Aarti Industries Limited

BSE SENSEX	S&P CNX
27,144.91	8,328.35

(INR CRORES)

Y/E MARCH	FY16	FY17E	FY18E
Revenue	2,729	3,150	3,622
EBITDA	572	670	758
EBITDA Margin	21.0%	21.3%	20.9%
NP (Adj.)	257	317	378
EPS (Adj.)	29.0	35.8	42.7
EPS Growth	25%	23%	19%
BV/share	134	162	197
Core ROE (%)	24	26	25
Core ROCE (%)	18	18	19
P/E (x)	18.1	14.7	12.3
P/BV (x)	4.0	3.3	2.7

KEY FINANCIALS	
Diluted Shares (cr)	8.3
Market Cap. (Rs cr)	4,416
Market Cap. (US$ m)	651.90
Past 3 yrs Sales Growth (%)	9%
Past 3 yrs NP Growth (%)	25%

STOCK DATA	
52-W High/Low Range (INR)	587/331
Major Shareholders (as of 31st March 2016)	
Promoter	54.8
Institutions	15.7
Public & Others	29.5
Average Daily Turnover(6 months)	
Volume	36941
Value (Rs cr)	1.85
1/6/12 Month Rel. Performance (%)	1/-1/60
1/6/12 Month Abs. Performance (%)	2/1/56

CMP: INR526 TP: INR630 (+20%) Buy

We recommend to BUY Aarti Industries for a target of INR 630- valuing the company on SOTP basis.

Geared for growth with global leadership in Speciality Chemicals: AIL has a strong understanding of chlorine derivative chemistry and has the largest nitro-chlorobenzene capacity in India at 60,000 tonnes per annum. Exports account for 51% of speciality chemicals division. It offers over 100+ products to MNCs globally(globally ranks 1st -5th for most of its key products) having end-user applications in polymers, additives, pigments, paints, dyes, agro chemicals, etc to 800+ clients. It has a "Strategic Supplier" status with many MNCs due to its wider product portfolio, cost competitiveness and ability to supply consistently. The Indian Speciality Chemical Industry is expected to reach $60-70bn by 2020 from $23bn in 20131. Aarti Industries should gain from this growth given its strong customer linkages and command over Chlorine chemistry.

Capex to lead to revenue growth as well as margin expansion: The company is looking to expand capacities across benzene, toluene & ethylene, and nitro toluene based value chain with a capex of ~INR 500cr over the next 3yrs (~asset turnover of 3-4 times) to cater growing end-user markets and space vacated by closing down of few capacities in developed markets & reduced global supplies from China. The company is expected to have firm off-take commitments from global agrochemical majors for exclusive supply. The addition of value added products will further aid in margin expansion over the next 3yrs.

Pharma business to growth driver (to grow at 20% CAGR over next 2-3 years): Pharma is a high-margin and potential high-growth business in a nascent stage. Most of the investment in pharma facilities is already complete and the segment broke even in FY12. Now, incremental volumes would only contribute to expansion in segment margins and ROE.

Valuations & View: Aarti Industries is a high quality proxy play two key emerging trends: (1) rising demand for specialty chemicals in India (15% CAGR FY15-FY20E) and (2) eastward migration of global chemical manufacturing (Asia to have 70% production share by 2030). We expect EBIT/Ton to improve in Speciality Chemicals segments due to benefits of operating leverage and better product mix. The company is setting up capacities for different chemistries which gives us visibility of volume growth for the next three years. We expect the company to grow its profits at 21% CAGR over FY16-17E and improve its ROCE from 17% in FY15 to 19% in FY18E. We value the company at 15x FY18E EPS at INR 630 providing for an upside of 20%

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INVESTMENT CONCERNS

High sensitivity to currency movement: AIL's exports accounted for ~50% for FY16 revenue expose AIL to risk of foreign exchange fluctuations. A significant appreciation of INR against USD also poses a risk to AIL's competitiveness in global markets.

Benzene prices (short term risk): Though AIL works on a cost plus basis model in its speciality chemical segment, any significant fluctuation in benzene prices will affect profitability in the short term. Further, any significant increase in benzene prices will increase the working capital requirement for the business funded by short term debt, leading to increase in interest outgo and decline in profitability.

Demergers postponed: While expectation was for the demerger to be announced this quarter, AIL has postponed its plans to demerge its 3 segments as it wants to see further improvement in pharma and home & personal care segments.

Company background:

Aarti Industries manufactures speciality chemicals, pharmaceuticals drugs (API's), and home & personal care chemicals. Mr. Rajendra Gogri (MS Chemical Engineering) is the Chairman & Managing Director of the company. The company has 10 manufacturing units for the speciality chemicals division, 4 units for the pharmaceutical division, and 2 units for the home& personal care division. The group has a strong market position in the benzene-based specialty chemicals segment. It also has a full-fledged research and development centre, recognised by the Department of Scientifiand Industrial Research, Government of India.

INRCr	4QFY15	3QFY16	4QFY16	yoy	qoq
Total Income	677	679	699	3.1%	2.9%
Expenditure	556	547	562	1%	3%
EBITDA	121	132	137	12.8%	4%
Other Income	0	1	8		
Interest	32	28	28	-11%	3%
Depreciation	21	23	25	22%	11%
PBT	69	82	91	33%	11%
Tax	17	20	22		
P\L of Associates	0	0	0		
Adj. PAT	52	62	70	33.9%	11.8%
EBITDA (%)	18.2%	19.7%	19.9%		
Tax rate (%)	24%	24%	24%		

Quarterly Performance

- Speciality chemicals: Revenues were up by 3.1% YoY, however volumes remained flat OoQowing to issues concerning availability of nitric acid . (mainly hit by the prevalent drought conditions). Hence, NCB volumes fell to 12,460 tonnes versus 16,400 tonnes in Q3FY16. Similarly, run-rate of hydrogenation volumes also decelerated. Despite this, higher volumes of other products saw EBIT rise by 15% YoY to INR1.2bn. Volumes for the year increased by ~10% YoY with guidance of 15% YoY growth for FY17. Average benzene price was INR 40.3/kg in Q4FY16 v/s Rs 44/kg in Q3 FY16 and current prices is ~INR 45/kg. Spend in FY17 is expected to be INR4bn. This year, AIL will spend on second phase of PDA, calcium chloride unit and ethylene unit. The company expects this to be commissioned by Q1FY17.
- Pharma & Home & personal segment: Pharma segment had a strong quarter clocking 47% YoY growth to INR1.2bn, highest in past many quarters. Management had guided for 20% QoQ growth, but the segment delivered a superior 35% QoQ growth. This was driven by robust performance by both API/intermediates and caffeine. Home & personal care segment reported another disappointing quarter again.

Aarti Industries Limited Financials & Valuation

INCOME STATEMENT					(INRCR)
Y/E MARCH	FY14	FY15	FY16	FY17E	FY18E
Net sales	**2,598**	**2,861**	**2,729**	**3,150**	**3,622**
Growth	24%	10%	-5%	15%	15%
COGS	1,685	1,832	1,522	1,789	2,057
Employee Cost	79	94	121	142	109
Other Expenses	467	516	565	605	634
EBITDA	**402**	**466**	**572**	**670**	**758**
EBITDA Margin	15.5%	16.3%	21.0%	21.3%	20.9%
Depreciation	89	82	99	124	138
Other Income	11	6	6	10	11
Interest Cost	118	138	117	127	120
PBT	**206**	**251**	**363**	**429**	**511**
Tax	54	61	95	112	133
Rate	26%	24%	26.1%	26.0%	26.0%
Adjusted PAT	**162**	**205**	**257**	**317**	**378**
Growth	23%	26%	25%	23%	19%
PAT Margin	**6.2%**	**7.2%**	**9.4%**	**10.1%**	**10.4%**

RATIOS					
Y/E MARCH	FY14	FY15	FY16	FY17E	FY18E
Adjusted EPS (INR)	18.3	23.1	29.0	35.8	42.7
Book Value	98	115	134	162	197
Div Per Share	4.7	5.5	7.1	8.0	9.1
Dividend Payout	26%	24%	24%	22%	21%
Net Debt / Equity	1.1	1.0	1.1	0.9	0.8
P/E	28.7	22.7	18.1	14.7	12.3
P/BV	5.4	4.6	4.0	3.3	2.7
Dividend Yield	0.9%	1.0%	1.3%	1.5%	1.7%
EV/EBITDA	14.0	12.3	9.9	8.3	7.4
ROCE	18%	17%	18%	18%	19%
ROE	20%	22%	24%	26%	25%
Debtor days	62	56	70	60	60
Inventory days	126	103	119	105	105
Creditor days	80	50	73	63	57
W.Cap cycle	108	110	116	102	108

BALANCE SHEET					(INRCR)
Y/E MARCH	FY14	FY15	FY16	FY17E	FY18E
Share Capital	44	44	42	42	42
Reserves	826	972	1,073	1,310	1,597
Networth	**871**	**1,016**	**1,114**	**1,352**	**1,639**
Minority interest	4	6	52	63	75
Loans	942	1,068	1,308	1,283	1,283
Less Net Def. Tax Liab	85	103	127	127	127
Less other long term liability	7	306	308	308	308
SOURCES OF FUNDS	**1,909**	**2,498**	**2,910**	**3,133**	**3,433**
Net Fixed Assets	826	967	1,399	1,656	1,822
Capital WIP	117	193	160	160	160
Inventories	606	552	495	515	592
Debtors	443	439	523	518	595
Cash & Investments	15	34	29	75	39
Loans & Advances	131	141	134	123	130
Other Curr Assets	30	32	18	16	18
Current investments	0	0	0	0	0
Curr. Assets	1,225	1,198	1,200	1,246	1,375
Creditors and Prov.	761	439	342	421	417
Net Current Assets	**464**	**758**	**858**	**825**	**958**
Other LT Assets	502	581	493	493	493
APPLICATION OF FUND	**1,909**	**2,499**	**2,910**	**3,133**	**3,433**

CASH FLOW					(INRCR)
Y/E MARCH	FY14	FY15	FY16	FY17E	FY18E
NI	**206**	**251**	**363**	**429**	**511**
Adjustments	196	215	215	247	253
(Inc)/Dec in W.Cap	(92)	(72)	(0)	(75)	(144)
Others	59	6	0	135	33
Pre Tax OCF	369	401	578	736	653
Tax Paid	(54)	(61)	(95)	(112)	(133)
CF from Operations	**315**	**339**	**483**	**624**	**520**
(Inc)/Dec in FA	(288)	(295)	(531)	(299)	(304)
Net investments	(4)	(4)	121	0	0
Others	1	1	0	0	0
CF from Investing act.	**(291)**	**(298)**	**(410)**	**(299)**	**(304)**
Equity issuance/ Share buy back	0	0	0	0	0
Inc/(Dec) in Debt	138	163	100	(75)	(50)
Interest Paid	(116)	(138)	(117)	(127)	(120)
Divd Paid (incl Tax)	(42)	(49)	(59)	(67)	(76)
Others	(2)	1	(6)	(6)	(6)
CF from Financing act.	**(22)**	**(23)**	**(82)**	**(275)**	**(251)**
Inc/(Dec) in Cash	2	19	(9)	50	(35)
Add: Opening Balance	12	15	34	25	75
Closing Balance	**15**	**34**	**25**	**75**	**39**

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