

Retail Equity Research

**Aarti Industries Ltd.**

Speciality chemicals

BSE CODE : 524208

NSE CODE: AARTIIND

BLOOMBERG CODE: ARTO:IN

SENSEX : 65,676

**BUY**

12 Months Investment Period

Rating as per Mid Cap

CMP Rs. 523 TARGET Rs. 600 RETURN 15%

(Closing: 15-11-2023)

KEY CHANGES:

TARGET

RATING

EARNINGS

**Destocking impacts growth...sequential earning beat**

AARTI Industries Ltd. (ARTO) is a global leader in Benzene based derivative products. The company has a diversified product portfolio with end users in pharma, agrochemicals, specialty polymers, paints & pigments.

- Revenue growth was lower than estimates on account of the continued impact of inventory destocking coupled with a fall in realization.
- EBITDA de-grew by 13% YoY; however, sequentially, EBITDA grew by 15% and margins expanded by 170bps, led by ease in input prices & operational expenses, which was better than expected.
- ARTO's 50% are exports, given global inventory destocking, high interest rates, and recessionary trends across various end-user markets that impacted growth. This trend is expected to persist in the near term, while gradual normalization is expected in H2FY24.
- Management has downward revised its EBITDA guidance for FY25E by 5-10% from earlier Rs.1,700cr. We cut our EPS estimates by 29% & 19% for FY24E & FY25E to factor in demand weakness and higher expenses.
- As per management, the worst impact has been seen in H1FY24, while green shoots of demand revival have been witnessed in dyes, polymers, additives, and some discretionary categories.
- The capex amount of Rs.3,000cr (for adding new +40 value-added products) over FY23-FY25E, is in progress.
- Despite a downward revision in earnings, our confidence is bolstered by the sector's robust growth prospects, ARTO's strategic emphasis on portfolio expansion, aggressive capacity expansion, and the anticipated uptick in long-term contracts.
- Overall, we expect PAT to grow by 12% CAGR over FY23-25E. We value ARTO at a P/E of 32x on FY25E, and maintain BUY rating for the stock, with a target price of Rs. 600, reflecting our conviction in its resilience and potential for sustained growth going ahead.

**De-stocking hurt growth....In H2FY24 to see revival**

In Q2FY24, ARTO grappled with a 14% YoY decline in revenue, attributed to destocking and realization challenges impacting overall growth. Approximately half of the company's product revenue, characterized by cyclical and discretionary nature, experienced a slowdown in demand. Despite these headwinds, a modest 3% sequential growth emerged, with green shoots of demand revival in dyes, polymer, additives, and certain discretionary categories, while agrochemicals remained weak, expected to recover in FY25. Looking ahead, management anticipates a sequential improvement in revenue growth from H2FY24 onwards. To align with the prevailing demand challenges, we revised our revenue estimates for FY24 and FY25E downward by 18% and 19%, respectively. We anticipate a 10% CAGR revenue growth over FY23-25E.

**EBITDA margin improve sequentially....**

In Q2FY24, EBITDA fell by 13% YoY due to lower revenue growth amid destocking, but EBITDA margins improved by 20bps YoY to 16%, driven by gross margin expansion. Sequentially, EBITDA margin saw a 170bps improvement, attributed to lower input costs and reduced operating expenses, surpassing our profitability estimates. While management foresees a 5-10% EBITDA miss in FY25E compared to the earlier Rs.1,700cr guidance, FY24's guided EBITDA range was Rs.900-Rs.1,000cr. The worst impact of raw material price volatility and destocking concluded in H1FY24, with a gradual margin improvement expected from H2FY24 onwards. Acknowledging weak earnings in H1FY24, we revised our EPS estimates downward by 29% and 19% for FY24 and FY25E, while anticipating a 12% CAGR in PAT over FY23-25E.

**Valuations**

The worst impact of earnings challenges attributed to input price volatility, demand slowdown, and destocking is now behind us. Despite a downward revision in earnings, our confidence is bolstered by the sector's robust growth prospects, ARTO's strategic emphasis on portfolio expansion, aggressive capacity expansion, and the anticipated uptick in long-term contracts. We value ARTO at a P/E of 32x on FY25E and we maintain BUY rating with target price of Rs. 600.

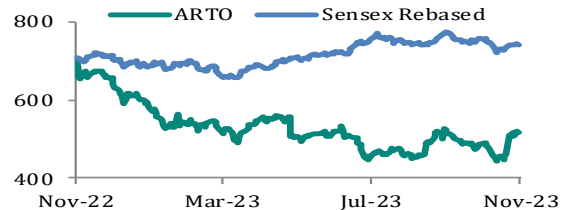
**Company Data**

Market Cap (cr)	Rs.18,943
Enterprise Value (cr)	Rs.21,882
Outstanding Shares (cr)	36.3
Free Float	56.4%
Dividend Yield	0.48%
52 week high	Rs.717
52 week low	Rs.438
6m average volume (cr)	0.01
Beta	1.06
Face value	Rs. 5

Shareholding (%)	Q4FY23	Q1FY24	Q2FY24
Promoters	44.1	43.7	43.6
FII's	12.3	12.2	10.6
MFs/Institution	14.7	14.8	16.1
Public	28.9	29.3	29.7
Total	100.0	100.0	100.0

Price Performance*	3 Month	6 Month	1 Year
Absolute Return	12.2%	2.9%	-26.7%
Absolute Sensex	-0.9%	5.50%	4.9%
Relative Return	13.1%	-2.5%	-31.7%

\*over or under performance to benchmark index



Consolidated (cr)	FY23A	FY24E	FY25E
Sales	6,691	6,531	8,008
Growth (%)	8.8	(1.3)	22.6
EBITDA	1,089	1,045	1,441
EBITDA margins (%)	16.4	16.0	18.0
PAT Adjusted	545	431	679
Growth (%)	(54.1)	(20.8)	57.4
Adjusted EPS	15.0	11.9	18.7
Growth (%)	(54.1)	(20.8)	57.4
P/E	34.8	43.9	27.9
P/B	3.9	3.6	3.2
EV/EBITDA	20.1	21.2	15.8
ROE (%)	11.5	8.5	12.2
D/E	0.6	0.7	0.7

**ANIL R**  
Research Analyst

## Consolidated Financials

### Profit & Loss

Rs.cr	Q2FY24	Q2FY23	YoY Growth (%)	Q1FY24	QoQ Growth (%)	H1FY24	H1FY23	YoY Growth (%)
Sales	1,454	1,685	-13.7	1,414	2.8	2,868	3,295	-13.0
EBITDA	233	267	-12.7	202	15.3	435	547	-20.5
EBITDA margin	16.0	15.8	18bps	14.3	174bps	15.2	16.6	-143bps
Depreciation	93	73	27.6	89	4.5	182	145	25.6
EBIT	140	194	-27.9	113	23.9	253	402	-37.1
Interest	58	44	32.6	40	45.0	98	89	10.4
Other Income	-	-	-	-	-	-	-	-
Exceptional Items	-	-	-	-	-	-	-	-
PBT	82	150	-45.5	73	12.3	155	313	-50.5
Tax	-9	26	-134.7	3	-400.0	-6	56	-110.7
Share of profit from Associate	-	-	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-	-	-
Reported PAT	91	124	-26.9	70	30.0	161	257	-37.5
Adjustments	-	-	-	-	-	-	-	-
Adjusted PAT	91	124	-26.9	70	30.0	161	257	-37.5
No. of Shares	36	36	-	36	-	36	36	-
EPS (Rs)	2.5	3.4	-26.9	1.9	30.0	4.4	7.1	-37.5

### Change in Estimates

Year / Rs cr	Old estimates		New estimates		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	8,003	9,858	6,531	8,008	(18.4)	(18.8)
EBITDA	1,297	1,686	1,045	1,441	(19.4)	(14.5)
Margins (%)	16.2	17.1	16.0	18.0	(20bps)	90bps
Adjusted PAT	608	838	431	679	(29.1)	(19.0)
EPS	16.8	23.1	11.9	18.7	(29.1)	(19.0)

## Consolidated Financials

### PROFIT & LOSS

Y.E March (Rs Cr)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Sales</b>	<b>4,506</b>	<b>6,086</b>	<b>6,619</b>	<b>6,531</b>	<b>8,008</b>
% change	5.6	35.1	8.8	-1.3	22.6
<b>EBITDA</b>	<b>982</b>	<b>1,720</b>	<b>1,089</b>	<b>1,045</b>	<b>1,441</b>
% change	-7.3	75.2	-36.7	-4.0	38.0
Depreciation	231	246	310	370	425
EBIT	750	1,474	779	675	1,016
Interest	86	102	168	191	219
Other Income	1	1	0	0	2
<b>PBT</b>	<b>665</b>	<b>1,372</b>	<b>611</b>	<b>484</b>	<b>799</b>
% change	-12.2	106.5	-55.5	-20.8	65.3
Tax	129	186	66	52	120
Tax Rate (%)	19.5	13.6	10.8	10.8	15.0
<b>Reported PAT</b>	<b>523</b>	<b>1,186</b>	<b>545</b>	<b>431</b>	<b>679</b>
Adj.*	0	0	0	0	0
<b>Adj. PAT</b>	<b>523</b>	<b>1,186</b>	<b>545</b>	<b>431</b>	<b>679</b>
% change	-6.5	126.5	-54.1	-20.8	57.5
No. of shares (cr)	17.4	36.3	36.3	36.3	36.3
<b>Adj EPS (Rs)</b>	<b>14.4</b>	<b>32.7</b>	<b>15.0</b>	<b>11.9</b>	<b>18.7</b>
% change	-6.5	126.5	-54.1	-20.8	57.5
DPS (Rs)	2.5	3.5	2.5	2.5	2.5
CEPS (Rs)	43.3	39.5	23.6	22.1	30.5

### BALANCE SHEET

Y.E March (Rs Cr)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash	412	94	167	243	(2)
Accounts Receivable	794	1,092	940	930	1,097
Inventories	936	934	1,031	1,150	1,380
Other Cur. Assets	546	735	415	394	395
Investments	64	28	17	2	0
Gross Fixed Assets	5,115	5,046	6,304	7,604	9,404
Net Fixed Assets	3,592	3,595	4,859	5,790	7,164
CWIP	1,298	1,303	989	750	300
Intangible Assets	1	430	1,087	1,087	1,087
Def. Tax (Net)	(234)	28	53	53	53
Other Assets	0	-	-	-	-
<b>Total Assets</b>	<b>7,408</b>	<b>7,851</b>	<b>8,581</b>	<b>9,419</b>	<b>10,496</b>
Current Liabilities	1,136	492	506	657	789
Provisions	40	32	30	27	33
Debt Funds	2,717	2,811	3,124	3,474	3,824
Other Liabilities	12	1	1	1	1
Equity Capital	87	181	181	181	181
Reserves & Surplus	3,416	4,335	4,739	5,080	5,668
Shareholder's Fund	3,503	4,516	4,920	5,261	5,850
<b>Total Liabilities</b>	<b>7,408</b>	<b>7,851</b>	<b>8,581</b>	<b>9,419</b>	<b>10,496</b>
BVPS	201	125	136	145	161

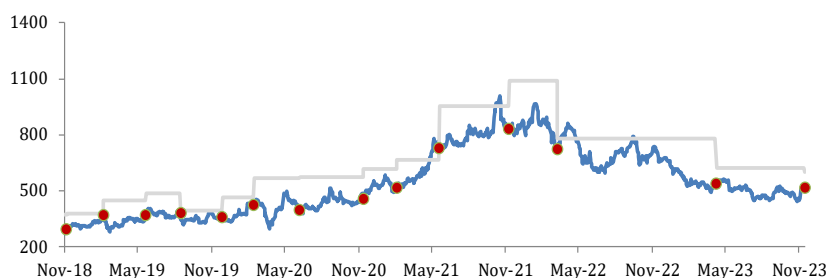
### CASH FLOW

Y.E March (Rs Cr)	FY21A	FY22A	FY23A	FY24E	FY25E
Net inc. + Depn.	767	1474	855	801	1105
Non-cash adj.	113	27	143	191	219
Changes in W.C	(7)	(1,186)	312	60	(260)
<b>C.F. Operation</b>	<b>873</b>	<b>316</b>	<b>1,309</b>	<b>1,053</b>	<b>1,063</b>
Capital exp.	(1,314)	(1,306)	(1,326)	(1,061)	(1,350)
Change in inv.	(8)	1	(3)	15	2
Other invest.CF	-	-	-	-	-
<b>C.F - Investment</b>	<b>(1,322)</b>	<b>(1,305)</b>	<b>(1,330)</b>	<b>(1,046)</b>	<b>(1,348)</b>
Issue of equity	-	-	-	-	-
Issue/repay debt	660	(381)	138	159	131
Dividends paid	(45)	(127)	(91)	(91)	(91)
Other finance.CF	-	-	-	-	-
<b>C.F - Finance</b>	<b>614</b>	<b>679</b>	<b>47</b>	<b>68</b>	<b>40</b>
Chg. in cash	165	(310)	27	75	(245)
Closing cash	493	102	120	243	(2)

### RATIOS

Y.E March	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Profitab &amp; Return</b>					
EBITDA margin (%)	21.8	28.3	16.4	16.0	18.0
EBIT margin (%)	16.6	24.2	11.8	10.3	12.7
Net profit mgn.(%)	11.6	19.5	8.2	6.6	8.5
ROE (%)	16.2	29.6	11.5	8.5	12.2
ROCE (%)	9.8	18.3	8.9	7.2	9.4
<b>W.C &amp; Liquidity</b>					
Receivables (days)	62.7	56.5	56.0	52.3	46.2
Inventory (days)	151.9	119.5	93.3	99.6	96.2
Payables (days)	152.9	104.1	47.4	53.1	55.0
Current ratio (x)	2.3	5.5	4.8	4.0	3.5
Quick ratio (x)	1.0	2.2	1.9	1.4	1.4
<b>Turnover &amp; Leverage</b>					
Gross asset T.O (x)	1.0	1.2	1.2	0.9	0.9
Total asset T.O (x)	0.7	0.8	0.8	0.7	0.8
Int. covge. ratio (x)	8.7	14.4	4.6	3.5	4.6
Adj. debt/equity (x)	0.9	0.6	0.6	0.7	0.7
<b>Valuation</b>					
EV/Sales (x)	4.7	3.6	3.3	3.4	2.8
EV/EBITDA (x)	21.6	12.6	20.1	21.2	15.8
P/E (x)	36.2	16.0	34.8	43.9	27.9
P/BV (x)	2.6	4.2	3.9	3.6	3.2

## Recommendation summary (Last 3 years)



Source: Bloomberg, Geojit Research.

Dates	Rating	Target
06-November-2018	Accumulate	377
06-February-19	Hold	447
23-May-19	Buy	487
16-August-19	Reduce	393
28-November-2019	Accumulate	467
17-February-2020	Accumulate	567
08-June-2020	Buy	576
12-November-2020	Accumulate	616
04-February-2021	Accumulate	667
21-May-2021	Accumulate	951
10-November-2021	Accumulate	1,091
10-March-2022	Buy	779
10-April-2023	Buy	624
15-November-2023	Buy	600

## Investment Rating Criteria

Ratings	Large caps	Midcaps	Small caps
Buy	Upside is above 10%	Upside is above 15%	Upside is above 20%
Accumulate	-	Upside is between 10% - 15%	Upside is between 10% - 20%
Hold	Upside is between 0% - 10%	Upside is between 0% - 10%	Upside is between 0% - 10%
Reduce/sell	Downside is more than 0%	Downside is more than 0%	Downside is more than 0%
Not rated/ Neutral	-	-	-

### Definition:

**Buy:** Acquire at Current Market Price (CMP), with the target mentioned in the research note.

**Accumulate:** Partial buying or to accumulate as CMP dips in the future.

**Hold:** Hold the stock with the expected target mentioned in the note.

**Reduce:** Reduce your exposure to the stock due to limited upside.

**Sell:** Exit from the stock.

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating. For reasons of valuations/ return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

Not rated/Neutral- The analyst has no investment opinion on the stock under review

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