

August 07, 2018

Aarti Industries Ltd.

Profitability growth guidance revised to +25%, Margins to improve further

Management upticks profitability guidance to upwards of 25%, margins to improve further going ahead

Management sounded very much confident on strong profitability growth going ahead and have revised the profitability guidance from 15-20% earlier to now upwards of 25%. We believe strong profitability growth will be on the back of (i) Optimum utilization from the nitro-toluene and ethylation business (ii) Strong demand of Phenylene Diamines(PDA) and increasing prices will lead to growth(iii) Approvals from API pharma business to see strong traction going ahead.

Q1FY19 margins almost in-line, revenue & profits grew strongly

The company has reported EBITDA margins of 17.4% in Q1FY19 as compared to 17.5% in Q1FY18. Margins were almost flat because of increasing raw material cost. Raw material cost have increased by 49.9% y-o-y to INR 664.5 crore. This increase in cost is because of higher off take of raw materials owing to new production facilities of nitro-toluene and ethylation. Raw material prices in speciality chemicals have been more or less constant in Q1FY19.

Price increase in key product is a big trigger going ahead

We believe price increase in key chemicals like PDA, nitro-toluene, NCB etc. will be the key growth driver going ahead. These are high margin products and price increase will lead to much higher quantification in terms of profitability growth.

Margins to expand further post expansion

The company has consistently improved EBITDA margins from FY14-17. However, in FY18 company witnessed decline in margins to the tune of 230 bps and stood at 18.4% as compared to 20.7% in FY17. We believe stability of margins is linked to volumes which had consistently recorded growth of 10-15%. The company adopts a cost + margin model where the effective raw material price hike is passed on to end user with one quarter lag. We believe optimum utilization coupled with operating leverage in new business verticals will lead to improvement in margins and likely to be around 21-22% by FY20E and FY21E.

Valuations

Aarti Industries Ltd has consistent track record of performance in terms of volume growth and revenue visibility. We believe the company will be able to grow in higher double digits going ahead on the back of strong execution and proven leadership record. We continue to maintain **"Strong Buy"** on the stock and assign a target price of INR 1543/share, thereby giving an upside of 19.2% from current valuations.

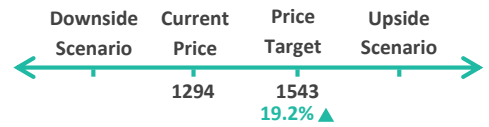
Financial Snapshot

(INR Crores)	FY16	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	3006.6	3163.5	3806.2	4554.5	4824.7	6036.2
Growth%		5.2%	20.3%	19.7%	5.9%	25.1%
EBITDA	572.3	653.5	699.3	870.2	983.8	1254.6
Growth%		14.2%	7.0%	24.5%	13.0%	27.5%
PAT	268.1	327.5	346.3	418.1	466.9	647.8
Growth%		22.9%	5.5%	20.7%	11.7%	38.7%
EPS (INR)	30.8	38.5	41.0	49.5	55.2	76.6
P/E (x)	14.0	19.8	30.3	25.1	22.4	16.2
P/B (x)	3.1	4.6	6.4	5.3	4.6	3.9
EV/EBITDA(x)	11.0	12.0	15.4	14.0	12.6	9.9

Source: NSPL Research

* Read last page for disclaimer & rating rationale

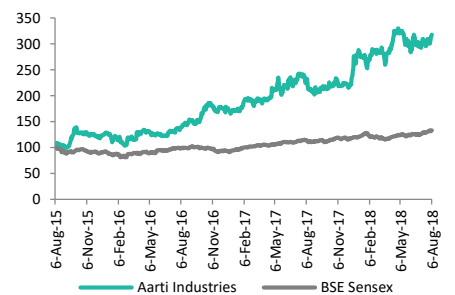
STRONG BUY *



Stock Details	
Industry	Speciality Chemicals
Sensex	37692
Nifty	11387
Bloomberg Code	ARTO:IN
Eq. Cap. (INR. crore.)	40.65
Face Value (INR.)	5
52-w H/L	1378/772
Market Cap (INR. crore.)	10520

	Valuation Data			
	FY18	FY19E	FY20E	FY21E
P/E (x)	30.3	25.1	22.4	16.2
P/B (x)	6.4	5.3	4.6	3.9
EV/EBITDA(x)	15.4	14.0	12.6	9.9

Aarti Industries Ltd Vs SENSEX



Shareholding Pattern (in %)

	Jun'18	Mar'18	Jun'17
Promoters	53.07	51.08	54.26
FIIIs	4.55	4.34	4.56
DIIIs	14.29	14.17	12.47
Retail	28.09	30.42	28.7
Total	100.0	100.0	100.0

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Q1FY19 Result Analysis

(INR Millions)	Q1FY19	Q1FY18	Q4FY18	Y-o-Y	Q-o-Q
Revenue	1078	792	1029	36.2%	4.8%
COGS	660	442	607	49.2%	8.6%
Employee Expenses	51	39	51	32.3%	0.6%
Other Expenses	180	173	191	4.1%	-5.9%
Total Expenses	891	653	849	36.3%	4.9%
EBITDA	188	138	180	35.8%	4.2%
Depreciation	38	32	37	19.0%	2.3%
Other Income	3	0	1	-	-
EBIT	154	107	145	43.8%	6.3%
Finance Cost	46	29	36	57.7%	26.6%
PBT	107	78	108	38.6%	-0.6%
Taxes	18	15	23	25.5%	-22.3%
Net Profit	89	63	85	41.6%	5.4%
EPS in INR	10.98	7.68	10.42	43.0%	5.4%

- The company revenue recorded growth of 36.2% y-o-y & 4.8% q-o-q to INR 1078 crore.
- Raw material cost have increased by 49.9% y-o-y to INR 664.5 crore. This increase in cost is because of higher off take of raw materials owing to new production facilities of nitro-toluene and ethylation. Raw material prices in speciality chemicals have been more or less constant in Q1FY19.
- EBITDA recorded growth of 35.8% y-o-y & 4.2% q-o-q to INR 188 crore. EBITDA margins stood at 17.4% in Q1FY19 as compared to 17.5% in Q1FY18 and 17.5% in Q4FY18. Margins were almost flat on despite providing for Mark to Market loss of INR 28.95 crore.
- Depreciation grew by 19% y-o-y & 2.3% q-o-q to INR 38 crore. This increase was due to increase in asset base in Q3FY18 owing to start of new production lines of nitro-toluene and ethylation.
- Finance cost reported growth of INR 57.7% y-o-y & 26.6% q-o-q to INR 46 crore. We believe the increase in finance cost might be on the back of increase in debt to fund the capex and working capital requirements.
- Tax rate in Q1FY19 is 17% as compared to 19% in Q1FY18 and 22% in Q4FY18. Since the plants fall in SEZ Dahej, Gujarat the facilities are exempted from paying higher tax and also the company is entitled for MAT entitlement which resulted in lower tax rate for Q1FY19
- PAT recorded growth of 41.6% y-o-y & 5.4% q-o-q to INR 89 crore. PAT margins stood at 8.3% in Q1FY19 as compared to 8.0% in Q1FY18 and 8.2% in Q4FY18.

Revenue & EBIT breakup

Revenue breakup (INR Crores)	Q1FY19	Q1FY18	Q4FY18	Y-o-Y	Q-o-Q
Speciality chemicals	848	626	787	35.5%	7.8%
Pharmaceuticals	150	106	174	41.1%	-14.1%
HPC	80	60	68	34.9%	18.6%
Total	1078	792	1029	36.2%	4.8%

EBIT breakup (INR Crores)	Q1FY19	Q1FY18	Q4FY18	Y-o-Y	Q-o-Q
Speciality chemicals	149	113	144	31.8%	3.3%
EBIT Margins	17.5%	18.3%	18.0%		
Pharmaceuticals	26	14	30	91.0%	-12.8%
EBIT Margins	17.4%	17.1%	12.8%		
HPC	2	1	-1	-	-
EBIT Margins	2.5%	-1.4%	1.0%		
Total	68.34	127	173	39.1%	2.2%

Source: NSPL Research

- The speciality chemicals reported growth of 35.4% y-o-y & 7.8% q-o-q to INR 848 crore in Q1FY19. The pharma business reported growth of 41.1% y-o-y & de-growth of -14.1% q-o-q to INR 150 crore in Q1FY19. The HPC business reported growth of 34.9% y-o-y & 18.6% q-o-q to INR 80 crore in Q1FY19.
- EBIT margins in speciality chemicals stood at 17.5% in Q1FY19 and EBIT margins in pharma stood at 17.4% in Q1FY19.



Q1FY19 conference call highlights

- Raw material cost have increased by 49.9% y-o-y to INR 664.5 crore. This increase in cost is because of higher off take of raw materials owing to new production facilities of nitro-toluene and ethylation. Raw material prices in speciality chemicals have been more or less constant in Q1FY19.
- To insulate itself from rupee volatility the company has entered into forward contracts to hedge its export contracts.
- Further impact of revaluation loss on long term borrowing (ECBs) to the extent of INR 7.23 crore as at 30th June, 2018 has been provided. This loss had been provided in the finance costs of the company.
- Volume grew by 12% in Q1FY19. Realization growth was to the tune of 20-25% in Q1FY19.
- EBITDA impacted by INR 28 crore on account of MTM losses.
- Volumes recorded for the quarter are: NCB = 17,000 MT, Nitro-toluene = 3070 MT, Hydrogenation = 1952 TPM, PDA = 550 TPM.
- NCB business operated at 95% utilization in Q1FY19.
- Nitro-toluene business operated at 40% in Q1FY19. Management expects the business to operate at 80-90% by FY20E.
- Benzene prices for the quarter stood at INR 58/kg.
- Management guided that key end user industries like Dyes & pigments are witnessing strong volume growth and will continue going ahead.
- Prices in key products have seen improvement and sustainability in the long term is seen.
- Capex for the quarter is INR 153 crore. Overall capex of INR 600 crore in FY19E as mentioned in our initiating coverage report.
- Management expects the margins to be higher going ahead owing to increase in prices of high margin products.
- The advance of INR 290-300 crore on INR 10,000 crore deal capex is expected to receive from the next quarter.
- The R&D facility is scheduled to start in Q1FY20. Capex on the same will be INR 75 crore.
- Export contribution to china is reducing because of volume shift from China to India.
- Exports have seen decent growth in Q1FY19.
- Management revised their profitability guidance to upwards of 25%. Previous guidance of 15-20%.
- Home & Personal Care(HPC) chemicals have seen strong performance in Q1FY19. This was on the back of improving utilization & prices in the HPC business.
- Pharma business has shown strong growth in Q1FY19. Pharma business recorded topline growth of 41% y-o-y & bottom-line growth of 91% y-o-y.
- Management guided that 13-14 USDMF's have been commercialized in the quarter.
- API intermediates has shown strong traction in Q1FY19. Management expects the traction to continue going ahead.
- Overall utilization of the pharma business is 70-80%. With API intermediates business improving going ahead, overall pharma business utilization to improve going ahead.

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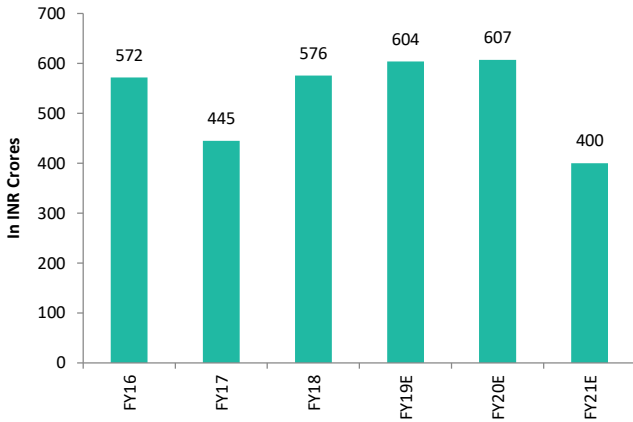
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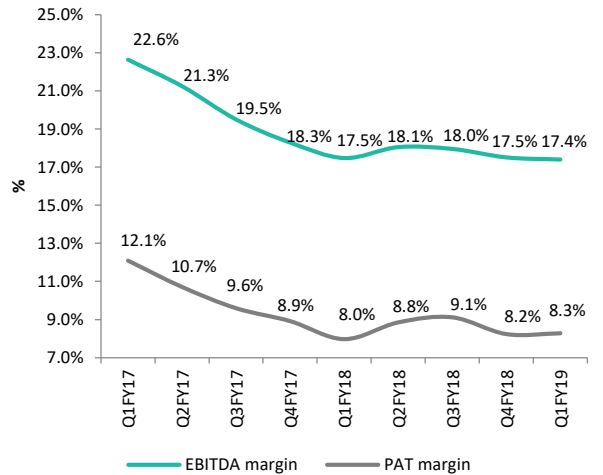
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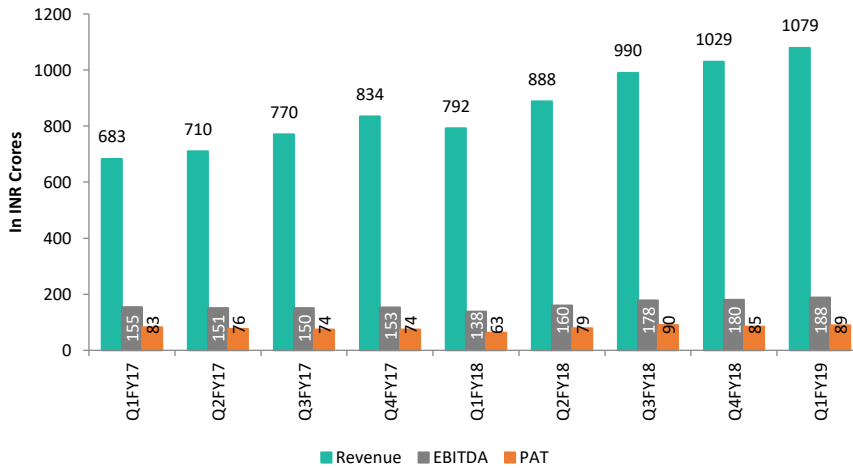
Capex intensity to remain high going ahead



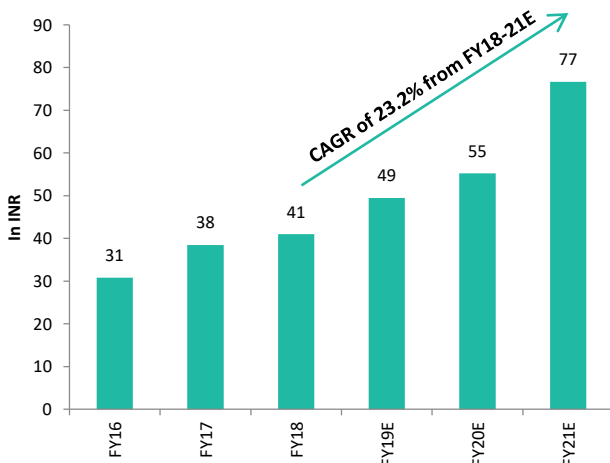
Margins trend is almost stable from Q1FY18



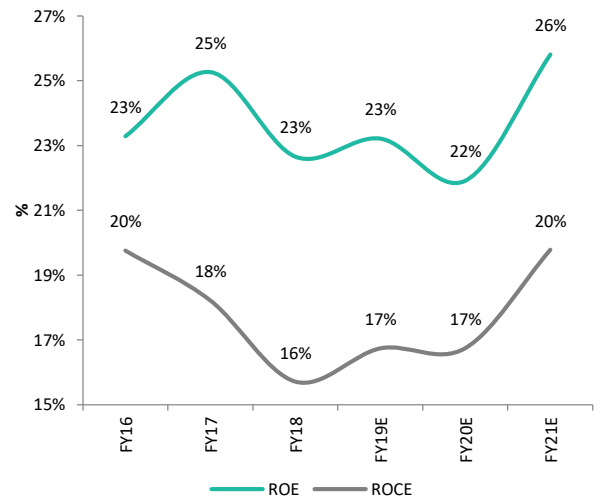
Strong financial performance seen in Q1FY19



EPS growth to remain in double digits going ahead



Return ratios to remain robust going ahead



Source: NSPL Research



Profit and Loss (INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	2908.0	3006.6	3163.5	3806.2	4554.5	4824.7	6036.2
Cost of raw materials	1644.3	1603.5	1673.1	2170.0	2568.9	2644.3	2811.7
Purchase of stock in trade	170.6	115.0	101.8	117.5	0.0	0.0	0.0
Change of Inventories	17.2	49.3	-31.6	-105.9	0.0	0.0	0.0
Employee Benefit Expenses	93.6	120.7	152.3	190.1	219.6	253.7	293.0
Other Expenses	516.5	545.8	614.4	735.3	895.7	942.9	1011.9
TOTAL EXPENDITURE	2442.3	2434.3	2510.0	3106.9	3684.2	3840.9	4781.6
EBIDTA	465.7	572.3	653.5	699.3	870.2	983.8	1254.6
Other Income	5.5	5.9	2.0	7.8	2.9	3.0	3.0
Depreciation	82.0	98.5	122.5	146.2	170.5	193.8	209.8
EBIT	389.2	479.8	532.9	560.8	702.6	792.9	1047.8
Interest	138.0	117.0	117.3	131.7	173.3	201.9	227.8
Exceptional Items	3.5	0.0	0.0	0.0	0.0	0.0	0.0
PBT	254.8	362.8	415.6	429.2	529.3	591.0	820.0
Tax	61.0	94.6	88.1	82.9	111.1	124.1	172.2
PAT	193.7	268.1	327.5	346.3	418.1	466.9	647.8
Profit attributable to Non Control. Interest	-1.7	-11.2	-11.8	-13.2	-15.9	-17.8	-24.6
Share of Profit/Loss of Associates	13.9	0.0	0.0	0.0	0.0	0.0	0.0
PAT	205.9	256.9	315.8	333.1	402.2	449.1	623.2
EPS in Rs	23.2	30.8	38.5	41.0	49.5	55.2	76.6
Dividend Amount	52.0	68.8	67.4	66.1	79.3	105.8	185.1
Balance Sheet (INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Share Capital	44.3	41.7	41.1	40.7	40.7	40.7	40.7
Reserves & Surplus	1025.3	1095.6	1321.4	1537.8	1846.7	2171.4	2576.8
Shareholders Fund	1069.6	1137.3	1362.5	1578.4	1887.3	2212.1	2617.5
Non Controlling Interest	5.9	52.1	63.9	77.0	93.0	103.8	144.1
- Long Term Borrowings	419.1	526.8	596.4	908.3	1018.3	1118.3	1168.3
- Deferred Tax Liabilities(Net)	102.7	127.1	155.4	177.4	231.3	259.1	344.8
- Other Non Current Liabilities	0.2	0.2	0.5	0.0	0.5	0.5	0.5
Total Non Current Liabilities	521.9	654.0	752.3	1085.7	1250.0	1377.8	1513.5
- Short Term Borrowings	648.3	706.4	839.3	1012.5	1162.5	1262.5	1362.5
- Trade Payables	248.8	305.2	299.7	357.5	487.1	454.7	623.7
- Other Current Liabilities	156.6	91.0	153.6	185.3	204.5	217.3	223.7
- Short Term Provisions	14.6	20.5	27.8	31.0	41.7	48.2	55.7
Total Current Liabilities	1068.4	1123.1	1320.4	1586.3	1895.8	1982.7	2265.6
TOTAL EQUITY & LIABILITIES	2665.7	2966.5	3499.1	4327.5	5126.1	5676.4	6540.7
Fixed Assets	966.9	1245.5	1694.9	1996.2	2399.1	2809.0	3206.1
- Capital Work in Progress	193.0	313.0	269.5	436.2	520.9	545.1	439.5
- Goodwill	0.0	0.4	0.4	0.4	0.4	0.4	0.4
- Intangible Assets under development	0.0	0.0	1.7	1.3	1.3	1.3	1.3
- Non Current investments	172.9	41.3	47.0	47.2	49.9	53.2	56.8
- Other Non Current Assets	103.3	132.3	168.4	225.2	269.5	337.7	385.2
Total Non Current Assets	1436.1	1732.5	2181.9	2706.5	3241.1	3746.8	4089.3
- Other Current Financial Assets	172.9	167.9	168.7	224.8	296.0	337.7	385.2
- Inventories	551.7	495.2	571.4	747.3	801.1	792.7	824.9
- Trade Recievables	439.0	523.4	524.7	590.8	657.1	664.8	989.0
- Cash	33.7	29.0	28.5	32.1	89.8	86.2	200.9
- Other Current Assets	32.3	18.5	23.9	26.0	41.0	48.2	51.4
Total Current Assets	1229.7	1234.0	1317.2	1620.9	1885.0	1929.7	2451.4
TOTAL ASSETS	2665.7	2966.4	3499.0	4327.4	5126.1	5676.4	6540.7

Source: NSPL Research



Cash Flow (INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Cash Flow from Operating Activities							
Profit before tax	251.3	362.8	415.6	429.2	529.3	591.0	820.0
Op. Profit before Working Capital Change	466.6	575.0	654.4	707.0	873.1	986.8	1257.7
Op. Profit After Working Capital Changes	397.7	671.5	567.5	442.8	782.0	857.1	986.0
Taxes Paid(Net)	-58.3	-97.8	-97.5	-82.9	-111.1	-124.1	-172.2
Net Cash Flow from Operating Activities	339.5	573.6	470.1	359.9	670.9	733.0	813.9
Cash Flow from Investing Activities							
Purchased of Fixed Assets	-303.1	-466.5	-530.2	-576.3	-603.8	-607.0	-400.0
Sale/(Purchase) of Investments	-4.2	-4.0	0.8	-0.3	-2.7	-3.3	-3.6
Net Cash Flow from Investing Activities	-297.7	-452.0	-528.9	-576.5	-606.5	-610.3	-403.6
Cash Flow from Financing Activities							
Proceeds From Long-Term Borrowings	285.0	201.1	200.0	311.8	110.0	100.0	50.0
Proceeds/Repayment from Other Borrow	-38.5	52.7	132.9	173.2	150.0	100.0	100.0
Interest Paid	-138.0	-117.0	-117.3	-131.7	-173.3	-201.9	-227.8
Dividend Paid	-48.3	-95.2	-0.6	-77.8	-93.3	-124.4	-217.7
Net Cash Flow from Financing Activities	-23.0	-128.4	58.3	220.2	-6.7	-126.3	-295.6
Net Inc/(Dec) in Cash and Cash Equivalent	18.9	-6.8	-0.5	3.6	57.7	-3.7	114.7
Cash and Cash Equivalents at Beginning	14.9	33.7	29.0	28.5	32.1	89.8	86.2
Total Cash & Cash Equivalent	33.7	29.0	28.5	32.1	89.8	86.2	200.9
Financial Ratios							
Growth Ratios							
Revenue Growth	10.5%	3.4%	5.2%	20.3%	19.7%	5.9%	25.1%
EBITDA Growth	16.0%	22.9%	14.2%	7.0%	24.5%	13.0%	27.5%
PAT Growth	26.7%	24.8%	22.9%	5.5%	20.7%	11.7%	38.7%
PBT Growth	23.6%	42.4%	14.6%	3.3%	23.3%	11.7%	38.7%
Raw Materials Growth	8.8%	-3.5%	-1.4%	25.1%	17.8%	2.9%	6.3%
Margin Profile							
EBITDA Margins	16.0%	19.0%	20.7%	18.4%	19.1%	20.4%	20.8%
PBT Margins	8.8%	12.1%	13.1%	11.3%	11.6%	12.2%	13.6%
PAT Margins	7.1%	8.5%	10.0%	8.8%	8.8%	9.3%	10.3%
Gross Margins	63.0%	58.8%	55.1%	57.3%	56.4%	54.8%	46.6%
Return Ratios							
ROCE	17.1%	19.8%	18.2%	15.7%	16.7%	16.7%	19.8%
ROIC	15.6%	17.4%	17.6%	15.8%	16.4%	16.4%	18.7%
ROA	7.3%	7.9%	8.1%	7.0%	7.4%	7.4%	9.5%
Operating ROA	16.5%	17.7%	16.7%	14.8%	16.1%	16.1%	19.2%
Debt Ratios							
Debt to Equity	1.0	1.1	1.1	1.3	1.2	1.1	1.0
Debt to Assets	0.5	0.4	0.4	0.4	0.5	0.4	0.4
Debt to Total Capital	0.5	0.5	0.5	0.6	0.6	0.5	0.5
Interest Coverage	2.8	4.1	4.5	4.3	4.1	3.9	4.6
DuPont Analysis							
PAT Margin	7.1%	8.5%	10.0%	8.8%	8.8%	9.3%	10.3%
Asset Turnover	1.1	1.1	1.0	1.0	1.0	0.9	1.0
Equity Multiplier	2.5	2.6	2.6	2.7	2.7	2.6	2.5
ROE	19.2%	23.3%	25.3%	22.7%	23.2%	21.9%	25.8%

Source: NSPL Research

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Aarti Industries Ltd				Rating Legend	
Date	CMP (INR)	Target Price (INR)	Recommendation	Strong Buy	More than 15%
July 16, 2018 – IC	1240	1543	Strong Buy	Buy	5% - 15%
August 07, 2018	1294	1543	Strong Buy	Hold	0 – 5%
				Reduce	-5% - 0
				Sell	Less than -5%

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Other disclosures	NO

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