



TM

SYSTEMATIX INSTITUTIONAL EQUITIES

Systematix

Institutional Equities

14 May 2024

Aarti Industries

Volume and margins improve sequentially

RESULT UPDATE

Sector: Chemical **Rating:** HOLD
CMP: Rs 669 **Target Price:** Rs 648

Stock Info

Sensex/ Nifty	72,776/ 22,104
Bloomberg	ARTO IN
Equity shares (mn)	363
52-wk High/Low	755/443
Face value	Rs 5
M-Cap	Rs 244bn/ USD 2.9bn
3-m Avg traded value	USD 10.8mn

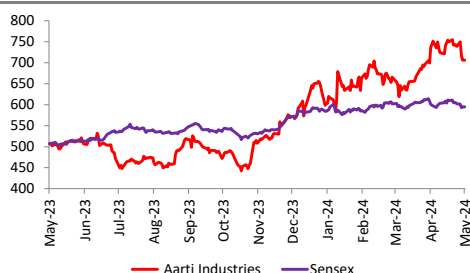
Financial Snapshot (Rs mn)

Y/E March (Rs mn)	FY24	FY25E	FY26E
Net sales	70,120	87,650	1,05,180
EBITDA	9,760	15,155	18,651
PAT (adj.)	4,160	7,455	9,792
EPS (adj.) (Rs)	11.5	20.6	27.0
PE (x)	58.3	32.5	24.8
P/B (x)	4.6	3.6	3.2
EV/EBITDA (x)	28.2	18.6	15.0
RoE (%)	8.1	12.5	13.8
RoCE (%)	7.2	11.5	12.8
D/E (x)	0.6	0.6	0.5
OPM (%)	13.9	17.3	17.7
Dividend Per Share (Rs)	1.5	4.1	5.4
Dividend Yield (%)	0.2	0.6	0.8
Dividend payout (%)	13	20	20

Shareholding pattern (%)

	Dec'23	Sep'23	Jun'23
Promoter	43.6	43.6	43.7
–Pledged	2.4	-	-
FII	10.8	10.6	12.2
DII	15.9	16.2	14.9
Others	29.7	29.6	29.2

Stock Performance (1-year)



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Aarti Industries' (ARTO IN) 4Q revenue increased 7% YoY and 2% QoQ to Rs 17.7bn, (8% lower than our estimate), driven by sequential volumes uptick in the discretionary segment propelled by better demand recovery and also due to passing on of input price inflation. Soft raw material (RM) costs led to 316bps QoQ improvement in gross margin to 39.6% (-228bps YoY), more than our estimate of 36%. Other expenses increased 19% QoQ mainly on higher freight costs. EBITDA increased 13% YoY and 9% QoQ to Rs 2.8bn, but fell 4% short of our expectation. EBITDA margin expanded 80bps YoY and 95bps QoQ to 16%, overshooting our estimate of 15.3%, on a favourable product mix. APAT (Rs 1.3bn, -11% YoY, +6% QoQ) was broadly in line.

Key takeaways: Management has guided (1) 20-30% volume growth for FY25, which it believes should pick up 1Q onwards and continue every quarter; it expects volume recovery across sectors (2) FY25 EBITDA to sustain at Rs 14.5-17bn, likely to be driven by capacity ramp up and higher operating leverage, (3) FY25 capex of Rs 15-18bn, (4) Nitrotoluene and ethylation capex to be commissioned by 2QFY25, which will likely generate revenue 3QFY25 onwards, given that the company has already tied up for some of the volumes with customers, (5) FY26 EBITDA at 20-25% CAGR, driven by ramping up of Zone 4, new strategic opportunities and higher utilisation of existing capacities at Zones 1, 2 and 3. We maintain HOLD rating on ARTO, exercising caution in light of sector-wide headwinds within the specialty chemicals space. While sequential volume improvement in the discretionary segment is a positive signal, agrochemicals and pharmaceuticals still await demand normalization. We raise our FY25E/FY26E EPS by 1% each to reflect the FY24 performance. Our revised target price of Rs 648 (earlier Rs 642), valued at 24x FY26E P/E (unchanged), reflects our tempered outlook. Key risks: slower-than-expected demand recovery in discretionary products and lower offtake of value-added products (VAP).

Discretionary segment continues to improve, while non-discretionary remains under pressure: Products within ARTO's discretionary portfolio have been witnessing volume recovery for the second straight quarter in a row, while those within the non-discretionary portfolio (agrochemicals and pharmaceuticals) continue to remain soft. We expect the demand for non-discretionary products to gradually improve and contribute to volume growth in the upcoming quarters. Management expects a broad-based progressive revival in FY25.

4QFY24 volume update: 1) **NCB:** ~ 17,646 MT vs 18,842 MT in 4QFY23 and 19,580 MT in 3QFY24, 2) **Hydrogenated products:** 3,389 TPM vs 3,315 TPM in 4QFY23 and 3,644TPM in 3QFY24, and 3) **Nitro toluene:** 6,675 MT vs 6,130 MT in 4QFY23 and 6,951 MT in 3QFY24. **PDA:** ~523 TPM vs 348 TPM in 4QFY23 and 481 TPM in 3QFY24.

Capex guidance: ARTO incurred a capex of Rs 12.8bn in FY24 and has guided Rs 15-18bn for FY25. It expects to commission the expanded capacities of nitrotoulene and ethylation by 2QFY25. Acid Phase 2 expansion, debottlenecking and expansion of few specialty chemicals units, greenfield projects at Zone 4 (MPP, pilot plant and chlorotoluene units), are progressing as planned.

Investors are advised to refer disclosures made at the end of the research report.

Concall KTAs

- **FY25 EBITDA guidance:** Maintained at Rs 14.5–Rs 17bn.
- **Red Sea issue:** Concerns related to Red Sea resulted in freight costs and transit times increasing. Management says a higher round trip time could disrupt the global supply chain in future, likely altering global sourcing strategies.
- **Demand trends:** Demand in ARTO's regular markets is improving, driving down reliance on the non-regular ones. Major customers in the different segments are witnessing demand revival, except in agrochemicals.
- **Geographical revenue mix:** 11% North America, 6% Europe, 4% China, 3% Japan
- In FY24, its long-term contract of Rs 33bn contributed revenue of less than Rs 1bn and is expected to contribute Rs 2.5bn in FY25.
- **MMA contract:** Management expects 50-60% YoY revenue growth from this contract incrementally.
- **Tax benefit:** **FY24:** Negative due to deferred tax assets; **FY25:** 12-15%.
- **Gross margin fluctuation:** Favourable product mix aided sequential improvement in gross margin. The focus is on gross profit (absolute terms) and profit per kg for specific products.
- **Outlook on agrochemicals:** Demand remains under pressure.
- **Ethylation and nitrotoluene:** Primarily geared towards agrochemicals, but nitrotoluene has wider applications.
- **FY24 discretionary and non-discretionary mix:** **Discretionary:** ~65%, **non-discretionary:** ~35%.

Change in estimates

We have slightly raised our FY25E/FY26E revenue by 1%/0.5%, respectively, but retained our EBITDA margins for these periods. We have raised EPS by 1% each for FY25/26E. Reiterating HOLD with a revised TP of Rs 648 (Rs 642 earlier), based on 24x FY26E P/E (unchanged).

Exhibit 1: Change in estimates

	Old Estimates		New Estimates		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Net Sales	78,702	95,134	79,762	95,580	1.3	0.5
EBITDA	14,920	18,515	15,155	18,651	1.6	0.7
EBITDA Margin (%)	19.0	19.5	19.0	19.5	4bp	5bp
Adjusted PAT	7,393	9,692	7,455	9,792	0.8	1.0
EPS (INR)	20.4	26.7	20.6	27.0	0.8	1.0
Target Price		642		648		1.0

Source: Company, Systematix Institutional Research

Exhibit 2: Quarterly financial statement

YE March (Rs mn)	4QFY24	4QFY23	YoY(%)	3QFY24	QoQ(%)
Net Sales	17,730	16,550	7.1	17,320	2.4
Raw material cost	10,710	9,620	11.3	11,010	(2.7)
Employees cost	1,000	1,090	(8.3)	1,030	(2.9)
Other expenses	3,190	3,330	(4.2)	2,680	19.0
Operating Expenses	14,900	14,040	6.1	14,720	1.2
% of Sales	84	85	-80bp	85	-95bp
EBITDA	2,830	2,510	12.7	2,600	8.8
EBITDA Margins (%)	16.0	15.2	80bp	15.0	95bp
Other Income	-	-	NA	80	NA
Finance Cost	590	330	78.8	540	9.3
Depreciation	980	840	16.7	970	1.0
PBT	1,260	1,340	(6.0)	1,170	7.7
Tax	(60)	(150)		(70)	
Effective Tax Rate (%)	(5)	(11)		(6)	
Reported PAT	1,320	1,490	(11.4)	1,240	6.5
NPM (%)	7	9	(156)	7	29bp
Adjusted PAT	1,320	1,490	(11.4)	1,240	6.5
No. of equity shares	363	363		363	
Adj. EPS (Rs)	3.6	4.1	(11.4)	3.4	6.5

Source: Company, Systematix Institutional Research

Exhibit 3: Key Ratios

Key Ratios (% of revenues)	4QFY24	4QFY23	YoY(%)	3QFY24	QoQ(%)
Raw Material Cost	60	58	228bp	64	-316bp
Staff Costs	6	7	-95bp	6	-31bp
Other Expenses	18	20	-213bp	15	252bp
Effective Tax rate	(5)	(11)	NA	(6)	NA
Gross Margin	39.6	41.9	-228bp	36.4	316bp
OPM	16.0	15.2	80bp	15.0	95bp
NPM	7.4	9.0	-156bp	7.2	29bp

Source: Company, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Net revenues	68,711	72,830	70,120	87,650	1,05,180
Revenue growth (%)	35.1	8.8	-3.7	25.2	19.8
- Op. expenses	43,654	55,300	53,960	64,606	76,929
EBITDA (Excl. OI)	17,201	10,890	9,760	15,155	18,651
EBITDA margins (%)	25.0	15.0	13.9	17.3	17.7
- Interest expenses	1,023	1,680	2,110	2,387	2,523
- Depreciation	2,464	3,100	3,780	4,397	5,085
+ Other income	10	10	80	399	478
- Tax	1,863	670	-210	1,316	1,728
Effective tax rate (%)	14	11	-5	15	15
Reported PAT	11,861	5,450	4,160	7,455	9,792
+/- Extraordinary items	-	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	11,861	5,450	4,160	7,455	9,792
EPS (Rs/share)	32.7	15.0	11.5	20.6	27.0

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Share capital	1,813	1,813	1,813	1,813	1,813
Reserves & Surplus	43,350	47,390	51,090	65,026	72,860
Networth	45,163	49,203	52,903	66,838	74,672
Minority interest	10	10	10	10	10
Total Debt	28,110	31,240	34,170	39,830	38,391
Def. tax liab. (net)	-	-	-	-	-
Capital employed	73,283	80,453	87,083	1,06,678	1,13,073
Net Fixed assets	49,410	59,560	68,780	79,383	80,298
Investments	280	170	230	230	230
Net Working capital	21,853	18,723	16,773	26,009	31,180
Cash and bank balance	1,740	2,000	1,300	1,056	1,364
Capital deployed	73,283	80,453	87,083	1,06,678	1,13,073
Net debt	26,371	29,240	32,870	38,774	37,027
WC (days)	101	86	84	84	84
DE(x)	0.6	0.6	0.6	0.6	0.5

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
PAT	11,861	5,450	4,160	7,455	9,792
+ Non cash items	125	3,100	3,780	4,397	5,085
Cash profit	11,985	8,550	7,940	11,851	14,877
- Incr/(Decr) in WC	5,264	-3,131	-1,950	9,237	5,171
Operating cash flow	6,721	11,681	9,890	2,615	9,706
- Capex	2,970	13,250	13,000	15,000	6,000
Free cash flow	3,751	-1,570	-3,110	-12,385	3,706
- Dividend	544	906	540	1,491	1,958
+ Equity raised	12,871	-	-	-	-
+ Debt raised	-4,652	3,130	2,930	5,660	-1,439
- Investments	-355	-110	60	-	-
- Misc. items	14,167	504	-80	-7,972	-
Net cash flow	-2,385	261	-700	-244	309
+ Opening cash	4,124	1,740	2,000	1,300	1,056
Closing cash	1,740	2,000	1,300	1,056	1,364

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY22	FY23	FY24	FY25E	FY26E
P/E (x)	15.4	34.5	58.3	32.5	24.8
P/BV (x)	4.1	3.8	4.6	3.6	3.2
EV/EBITDA (x)	13.2	19.9	28.2	18.6	15.0
RoE (%)	27.4	10.8	8.1	12.5	13.8
RoCE (%)	20.0	9.7	7.2	11.5	12.8
Fixed Asset turnover (x)	1.2	1.2	0.9	1.0	1.0
Dividend (%)	30	50	30	82	108
Dividend yield (%)	0.3	0.5	0.2	0.6	0.8
Dividend payout (%)	5	17	13	20	20
Debtors days	65	52	47	47	47
Creditor days	21	22	30	30	30
Inventory days	56	57	66	66	66
Revenue growth (%)	35	9	-4	25	20
EBITDA growth (%)	75	-37	-10	55	23
PAT growth (%)	122	-54	-24	79	31

Source: Company, Systematix Institutional Research

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Disclosure of Interest Statement	Update
Analyst holding in the stock	No
Served as an officer, director or employee	No

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