Aarti Industries (AARIND)

CMP: ₹ 926 | Target: ₹ 1085 (17%) | Target Period: 12 months | **BUY**

August 23, 2021

Company Update

Demerger to unlock potential segmental value…

About the Demerger: Aarti industries' board has approved the restructuring of the pharma business and allied activities of the company, which will be demerged into Aarti Pharmalabs Ltd (formerly known as Aarti Organics Ltd), a wholly owned subsidiary company of Aarti Industries Ltd. The demerged undertaking also includes a part of the specialty chemical business, which is a backward integrated facility providing feeding material to the pharma business. This part of the specialty chemical business accounts for less than 3% of revenues of the speciality chemical business. The demerged company would continue to run and operate the remaining specialty chemical business.

Exchange Ratio: One fully paid up equity share of ₹ 5 each in Aarti Pharmalabs Ltd for every four fully paid up equity shares of ₹ 5 each held in Aarti Industries Ltd. No cash consideration is payable under the scheme.

Financial profile of pharma business: The pharma business recorded a revenue CAGR of 19.6% over FY17-21 to ₹ 872 crore while EBIT grew at 43.8% CAGR to ₹ 205 crore for the same period. The focus of the management towards increasing speciality value portfolio share has aided margins historically. Going forward, once additional capacity for APIs and intermediates comes on stream by H2FY22E, one can expect strong momentum for the segmental growth. We expect revenues to grow in high teens over the next period.

Valuations:

- As per the exchange ratio, the pharma business is valued at around ₹ 6900 crore, implying a valuation EV/sales of ~6x FY23E. We expect average EBIT margins to reach normalised levels of 22%. Thus, based on our expected bottomline of the pharma segment, it is valued at ~38x PER on FY23E. We believe based on the peers' valuation for the same stream of business line, it is on the higher side. However, any development in the CDMO space or improving margins profile ahead of estimates would support valuations, going ahead

Alternate Stock Idea: Apart from Aarti Industries, in our chemical coverage we also like Neogen Chemical.

- Trigger for Neogen Chemical's future revenue growth would be increasing custom synthesis opportunity
- BUY with a target price of ₹ 1095

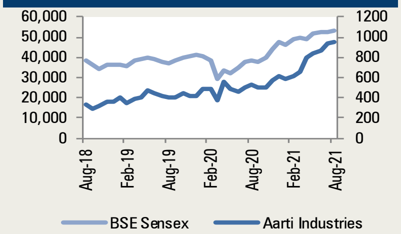
Particulars

Particular	Amount
Market cap (₹ Crore)	33,477
FY21 Total Debt (₹ Crore)	2,492
FY21 Cash & Inv (₹ Crore)	412
EV (₹ Crore)	35,557
52 Week H/L	987/483
Equity Capital (₹ Crore)	181.3
Face Value (₹)	5

Shareholding pattern

in %	Sept-20	Dec-20	Mar-21	Jun-21
Promoter	47.6	47.3	46.8	44.9
DII	15.8	14.6	15.6	13.6
FII	7.5	9.0	8.7	11.9
Others	29.2	29.1	28.9	29.6

Price Chart



Recent event & key risks

- Overall revenue growth guidance remains 25-35% for FY22
- Key Risk: (i) Higher than expected volatility in RMAT prices (ii) Slowdown in end user industries demand to hurt growth

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ICICI Securities – Retail Equity Research

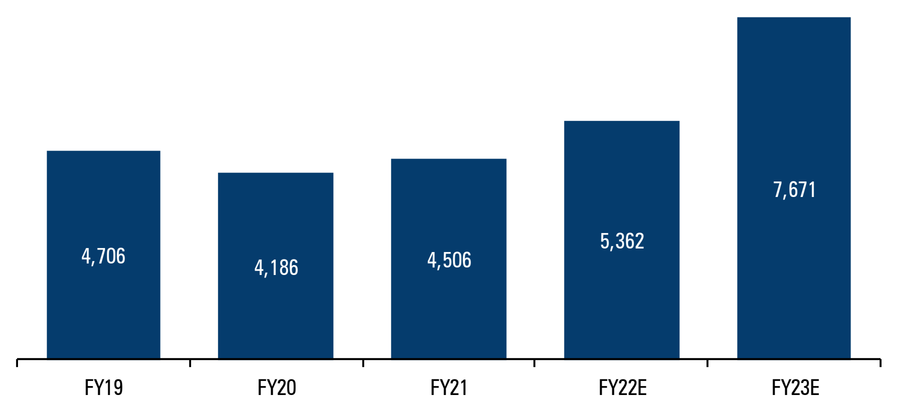
Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	2 year CAGR (FY21-23E)
Net Revenue	4,705.5	4,186.3	4,506.1	8.4%	5,362.5	7,671.2	30.5%
EBITDA	965.1	977.3	981.5	11.4%	1,283.4	1,875.9	38.2%
EBITDA Margins (%)	20.5%	23.3%	21.8%		23.9%	24.5%	
Adj.PAT	504.2	536.1	525.8	15.4%	681.9	1,125.7	46.3%
Adj. EPS (₹)	13.6	14.8	14.5		18.8	31.1	
EV/EBITDA	36.3x	36.1x	36.8x		27.6x	19.1x	
P/E	68.1x	62.4x	63.7x		49.1x	29.7x	
ROE (%)	18.7	18.0	15.0		12.8	17.8	
ROCE (%)	14.6	13.5	10.7		11.2	15.6	

Source: Company, ICICI Direct Research

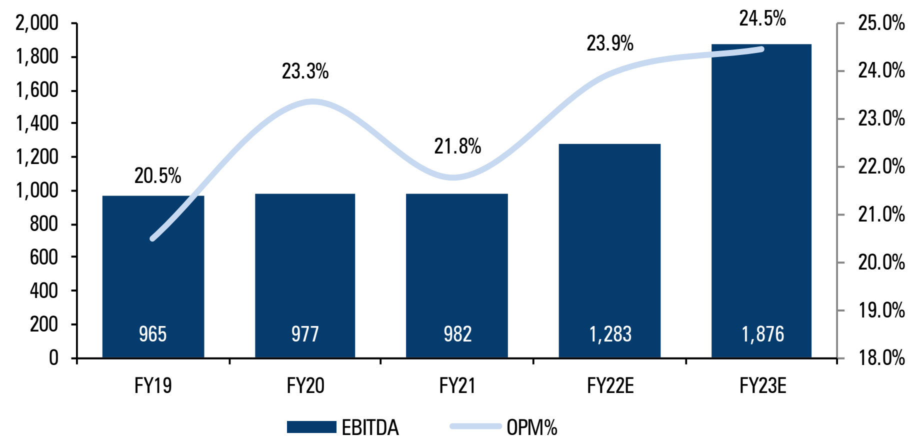
Financial story in charts….

Exhibit 1: Revenue trend (₹ crore)



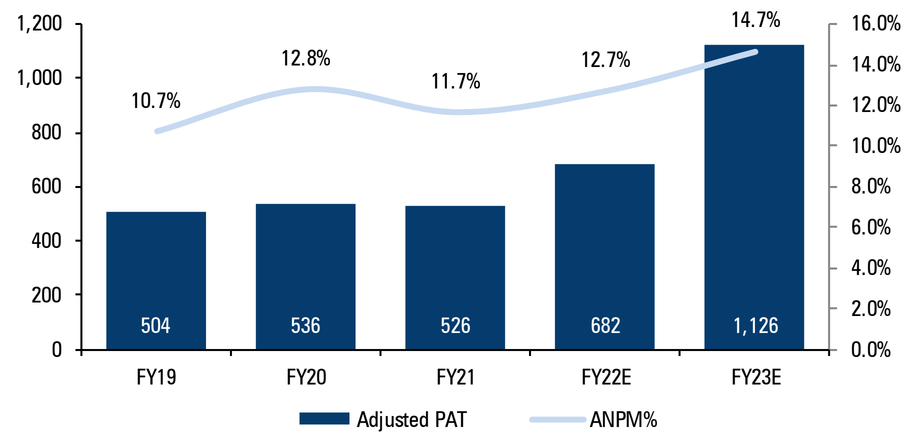
Source: Company, ICICI Direct Research

Exhibit 2: EBITDA (₹ crore) and OPM (%) trend



Source: Company, ICICI Direct Research

Exhibit 3: PAT growth trend (₹ crore)



Source: Company, ICICI Direct Research

Financial summary

Exhibit 4: Profit and loss statement ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Total Operating Income	4,186.3	4,506.1	5,362.5	7,671.2
Growth (%)	-11.0	7.6	19.0	43.1
Raw Material Expenses	2,056.3	2,128.6	2,484.5	3,554.1
Gross Profit	2,130.0	2,377.5	2,878.0	4,117.0
Gross Profit Margins (%)	50.9	52.8	53.7	53.7
Employee Expenses	305.2	371.4	405.1	579.5
Other Expenditure	847.4	1,024.6	1,189.5	1,661.7
Total Operating Expenditure	3,209.0	3,524.6	4,079.1	5,795.3
EBITDA	**977.3**	**981.5**	**1,283.4**	**1,875.9**
Growth (%)	1.3	0.4	30.8	46.2
Interest	124.8	86.4	153.2	153.2
Depreciation	185.2	231.3	274.4	329.3
Other Income	8.8	1.1	0.2	19.2
PBT before Exceptional Item	**676.2**	**664.9**	**856.1**	**1,412.6**
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	676.2	664.9	856.1	1,412.6
Total Tax	129.4	129.3	173.3	286.0
PAT after MI	536.1	525.8	681.9	1,125.7
Adjusted PAT	**536.1**	**525.8**	**681.9**	**1,125.7**
Growth (%)	6.3	-1.9	29.7	65.1
EPS (Adjusted)	**14.8**	**14.5**	**18.8**	**31.1**

Source: Company, ICICI Direct Research

Exhibit 5: Cash flow statement ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Profit/(Loss) after taxation	512.3	567.9	1,190.3	1,125.7
Add: Depreciation & Amortiza	185.2	231.3	274.4	329.3
Net Increase in Current Asset	-68.6	-136.0	-248.1	-854.0
Net Increase in Current Liabili	358.8	128.8	12.7	254.4
Others	114.3	80.7	153.2	153.2
CF from Operating activities	**1,102.1**	**872.7**	**1,382.5**	**1,008.6**
Investments	1.3	-7.8	0.0	0.0
(Purchase)/Sale of Fixed Ass	-1,125.5	-1,314.4	-1,200.0	-1,200.0
Others	0.2	0.1	3.0	3.1
CF from Investing activities	**-1,124.1**	**-1,322.1**	**-1,197.0**	**-1,196.9**
(inc)/Dec in Loan	-303.2	745.9	200.0	0.0
Dividend & Dividend tax	-106.4	-45.1	-119.0	-112.6
Other	-125.4	-86.4	-153.2	-153.2
CF from Financing activities	-534.9	614.5	-72.2	-265.7
Net Cash Flow	**-556.9**	**165.0**	**113.3**	**-454.1**
Cash and Cash Equivalent	804.2	247.3	412.3	525.6
Cash	**247.3**	**412.3**	**525.6**	**71.5**
Free Cash Flow	**-23.4**	**-441.7**	**182.5**	**-191.4**

Source: Company, ICICI Direct Research

Exhibit 6: Balance sheet ₹ crore

(Year-end March)	FY20	FY21	FY22E	FY23E
Equity Capital	87.1	87.1	181.3	181.3
Reserve and Surplus	2,891.7	3,415.8	4,392.9	5,406.1
Total Shareholders funds	2,978.8	3,502.9	4,574.2	5,587.4
Total Debt	2,094.2	3,022.1	3,222.1	3,222.1
Deferred Tax Liability	211.0	233.9	238.6	243.4
Minority Interest	94.6	12.2	12.5	12.7
Other Non Current Liabilities	550.9	224.4	228.9	233.5
Source of Funds	**5,929.5**	**6,995.6**	**8,276.3**	**9,299.1**
Gross Block - Fixed Assets	3,837.0	5,192.4	6,492.4	7,792.4
Accumulated Depreciation	1,368.6	1,599.9	1,874.2	2,203.5
Net Block	2,468.5	3,592.6	4,618.2	5,588.9
Capital WIP	1,417.6	1,297.9	1,197.9	1,097.9
Fixed Assets	3,886.1	4,890.5	5,816.1	6,686.8
Investments	37.0	63.5	63.5	63.5
Other non-Current Assets	404.5	320.1	326.5	333.0
Inventory	835.7	935.7	1,028.4	1,471.2
Debtors	753.4	793.7	944.6	1,351.2
Other Current Assets	168.5	225.9	230.4	235.0
Cash	247.3	412.3	525.6	71.5
Total Current Assets	2,004.9	2,367.6	2,729.0	3,129.0
Creditors	345.2	576.3	587.7	840.7
Provisions	39.9	40.1	40.9	41.7
Other Current Liabilities	18.0	29.6	30.2	30.8
Total Current Liabilities	403.1	646.1	658.8	913.2
Net Current Assets	1,601.8	1,721.5	2,070.2	2,215.7
Application of Funds	**5,929.5**	**6,995.6**	**8,276.3**	**9,299.1**

Source: Company, ICICI Direct Research

Exhibit 7: Key ratios

(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
Reported EPS	14.8	14.5	18.8	31.1
Cash EPS	11.2	12.3	16.9	27.9
BV per share	82.2	96.6	146.5	174.4
Cash per Share	6.8	11.4	34.8	22.3
Dividend per share	3.6	2.2	1.9	3.1
Operating Ratios (%)				
Gross Profit Margins	50.9	52.8	53.7	53.7
EBITDA margins	23.3	21.8	23.9	24.5
Adjusted PAT Margins	12.8	11.7	12.7	14.7
Cash Conversion Cycle	108.5	93.4	94.3	94.3
Asset Turnover	1.1	0.9	0.8	1.0
EBITDA conversion Rate	112.8	88.9	67.6	53.8
Return Ratios (%)				
RoE	18.0	15.0	12.8	17.8
RoCE	13.5	10.7	11.2	15.6
RoIC	18.6	14.2	15.4	19.0
Valuation Ratios (x)				
P/E	62.4	63.7	49.1	29.7
EV / EBITDA	36.1	36.8	27.6	19.1
EV / Net Sales	8.4	8.0	6.6	4.7
Market Cap / Sales	8.0	7.4	6.2	4.4
Price to Book Value	11.2	9.6	6.3	5.3
Solvency Ratios				
Debt / EBITDA	2.1	3.1	2.5	1.7
Debt / Equity	0.7	0.9	0.6	0.5
Current Ratio	4.4	3.0	3.3	3.3
Quick Ratio	**2.3**	**1.6**	**1.8**	**1.7**
Inventory days	72.9	75.8	70.0	70.0
Debtor days	65.7	64.3	64.3	64.3
Creditor days	30.1	46.7	40.0	40.0

Source: Company, ICICI Direct Research

Exhibit 8: ICICI Direct coverage universe (Chemicals)

Company	CMP			M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
PI Industries	3316	3,855	Buy	50,403	48.6	59.2	77.1	68.3	56.0	43.0	47.8	39.2	30.1	17.2	18.6	20.4	13.8	14.6	16.1
Aarti Industries	924	1,085	Buy	33,477	14.5	32.8	31.1	63.7	28.1	29.7	36.8	28.2	19.5	10.7	12.2	16.8	15.0	14.9	20.1
Sumitomo Chemical	431	505	Buy	21,513	6.9	8.5	10.1	62.3	50.6	42.6	43.1	35.1	29.0	29.8	29.3	28.1	22.4	22.1	21.2
Vinati Organics	1954	2,300	Buy	20,086	26.2	40.2	44.3	74.6	48.6	44.1	56.4	36.2	32.3	21.7	29.4	27.1	17.4	22.1	20.4
Tata Chemical	824	925	Hold	20,997	10.1	39.1	42.6	81.9	21.1	19.3	15.8	10.0	8.3	4.1	7.1	7.7	1.8	6.6	6.9
Navin Fluorine	3720	3,712	Hold	18,413	45.0	53.0	73.1	82.6	70.2	50.9	57.5	49.7	33.9	21.0	19.0	22.6	13.6	14.2	17.0
Rallis India	320	400	Buy	6,215	11.4	12.7	16.0	28.1	25.1	20.0	18.4	16.8	13.0	18.0	17.7	20.0	13.9	13.9	15.3
Sudarshan chemical	642	795	Buy	4,447	20.4	26.2	31.7	31.5	24.5	20.3	17.2	13.7	11.4	15.2	18.2	19.7	19.0	20.7	21.1
Neogen Chemicals	897	1,095	Buy	2,093	13.4	18.8	28.8	66.8	47.7	31.2	35.6	26.7	19.4	15.1	16.5	20.1	17.1	19.8	23.7

Source: Bloomberg, ICICI Direct Research

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