

November 06, 2018

Aarti Industries Ltd.

Strong demand, improved visibility and import substitution will be the key

Strong profitability growth led by strong volumes

The company reported revenue growth of 46.4% y-o-y and 20.5% q-o-q to INR 1299.5 crore in Q2FY19. This growth was on the back of strong volumes from the nitro-toluene and PDA business. EBITDA stood at INR 242.1 crore in Q2FY19 up 51% y-o-y and 28.8% q-o-q. EBITDA Margins stood at 18.6% in Q2FY19 as against 18.1% in Q2FY18 and 17.4% in Q1FY19. PAT stood at INR 122.9 crore in Q2FY19 up 56.6% y-o-y and 37.7% q-o-q.

Geographical shift to India leading to strong demand in various speciality chemicals

The company exports stood at 36.3% in Q2FY19 as compared to 46.5% in Q2FY18 indicating much of the company's business is becoming domestic oriented. We believe domestic industry has huge potential for growth going ahead on the back of 1.) Market shift from china to India in various speciality chemical products 2.) Value added high margin products available at competitive prices in Indian markets as compared to china 3.) Easy availability of power etc and various other factors has led to Indian chemical industry much ahead as compared to other emerging nations and we believe this will positively impact Aarti Industries owing to continual focus in Indian markets going ahead.

Operating leverage leading to higher capacity utilization in various segments

The nitro-toluene plant is currently operating at near 50% utilizations. Since, toluene is import substitute, hence strong demand from Indian markets coupled with operating leverage will improve the revenues going ahead. Also, the company has expanded the capacity of Phenylene Diamines(PDA) from 5400 TPA to 12,000 TPA and utilizations are hovering near 55-60% levels and margins are around 25-27%.

Pharma business reported strong momentum on back of increased volumes

The pharma business recorded revenue growth of 40% y-o-y to INR 192 crore and EBIT growth of 53.3% y-o-y to INR 29 crore in Q2FY19. This strong growth was on the back of volumes which recorded strong growth and management is quite confident that the volume growth will sustain going ahead. EBIT margins improved by 124 bps and stood at 15.1% in Q2FY19 as compared to 13.9% in Q2FY18. Margin improvement is attributable to higher capacity utilization in key segments like API's and caffeine. Going ahead the company is focusing on off-patented generics to be supplied in regulated markets which will lead to improvement in revenues going ahead.

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 re-iterate to "STRONG BUY" on the stock and maintain our target price of INR 1651/share, thereby giving an upside of 21.3% 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	27.5	24.6	17.8
P/B (x)	3.1	4.6	6.4	5.9	5.0	4.2
EV/EBITDA(x)	11.0	11.6	15.4	15.1	13.6	10.7

Source: Company, NSPL Research

* Read last page for disclaimer & rating rationale

ANALYST
 Vaibhav Chowdhry
vaibhav.chowdhry@nalandasecurities.com

ASSOCIATE
 Aditya Khetan
aditya.khetan@nalandasecurities.com

NALANDA SECURITIES PRIVATE LIMITED
 310-311 Hubtown Solaris, NS Phadke Marg, Opp Teli Gali, Andheri East, Mumbai 69
 +91-22-6281-9649 | research@nalandasecurities.com | www.nalandasecurities.com

STRONG BUY*

Downside Scenario	Current Price	Price Target	Upside Scenario
	1361	1651	
21.3% ▲			

Market Data	
Industry	Speciality Chemicals
Sensex	34951
Nifty	10524
Bloomberg Code	ARTO:IN
Eq. Cap. (INR Crores)	40.65
Face Value (INR)	5
52-w H/L	1378/772
Market Cap (INR Crores)	11,122

Valuation Data	FY18	FY19E	FY20E
P/E (x)	30.3	27.5	24.6
P/B (x)	6.4	5.9	5.0
EV/EBITDA (x)	15.4	15.1	13.6

Aarti Industries Ltd Vs SENSEX



Shareholding Pattern (in %)			
	Sept'18	Jun'18	Sept'17
Promoters	52.84	52.91	53.54
FIIIs	13.92	14.30	12.65
DIIIs	4.22	3.82	3.97
Retail	28.86	28.81	29.68
Total	100.0	100.0	100.0



Q2FY19 Result Analysis

(INR Crores)	Q2FY19	Q2FY18	Q1FY19	Y-o-Y	Q-o-Q
Revenue (Net of excise duty)	1299.5	887.9	1078.5	46.4%	20.5%
COGS	794.3	522.3	659.6	52.1%	20.4%
Employee Expenses	52.9	41.4	51.3	27.6%	3.1%
Other Expenses	210.3	163.9	179.8	28.3%	17.0%
Total Expenses	1057.4	727.6	890.6	45.3%	18.7%
EBITDA	242.1	160.3	187.9	51.0%	28.8%
Depreciation	38.9	33.0	37.7	17.7%	3.0%
Other Income	0.2	0.1	3.4	118.2%	-92.9%
EBIT	203.5	127.4	153.6	59.7%	32.5%
Finance Cost	51.3	31.4	46.1	63.5%	11.3%
PBT (before exceptional item)	152.2	96.0	107.5	58.5%	41.6%
Share of associates	0.0	0.0	0.0		
Exceptional items	0.0	0.0	0.0		
PBT (after exceptional item)	152.2	96.0	107.5	58.5%	41.6%
Taxes	29.2	17.5	18.2	67.1%	60.7%
Net Profit	122.9	78.5	89.3	56.6%	37.7%
EPS in INR	15.1	11.0	9.6	37.7%	58.2%

Source: Company, NSPL Research

- The company's net sales grew 46.4% y-o-y and 20.5% q-o-q to INR 1299.5 crore in Q2FY19.
- EBITDA grew by 51% y-o-y and 28.8% q-o-q to INR 242.1 crore in Q2FY19. EBITDA Margins stood at 18.6% in Q2FY19 as against 18.1% in Q2FY18 and 17.4% in Q1FY19. Margins improved owing to strong growth in revenues.
- Employee expense grew by 27.6% y-o-y and 3.1% q-o-q to INR 52.9 crore owing to expansion of nitro-toluene and ethylation facility.
- Finance cost grew by 63.5% y-o-y & 11.3% q-o-q to INR 51.3 crore in Q2FY19.
- PBT grew by 58.5% y-o-y & 41.6% q-o-q to INR 152.2 crore in Q2FY19.
- Reported PAT grew 56.6% y-o-y and 37.7% q-o-q to INR 122.9 crore in Q2FY19. PAT margins stood at 9.5% in Q2FY19 as compared to 8.8% in Q2FY18 and 8.3% in Q1FY19.

(INR Crores)	Q2FY19	Q2FY18	Q1FY19	Y-o-Y	Q-o-Q
Revenue Breakup					
Speciality Chemicals	1039.1	690.9	848.5	50.4%	22.5%
Pharmaceuticals	192.3	136.9	149.7	40.5%	28.4%
Home & Personal care	68.2	60.0	80.3	13.5%	-15.1%
Total	1299.5	887.9	1078.5	46.4%	20.5%
EBIT breakup					
Speciality Chemicals	209.8	128.6	148.3	63.1%	41.4%
Pharmaceuticals	29.2	19.0	26.0	53.3%	12.2%
Home & Personal care	-3.8	-0.1	1.9	-	-
Total	235.2	146.9	176.3	60.1%	33.4%

Source: Company, NSPL Research

- The company's speciality chemicals revenue grew 50.4% y-o-y and 22.5% q-o-q to INR 1039.1 crore in Q2FY19. EBIT grew by impressive 63.1% y-o-y & 41.4% q-o-q to INR 209.8 crore in Q2FY19. The company exports stood at 36.3% in Q2FY19 as compared to 46.5% in Q2FY18 indicating much of the company's business is becoming domestic oriented. The nitro-toluene plant is currently operating at near 50% utilizations. Since, toluene is import substitute hence strong demand from Indian markets coupled with operating leverage will improve the revenues going ahead. Also, the company has expanded the capacity of Phenylene Diamines(PDA) and utilizations are hovering near 55-60% levels and margins are around 25-27%. Since, Aarti industries is the only player in India to manufacture PDA, hence we believe improved visibility in Indian markets will lead to strong growth in revenues.
- The company's pharmaceuticals revenue grew 40.5% y-o-y and 28.4% q-o-q to INR 192.3 crore in Q2FY19. EBIT grew by strong 53.3% y-o-y & 12.2% q-o-q to INR 29.2 crore in Q2FY19. This strong growth was on the back of strong volumes which recorded strong growth and management is quite confident that the volume growth will sustain going ahead.

ANALYST

Vaibhav Chowdhry
vaibhav.chowdhry@nalandasecurities.com

ASSOCIATE

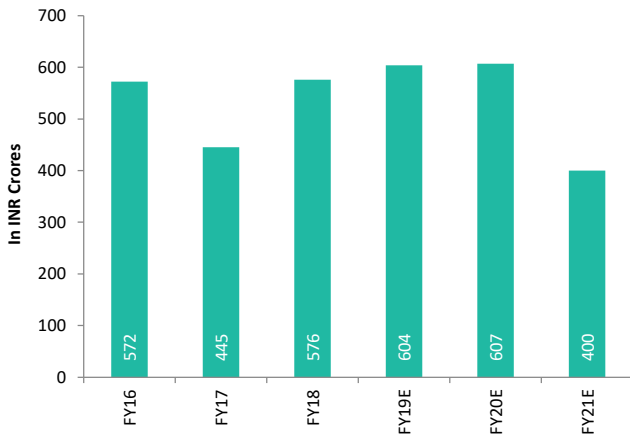
Aditya Khetan
aditya.khetan@nalandasecurities.com

NALANDA SECURITIES PRIVATE LIMITED

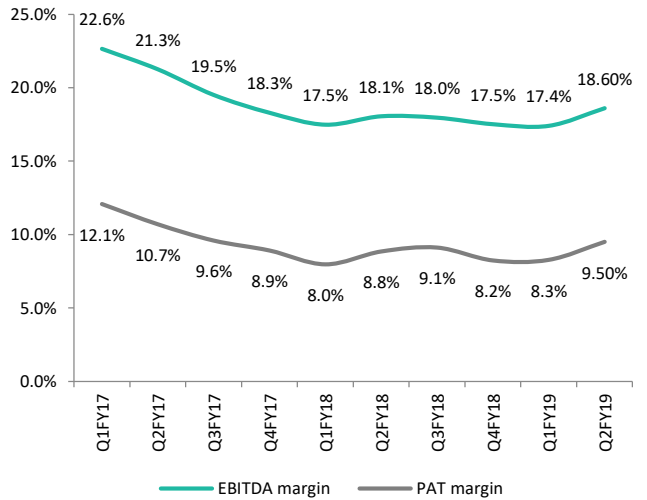
310-311 Hubtown Solaris, NS Phadke Marg, Opp Teli Gali, Andheri East, Mumbai 69
 +91-22-6281-9649 | research@nalandasecurities.com | www.nalandasecurities.com



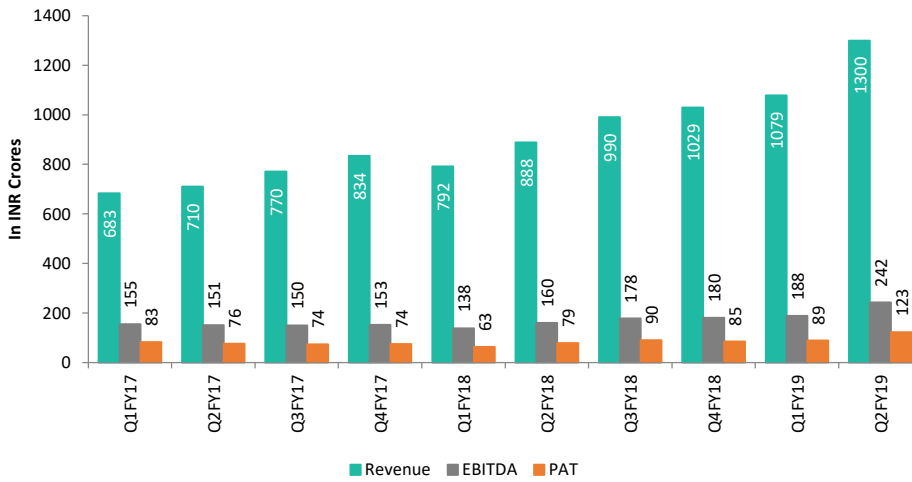
Capex intensity to remain high going ahead



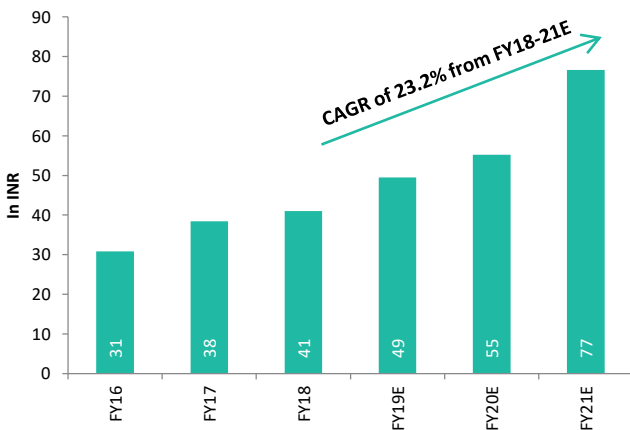
Margins started to inch up on back of operating leverage



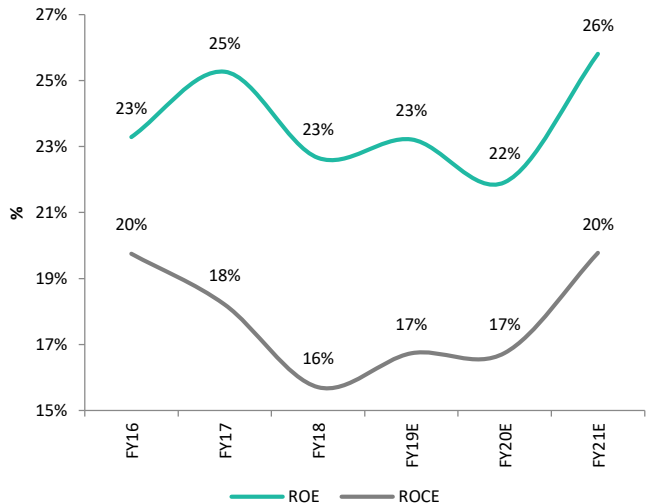
Profitability recorded an impressive growth of 38% q-o-q basis



EPS growth to remain in double digits going ahead



Return ratios to remain robust going ahead



Source: Company, NSPL Research



Profit and Loss(INR Crores)	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Revenue From Operations	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 Crore)	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	2966.5	3499.1	4327.5	5126.1	5676.4	6540.7

Source: Company, NSPL Research

ANALYSTVaibhav Chowdhry
vaibhav.chowdhry@
nalandasecurities.com**ASSOCIATE**Aditya Khetan
aditya.khetan@
nalandasecurities.com**NALANDA SECURITIES PRIVATE LIMITED**310-311 Hubtown Solaris, NS Phadke Marg, Opp Teli Gali, Andheri East, Mumbai 69
+91-22-6281-9649 | research@nalandasecurities.com | www.nalandasecurities.com



Cash Flow (INR Crore)	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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Vaibhav Chowdhry
vaibhav.chowdhry@nalandasecurities.com

ASSOCIATE
Aditya Khetan
aditya.khetan@nalandasecurities.com

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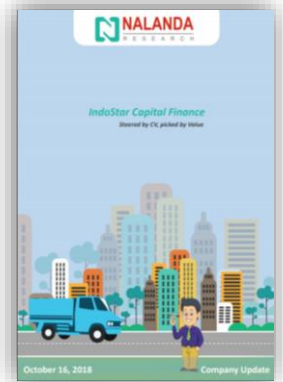
Dalmia Bharat



Coromandel International



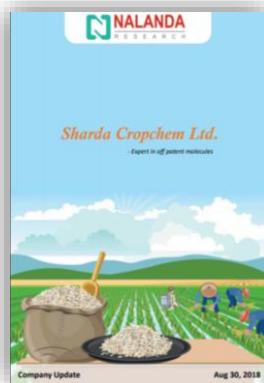
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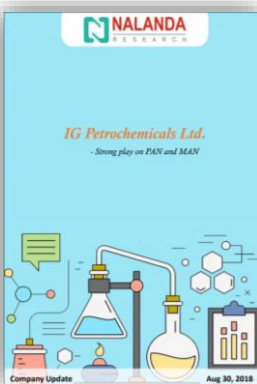
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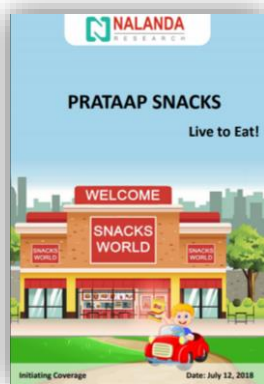
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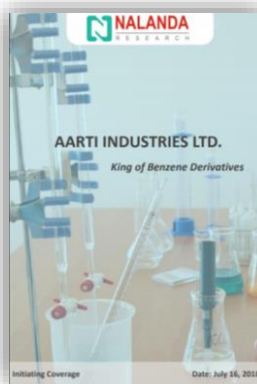
Manappuram Finance



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Aarti Industries Ltd				Rating Legend	
Date	CMP (INR)	Target Price (INR)	Recommendation	Strong Buy	More than 15%
November 06, 2018	1361	1651	Strong Buy	Buy	5% - 15%
August 07, 2018	1294	1543	Strong Buy	Hold	0 - 5%
July 16, 2018 - IC	1240	1543	Strong Buy	Reduce	-5% - 0
				Sell	Less than -5%

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Other disclosures	NO

ANALYST

Vaibhav Chowdhry
vaibhav.chowdhry@nalandasecurities.com

ASSOCIATE

Aditya Khetan
aditya.khetan@nalandasecurities.com

NALANDA SECURITIES PRIVATE LIMITED

310-311 Hubtown Solaris, NS Phadke Marg, Opp Teli Gali, Andheri East, Mumbai 69
 +91-22-6281-9649 | research@nalandasecurities.com | www.nalandasecurities.com