

## Aarti Industries Ltd.

No. of shares (m)	362.5
Mkt cap (Rs crs/\$m)	17900/2150.6
Current price (Rs/\$)	494/5.9
Price target (Rs/\$)	540/6.5
52 W H/L (Rs.) (since demerger)	744/445
Book Value (Rs/\$)	136/1.6
Beta	0.9
Daily volume NSE (avg. monthly)	2066360
P/BV (FY23e/24e)	3.6/3.3
EV/EBITDA (FY24e/25e)	20.4/16.0
P/E (FY24e/25e)	44.0/32.0
EPS growth (FY23/24e/25e)	-8.9/-25.4/37.5
OPM (FY23/24e/25e)	16.5/16.0/17.5
ROE (FY23/24e/25e)	11.7/8.1/10.3
ROCE(FY23/24e/25e)	9.4/7.1/8.3
D/E ratio (FY23/24e/25e)	0.6/0.6/0.7
BSE Code	524208
NSE Code	AARTIIND
Bloomberg	ARTO IN
Reuters	ARTINS

## Shareholding pattern

	%
Promoters	43.7
MFs / Banks / FIs	14.8
Foreign Portfolio Investors	12.2
Govt. Holding	0.0
Public & Others	29.3
<b>Total</b>	<b>100.0</b>

As on June 30, 2023

## Recommendation

**HOLD**

## Analyst

**KISHAN GUPTA, CFA, FRM**

Phone: + 91 (33) 4488 0043

E- mail: kishan.gupta@cdequi.com

## Company Brief

AIL is one of India's leading manufacturers of chemicals and pharmaceutical intermediates: dyestuff; pigment; agro chemicals; speciality chemicals; API.

## Quarterly Highlights

- Increased dumping by China coupled with depreciation of Chinese currency had its after effects for Aarti saw its margin erosion deepened in Q1 - OPM: 14.1% Vs 15.2% in Q4. Inventory correction across industries witnessed almost throughout the globe led to significant demand contraction which hindered Aarti's exports and domestic supply focused on global markets. Thence, revenues tumbled over 12% to Rs 1414 crs from Rs 1610 crs in the same quarter a year ago.
- Inventory corrections seemingly have been induced by high interest rates and barely sober inflation. Falling logistics cost has also made hoarding of materials less profitable thus prompting manufacturers to trim inventories of intermediates. Aarti reckons that the effect of inventory correction was more pronounced in agro chemicals while dyes, pigments etc also suffered due to prolonged weakness in demand.
- Margin also fell victim to inert capacity utilization as volumes tumbled by over 10% last quarter. Fall in prices of key raw materials like benzene barely save blushes for weakness in finished product prices had an adverse impact, aptly reflected in lower revenues. Lower margins thus pulled down operating profit by some 29% and post-tax earnings by 48.5%. Causes for decline in Aarti's margins for the last few quarters have been barely unvaried ranging from low operating days in few plants to slowdown in dyes and pigments to higher supplies to low margin yielding non-regular markets to high material inflation to inventory correction.
- The stock currently trades at 44x FY24e EPS of Rs 11.21 and 32x FY25e EPS of Rs 15.41. Margin woes coupled with weakening "sales velocity" would hurt earnings during much of current fiscal, somewhat manifested in obnoxious reading of return on capital (ROE stumbled at 11.7% last fiscal and would fall a shade below 10% in current fiscal). Yet specialization in nitration and ability to launch valued added products in both existing and new chemistries would help in business revival as and when export demand picks up. Execution holds key for the company has lined up no puny capex program. On balance, we assign hold rating on the stock with target of Rs 540 based on 35x FY25e earnings over a period of 6-9 months.

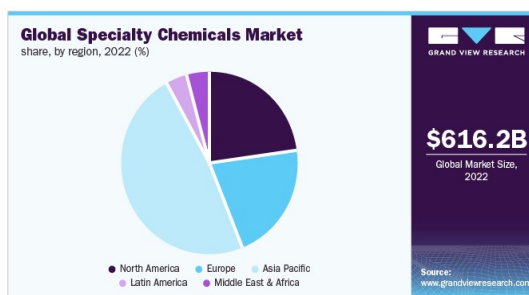
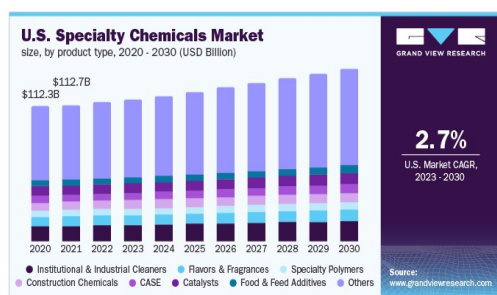
Consolidated (Rs crs)	FY22	FY23	FY24e	FY25e
Income from operations	6085.51	6618.58	6287.65	7356.55
Other Income	0.77	0.86	0.65	0.70
EBITDA (other income included)	1720.88	1089.93	1006.67	1288.10
Profit after MI & EO	598.07	545.02	406.48	558.74
EPS(Rs)	16.50	15.03	11.21	15.41
EPS growth (%)	-	-8.9	-25.4	37.5

## Outlook & Recommendation

### Global Specialty Chemicals Update

If the report by Grand View Research on global specialty chemicals industry is anything to go by, then its market size is estimated to be CAGR of 5.1% between 2023 and 2030 driven by rising demand for construction, water treatment, and electronics chemicals, along with progress in process technology and trade liberalization. Other sectors which would contribute to the bounty include pharmaceuticals, food and feed additives, and flavors and fragrances.

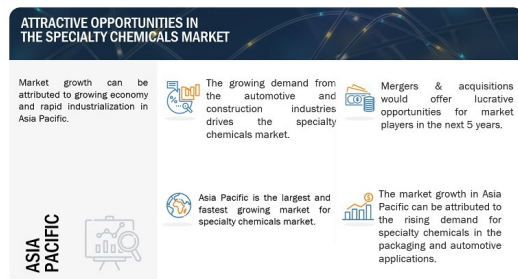
Demand for flavoring agents has started to find favor as processed foods and beverages have become more prevalent in developed countries. Yet unsavory impact of headwinds cannot be turned down in a hurry. Prices of specialty chemicals shot up as geopolitical conflict in Europe made crude oil prices rich. Rising energy prices, barely unaffected by the conflict, also played spoilsport.



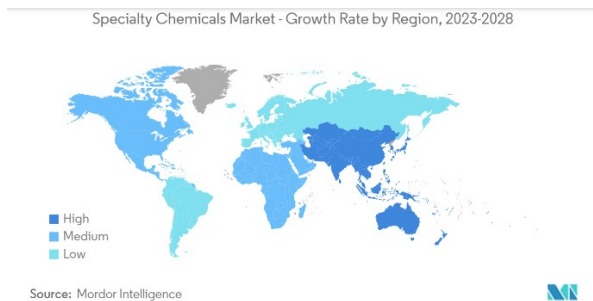
Source: Grandview Research

Source: Grandview Research

Asia Pacific region scarcely trail the pack for it commanded revenue share of 48.5% in 2022 as rapid economic progress and industrialization become cornerstones of its specialty chemicals market growth. China and India have emerged as economic powerhouses in this region which has fueled market growth. The demand for additives in the region is influenced by food and beverages, personal care and cosmetics, and pharmaceutical applications. Not far behind, Middle East and Africa region could see market expand by a CAGR of 3.6% by 2030 as per the report.



Source: Fortune Insights



Source: Modor Intelligence

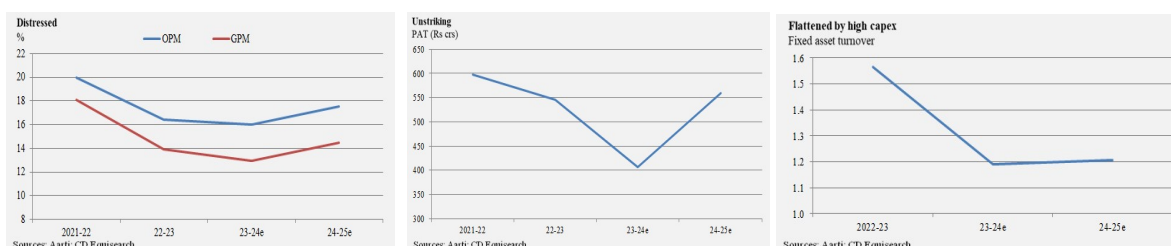
A publication by Markets and Markets, the Asia Pacific region has been seeing increased infrastructure and construction activities not least due to rising disposable incomes. Automotive companies get attracted to India and China due to low labor costs prevailing in these nations. Favorable demographics coupled with cost advantage have led to demand resurgence for specialty chemicals in automotive, construction, medical, packaging and consumer goods.

Modor Intelligence posits that the agrochemicals segment is set to dominate the market growth of specialty chemicals in years to come. Increasing urbanization and thus reducing arable land has raised questions of food security. Thus fertilizers have to be used for a longer time to enhance crop productivity. Demand for agrochemicals in form of micronutrient fertilizers, bio based fertilizers and specialty fertilizers will get a boost from growing concerns about nutrient efficiency uptake by plants and regulatory health and environment.

## Financials & Valuation

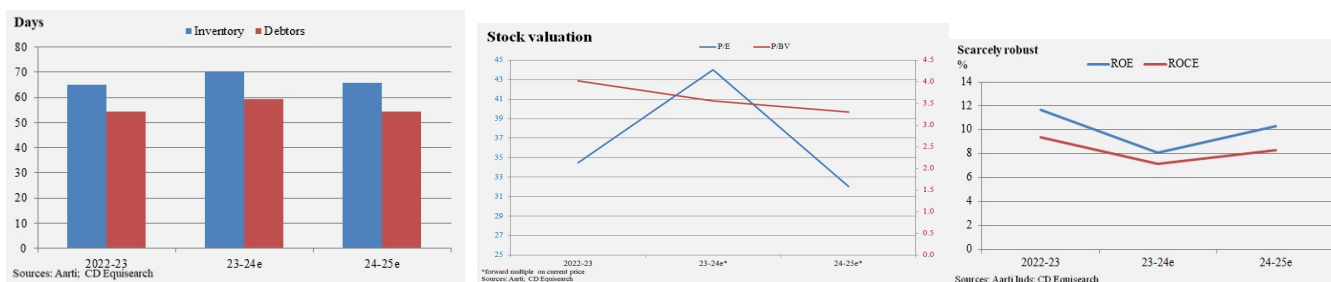
Leapfrogged by regulatory tightening in China, the Indian specialty chemical industry has seen a transformation of sorts in last few years with exports of top Indian specialty chemical manufacturers growing at a fast clip. Other factors played too. Increased demand from end user industries like pharmaceuticals, agro-chemicals, GOI's manufacturing boost through PLI scheme and rising disposable incomes all but galvanize the capacity building of Indian specialty chemical manufacturers, thus helping them win greater market share. By some estimate India's market share in specialty chemicals is estimated to jump to some 6% by 2026 from some 4%.

With seemingly vast opportunities in sight, Aarti's has taken a number of initiatives worth noting, including demerger of its pharmaceutical business, long term contract for sourcing of nitric acid with Deepak Fertilizers and long term supply contracts with some top players. With no intention to tail off capex, Aarti plans to invest Rs 1200-1300 crs annually over the next two years in either setting up new capacities or debottlenecking capacities of existing products.



The last few quarters have seen Aarti commercializing NCB capacity from 75000 tpa to 108000 tpa, besides commencing facility for third long term contract and commercializing a couple of specialty chemical process blocks at Jhagadia. Progress has also been made to expand the ethylation capacity at Dahej SEZ and on debottlenecking nitro toluene capacity as the latter has reached optimum utilization. Crowning its expansion projects would be a new state of the art pilot plant, a multipurpose plant and capacities for new chlorotoluene value chain at Jhagadia with commissioning in phases starting sometime in FY26.

To battle out vagaries of material availability and gain competitive advantage, Aarti has signed a binding agreement with Deepak Fertilizers and Petrochemicals Corporation for supply of nitric acid at formula driven prices for a period of 20 years beginning 1st April 2023. With four-fifth of its total nitric acid offtake secured, Aarti can now focus on enhanced value addition and on peddling value chains for niche applications. Valued at some Rs 8000 crs it will also forgo the need to invest in "capital hungry" projects, thus shielding erosion in its return on capital.



The stock currently trades at 44x FY24e EPS of Rs 11.21 and 32x FY25e EPS of Rs 15.41. Dumping by China has aggravated problem of swooned export markets of Indian chemical manufacturers resulting in falling demand for their wares and declining margins. Aarti is no exception for it would report eye popping fall in earnings in current fiscal before recovery expectedly sets in sometime in the second half of current fiscal. Foray in newer chemistries (chlorotoluene; photo chlorination etc) coupled with formidable focus on chemicals (post pharma business demerger) could catalyze business growth. Yet near term demand headwinds would make growth elusive. Weighing odds we assign hold rating on the stock with target of Rs 540 based on 35x FY25e earnings over a period of 6-9 months. For more info refer to our Sep 22 report.

## Cross Sectional Analysis

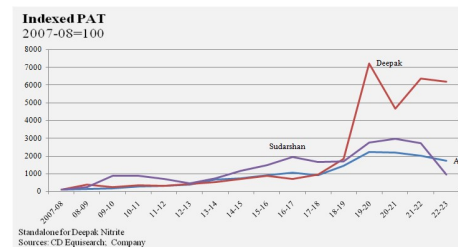
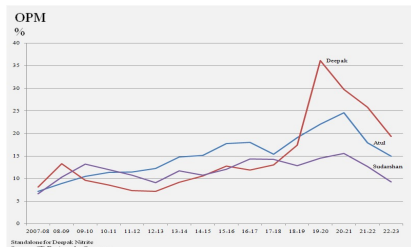
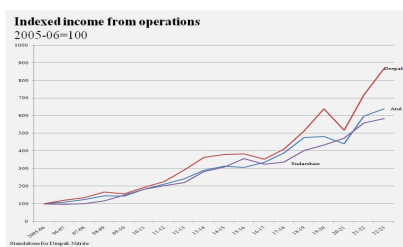
Company	Equity (Rs crs)	CMP (Rs crs)	Mcap (Rs crs)	Inc. from ops. (Rs crs)	Profit (Rs crs)	OPM (%)	NPM (%)	Int. cov.	ROE (%)	Mcap / IO	P/BV	P/E
Atul Ltd	30	6975	20586	5133	430	14.1	8.1	69.1	9.4	4.0	4.3	47.9
Deepak Nitrite	27	2109	28759	7682	769	14.9	10.0	52.9	20.2	3.7	7.0	37.4
Sudarshan	14	474	3284	2356	59	10.3	2.5	2.6	7.2	1.4	3.0	55.9
Aarti Inds.	181	494	17900	6423	479	15.7	7.5	4.2	10.1	2.8	3.6	37.4

calculations on ttm basis; Aarti income from operations approximated  
Companies not truly comparable due to product dissimilarity

To stimulate business scaling and gain competitive advantage through enhanced cost efficiencies, DNL has mapped out barely unambitious capex plans over the next few years. One project which hogged the limelight was a Rs 5000 crs project Deepak Chem Tech Ltd, a wholly owned subsidiary of Deepak Nitrite, signed with Government of Gujarat for setting up manufacturing facilities of specialty chemicals, phenol/acetone and bisphenol. Aimed at import substitution, this four year project largely targets enhanced capacities of firm's existing products. Other seemingly less famed expansion projects include downstream derivatives of phenol and acetone (read: MIBK and MIBC plants), debottlenecking phenol plant, new chemistries like photo chlorination and fluorination, and acid plant. The MIBK and MIBC projects would see the light of day by middle of next fiscal.

Distinct slowdown in Atul's both domestic and overseas markets have scarcely deterred its expansion plans with projects totaling Rs 1420 crs are at different stages of implementation at its standalone entity (Rs 561 crs) and various entities including Atul Products (Rs 817 crs) and Atul Finserv. Capacity of caustic soda is expected to come on stream sometime in the current quarter, while the reconstruction of pharmaceutical plant, which was affected by fire, is expected to get over by Q2 of current fiscal. Competitive advantage in terms of good market share in some key products coupled with benefits of integration and overseas market presence has envious business scaling power. It has managed to contain capital costs thanks to product specialization and debottlenecking.

For boosting its overseas presence, Sudarshan Chemicals has begun seeking growth opportunities through increased competitiveness in overseas markets. Plans are afoot to increase penetration in select international geographies while expand its product portfolio to build a comprehensive product range. To optimize costs, integration costs would be taken up which would also help in achieving increased efficiency of value chain. Business scaling would cling to higher capex and gradual improvement in demand of global pigments industry



## Financials

## Quarterly Results - Consolidated

Figures in Rs crs

	Q1FY24	Q1FY23	% chg.	FY23	FY2	% chg.
<b>Income from operations</b>	<b>1414</b>	<b>1610</b>	<b>-12.2</b>	<b>6618.58</b>	<b>6085.51</b>	<b>8.8</b>
Other Income	0	1	-100.0	0.86	0.77	11.7
<b>Total Income</b>	<b>1414</b>	<b>1611</b>	<b>-12.2</b>	<b>6619.44</b>	<b>6086.28</b>	<b>8.8</b>
Total Expenditure	1214	1328	-8.6	5529.61	4365.40	26.7
<b>EBIDTA (other income included)</b>	<b>200</b>	<b>283</b>	<b>-29.3</b>	<b>1089.83</b>	<b>1720.88</b>	<b>-36.7</b>
Interest	40	45	-11.1	168.28	102.33	64.4
Depreciation	89	72	23.6	310.45	246.40	26.0
<b>PBT</b>	<b>71</b>	<b>166</b>	<b>-57.2</b>	<b>611.10</b>	<b>1372.15</b>	<b>-55.5</b>
Tax	1	30	-96.7	65.87	186.25	-64.6
<b>PAT</b>	<b>70</b>	<b>136</b>	<b>-48.5</b>	<b>545.23</b>	<b>1185.90</b>	<b>-54.0</b>
Minority Interest	0	0	0.0	0.00	0.23	-100.0
<b>PAT post MI</b>	<b>70</b>	<b>136</b>	<b>-48.5</b>	<b>545.23</b>	<b>1185.67</b>	<b>-54.0</b>
Extraordinary Item	-	-	-	0.21	587.60	-100.0
<b>Adjusted Net Profit</b>	<b>70</b>	<b>136</b>	<b>-48.5</b>	<b>545.02</b>	<b>598.07</b>	<b>-8.9</b>
EPS (F.V. 5)	1.93	3.74	-48.4	15.03	16.50	-8.9

## Income Statement - Consolidated

Figures in Rs crs

	FY22	FY23	FY24e	FY25e
<b>Income from operations (net)</b>	<b>6085.51</b>	<b>6618.58</b>	<b>6287.65</b>	<b>7356.55</b>
Growth (%)	-	21.3	-5.0	17.0
Other Income	0.77	0.86	0.65	0.70
<b>Total Income</b>	<b>6086.28</b>	<b>6619.44</b>	<b>6288.30</b>	<b>7357.25</b>
Total Expenditure	4365.40	5529.61	5281.63	6069.16
<b>EBITDA (other income included)</b>	<b>1720.88</b>	<b>1089.83</b>	<b>1006.67</b>	<b>1288.10</b>
Interest	102.33	168.28	192.55	225.44
<b>EBDT</b>	<b>1618.55</b>	<b>921.55</b>	<b>814.12</b>	<b>1062.66</b>
Depreciation	246.40	310.45	362.48	405.31
Tax	186.25	65.87	45.16	98.60
<b>Net profit</b>	<b>1185.90</b>	<b>545.23</b>	<b>406.48</b>	<b>558.74</b>
Minority interest	0.23	0.00	0.00	0.00
<b>Net profit after MI</b>	<b>1185.67</b>	<b>545.23</b>	<b>406.48</b>	<b>558.74</b>
Extraordinary item	587.60	0.21	-	-
<b>Adjusted Net Profit</b>	<b>598.07</b>	<b>545.02</b>	<b>406.48</b>	<b>558.74</b>
EPS (Rs.)	16.50	15.03	11.21	15.41

## Consolidated Balance Sheet

Figures in Rs crs

	FY22	FY23	FY24e	FY25e
<b>SOURCES OF FUNDS</b>				
Share Capital	181.25	181.25	181.25	181.25
Reserves	4334.73	4738.83	5054.69	5522.82
<b>Total Shareholders Funds</b>	<b>4515.98</b>	<b>4920.08</b>	<b>5235.94</b>	<b>5704.07</b>
Minority Interest	0.72	0.72	0.72	0.72
Long term debt	929.85	634.71	1134.71	1634.71
<b>Total Liabilities</b>	<b>5446.55</b>	<b>5555.51</b>	<b>6371.37</b>	<b>7339.50</b>
<b>APPLICATION OF FUNDS</b>				
Gross Block	5005.00	6306.26	7506.26	8706.26
Less: Accumulated Depreciation	1410.35	1445.31	1807.79	2213.11
<b>Net Block</b>	<b>3594.65</b>	<b>4860.95</b>	<b>5698.47</b>	<b>6493.15</b>
Capital Work in Progress	1345.99	1096.22	1000.00	1100.00
Investments	28.29	17.17	17.17	17.17
<b>Current Assets, Loans &amp; Advances</b>				
Inventory	934.12	1031.05	1006.02	1177.05
Sundry Debtors	1091.52	940.49	987.51	1036.89
Cash and Bank	173.56	200.73	197.61	196.58
Other Assets	499.63	287.01	297.22	325.50
<b>Total CA &amp; LA</b>	<b>2698.83</b>	<b>2459.28</b>	<b>2488.36</b>	<b>2736.02</b>
Current liabilities	2133.97	2753.46	2692.06	2863.78
Provisions	31.68	29.86	33.21	35.71
<b>Total Current Liabilities</b>	<b>2165.65</b>	<b>2783.32</b>	<b>2725.28</b>	<b>2899.49</b>
Net Current Assets	533.18	-324.04	-236.91	-163.47
Net Deferred Tax (net of liability)	27.74	52.78	37.78	22.78
Other Assets (Net of liabilities)	-83.30	-147.57	-145.13	-130.13
<b>Total Assets</b>	<b>5446.55</b>	<b>5555.51</b>	<b>6371.37</b>	<b>7339.50</b>

**Key Financial Ratios**

	<b>FY22</b>	<b>FY23</b>	<b>FY24e</b>	<b>FY25e</b>
<b>Growth Ratios</b>				
Revenue (%)		21.3	-5.0	17.0
EBIDTA (%)		0.1	-7.6	28.0
Net Profit (%)		-8.9	-25.4	37.5
EPS (%)		-8.9	-25.4	37.5
<b>Margins</b>				
Operating Profit Margin (%)	20.0	16.5	16.0	17.5
Gross Profit Margin (%)	18.1	13.9	12.9	14.4
Net Profit Margin (%)	11.0	8.2	6.5	7.6
<b>Return</b>				
ROCE (%)		9.4	7.1	8.3
ROE (%)		11.7	8.1	10.3
<b>Valuations</b>				
Market Cap / Sales		2.8	2.8	2.4
EV/EBIDTA		19.7	20.4	16.0
P/E		34.5	44.0	32.0
P/BV		4.0	3.6	3.3
<b>Other Ratios</b>				
Interest Coverage	8.2	4.6	3.3	3.9
Debt-Equity Ratio	0.6	0.6	0.6	0.7
Current Ratio	1.2	0.9	0.9	0.9
<b>Turnover Ratios</b>				
Fixed Asset Turnover		1.6	1.2	1.2
Total Asset Turnover		1.2	1.1	1.1
Debtors Turnover		6.7	6.2	6.7
Inventory Turnover		5.6	5.2	5.6
Creditors Turnover		14.7	13.5	14.8
<b>WC Ratios</b>				
Debtor Days		54.2	59.1	54.2
Inventory Days		64.9	70.4	65.6
Creditor Days		24.7	27.0	24.6
Cash Conversion Cycle		94.3	102.5	95.2

**Financial Summary – US dollar denominated**

million \$	FY22	FY23	FY24e	FY25e
Equity capital	23.9	22.0	21.8	21.8
Shareholders funds	588.5	591.8	622.5	678.8
Total debt	338.8	349.6	400.6	472.7
Net fixed assets (incl CWIP)	651.7	724.6	804.8	912.3
Investments	3.7	2.1	2.1	2.1
Net current assets	63.2	-46.0	-35.0	-26.2
Total assets	711.3	669.1	759.0	875.3
Revenues (Gross)	816.7	823.3	755.4	883.9
EBITDA	146.2	135.5	120.9	154.8
EBDT	132.4	114.6	97.8	127.7
PBT	99.4	76.0	54.3	79.0
Profit after MI	80.3	67.8	48.8	67.1
EPS(\$)	0.22	0.19	0.13	0.19
Book value (\$)	1.62	1.56	1.67	1.79

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates(Rs 83.23/\$). All dollar denominated figures are adjusted for extraordinary items.



## Disclosure & Disclaimer

CD Equisearch Private Limited (hereinafter referred to as 'CD Equi') is a Member registered with National Stock Exchange of India Limited, Bombay Stock Exchange Limited and Metropolitan Stock Exchange of India Limited (Formerly known as MCX Stock Exchange Limited). CD Equi is also registered as Depository Participant with CDSL and AMFI registered Mutual Fund Advisor. The associates of CD Equi are engaged in activities relating to NBFC-ND - Financing and Investment, Commodity Broking, Real Estate, etc.

CD Equi is registered under SEBI (Research Analysts) Regulations, 2014 with SEBI Registration no INH300002274. Further, CD Equi hereby declares that –

- No disciplinary action has been taken against CD Equi by any of the regulatory authorities.
- CD Equi/its associates/research analysts do not have any financial interest/beneficial interest of more than one percent/material conflict of interest in the subject company(s) (*kindly disclose if otherwise*).
- CD Equi/its associates/research analysts have not received any compensation from the subject company(s) during the past twelve months.
- CD Equi/its research analysts has not served as an officer, director or employee of company covered by analysts and has not been engaged in market making activity of the company covered by analysts.

This document is solely for the personal information of the recipient and must not be singularly used as the basis of any investment decision. Nothing in this document should be construed as investment or financial advice. Each recipient of this document should make such investigations as they deem necessary to arrive at an independent evaluation of an investment in the securities of the companies referred to in this document (including the merits and risks involved) and should consult their own advisors to determine the merits and risks of such an investment.

Reports based on technical and derivative analysis center on studying charts of a stock's price movement, outstanding positions and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

The information in this document has been printed on the basis of publicly available information, internal data and other reliable sources believed to be true but we do not represent that it is accurate or complete and it should not be relied on as such, as this document is for general guidance only. CD Equi or any of its affiliates/group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. CD Equi has not independently verified all the information contained within this document. Accordingly, we cannot testify nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this document.

While, CD Equi endeavors to update on a reasonable basis the information discussed in this material, there may be regulatory compliance or other reasons that prevent us from doing so.

This document is being supplied to you solely for your information and its contents, information or data may not be reproduced, redistributed or passed on, directly or indirectly. Neither, CD Equi nor its directors, employees or affiliates shall be liable for any loss or damage that may arise from or in connection with the use of this information.

CD Equisearch Private Limited (CIN: U67120WB1995PTC071521)

Registered Office: 37, Shakespeare Sarani, 3rd Floor, Kolkata – 700 017; Phone: +91(33) 4488 0000; Fax: +91(33) 2289 2557 Corporate Office: 10, Vasawani Mansion, 5th Floor, DinshawWachha Road, Churchgate, Mumbai – 400 020. Phone: +91(22) 2283 0652/0653; Fax: +91(22) 2283, 2276 Website: www.cdequi.com; Email: research@cdequi.com

buy: >20%    accumulate: >10% to ≤20%    hold: ≥-10% to ≤10%    reduce: ≥-20% to <-10%    sell: <-20%

Exchange Rates Used- Indicative

Rs/\$	FY19	FY20	FY21	FY22	FY23
Average	69.89	70.88	74.20	74.51	80.39
Year end	69.17	75.39	73.50	75.81	82.22

All \$ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.