

19<sup>th</sup> November, 2019

## Aarti Industries–BUY

**CMP** :Rs.839  
**Target Price** :Rs. 1042  
**Upside** : 24%+  
**Stop Loss** :Rs.719 (Closingbasis)

### Investment Thesis

Aarti Industries started its operations in Gujarat with 1,200TPA capacity of Nitro Chloro Benzenes (NCBs) in 1986 and gradually evolved as a global supplier of various specialty chemicals and pharmaceuticals products. Over the time, it has developed its expertise in benzene-based specialty chemicals enabling it to widen its portfolio with more value-added products. Aarti Industries has evolved as an integrated (backward & forward) player manufacturing more than 125 products through various processes like chlorination, nitration, ammonolysis, hydrogenation and halox chemistry. Globally, it is ranked from 1<sup>st</sup> to 4<sup>th</sup> for majority of its products (75% of its portfolio) and enjoys a global market share of 25-40% across various products. It caters to more than 650 customers spread across 60 countries with no customer contributing more than 9% of its total revenue. Aarti Industries cater to various industries like, pharmaceuticals, agrochemicals, dyes & pigments, polymers & additives, fuel additive, rubber chemicals, surfactants, etc.

Recently, Aarti Industries has expanded its product portfolio by entering into toluene value chain coupled with other expansion plans, including greenfield chlorination complex, calcium chloride unit, PDA & Ethylene derivatives. Going forward, the specialty chemicals industry in India is expected to grow at 14% over FY17-FY20E scaling to US\$54.0bn. We believe favorable macro outlook combined with Aarti Industries' expansion plans will fuel future growth and consequently, the revenues of Aarti Industries is expected to witness a good double-digit growth over FY18-FY20E.

### Financials

- During the past 5 years, revenue of Aarti Industries grew at a CAGR of 18.9% while PAT grew at a CAGR of 22% in the same period.

Particulars	FY17	FY18	FY19	FY20	FY21
Revenue	3164	3806	4706	5364	6330
EBITDA	654	699	965	1,067	1,298
Net profit	328	333	492	563	684
EPS	20.0	19.1	28.25	34.6	41.2
PE	36.7	41.6	28.2	25.3	18.8
ROE	24.0%	22.6%	23.4%	19.2%	21.7%

- Aarti Industries has reported 46.4% YoY growth in revenue to Rs.12,995mn in Q2FY19 led by strong growth across business segments with specialty chemical business grew by 50% YoY.
- Pharma segment of Aarti Industries has reported a robust growth of 41% YoY led by better realizations and higher sales of intermediates.

Stock Data	
Market Cap (Rs. Mn)	127,113
Market Cap (\$ Mn)	1,787.8
Shares O/S (in Mn)	81.30
Avg. Volume (3 month)	65,000
52-Week Range (Rs.)	1,589 / 1,000

Shareholding Pattern	
Promoters	52.74%
FII's	4.45%
Institutions	14.35%
Others (incl. body corporate)	28.47%

Performance (%)	1M	6M	1Yr
Absolute	8.4%	25.0%	43.5%
BSE 500	-0.1%	-4.9%	-8.1%

Key Ratios	
Div Yield	0.1%
TTM PE	32.8x
ROE	23.4%
TTM EPS (Rs.)	47.6/-

- EBITDA of Aarti Industries increased by 51.0% YoY to Rs.2,421mn on account of cost rationalization and forex impact in the quarter. As a result, EBITDA margin improved by 60bps YoY to 18.6% in Q2FY19.

## Key Business Highlights

- Aarti Industries is the largest producer of benzene-based derivatives in India and has a global footprint with presence in 60 countries. It operates through 17 integrated plants located on the western belt of India enjoying easy procurement of raw materials used for manufacturing more than 125 products.
- Over the years, Aarti Industries has evolved as an integrated (backward and forward) specialty chemicals manufacturing company on the back of it gradually developing its core competencies in various chemical processes and reactions.
- Aarti Industries has a wide range of product portfolio, used in manufacturing of agrochemicals, pharmaceuticals, polymers & additives, dyes & pigments, rubber chemicals, surfactants, etc.

## Valuation

- Aarti Industries, on the back of a sustainable track record of supply of quality intermediates, has recently bagged two multi-year contracts under the speciality chemical segment, which will start from 2020. The first contract amounting to Rs.40,000mn for an agro-chemical major, spread over a 10-year period, which will provide a revenue of ~Rs.4,000mn annually. In this contract, it is expected to realize ~20% EBITDA margins and RoCE of 20%, incorporating a capex spend of ~Rs.4,000mn. The second contract amounts to ~Rs.100,000mn for a chemical major, spread over a 20-year period with annual revenue potential of ~Rs.5,000mn. In this contract, due to partial funding of capex of ~Rs.2,500mn from the customer's end in the form of advances, the intended EBITDA margins and RoCE will be sub 20%.
- Higher export demand and surge in domestic demand owing to increasing disposable incomes, higher infrastructure activities and overall growth of rural economy has resulted into robust and sustainable growth for specialty chemicals industry in India. With Indian specialty chemicals market being in a sweet spot, Aarti Industries is poised to be one of the biggest beneficiaries of the favorable market scenario. Further, it has been addressing regulated markets directly or indirectly with its presence in generics. Going forward, we expect the pharma industry to witness a turnaround on account of higher drugs going off-patent and as a result, Aarti Industries is expected to report double digit growth in the segment over FY19-FY20E.
- With gradual evolving as a global supplier of various specialty chemicals, manufacturing more than 125 products through various processes, expanded its product portfolio, recently bagged two multi-year contracts and robust growth for specialty chemicals industry in India, we value Aarti Industries at 25.3x FY20E EPS of Rs.41.2 to arrive at target price of Rs.1042, an upside of 24%.

## Risk & Concern

- Any regulatory restriction like, implementation of 'Phase-3 of EU's REACH' from June 2018, may have negative impact on the growth of Aarti Industries in that region.
- Any mass scale dumping from China into Indian market may negatively affect domestic business of Aarti Industries.
- Rise in crude oil price and rupee appreciation may also impact Aarti Industries' margin.

## Graphs & Charts

Figure 1: Net Sales Trend

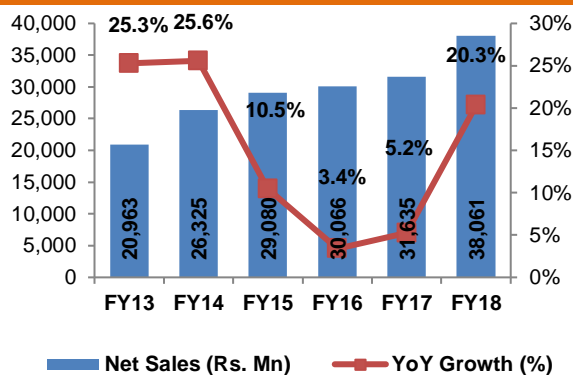


Figure 2: EBITDA & EBITDA Margin Trend

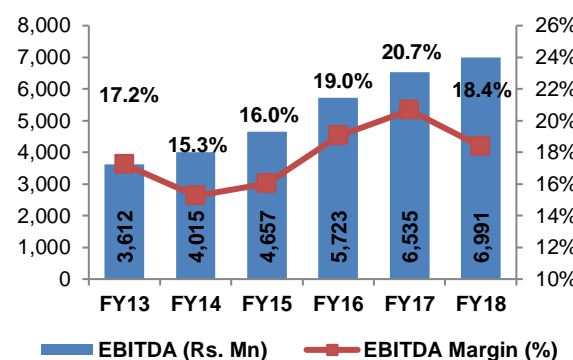


Figure 3: PAT Trend

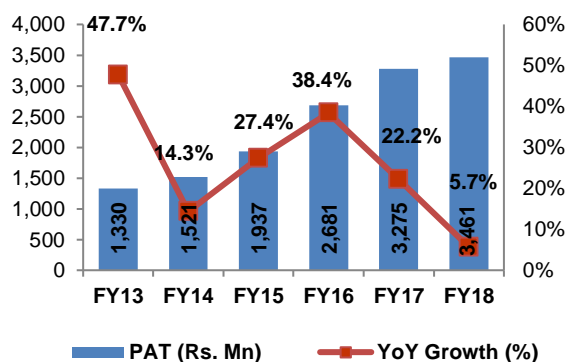
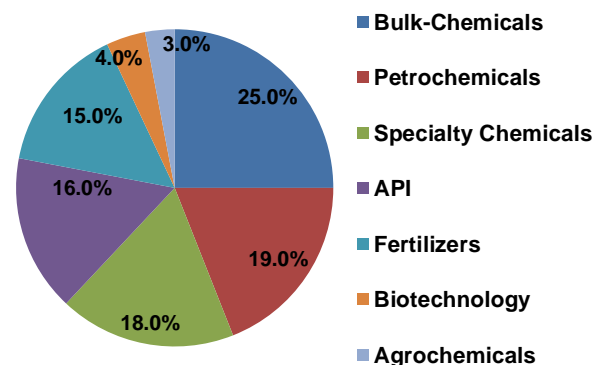


Figure 4: Indian Chemical Industry Break-up



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