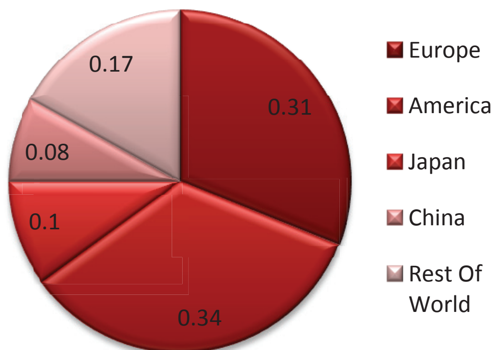
AARTI INDUSTRIES Ltd.

Aarti Industries : A Overview

Aarti Industries specialized in production of benzene derivatives, agrochemicals, pharmaceuticals, dyes and surfactants. The company has grown consistently and we expect it to continue growing profits at a CAGR of more than 20% over the next 3 years. Over the last ten years it's sales have grown at a CAGR of 15%. The company ranks 3rd globally in production of nitro-chloro benzene and has further expanded its capacity by 28% in the last 2 years. It has also doubled its hydrogenation capacity. Aarti Industries was founded by the Gogri family and is currently being managed by Mr Rajendra and Rashesh Gogri both Chemical Engineers. Its business is structured under three segments - Specialty Chemicals, Pharmaceuticals and Homecare. We expect future growth will primarily be driven by increased volume due to capacity expansion and higher sales of value added products. During last few years, with scale up of capacities and introduction of various high growth and high margin export oriented products, the share of Exports Revenue to Total Revenue has been increasing. Exports represent about 50% of the total revenues. Also a bulk of products sold in domestic markets are converted and ultimately exported. Hence considering this, about 70% of our output would be exported either directly or indirectly.

Distribution Of Exports	
Europe	31%
America	34%
Japan	10%
China	8%
Rest Of World	17%



Aarti's Product By End Use

Dyestuff Intermediates
Pharma Intermediates
Pigment Intermediates
Agro Chemical Intermediates
Speciality Chemicals
Active Pharma Ingredient (API)

As the expansion plans are going on we expect the company will make capex and debt for FY16 only, after that company will see strong cash flows and strength in the balance sheet. At CMP of Rs.294, We initiate coverage on AARTIIND, recommending Buy on the stock with a target price of Rs383 looking at a investment horizon of 12 months. It provides ~30% upside platform to our investors.

Investment Thesis

1. Aarti is One of the integrated player in benzene derivatives and leading supplier to global manufacturers of Dyes, Pigments, Agrochemicals, Pharmaceuticals & rubber chemicals. Aarti has acquired world-class expertise in the development & manufacture of these chemicals. Aarti is amongst the largest producers of Benzene based basic and intermediate chemicals in India.
2. Aarti has 16 manufacturing units spread across Gujarat & Maharashtra and a strong Research & Development with sophisticated instruments & pool of scientists.
3. Diversified customer base with over 150 export customers and 500 domestic customers: Aarti has customers spread across the globe in 60 countries with major presence in USA, Europe, Japan & India. Some of the marquee names like BASF, Syngenta, Dow, Dupont, Flint Inks, Clariant etc in the international markets with exports accounting for 48-50% of total sales turnover. In the domestic markets also, the company supplies products to Atul ltd., Sudarshan Chemicals, UPL, Micro Inks etc.
4. As the company is planning to over its majority of capex by FY16 only we don't see the debt equity ratio to rise in future, We see D/E at 0.7x for FY17E (Currently at 1.2x).
5. Management believes the expansion in Chlorination and calcium chloride granulation plant for Pharma Business will drive for higher growth in sales and PAT.
6. We believe the company's Sales and Pat growth CAGR for the next 3 financial year will be at 18% and 33% respectively. Adding to this we expect ~240Bps margin expansion in NPM and and ~70Bps expansion in EBIDTA level.

Segmental Business And Outlook

Speciality Chemicals :

Specialty Chemicals is based on Benzene chemistry where its products are supplied for seg-ments like polymers, pigments and agro chemicals. This segment accounts for 84% of the revenues, of which 52% is export driven. The segment is growing by 15-16% YOY. The crude decline was a key factor in Q3. As you are aware, our operating profit is based on the volumes. So increase or decrease in crude oil or benzene does not affect the actual operating profit. But this quarter, crude and benzene prices had gone down from Rs 85 to 70 and that resulted in inventory valuation loss of about Rs 9 crore. But, in general, the crude oil or benzene price fall helped the company in reducing their working capital requirement and debt as well. The management is of the view that it does not have significant impact on realizations. Also the company works on cost plus business model. Thus if due to lower prices of benzene the revenues were to decline on absolute terms the profitability would be intact. In fact on percentage margin terms the EBIT margins in the segment may go up from the present 16.5%.

The company has undertaken capacity expansion at its nitro chloro benzene and hydration units. Apart from this it is also entering into toluene based chemistry. The expanded capacities are expected to be commissioned by end of Q4 FY15 and the full impact would be visible in FY16 and FY17 leading to growth in turnover.

Pharmaceutical business segment :

On smaller base, it is growing at 25-30% CAGR. Management believes the segment is expected to clock Rs250cr turnover in FY15. It has 4-5 approved ANDAS and is already supplying to the US markets from its two US FDA approved facilities. It also expects approvals for another 2 products in the near future and has a pipeline of 7-8 products which will take care of its growth for next 2-3 years. The company has been operating at 17% EBIT margins and expects the segment to reach EBIT margins of up to 20% by FY17-18.The management has also laid out a road map to demerge the Pharma business for focused growth and value un-locking. Putting things into aside, the current market cap of the company is Rs. 2560cr.

Homecare business under restructuring

The company is known for supplying surfactants to FMCG com-panies, but it was always a low margin, high volume business. The management has started restructuring the portfolio and its future product launches would be for value added high margin products. Currently the segment is small with sales contribution of only 5% to the total turnover with EBIT margins of 4-5%.

Financial Analysis & Valuation

Management remained Positive on volume front with quarterly run rate of ONCB+PNCB reaching to about 15,500mt in Q1FY16E from 12,500mt in Q3FY15. For the 9 months ending Dec, the company has already reported net profit of Rs135crore on net sales of Rs2,156crore, indicating a growth of 32.6% and 15.7% respectively, as compared to same quarter previous year. Also, if the benzene prices continue to remain low, there will be benefit from lower working capital requirement. Further dollarization of debt would lower interest outgo. Pharma segment would also report better performance from Q4FY15E with higher capacity utilization. Equity restructuring is expected to be complete by Q1FY16E and the demerger by end FY16E. The company has outlined capex to the tune of Rs 400cr for FY15 & FY16, with ~Rs220cr being spent in FY15. The new capex has been for higher value added products and could add ~Rs1200-1500cr to the topline over FY16 & FY17. It would also lead to an asset turnover of 3-4x and incremental higher margins. The stock is currently available at 2.71x and 2.12x FY15E and FY16E P/B to a ROE estimate of 20.6 and 21.8 in FY15E and FY16E respectively. Management re-iterated that it is confident of achieving 15-20% revenue CAGR and about 20% earnings CAGR over the next 3-4 years, on the back of planned capacity expansion.We valued the stock and remain positive on the growth prospects of the company and maintain 'Buy' with a initial target of Rs383/share. The target here makes a 25% potential upside to the stock.

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Financials

	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15	Q3FY15
Speciality chemicals	388	381	506	493	537	557	630	614	625	568
Pharmaceuticals	43	44	52	63	69	52	64	67	79	75
Home and Personal Care Solutions	38	34	37	38	39	41	50	58	57	50
Sales	470	459	595	594	645	650	744	740	761	692
Cost Of Raw material consumed	303	296	371	393	405	408	480	483	488	430
Employee Benefit Expense	13	15	18	17	19	19	22	20	22	23
Other Expense	80	81	113	108	116	115	137	124	129	136
EBIDTA	74	67	93	76	106	108	106	113	122	103
EBIDTA+Other income	75	68	95	79	110	108	110	113	122	104
Interest	20	21	26	26	28	32	32	38	36	32
Depreciation	16	17	22	20	22	22	23	19	19	20
Tax	11	9	9	10	18	17	8	15	17	10
Net profit	28	22	39	23	42	37	47	41	51	43

P/L Yly	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
Sales	692	790	713	892	1451	1297	1474	1673	2096	2632	3064	3615	4338
Growth YoY		14%	-10%	25%	63%	-11%	14%	14%	25%	26%	16%	18%	20%
EBIDTA	96	114	91	127	251	203	201	249	361	401	463	578	694
OPM	13%	14%	11%	13%	17%	16%	13%	15%	17%	15%	15%	16%	16%
Other Income	2	1	1	0	1	2	1	4	4	11	11	11	11
EBIDTA+Other income	98	114	92	127	252	205	202	253	365	412	474	589	705
Interest	14	21	30	39	90	52	56	72	95	118	136	132	135
Depreciation	20	22	26	28	39	45	48	54	82	87	78	106	127
PBT	55	68	34	53	113	107	90	119	184	201	260	351	442
Tax	14	23	9	17	30	37	27	35	53	52	57	77	97
Net profit	44	49	26	37	84	70	67	87	131	149	203	274	345
Growth YoY		11%	-47%	40%	130%	-17%	-5%	31%	51%	13%	36%	35%	26%
B/S Yly	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
Equity Share Capital	36	36	36	36	36	38	38	40	40	44	44	44	44
Reserves	169	200	220	246	303	360	405	473	632	734	937	1211	1556
Networth	206	237	257	282	340	399	443	513	672	779	981	1255	1600
Total borrowings	225	300	337	429	483	436	526	585	805	942	1090	1062	1085
Total	431	539	596	712	824	835	973	1098	1478	1720	2071	2317	2685
Net Block	186	230	277	280	367	382	392	433	664	793	923	1089	1307
Capital Work in Progress	19	28	18	37	16	14	28	54	62	113	113	113	113
Investments	24	25	26	26	15	15	19	21	19	32	32	32	32
Working Capital	200	255	273	368	426	424	534	589	734	781	1003	1083	1233
Total	431	539	596	712	824	835	973	1098	1478	1720	2071	2317	2685

Ratios	**FY05**	**FY06**	**FY07**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15E**	**FY16E**	**FY17E**
ROE%	21.5	20.7	10.2	13.0	24.9	17.6	15.0	17.0	19.5	19.1	20.6	21.8	21.6
P/B	1.7	2.5	0.7	0.8	0.6	0.9	0.8	0.9	1.0	2.4	2.7	2.1	1.7
Debt/Equity	1.1	1.3	1.3	1.5	1.4	1.1	1.2	1.1	1.2	1.2	1.1	0.8	0.7
EBIDTA %	14%	14%	13%	14%	17%	16%	14%	15%	17%	15%	15%	16%	16%
NPM %	6%	6%	4%	4%	6%	5%	5%	5%	6%	6%	7%	8%	8%