believe the essential nature of the product could salvage some of the business lost during the lockdown period. From medium to long term perspective we expect the division to report healthy revenue growth alongwith margin expansion led by 1) higher contribution of value added products, 2) focus on off-patented generics in regulated markets and 3) healthy new product launch pipeline
- ❑ **High Entry barriers:** Given the specialized nature of chemicals AIL operates in, longer approval cycle times between 3 months upto 2 years depending on customer's requirements including complex products necessitates a strong balance sheet. Further, a manufacturing plant requires a number of end products to make it economically viable which is amongst the key strengths of AIL owing to its over 35 years experience in the industry
- ❑ **Outlook:** Expanding product portfolio, consistent growth capex, acceleration in trend towards shift of supply chain shift to India from China, multi-year contracts won by AIL that could contribute from FY21E onwards, Pharma segment in the drivers seat with sustainable +20% margins over FY19-21E all point to a steady earnings growth trajectory over FY19-22E. Factoring in the COVID-19 led pressure on earnings we now value the stock at 21x its FY22E EPS
- ❑ We recommend a **Buy** with target price of Rs 888.

Financial Summary

Y/E	Revenue	PAT	EPS	RoE	RoCE	P/E
March	(Rs Cr)	(Rs Cr)	(Rs)	(%)	(%)	(x)
FY19	4,706	492	28.2	22.8	17.8	26.8
FY20E	4,505	570	32.7	19.9	14.6	24.3
FY21E	5,342	610	35.0	18.5	14.6	22.7
FY22E	5,843	730	41.9	18.8	15.4	19.0

Source: Axis Securities

MARKET DATA

No. of Shares	: 17.49 cr
Market Cap	: Rs 13,866 Cr
52-week High / Low	: Rs 1071/668
BSE Code	: 524208
NSE Code	: AARTIIND

CMP (Rs)	Target (Rs)
793	888

Performance

No of Stocks Matrix

No of Stocks	9m	15m
Met Target	23	43
Not Met Target	17	23

Performance Matrix

% Return	9m	15m
Met Target	13.50	12.84
Not Met Target	(13.09)	(15.81)

Benchmark Performance Matrix

% Return	9m	15m
Met Target	1.81	3.04
Not Met Target	(4.87)	(3.39)

Note : Performance of the pick of the week is calculated for stocks recommended from Dec-18 to Feb-20 for 15 Months and from Jun-19 to Feb-20 for 9 Months.

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