Growth Plans Reset & Worst Priced In; Maintain BUY

Est. Vs. Actual for Q2FY25: Revenue: BEAT; EBITDA: MISS; PAT: MISS

Changes in Estimates post Q2FY25

FY25E/FY26E: Revenue: -5%/-5%; **EBITDA:** -30%/-31%; **PAT**: -51%/-45%

Recommendation Rationale

- **Volatility in Energy Business shakes growth plans:** During the previous quarter, the energy (MMA) business accounted for 41% of overall sales and was a key growth driver, helping the company negate the impact of headwinds in other segments. However, the energy segment volumes declined 36% QoQ in Q2FY25 due to a steep drop in gasoline-naphtha spreads. The management alluded to the fact that the earlier growth expectations from the energy business may not be fully met due to the volatile nature of the demand for MMA. As a result, the company has substantially downgraded its EBITDA guidance for FY25 as well as for the medium term. The company now expects EBITDA in the range of Rs 1,000-1,050 Cr (earlier Rs 1,450-1,700 Cr) in FY25 and annual EBITDA of Rs 1,800-2,000 Cr by FY28.
- **Resetting EBITDA Growth and Capex Plans:** The company has initiated various measures to recoup EBITDA growth, including cost optimization, volume ramp-up, and capex-led growth. The capex for FY25 is estimated to be Rs 1,300-1,500 Cr, compared to the earlier estimate of Rs 1,500-1,800 Cr, with another Rs 1,000 Cr expected to be spent in FY26. In addition to leveraging its R&D for asset-light growth and building strategic alliances, it also plans to make early forays into sunrise sectors such as chemical recycling and battery chemicals. The company aims to achieve consistent volume growth over the next 3 years, driven by increased capacities, which, coupled with operating leverage and cost optimization initiatives, shall help the company inch closer to the FY28 EBITDA target.

Sector Outlook: Cautiously Optimistic

Company Outlook & Guidance: The management has significantly cut down its FY25 EBITDA guidance to Rs 1,000-1,050 Cr from Rs 1,450-1,700 Cr, owing to weaker-than-expected performance, primarily in the energy business. However, the management noted that the non-energy volumes were up 22% and that some green shoots/positive demand trends have been observed across other segments. While it has reduced its FY25 capex budget, the company plans to continue expansion in a disciplined manner with a target of more than doubling EBITDA in three years.

Current Valuation: 25x FY27E (*Earlier:*30x FY26E)

Current TP: Rs 540/share (Earlier TP: 815/share).

Recommendation: We **maintain our BUY rating on the stock** with a revised target price of 540/share, implying a 14% upside from the CMP.

Financial Performance: Revenue came in at Rs 1,628 Cr, up 12% YoY but down 12% QoQ, beating estimates by 5%. EBITDA stood at Rs 196 Cr, down 16% YoY and 36% QoQ, missing estimates by 13%, mainly due to higher other operational expenses. EBITDA margin dropped to 12.04%, compared to 16.09% in Q2FY24 and 16.44% in Q1FY25. The company's PAT was Rs 52 Cr, down 43% YoY and 62% QoQ, missing estimates by 23%.

Key Financials (Consolidated)

(Rs Cr)	Q2FY25	YoY %	QoQ%	Axis Est.	Var %
Net Sales	1,628	12%	-12%	1,549	5%
EBITDA	196	-16%	-36%	226	-13%
EBITDA Margin	12.0%	-405bps	-440bps	14.6%	-256bps
Net Profit	52	-43%	-62%	67	-23%
EPS (Rs)	1.4	-43%	-62%	1.9	-23%

Source: Company, Axis Securities Research

(CMP as of 08th November 2024)

CMP (Rs)	474
Upside /Downside (%)	14%
High/Low (Rs)	770/472
Market cap (Cr)	17,211
Avg. daily vol. (12m) Shrs.	19,47,051
No. of shares (Cr)	36.2

Shareholding (%)

	Mar-24	Jun-24	Sep-24
Promoter	43.4	43.2	42.6
FIIs	10.9	10.6	9.7
DIIs	17.2	18.5	18.1
Retail	28.4	27.6	29.6

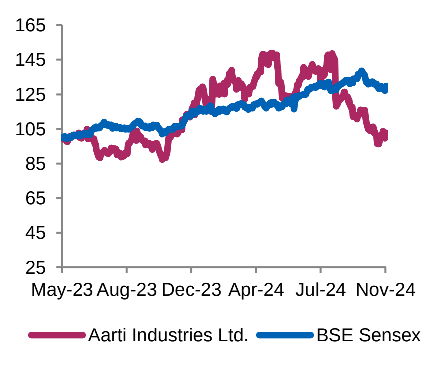
Financial & Valuations

Y/E Mar	FY24	FY25E	FY26E
Net Sales	6,372	7,009	8,411
EBITDA	976	1,016	1,363
Net Profit	417	325	542
EPS (Rs)	11.5	9.0	15.0
PER (x)	60.1	52.9	31.7
P/BV (x)	4.7	3.1	2.8
EV/EBITDA (x)	28.9	20.9	15.8
ROE (%)	8%	6%	9%

Change in Estimates (%)

Y/E Mar	FY25E	FY26E
Sales	-5%	-5%
EBITDA	-30%	-31%
PAT	-51%	-45%

Relative Performance



Source: Ace Equity, Axis Securities Research

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Outlook

- Aarti plans to invest prudently in developing its product pipeline, notably the Nitro-Chloro Toulene (NCT). This, along with a ramp-up in existing projects, is expected to contribute to revenue growth from FY25 onwards. With an anticipated recovery in market conditions, AIL's capacity expansion and entry into new chemistries may position it well to recoup the growth and achieve better margins.

Valuation

- We revise FY25/26E estimates downwards for the company considering the significant downgrade in EBITDA margins. We expect continued pricing pressures, adverse macros, overcapacity by China, and demand-related challenges in the near term. However, we believe the recent correction in stock price has already factored in the expected decline in EPS estimates, and the valuation provides considerable room for upside. **We have rolled forward our estimates to FY27E, valuing the company at 25x FY27E, which translates to a TP of Rs 540/share, implying a 14% upside from the CMP.**

Key Concall Highlights

- **Financial Performance:** Revenue grew by 12% YoY, led by 15% YoY volume growth. Pricing pressure across various products resulted in lower gross profits. Exceptional items of Rs 2.3 Cr consist of a gain from the divestment of a stake in a step-down subsidiary, Nascent Chemical Industries Ltd. The increase in depreciation is attributable to the commercialization of expanded capacities/projects. In H1FY25, the tax liability is decreasing, leading to the corresponding accumulation of deferred tax assets.

End-Use Segment Revenue Break-up (Q2FY25):

- Energy: 32%
- Agrochemicals: 18%
- Dyes & Pigments: 10%
- Pharma: 11%
- Polymers and Additives: 18%
- Others: 11%

- **Guidance:** The management expects consistent volume growth in the medium term, driven by increased capacities. Additionally, EBITDA growth beyond volume growth is anticipated, driven by operating leverage and cost optimization initiatives. The management has revised its EBITDA guidance for FY25 to Rs 1,000-1,050 Cr, which it believes is more "realistic." The company aims to achieve Rs 1,800-2,200 Cr of EBITDA in 3 years, with a Debt/EBITDA ratio of <2.5x and ROCE of >15%.
- **Margin Compression:** The company expects volume growth across segments and higher utilization of new capacities. The management indicated that margin pressure is driven by Chinese competition due to domestic overcapacity and volatility in energy applications, which now form a significant part of the portfolio.
- **Capex:** The company plans to spend approximately Rs 1,300-1,500 Cr in FY25, compared to the earlier estimate of Rs 1,500-1,800 Cr. Capex for FY26 is estimated to be significantly lower, at around Rs 1,000 Cr.
- **Volumes:** Overall volumes grew by 15% YoY. The management is witnessing a volume uptick in Dyes, Pigments, and Polymer Additives end-use applications, whereas Agrochemicals continue to remain soft. Non-energy business volumes were up 22% YoY and 11% QoQ, while Energy business volumes were down by 1% YoY and 36% QoQ. Volumes in the energy business were impacted largely due to a sharp drop in refining margins and the gasoline-naphtha delta.
- **MMA Business:** The company experienced a significant decline in volumes for its major product, MMA, in Q2, as the gasoline-naphtha crack has been declining, making octane-boosting economics difficult in the present market conditions. The gasoline-naphtha spreads declined by approximately 40% during the quarter. While there was some improvement in MMA demand during October, the gasoline-naphtha delta is anticipated to remain low in Q3, with a potential recovery expected in Q4 as USA seasonal demand picks up. New capacities have come up in China and India for manufacturing MMA, but Aarti remains the largest player compared to the current MMA capacities. The management believes that the energy end application is evolving and holds large potential, but remains volatile due to its linkage to gasoline-naphtha margins.

Key Risks to Our Estimates and TP

- Any delay in capacity expansion or existing projects may affect ROCE negatively.
- The global slowdown may affect volumes and value growth.
- Involvement in complex risky chemistries has significant operational risks.

Change in Estimates

	New		Old		% Change	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Sales	7,009	8,411	7,384	8,860	-5%	-5%
EBITDA	1,016	1,363	1,455	1,967	-30%	-31%
PAT	325	542	658	982	-51%	-45%

Source: Company, Axis Securities Research

Q2FY25 Results Review

Particulars	Q2FY24	Q1FY25	Axis Sec Estm (Rs cr)	Q2FY25	% Change (YoY)	% Change (QoQ)	Variance (%)
Sales	**1,454**	**1,855**	**1,549**	**1,628**	**12%**	**-12%**	**5%**
Expenditure							
COGS	854	1156	979	1017	**19%**	**-12%**	**4%**
Employee Expenses	99	113	93	105	6%	-7%	13%
Other Exp	267	281	251	310	16%	10%	24%
Total Expenditure	**1220**	**1550**	**1323**	**1432**	**17%**	**-8%**	**8%**
EBIDTA	**234**	**305**	**226**	**196**	**-16%**	**-36%**	**-13%**
EBITDA Margin (%)	16.09%	16.44%	14.60%	12.04%	-405bps	-440bps	-256bps
Depreciation	93	102	96	108	**16%**	**6%**	**13%**
Other Income	0	6	3	6			
EBIT	141	209	133	94	**-33%**	**-55%**	**-29%**
Interest	58	64	60	62	**7%**	**-3%**	**3%**
Exceptional Item							
PBT	**83**	**145**	**73**	**34**	**-59%**	**-77%**	**-54%**
Tax	-9	8	6	-18	100%	-325%	-408%
PAT	**92**	**137**	**67**	**52**	**-43%**	**-62%**	**-23%**
EPS (Rs)	2.5	3.8	1.9	1.4	-43%	-62%	-23%

Source: Company, Axis Securities Research

Financials (Consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Net sales	**6,619**	**6,372**	**7,009**	**8,411**	**9,925**
Cost of goods sold	3,842	3,880	4,276	5,047	5,876
Contribution (%)	*42.0%*	*39.1%*	39.0%	40.0%	40.8%
Employee Costs	385	404	456	530	605
Other Expenses	1,303	1,112	1,262	1,472	1,737
EBITDA	**1,089**	**976**	**1,016**	**1,363**	**1,707**
EBITDA Growth %	-36.7%	-10.4%	4.1%	34.1%	25.3%
Other income	1	8	0	0	0
Depreciation	310	378	430	480	525
EBIT	**780**	**606**	**586**	**883**	**1,182**
Interest & Fin Chg.	168	211	225	244	228
E/o income / (Expense)	0	0	0	0	0
Pre-tax profit	**612**	**395**	**361**	**638**	**954**
Tax provision	65	-21	36	96	172
Reported PAT	**547**	**416**	**325**	**542**	**782**

Source: Company, Axis Securities Research

Balance Sheet

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Equity + Liabilities					
Equity Capital	181	181	181	181	181
Reserves & Surplus	**4,335**	**5,109**	**5,434**	**5,976**	**6,758**
Total Equity	***4,517***	***5,290***	**5,615**	**6,157**	**6,939**
Long Term Borrowings	930	1,525	1,925	2,275	2,175
Lease Liabilities	15	49	49	49	49
Other Non-Current Liabilities	224	175	175	175	175
Total Non-Current Liabilities	***1,169***	***1,749***	**2,149**	**2,499**	**2,399**
Short Term Borrowings	**1,642**	**1,669**	**2,169**	**2,169**	**1,969**
Trade Payables	347	521	375	456	483
Provisions	32	40	40	40	40
Others	145	346	346	346	346
Total Current Liabilities	***2,166***	***2,576***	**2,930**	**3,011**	**2,838**
Total Liabilities	**3,335**	**4,325**	**5,079**	**5,510**	**5,237**
Total Equity + Liabilities	**7,852**	**9,615**	**10,694**	**11,668**	**12,176**
ASSETS					
Gross Block	5,528	7,453	8,599	9,599	10,099
Less: Depreciation	1,813	1,802	2,041	2,521	3,046
Property, Plant & Equipment	**3714.9**	**5,588**	**6,558**	**7,078**	**7,053**
Capital WIP	1,303	1,052	1,052	1,052	1,052
Right to Use Assets	17	53	53	53	53
Other Non-Current Assets	155	101	101	101	101
Total Non-Current Assets	**5,289**	**7,146**	**8,116**	**8,636**	**8,611**
Current Assets					
Inventories	934	1,160	1,344	1,498	1,632
Trade Receivables	1,092	826	768	1,037	1,360
Cash	**94**	**42**	**24**	**56**	**133**
Other Financial Assets	407	236	236	236	236
Current Tax Assets	55	77	77	77	77
Other Current Assets	37	40	40	40	40
Total Current Assets	**2,699**	**2,469**	**2,578**	**3,031**	**3,565**
Total Assets	**7,852**	**9,615**	**10,694**	**11,668**	**12,176**

Source: Company, Axis Securities Research

Cash Flow (Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Profit Before Tax	**611**	**395**	**361**	**638**	**954**
Finance Cost	168	211	225	244	228
Depreciation	310	378	430	480	525
(Inc)/Dec in Working Capital	312	306	-273	-341	-430
Tax Paid	(91.0)	(91.0)	(36.2)	(95.9)	(171.9)
Cash Flow from Operations	**1,310.0**	**1,202.0**	**707.6**	**925.7**	**1,105.6**
Change in Gross Block	-1,326	-1,328	-1,400	-1,000	-500
(Inc)/Dec in Investments	0	0	0	0	0
Cash Flow from Investing	**-1,330**	**-1,310**	**-1,400**	**-1,000**	**-500**
Inc/(Dec) in Loans	(301.0)	301.0	900.0	350.0	(300.0)
Finance Cost	(168.0)	(211.0)	(225.2)	(244.4)	(227.9)
Cash Flow from Financing	**47.0**	**36.0**	**674.8**	**105.6**	**(527.9)**
Net Inc/Dec in Cash	27	-72	-18	31	78
Opening Cash	174	201	42	24	56
Closing Cash	**201**	**129**	**24**	**56**	**133**

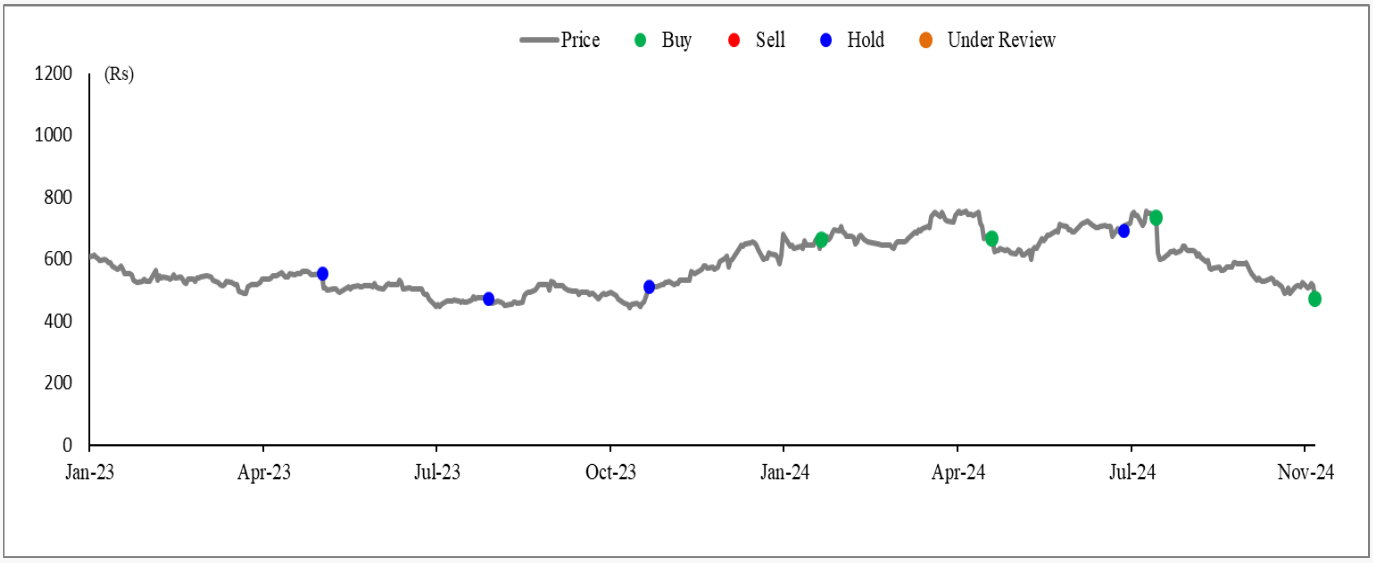
Source: Company, Axis Securities Research

Ratio Analysis (%)

Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Sales growth	**8.8**	**(3.7)**	**10.0**	**20.0**	**18.0**
OPM	**16.5**	**15.3**	**14.5**	**16.2**	**17.2**
Oper. profit growth	(36.7)	(10.3)	4.1	34.1	25.3
COGS / Net sales	58.0	60.9	61.0	60.0	59.2
Overheads/Net sales	5.8	6.3	6.5	6.3	6.1
Depreciation / G. block	5.0	5.3	5.0	5.0	5.2
RoCE	**10%**	**7.2%**	**6%**	**8%**	**11%**
Debt/equity (x)	0.6	0.6	0.7	0.7	0.6
Effective tax rate	10.8	(5.3)	10.0	15.0	18.0
RoE	**11%**	**7.9%**	**6%**	**9%**	**11%**
Payout ratio (Div/NP)	17.7	23.1	29.6	17.7	12.3
EPS (Rs)	**15.0**	**11.5**	**9.0**	**15.0**	**21.6**
EPS Growth	(54.0)	(23.6)	(22.0)	66.9	44.2
CEPS (Rs)	23.6	21.9	20.8	28.2	36.1
DPS (Rs)	2.4	**2.4**	2.4	2.4	2.4
Valuation (x)					
P/E	36.1	60	53	32	22
P/BV	4.0	4.7	3.1	2.8	2.5
EV/EBITDA	20.6	29	21	16	12
Mcap/Sales	3.0	3.9	2.5	2.0	1.7

Source: Company, Axis Securities Research

Aarti Industries Price Chart and Recommendation History



Date	Reco	TP	Research
10-May-23	HOLD	550	Result Update
10-Aug-23	HOLD	470	Result Update
07-Nov-23	HOLD	525	Result Update
12-Feb-24	BUY	735	Result Update
14-May-24	BUY	770	Result Update
1-Aug-24	HOLD	788	AAA
13-Aug-24	BUY	815	Result Update
11-Nov-24	BUY	540	Result Update

Source: Axis Securities Research

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Ratings	**Expected absolute returns over 12 – 18 months**
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%
NOT RATED	We have forward looking estimates for the stock, but we refrain from assigning valuation and recommendation.
UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NO STANCE	We do not have any forward-looking estimates, valuation or recommendation for the stock

Note: Returns stated in the rating scale are our internal benchmark.