

Better segmental performance; poor demand visibility to dent earning in near term

Aarti Industries Ltd (AIL), for Q1FY20, reported steady set of numbers. Revenue has grown by 8.8% (on adjusting HPC business revenue) mainly due to higher utilisation across all segments. EBITDA grew by 26.1%YoY to INR2.36bn with 439bps improvement in margins to 21.7% on account of increasing share of value added and high margin products. Net profit grew at a higher pace of 53.9% to INR 1.37bn, due to slower growth in depreciation and decline in interest expenses bolstered by operationally strong performance. AIL saw 15% yoy jump in export sales to INR 4.55bn and accounted for 42% of revenues.

Higher realization with favorable margin profile compensated to low volume growth

During the quarter, the speciality chemicals business, which accounts around 82.4% of AIL's overall revenues. EBIT margin has also shown 349bps improvement on the back of increasing share of value added and high margin products. AIL is expanding its nitrochlorobenzene capacity from 75,000MTPA to 108,000 MTPA resulting in a capex of INR1.5bn. These capacities would be fully commissioned in two phases, Phase 1 in end of FY20 and Phase 2 in FY21. The expanded capacity would not only help in meeting the increasing domestic demand but also for downstream captive requirement.

Pharma business: Continuing growth momentum

The pharmaceutical segment reported strong growth of 27.6% in Q1FY20, aided by expanding volumes across markets, higher share of value adds such as xanthene derivatives and opportunity from disruption in China. EBIT margin came at 16.8% on the back of increasing share of value-added products and operating leverage benefit. The Management expects pharma revenues to grow at 20-25% with margin improvement. Since major fixed costs are already built-in, incremental volumes will result in significant increase in segment profits. We expect AIL's pharma segment to deliver strong revenue growth of 21.5% CAGR over F19-FY21E.

Demand slowdown to hurt volume growth in H2FY20

Due to poor visibility led by slowdown in global agrochemical and automotive sectors (account for ~50% of revenue), the management has lowered its growth outlook for H2FY20 and guides for a downside risk to its FY20 earning guidance of 15-20%.

Stock Rating

BUY	HOLD	SELL
	HOLD	
> 15%	-5% to 15%	< -5%

Sector Outlook

Positive

Stock

CMP (Rs)	1,590
Target Price (Rs)	1,747
BSE code	524208
NSE Symbol	AARTIIND
Bloomberg	ARTO IN
Reuters	ARTI.BO

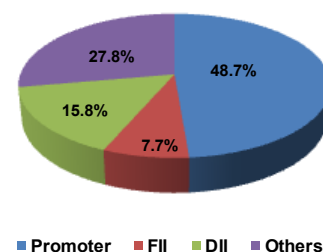
Key Data

Nifty	11,048
52WeekH/L(Rs)	1,899/1,106
O/s Shares (Mn)	87
Market Cap (Rs bn)	138
Face Value (Rs)	5

Average volume

3 months	84,533
6 months	1,04,157
1 year	82,665

Share Holding Pattern (%)

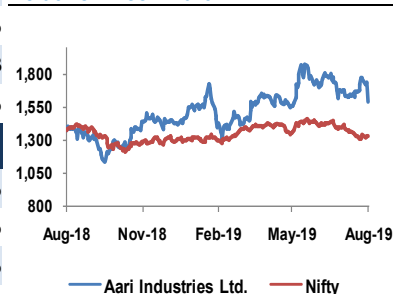


Key Financials					
YE March (INR. mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	29,977	36,993	48,576	52,345	63,950
Growth %	10%	23%	31%	7.8%	22.2%
EBIDTA	6,084	6,567	9,138	9,857	12,948
Growth%	15%	8%	39%	8%	31%
Net Profit	3,067	3,164	4,693	5,481	7,211
Growth %	21%	3%	48%	17%	32%
Diluted EPS	35	37	54	63	83
Growth %	21%	3%	48%	17%	32%

Profitability & Valuation					
EBIDTA (%)	20.3%	17.8%	18.8%	18.8%	20.2%
NPM (%)	10.2%	8.6%	9.7%	10.5%	11.3%
RoE (%)	25.8%	22.4%	22.3%	18.7%	20.7%
RoCE (%)	20.3%	17.6%	18.6%	16.1%	18.4%
P/E (x)	44.9	43.5	29.4	25.1	19.1
EV/EBITDA (x)	24.9	23.8	16.5	16.0	12.5
P/BV (x)	10.5	9.1	5.1	4.4	3.6

Source: Company, BP Equities Research

Relative Price Chart



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Aarti Industries Ltd Q1FY20 Quarterly Result

YE March (Rs. mn)	Q1 FY20	Q4 FY19	Q-o-Q change %	Q1 FY19	Y-o-Y change %
Net Sales	10,861	12,114	(10.3%)	10,785	0.7%
Other Operating Income	0	0		0	
Total Revenue	10,861	12,114	(10.3%)	10,785	0.7%
Less:					
Raw Material Cost	5,817	6,923	(16.0%)	6,596	(11.8%)
Operating & Manufacturing Expenses	2,007	2,106	(4.7%)	1,798	11.7%
Employee Cost	668	716	(6.7%)	513	30.4%
Total Expenditure	8,492	9,745	(12.9%)	8,906	(4.6%)
EBIDTA	2,369	2,369	(0.0%)	1,879	26.1%
Less: Depreciation	401	425	(5.6%)	377	6.3%
EBIT	1,968	1,945	1.2%	1,502	31.1%
Less: Interest	303.0	412.0	(26.5%)	461.0	(34.3%)
Add: Other income	43	7		34	
Profit before tax	1,709	1,540	11.0%	1,075	59.0%
Adjusted Profit before Tax	1,709	1,540	11.0%	1,075	59.0%
Less: Total Tax	335	295	13.6%	182	84.1%
Profit After Tax	1,374	1,245	10.4%	893	53.9%
Other comprehensive Income	0	0		0	
Minority Interest	0	0		0	
Adjusted Profit After Tax	1,374	1,245	10.4%	893	53.9%
Diluted EPS (Rs.)	15.9	14.4	10.4%	10.3	53.9%
Adjusted Diluted EPS	15.9	14.4	10.4%	10.3	53.9%
Diluted No of Share (mn)	86.7	86.7		86.7	
Margin Analysis %			Change in bps		Change in bps
EBIDTA Margin %	21.8%	19.6%	226	17.4%	439
EBIT Margin %	18.1%	16.1%	207	13.9%	420
NPM %	12.6%	10.3%	237	8.3%	437
Effective Tax Rate %	19.6%	19.2%	44	16.9%	267

Source: Company, BP Equities Research

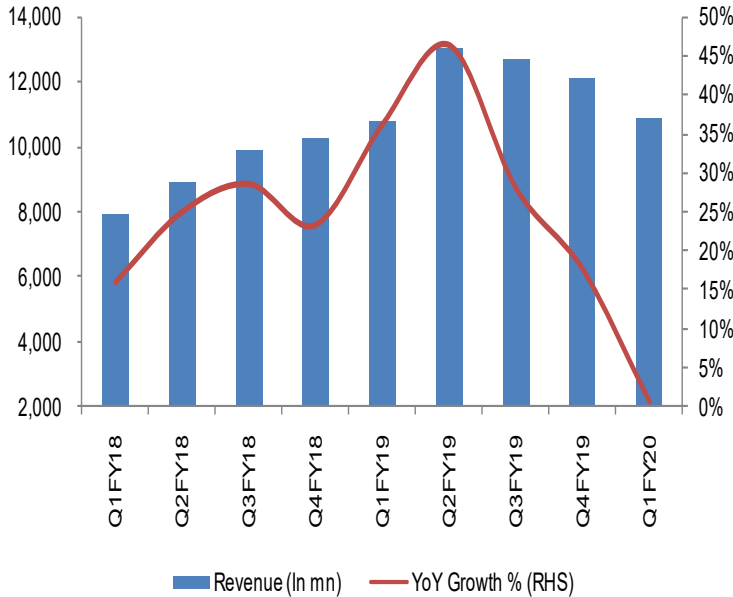
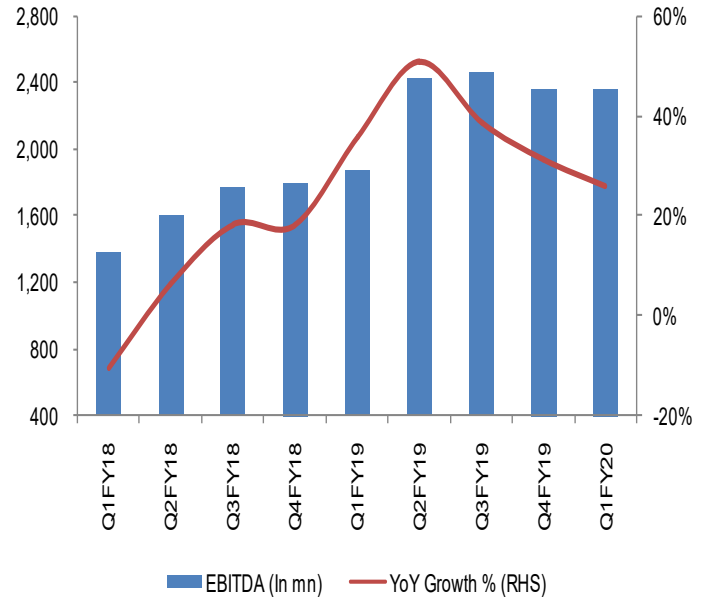
Revenue were below our below our estimates of INR 12,561mn mainly due to lower than expected volume growth in Speciality chemicals segment and adjustment of HPC segment.

Adj. PAT came above our estimate of INR 1,091mn due to slower growth in depreciation, decline in interest expenses and operationally strong performance

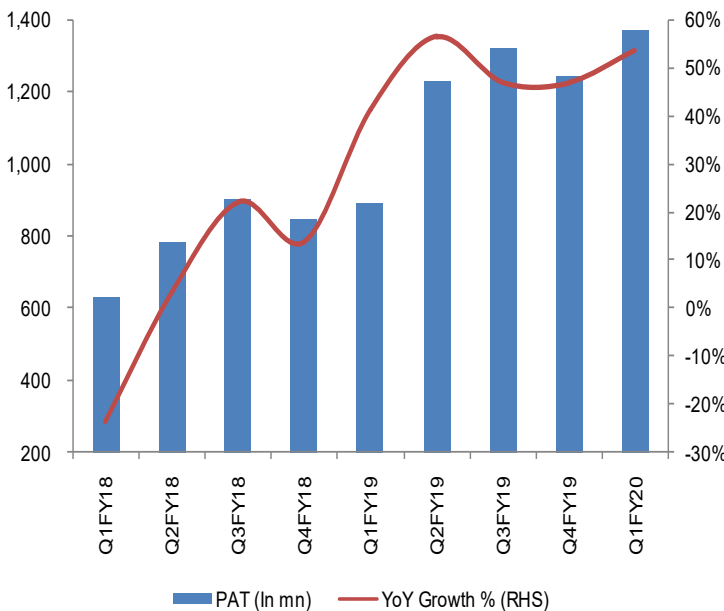
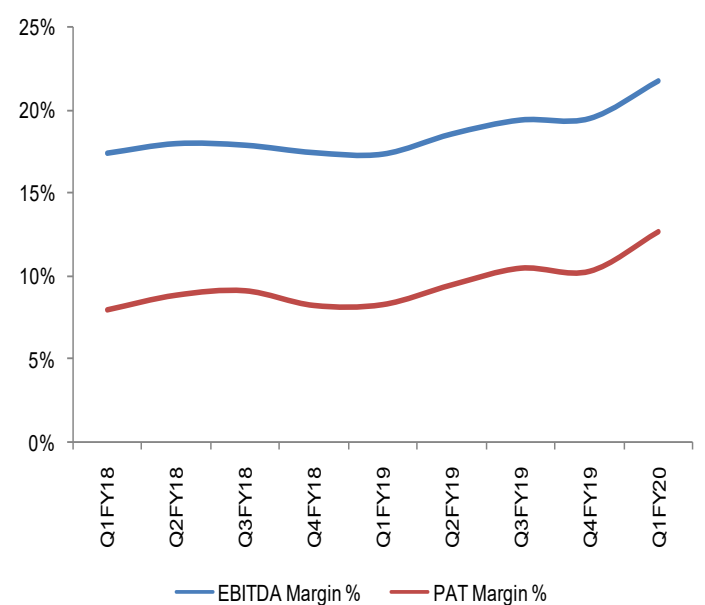
The EBITDA margin, at 21.8% was above our estimate of 19.6% mainly due to favorable product mix

Valuation and Outlook

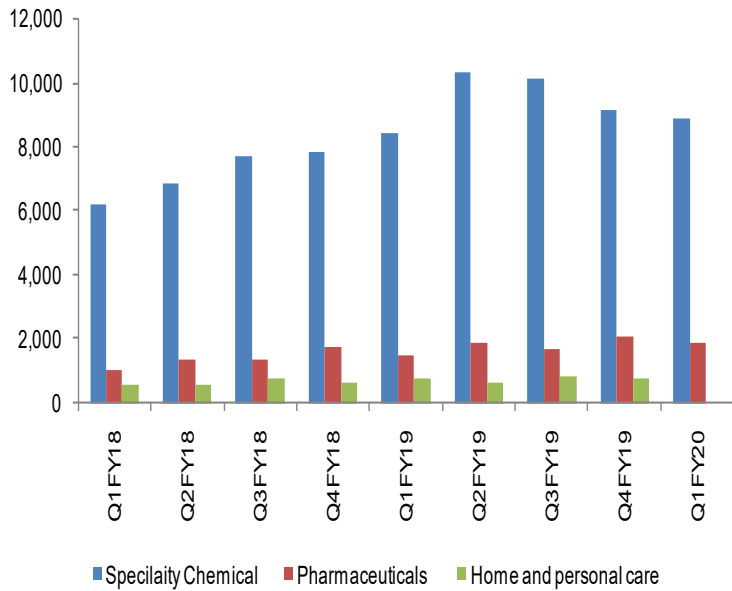
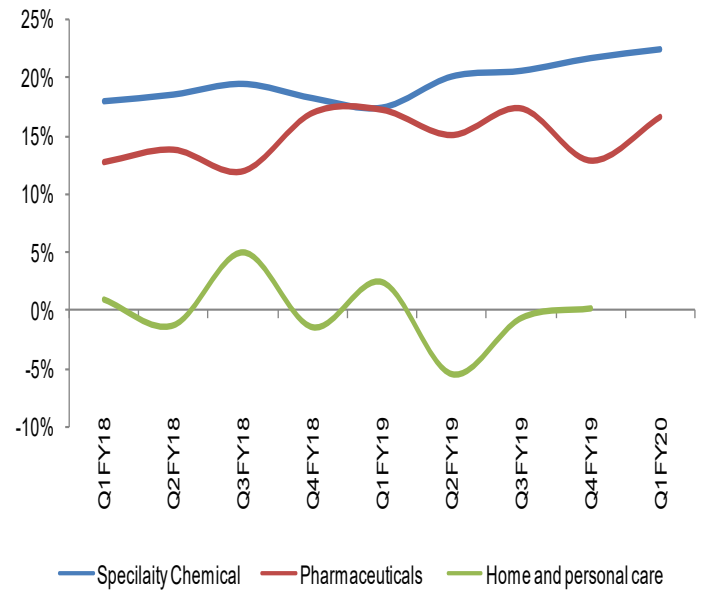
AIL is well placed to capture the benefit on account of shift in manufacturing base from western countries to emerging economies like India and China. With China facing environmental and cost pressures leading to the creation of a supply risk situation. This situation is beneficial for the company and it is expected to capitalize this opportunity and increase its market penetration. Improving demand visibility and new product introduction would lead to increased capacity utilization. However, cautious demand outlook for H2FY20 in speciality chemical segment can act as headwind in near term. Overall, we remain optimistic on the future growth prospects of the company. Hence, we retain our Hold rating, with a revised price target of INR1,747 (from earlier INR1,881) by assigning P/E of 21x on its FY21E earnings.

Revenues remain flat on YoY basis

EBITDA surged by 26.1% YoY


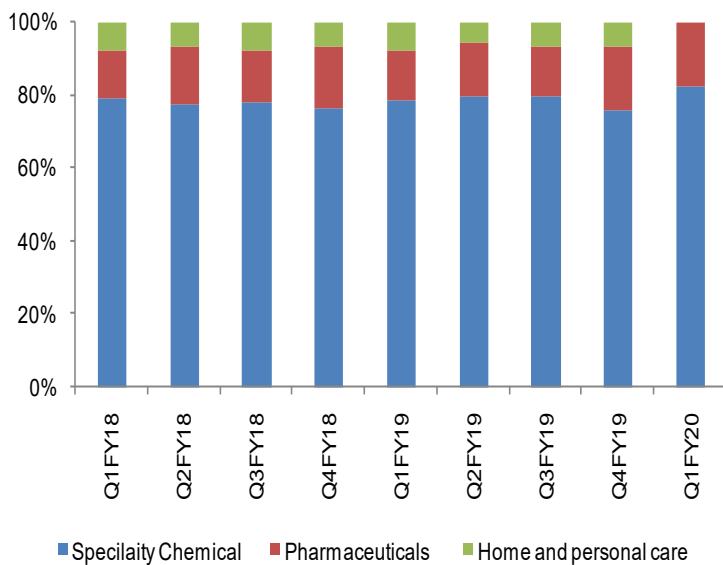
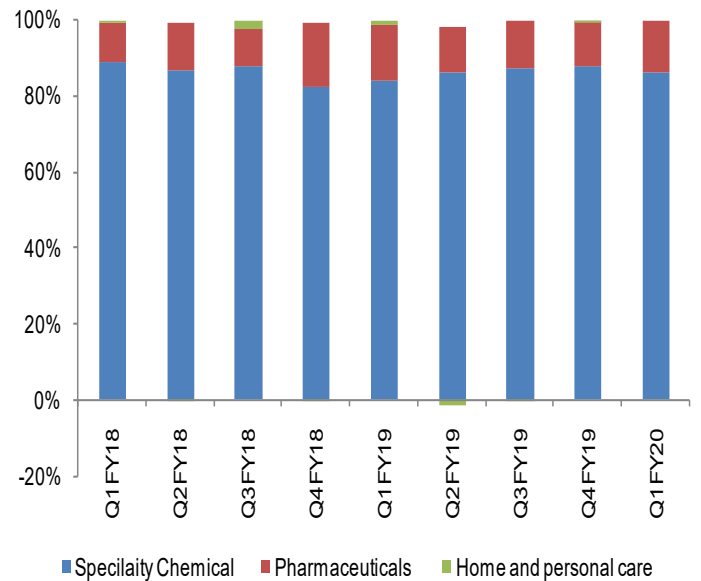
Source: Company, BP Equities Research

PAT showed growth of 53.9% YoY

EBITDA/ PAT margin trend


Source: Company, BP Equities Research

Quarterly Performance In Charts
Revenue by Segment (In mn)

Segment wise EBIT margin (%)


Source: Company, BP Equities Research

Segment Wise Revenue Contribution (%)

Segment Wise EBIT Contribution %


Source: Company, BP Equities Research



Profit & Loss A/c					
YE March (INR. mn)	FY17	FY18	FY19	FY20E	FY21E
Revenue	30,502	36,993	48,576	52,345	63,950
<i>Growth %</i>	12.3%	21.3%	31.3%	7.8%	22.2%
Total Revenue	30,502	36,993	48,576	52,345	63,950
Less:					
Raw Material Consumed	15,156	19,010	28,930	30,280	37,190
Employee Cost	1,402	1,768	2,381	2,535	2,942
Other Expenses	7,861	9,648	8,127	9,673	10,870
Total Operating Expenditure	24,418	30,426	39,438	42,488	51,001
EBIDTA	6,084	6,567	9,138	9,857	12,948
<i>Growth %</i>	14.8%	7.9%	39.1%	7.9%	31.4%
Less: Depreciation	1,148	1,358	1,596	1,858	2,669
EBIT	4,936	5,210	7,542	7,999	10,280
<i>Growth %</i>	12.8%	5.5%	44.8%	6.1%	28.5%
Interest Paid	1,174	1,307	1,810	1,211	1,346
Non-operating Income	25	21	46	52	64
Extraordinary Income	0	0	0	0	0
Profit Before tax	3,787	3,924	5,778	6,841	8,998
Tax	721	759	1,085	1,360	1,787
Net Profit	3,067	3,164	4,693	5,481	7,211
Adjusted Profit	3,067	3,164	4,693	5,481	7,211
Reported Diluted EPS Rs	35.4	36.5	54.2	63.2	83.2
<i>Growth %</i>	21.5%	3.2%	48.3%	16.8%	31.6%
Adjusted Diluted EPS Rs	35.4	36.5	54.2	63.2	83.2
<i>Growth %</i>	21.5%	3.2%	48.3%	16.8%	31.6%

Source: Company, BP Equities Research

Cash Flows Statement					
YE March (INR. Mn)	FY17	FY18	FY19	FY20E	FY20E
PAT	3,066.8	3,164.4	4,693.0	5,481.0	7,210.8
(Less)/Add: Extraordinary Income/Expense	0.0	0.0	0.0	0.0	0.0
Less: Non Operating Income	(25.1)	(21.3)	(45.5)	(52.3)	(63.9)
Add: Depreciation	1,148.0	1,357.7	1,596.3	1,857.9	2,668.5
Add: Interest Paid	1,173.8	1,307.4	1,809.6	1,210.6	1,346.3
Tax Adjustment	0.0	0.0	0.0	0.0	0.0
Operating Profit before Working Capital Changes	5,363.5	5,808.2	8,053.4	8,497.2	11,161.6
(Inc)/Dec in Current Assets	(662.0)	(1,481.3)	(1,529.2)	(692.4)	(2,043.3)
Inc/(Dec) in Current Liabilities	649.1	878.1	1,099.2	356.6	971.9
Changes in Inventory	(723.5)	(1,401.6)	(668.6)	(582.8)	(1,626.9)
Net Cash Generated From Operations	4,627.1	3,803.4	6,954.8	7,578.7	8,463.4
Cash Flow from Investing Activities					
(Inc)/Dec in Fixed Assets	(5,113.3)	(4,128.5)	(4,297.1)	(10,000.0)	(10,200.0)
(Inc)/Dec in Capital Work In Progress	399.7	(1,643.9)	(3,678.6)	0.0	0.0
(Inc)/Dec in Investment (Strategic)	0.0	0.0	0.0	0.0	0.0
(Inc)/Dec in Investment (Others)	2,765.7	(497.5)	(803.9)	(297.4)	(327.1)
Add: Non Operating Income	25.1	21.3	45.5	52.3	63.9
(Inc)/Dec in Intangible Assets	(293.0)	58.0	(90.1)	0.0	0.0
Net Cash Flow from/(used in) Investing Activities	(2,215.8)	(6,190.6)	(8,824.2)	(10,245.1)	(10,463.2)
Cash Flow from Financing Activities					
Inc/(Dec) in Total Loans	(592.4)	4,837.3	4,380.8	(1,218.6)	2,832.0
Inc/(Dec) in Reserves & Surplus	(574.2)	(1,022.7)	7,584.2	0.0	0.0
Inc/(Dec) in Equity	(6.0)	(4.1)	26.8	0.0	0.0
Dividend Paid	(86.7)	(86.7)	(606.6)	(685.0)	(773.6)
Less: Interest Paid	(1,173.8)	(1,307.4)	(1,809.6)	(1,210.6)	(1,346.3)
Adjustments	(3.4)	(6.3)	(0.0)	(0.0)	(0.0)
Exceptional Item	0.0	0.0	0.0	0.0	0.0
Net Cash Flow from Financing Activities	(2,436.5)	2,410.1	9,575.6	(3,114.3)	712.1
Net Inc/Dec in cash equivalents	(25.2)	22.9	7,706.2	(5,780.6)	(1,287.6)
Opening Balance	241.6	216.4	239.3	7,945.5	2,164.9
Closing Balance Cash and Cash Equivalents	216.4	239.3	7,945.5	2,164.9	877.2

Source: Company, BP Equities Research



Balance Sheet

YE March(INR. mn)	FY17	FY18	FY19	FY20E	FY21E
Liabilities					
Equity Capital	411	407	433	433	433
Reserves & Surplus	12,690	14,745	26,416	31,212	37,649
Equity	13,101	15,152	26,849	31,645	38,082
Net Worth	13,101	15,152	26,849	31,645	38,082
Minority Interest					
Net Deferred tax liability/(Asset)	1,420	1,594	3,815	1,596	1,953
Total Loans	14,179	18,843	21,003	22,003	24,478
Capital Employed	28,700	35,588	51,666	55,244	64,513
Assets					
Gross Block	24,745	28,873	33,170	43,170	53,370
Less: Depreciation	9,079	10,430	12,027	13,884	16,553
Net Block	15,666	18,443	21,144	29,286	36,817
Capital WIP	2,668	4,312	7,990	7,990	7,990
Investments	1,673	2,170	2,974	3,271	3,599
Others - A	617	559	649	649	649
Current Assets					
Inventories	5,466	6,868	7,536	8,119	9,746
Sundry Debtors	5,474	6,392	8,366	9,015	11,014
Cash and Bank Balance	216	239	7,946	2,165	877
Loans and Advances	1,425	1,948	1,411	1,452	1,494
Other Current Assets	205	245	337	339	342
Total Current Assets	12,786	15,692	25,596	21,090	23,472
Less: Current Liabilities & Provisions					
Sundry Creditors	2,949	3,466	3,131	3,277	4,025
Provisions	238	275	390	394	399
Other Current Liabilities	1,523	1,846	3,165	3,372	3,591
Total Current Liabilities & Provisions	4,709	5,587	6,686	7,043	8,015
Capital Applied	28,700	35,588	51,666	55,244	64,513

Source: Company, BP Equities Research

Key Ratios

YE March (INR. mn)	FY17	FY18	FY19	FY20E	FY21E
Key Operating Ratios					
EBITDA Margin (%)	19.9%	17.8%	18.8%	18.8%	20.2%
Tax / PBT (%)	19.0%	19.3%	18.8%	19.9%	19.9%
Net Profit Margin (%)	10.1%	8.6%	9.7%	10.5%	11.3%
RoE (%)	25.8%	22.4%	22.3%	18.7%	20.7%
RoCE (%)	20.3%	17.6%	18.6%	16.1%	18.4%
Current Ratio (x)	2.7x	2.8x	3.8x	3.0x	2.9x
Dividend Payout (%)	2.8%	2.8%	2.8%	2.8%	2.8%
Book Value Per Share (Rs.)	151.2	174.8	309.8	365.2	439.4
Financial Leverage Ratios					
Debt/ Equity (x)	1.1x	1.2x	0.8x	0.7x	0.6x
Interest Coverage (x)	5.2x	5.0x	5.0x	8.1x	9.6x
Interest / Debt (%)	8.9%	7.9%	9.1%	5.6%	5.8%
Growth Indicators %					
Growth in Gross Block (%)	26.0%	16.7%	14.9%	30.1%	23.6%
Sales Growth (%)	12.3%	21.3%	31.3%	7.8%	22.2%
EBITDA Growth (%)	14.8%	7.9%	39.1%	7.9%	31.4%
Net Profit Growth (%)	21.5%	3.2%	48.3%	16.8%	31.6%
Diluted EPS Growth (%)	21.5%	3.2%	48.3%	16.8%	31.6%
Turnover Ratios					
Debtors Days	66	63	63	63	63
Creditors Days	71	67	40	40	40
Inventory Days	82	82	70	70	70

Source: Company, BP Equities Research



Disclaimer Appendix

Analyst (s) holding in the Stock : Nil

Analyst (s) Certification:

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