



TM

Aarti Industries

21 August 2021

EVENT UPDATE

Sector: Chemical Rating: **SELL**

CMP: Rs 925 Target Price: Rs 766

Stock Info

Sensex/Nifty	55,329/ 16,450
Bloomberg	ARTO IN
Equity shares (mn)	362.5
52-wk High/Low	Rs 987/ 484
Face value	Rs 5
M-Cap	Rs 335bn/USD 4.6bn
3-m Avg volume	USD 2.0mn

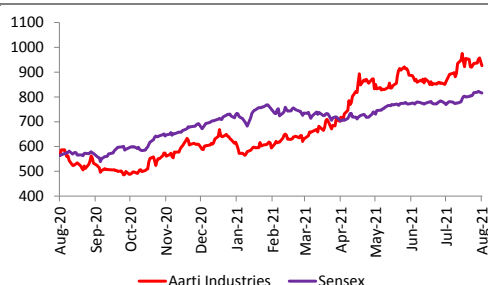
Financial Snapshot (Rs mn)

Y/E Mar	FY21	FY22E	FY23E
Net sales	45,061	58,941	72,447
EBITDA	9,815	13,674	16,764
PAT (adj.)	5,235	7,754	9,701
EPS (adj.) (Rs)	14.4	21.4	26.8
PE (x)	38.2	43.2	34.6
P/B (x)	5.7	6.3	5.5
EV/EBITDA (x)	23.3	26.0	21.3
RoE (%)	16.3	15.6	15.4
RoCE (%)	12.1	13.1	13.7
D/E (x)	0.9	0.6	0.6
OPM (%)	21.8	23.2	23.1
Dividend Per Share (Rs)	1.4	4.3	5.4
Dividend Yield (%)	0.3	0.5	0.6
Dividend payout (%)	10	20	20

Shareholding Pattern (%)

	Jun'21	Mar'21	Dec'20
Promoter	44.9	46.8	47.3
- Pledged	-	-	-
FII	11.9	8.7	9.0
DII	13.6	15.6	14.6
Others	29.6	28.9	29.1

Stock Performance (1-year)



Demerger to marginally impact valuations

To unlock value, improve operational efficiency and sharpen focus on business verticals, the board of Aarti Industries (ARTO) approved the de-merger of its pharmaceutical unit into Aarti Pharmedlabs effective from 1st July 2021. The demerger will be net-negative as the profitability of the pharma business was better than the chemical business and it was also aiding the market capitalization of the overall business. The sales/EBIT share of the pharma business was 17%/22% in FY21 and adjusted RoCE was 16% vs. 13% for the chemical business. The demerger includes a part of the chemicals business (~3% of sales), which is a backward integrated facility for pharma raw material. Shareholders will get 1 share of the demerged entity for every 4 ARTO shares they hold. Typically, API (active pharmaceutical ingredients) companies trade at 10-20x PE on a two-year forward basis vs. chemical companies at 25-40x. On a SoTP basis, we value the chemical/pharma business at Rs 677/Rs 89 per share based on 30x/20x PE on FY23E earnings (based on existing outstanding shares), implying a target price of Rs 766 (earlier Rs 803). Further, poor volume growth visibility, delay in key projects and the slow ramp-up of newly added capacities remain our concerns. We downgrade the stock to SELL from Hold.

Pharma business details

ARTO's pharmaceutical business can be classified into 1) API and intermediates and 2) Xanthine derivatives (caffeine & other products). It has four manufacturing plants with three dedicated to APIs & intermediates (two are USFDA approved) and one to Xanthine derivatives; it has an installed capacity of ~3,600tpa for its flagship product *Caffeine*. After a decade-long struggle, pharma unit EBIT margins improved over the last two years, before taking a hit in 1QFY22 due to a weak product mix and a rise in raw material & logistics-related costs. The management remains confident of continued growth and expects margin recovery in the coming quarters. We estimate a sales CAGR of 17% between FY21-23E given 1) capacity addition in APIs and intermediates (~Rs 2bn capex in FY21) to be operational from 2HFY22, 2) value additions (antihypertensive, cardiovascular, oncology and corticosteroids) and 3) increased penetration in regulated markets.

Exhibit 1: Chemicals & Pharma financials & valuations

YE (FY21) - Rs mn	Chemicals	Pharma	Blended	Pharma as % of blended value
Sales	41,514	8,719	50,233	17%
OPM (calculated)	18.6%	24.0%		
EBIT	7,528	2,046	9,573	21%
EBIT (adjusted)	5,822	1,688	7,509	22%
Capital employed	44,013	10,298		
RoCE	13%	16%		
Valuation				
Target PE (x) - 2 years forward	30	20		
Target Price (Rs)	677	89	766	
Market Cap	245,332	32,293	277,625	12%
Post-demerger				
Current outstanding share (mn)	362.5	362.5		
Share ratio (4:1)	1.0	4.0		
Post demerger no. of shares (mn)	362.5	90.6		
Share price post de-merger (Rs)	677	356		

Source: Company, Systematix Institutional Research

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FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Net revenues	42,136	41,863	45,061	58,941	72,447
Revenue growth (%)	10.7	-0.6	7.6	30.8	22.9
- Op. expenses	32,485	32,090	35,246	45,268	55,683
EBITDA (Excl. OI)	9,651	9,773	9,815	13,674	16,764
EBITDA margins (%)	22.9	23.3	21.8	23.2	23.1
- Interest expenses	1,825	1,248	864	990	1,041
- Depreciation	1,627	1,852	2,313	2,893	3,530
+ Other income	21	88	7	29	72
- Tax	1,178	1,294	1,293	1,964	2,453
Effective tax rate (%)	19	19	19	20	20
Reported PAT	5,042	5,468	5,352	7,856	9,813
+/- Extraordinary items	14	-	-	-	-
+/- Minority interest	124	107	118	102	112
Adjusted PAT	4,904	5,361	5,235	7,754	9,701
EPS (Rs/share)	13.5	14.8	14.4	21.4	26.8

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	433	871	871	1,813	1,813
Reserves & Surplus	25,873	28,916	34,158	51,521	59,394
Networth	26,306	29,787	35,029	53,334	61,207
Minority interest	840	946	122	122	122
Total Debt	26,044	26,489	32,762	33,226	36,146
Def. tax liab. (net)	1,930	2,110	2,339	2,339	2,339
Capital employed	55,121	59,333	70,252	89,022	99,814
Net Fixed assets	29,412	38,862	48,905	53,762	58,732
Investments	332	370	635	635	635
Net Working capital	17,335	17,628	16,589	21,592	26,544
Cash and bank balance	8,042	2,473	4,123	13,033	13,903
Capital deployed	55,121	59,333	70,252	89,022	99,814
Net debt	18,002	24,016	28,639	20,194	22,243
WC (days)	121	120	102	102	102
DE(x)	1.0	0.9	0.9	0.6	0.6

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY19	FY20	FY21	FY22E	FY23E
PAT	4,904	5,361	5,235	7,754	9,701
+ Non cash items	1,783	2,032	2,543	2,893	3,530
Cash profit	6,687	7,393	7,777	10,648	13,231
- Incr/(Decr) in WC	2,671	293	-1,039	5,003	4,952
Operating cash flow	4,017	7,100	8,816	5,645	8,279
- Capex	6,698	11,302	12,357	7,750	8,500
Free cash flow	-2,681	-4,202	-3,541	-2,105	-221
- Dividend	953	1,064	523	1,551	1,940
+ Equity raised	7,414	432	-	12,871	-
+ Debt raised	4,574	445	6,272	465	2,919
- Investments	-141	39	265	-	-
- Misc. items	773	1,141	295	770	-112
Net cash flow	7,721	-5,569	1,649	8,910	870
+ Opening cash	321	8,042	2,473	4,123	13,033
Closing cash	8,042	2,473	4,123	13,033	13,903

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY19	FY20	FY21	FY22E	FY23E
P/E (x)	27.8	25.4	38.2	43.2	34.6
P/BV (x)	5.2	4.6	5.7	6.3	5.5
EV/EBITDA (x)	16.0	16.4	23.3	26.0	21.3
RoE (%)	19.8	17.0	16.3	15.6	15.4
RoCE (%)	16.6	13.9	12.1	13.1	13.7
Fixed Asset turnover (x)	1.3	1.2	1.0	1.0	1.0
Dividend (%)	53	59	29	86	107
Dividend yield (%)	0.7	0.8	0.3	0.5	0.6
Dividend payout (%)	19	19	10	20	20
Debtors days	67	66	64	64	64
Creditor days	33	40	60	60	60
Inventory days	87	95	97	97	97
Revenue growth (%)	11	-1	8	31	23
EBITDA growth (%)	38	1	0	39	23
PAT growth (%)	46	8	-2	47	25

Source: Company, Systematix Institutional Research

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