

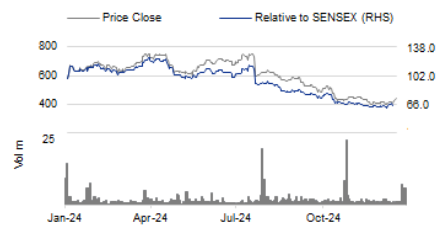
India

REDUCE (no change)

Consensus ratings*: Buy 9 Hold 3 Sell 13

Current price:	Rs443
Target price:	Rs281
Previous target:	Rs435
Up/downside:	-36.6%
InCred Research / Consensus:	-38.2%
Reuters:	ARTI.NS
Bloomberg:	ARTO IN
Market cap:	US\$2,210m Rs160,488m
Average daily turnover:	US\$16.2m Rs1173.2m
Current shares o/s:	362.5m
Free float:	57.7%

*Source: Bloomberg



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	3.2	(15.0)	(24.1)
Relative (%)	8.6	(10.1)	(29.1)

Major shareholders	% held
Promoter & Promoter Group	42.4
LIC India	6.8
ICICI Pru	2.8

Aarti Industries

Growth will be difficult to come by; REDUCE

- Aarti Industries faces significant challenges as falling demand and pricing pressure on MMA exports weigh on its earnings.
- Declining spreads for both MMA and PDCB, coupled with a leveraged balance sheet, indicate subdued margin and growth in the near term.
- With limited product differentiation and weak global market, the stock appears overvalued at current levels. Retain REDUCE rating with a lower TP of Rs 281.

Despite significant underperformance, the stock is still not a BUY

The overall growth in FY24 and FY25F was primarily driven by rising exports of MMA (mono methyl aniline). Higher global gasoline consumption had led to increased demand for MMA. However, falling demand and declining gasoline spreads over crude oil are now resulting in reduced demand for MMA. In recent quarters, all earnings growth and misses have been largely driven by MMA. Investors are essentially valuing MMA at 40x earnings. While capital allocation decisions are best left to investors, a company generating RoE below 10% and trading at 3x BV does not inspire confidence for an ADD rating. The stock has significantly underperformed the BSE Small Cap Index over the last five years, and the lacklustre earnings growth potential fails to instill confidence. Aarti Industries' products are comparable to those of any low-grade commodity maker. These products lack entry barriers, and customers are highly sensitive to price fluctuations. The balance sheet is leveraged, and a potential earnings collapse could trigger a steep correction in the stock price. Investors are advised to tread with caution and avoid rushing to buy this stock.

The best of MMA is behind us

MMA is an effective octane booster. Small amounts of MMA can significantly enhance octane ratings. It provides a cost-effective way to produce high-octane fuel blends compared to other additives. Compatible with various fuel types and refinery processes. The global imbalance because of the decline in Russian exports of gasoline created an opportunity for the other countries and hence, the UAE (primary customer for the company's MMA) jumped in to supply that; however, as gasoline demand itself is falling (as apparent in falling gasoline spreads over crude oil), the demand for MMA, at best, won't rise and, at worst, will fall. With no other big product in the pipeline, stagnant MMA itself will lead to below-consensus EPS growth.

Consensus EPS is still too high; stretched valuation; retain REDUCE

Aarti Industries' other pivot, PDCB (paradichlorobenzene), also faces falling exports, with its spreads close to pre-Covid lows. As a simple, commodity-grade chemical with minimal differentiation, PDCB adds to the company's struggles in sustaining profitability. With a leveraged balance sheet, slowing exports, and limited product differentiation, the RoE remains below 10%, and the stock trades at 3x BV, raising concerns. The overall weak outlook, coupled with falling earnings and margins, suggests cautious investor sentiment.

We retain REDUCE rating on the stock with a lower target price of Rs281 (Rs435 earlier).

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Financial Summary

	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue (Rsm)	66,186	63,720	70,092	76,169	79,243
Operating EBITDA (Rsm)	10,890	9,760	10,375	12,042	12,536
Net Profit (Rsm)	5,452	4,160	3,887	4,493	5,084
Core EPS (Rs)	15.0	11.5	10.7	12.4	14.0
Core EPS Growth	(58.3%)	(23.7%)	(6.6%)	15.6%	13.2%
FD Core P/E (x)	29.43	38.58	41.29	35.72	31.56
DPS (Rs)	2.5	2.5	2.5	2.5	2.5
Dividend Yield	0.56%	0.56%	0.56%	0.56%	0.56%
EV/EBITDA (x)	17.19	19.57	18.34	15.67	14.79
P/FCFE (x)	(803.21)	16.53	15.32	118.36	22.76
Net Gearing	54.3%	57.7%	53.4%	47.4%	39.2%
P/BV (x)	3.26	3.03	2.87	2.70	2.52
ROE	10.1%	8.1%	7.1%	7.8%	8.3%

% Change In Core EPS Estimates
InCred Research/Consensus EPS (x)

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Growth will be difficult to come by; REDUCE

The overall growth in FY24 and FY25F was primarily driven by rising exports of MMA (mono methyl aniline). Higher global gasoline consumption was resulting in higher demand for MMA. However, falling demand and declining gasoline spreads over crude oil are now resulting in lower demand for MMA. In recent quarters, all earnings growth and misses have been driven by MMA. Investors are essentially valuing MMA at 40x earnings. While decisions on capital allocation are best left to investors, a company generating below 10% RoE and trading at 3x book value does not inspire confidence for an **ADD** rating. The balance sheet is leveraged, and an earnings collapse could trigger a steep correction in stock prices. **Tread with caution and avoid rushing to buy this stock.**

The hey days of MMA are over

Aarti Industries performed exceptionally well in MMA exports over the last two years. However, with global demand slowing and declining gasoline spreads, there is a rising pricing pressure on MMA, and demand is also weakening. Aarti Industries will face two significant headwinds in the MMA segment:

1. **Demand slowdown**, which will result in lower volume growth.
2. **Pricing pressure**, which will lead to reduced spreads over aniline.

MMA demand primarily comes from gasoline, although it has multiple usage ➤

Monomethyl aniline (MMA), a derivative of aniline, has several industrial applications due to its chemical properties, primarily in fuel formulations and other niche areas. Below are its major uses:

1. **Octane booster in fuels:** MMA is widely used as an octane booster in gasoline formulations. It improves the anti-knock properties of gasoline, allowing for smoother combustion in internal combustion engines. MMA can replace lead-based additives, offering a relatively cleaner option for enhancing fuel performance.
2. **Industries:** Fuel refineries, and specialty fuel suppliers for racing and aviation.
3. **Intermediate in chemical synthesis:** MMA serves as an intermediate in the synthesis of other organic compounds. Used in the production of dyes, pharmaceuticals, and agrochemicals.
4. **Solvent:** MMA is used as a solvent in certain industrial applications, particularly in paints and varnishes, where its chemical stability and solvency are beneficial.
5. **Explosives:** MMA is a component in some explosive formulations, where it helps balance performance and safety characteristics.
6. **Specialty fuels:** MMA is used in military fuels and aviation fuels for its ability to improve combustion efficiency under extreme conditions.

Over the past few quarters, Aarti Industries' exports have been primarily driven by MMA ➔

Figure 1: For the past few quarters, all of Aarti Industries' exports have been driven primarily by MMA

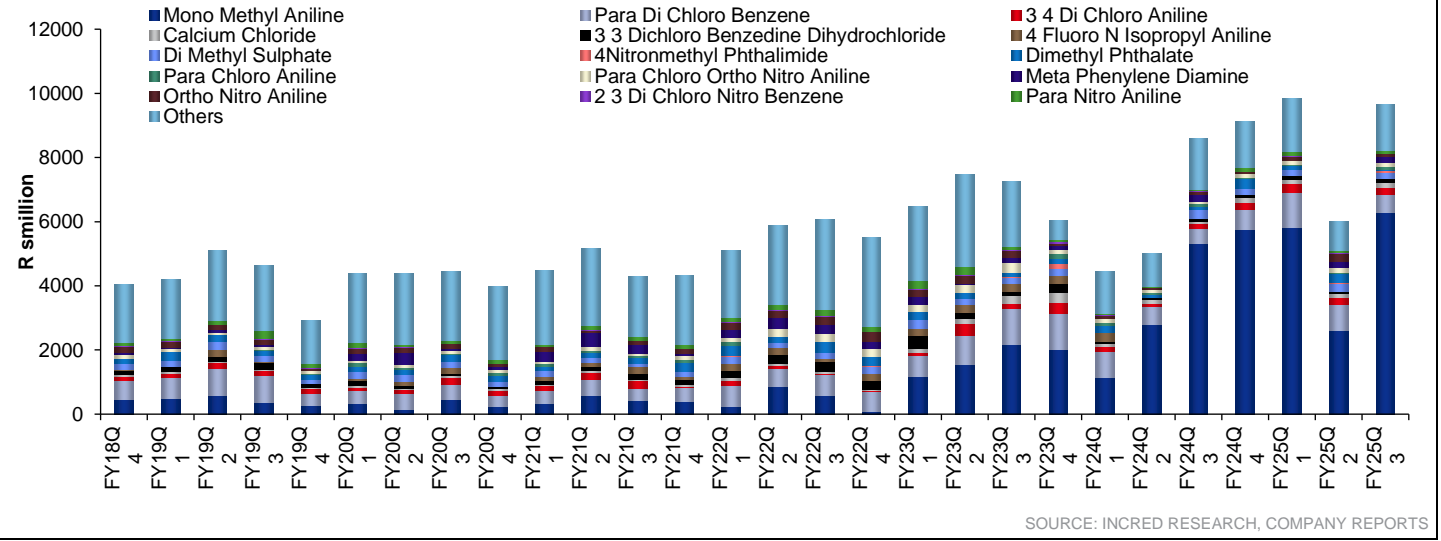
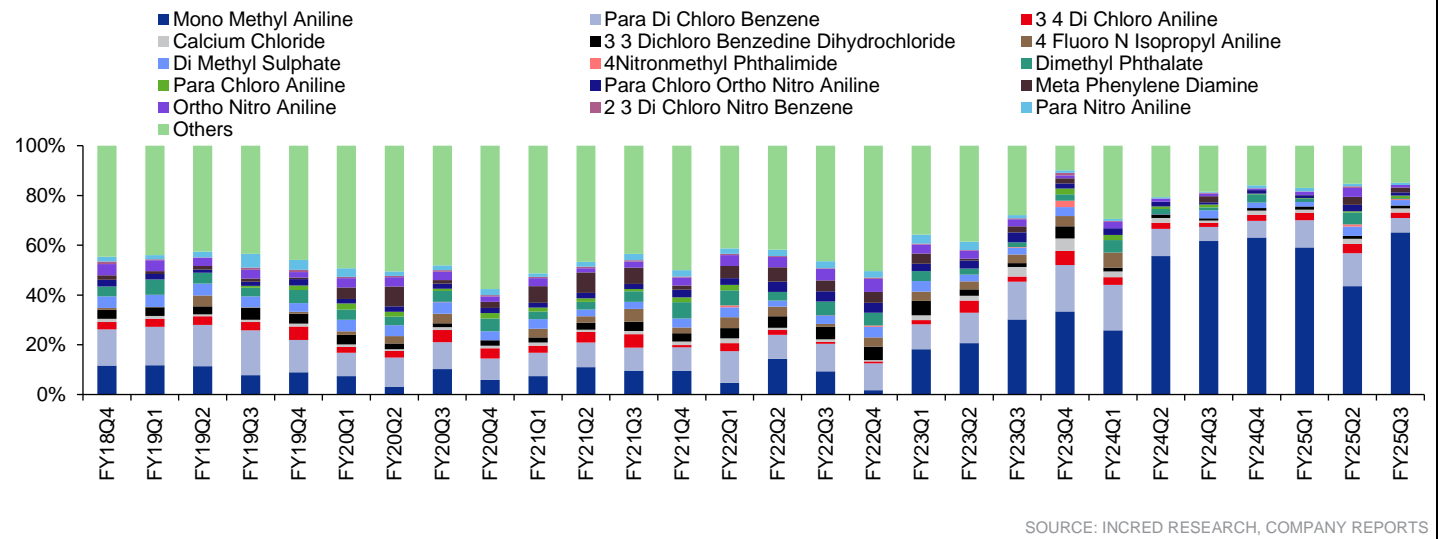
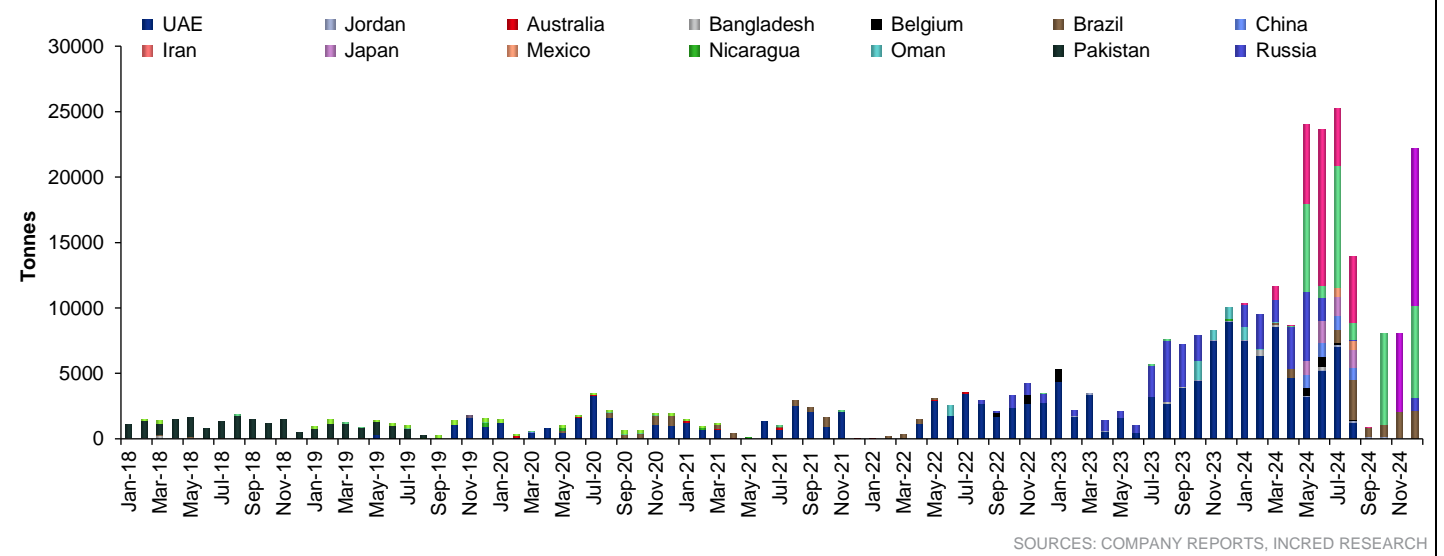


Figure 2: MMA accounted for bulk of the exports in value terms, representing 60%



In the past few quarters, Aarti Industries' exports of MMA have been primarily driven by the UAE and Russia

Figure 3: MMA has emerged as a significant export chemical over the last few quarters; the export growth has been primarily driven by demand from Russia and the UAE

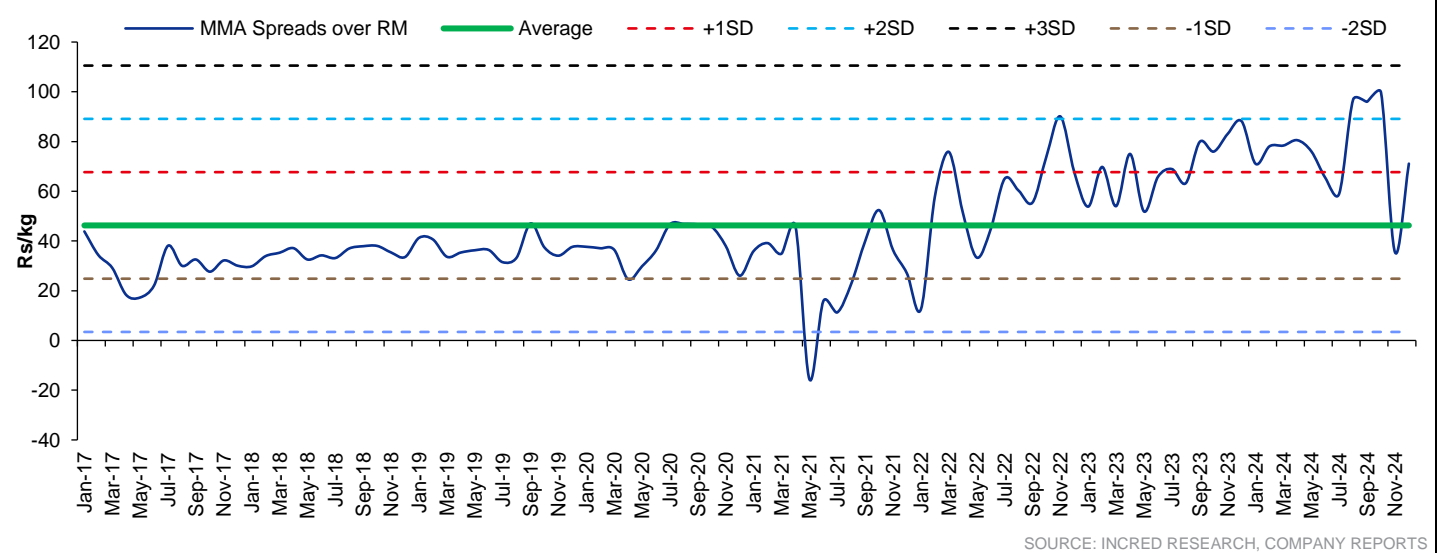


The partial recovery in MMA exports in Dec 2024 was driven by Aarti Industries' trader-driven sales

It appears that in a desperate attempt to sell the material and show revenue, Aarti Industries resorted to trader-driven sales in Nov and Dec 2024. However, realization in MMA is falling, which is not good news on the margin front in the coming quarters.

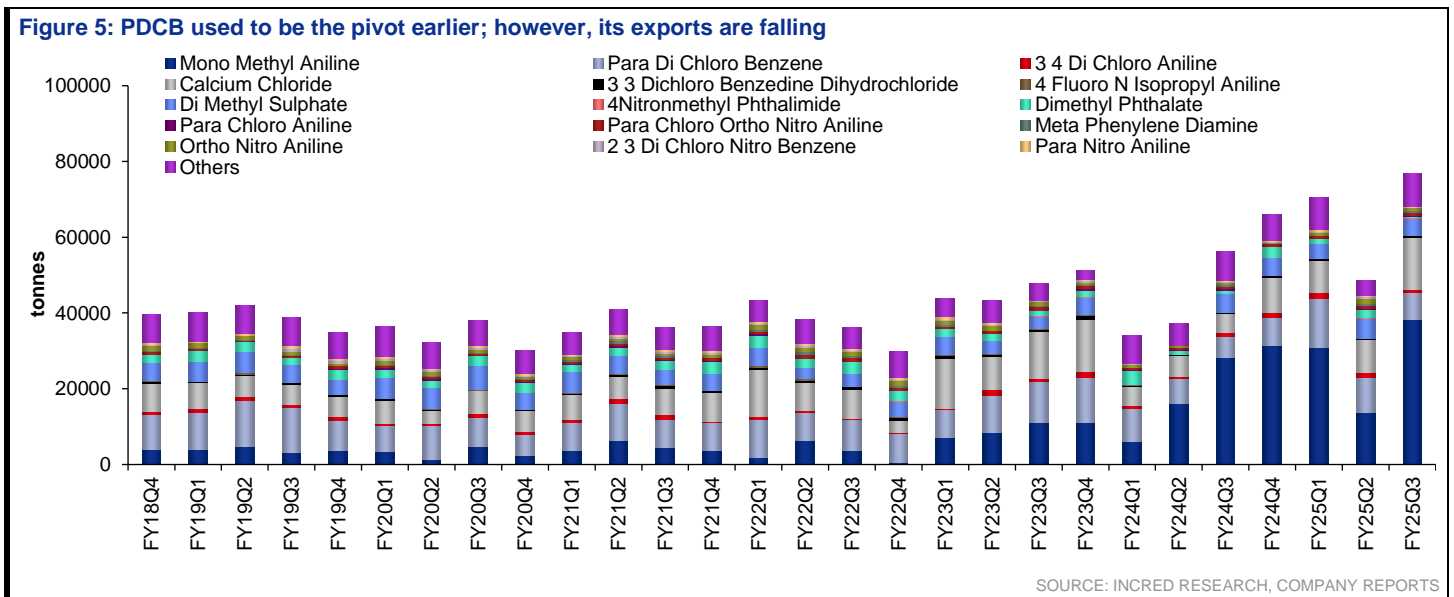
MMA margin over aniline is falling

Figure 4: MMA margin over aniline is falling



PDCB is another pivot that is fading

Figure 5: PDCB used to be the pivot earlier; however, its exports are falling



SOURCE: INCRED RESEARCH, COMPANY REPORTS

PDCB has multiple usage ➤

Paradichlorobenzene (PDCB), a chlorinated aromatic compound, has multiple industrial and commercial applications. Some of the primary uses of PDCB include:

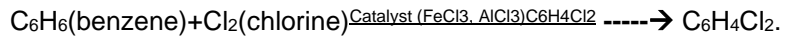
- Mothballs and deodorants:** PDCB is widely known for its use in mothballs and moth repellents, where it functions as an insect repellent. It helps protect clothing and fabrics from moth larvae, particularly in storage. It's also used in air fresheners and deodorants, often in solid or granular forms.
- Chemical intermediate:** PDCB serves as a precursor for manufacturing various chemicals. This includes the production of benzene derivatives, such as:
 - Aniline:** Used in the manufacture of dyes, drugs, and polymers.
 - Chlorobenzene:** Used as a solvent and intermediate in making other chemicals.
 - Pesticides and herbicides:** Some agrochemicals are synthesized from PDCB.
- Pesticides and fungicides:** PDCB is sometimes used in the formulation of certain pesticides and fungicides for its effectiveness against various pests and microorganisms.
- Polymerization:** It is utilized in the production of high-performance polymers. As a building block, PDCB is used in making polymer resins, which have applications in coatings, adhesives, and electronics.
- Solvent and degreaser:** PDCB is used as a solvent in various cleaning products, particularly in industrial degreasers, where its solvent properties help remove oils, grease, and other contaminants from machinery and equipment.
- Insecticides:** In addition to mothballs, PDCB is also incorporated into products designed to control other insects, including cockroaches, flies, and ants.
- Medical usage:** It has limited use in medical products for purposes such as disinfection and in some topical medications, although this is less common compared to other uses.
- Air and water purification:** PDCB can be used in certain water and air purification systems, where its properties help in eliminating odours and certain organic compounds.

PDCB is one of the simplest chemicals to produce, and in this regard, it's a pure commodity ➤

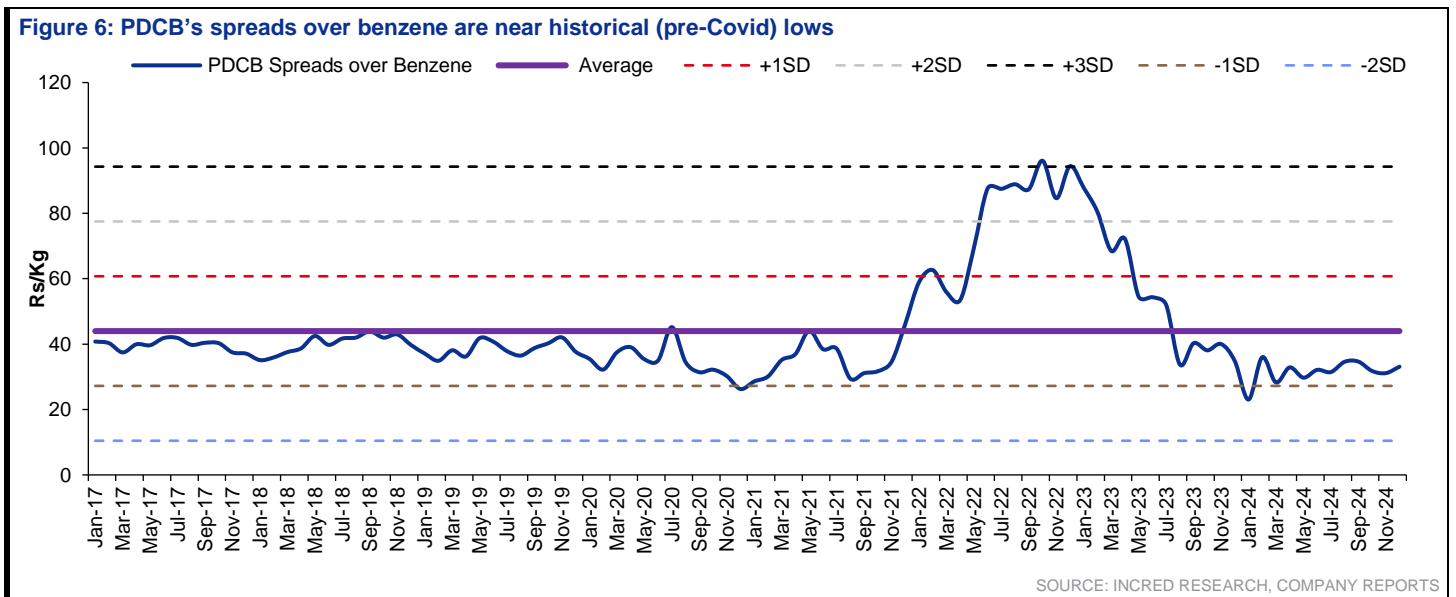
Paradichlorobenzene (PDCB) is one of the simplest chemicals to produce, which contributes to its status as a commodity chemical. The production process for PDCB typically involves the chlorination of benzene, which is a relatively straightforward and inexpensive process. This simplicity allows for low barriers to entry for manufacturers, increasing the availability of the product and leading to competitive markets.

Reaction to make PDCB:

The basic reaction is as follows:



The spreads of PDCB over its raw material is falling and are now approaching pre-Covid lows ➤

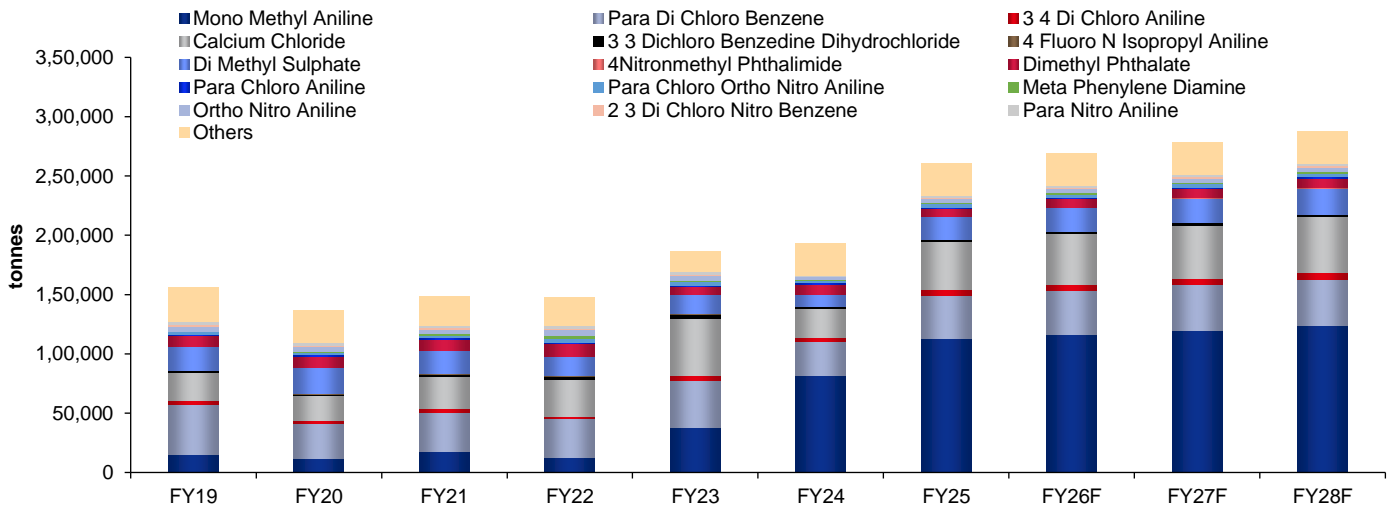


Earnings and valuation

A leveraged balance sheet, slowing product exports and lack of product differentiation means post-Covid margin and EBITDA are unlikely to come by for the next few quarters.

MMA exports will slow down, and its realization is unlikely to rise ➤

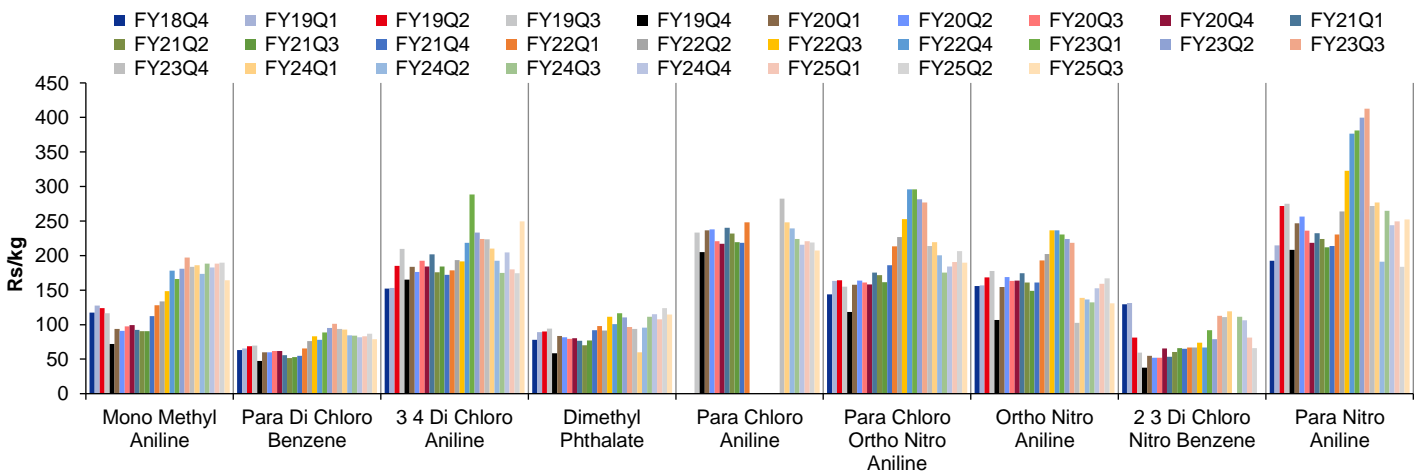
Figure 7: In a best-case scenario, MMA exports are likely to remain flattish



SOURCE: INCRED RESEARCH, COMPANY REPORTS

The best of the product price is behind us ➤

Figure 8: The best of the product price is behind us



SOURCE: INCRED RESEARCH, COMPANY REPORTS

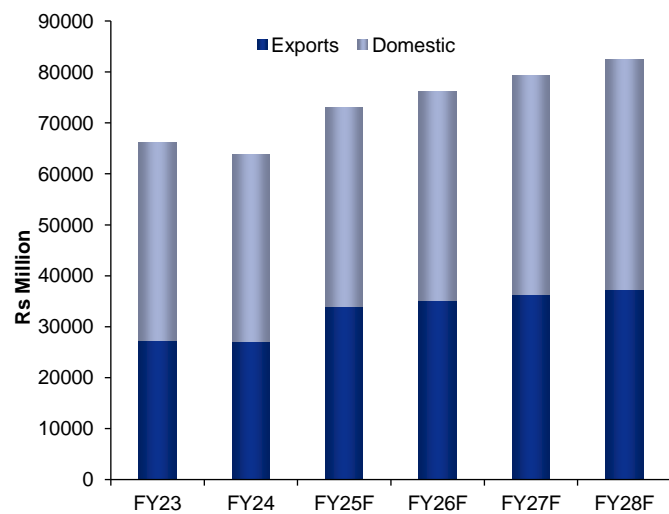
Unless there is a big domestic market recovery, revenue will lag the consensus forecast ➤

Figure 9: Consensus revenue and EBITDA forecasts don't make sense

Aarti Industries Ltd									
		Cslid C		Periodicity Annuals		Source Standard		Cur INR	
				Broker -----		Guidance			
More estimates are available MODL »									
1) Headline 2) Headline Growth 3) Company-Specific									
12 Months Ending	FY 2024 Act	FY 2025 Est		FY 2026 Est		FY 2027 Est		FY 2028 Est	
	03/31/2024	03/31/2025	#	03/31/2026	#	03/31/2027	#	03/31/2028	#
11) EPS, Adj+	11.490	10.625	23	14.511	23	19.308	21	28.557	4
12) EPS, GAAP	11.490	11.913 ↓	9	17.257 ↓	9	22.720	5		
13) Revenue	63.720B	73.120B	22	84.965B	22	98.626B	18	107.971B	4
14) Gross Margin %	36.158	38.035	16	39.302	16	39.839	14	43.457	4
15) Operating Profit	5.985B	6.376B	19	8.817B	20	11.020B	19	15.243B ↑	3
16) EBIT	5.980B	6.355B	17	8.815B	18	11.054B	17	15.243B ↑	3
17) EBITDA	9.760B	11.019B	22	13.792B	22	16.373B	18	20.437B	4
18) Pre-Tax Profit	3.950B	4.018B	15	4.911B	16	7.119B	17	12.969B	3
19) Net Income Adj+	4.160B	3.907B	22	5.728B	23	7.227B	20	10.350B	4
Current Multiples									
	Last 4 Qtrs Act	Next 4 Qtrs Est		FY 2025		FY 2026		FY 2027	
Price/EPS, Adj+	38.53	38.78		41.67		30.51		22.93	
Price/Book	3.03			2.86		2.64		2.44	
Price/Cash Flow	16.17			20.14		15.81		12.91	
EV/Revenue	2.81	2.50		2.68		2.31		1.99	

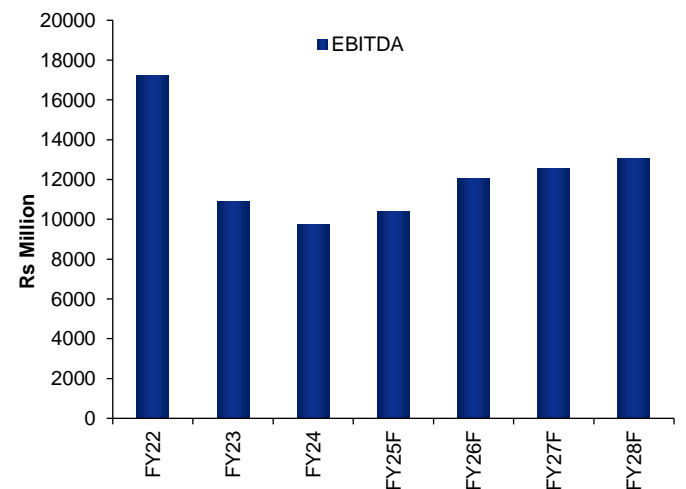
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 10: Revenue shall be way below the consensus forecast



SOURCE: INCRED RESEARCH, COMPANY REPORTS

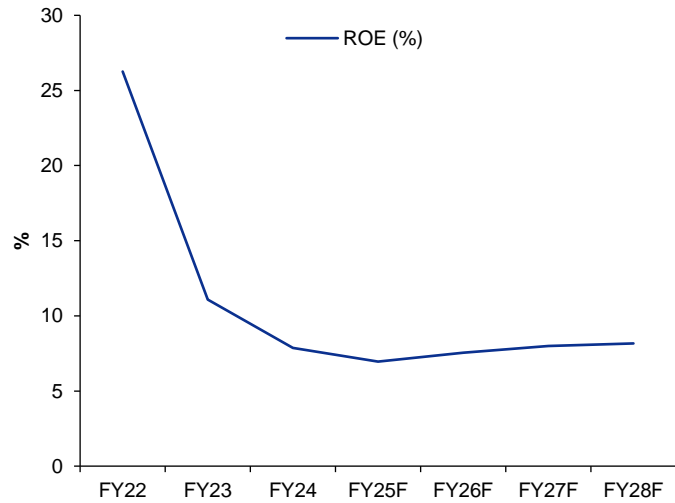
Figure 11: EBITDA of FY22 is unlikely to be repeated even in FY28F



SOURCE: INCRED RESEARCH, COMPANY REPORTS

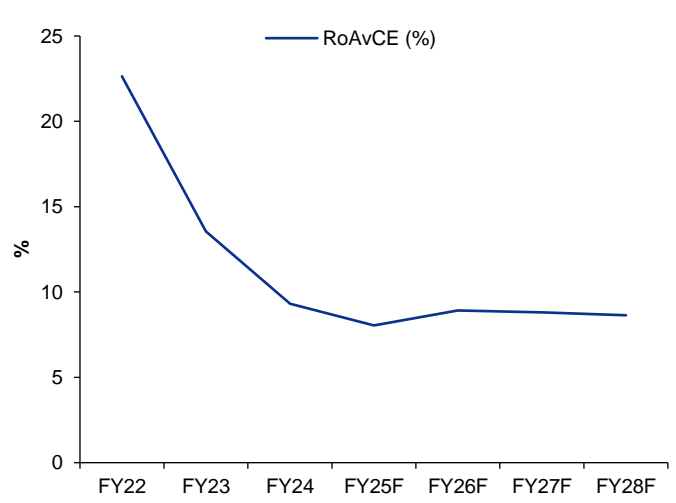
RoE and RoCE profiles will become worse ➤

Figure 12: RoE is unlikely to improve significantly...



SOURCE: INCRED RESEARCH, COMPANY REPORTS

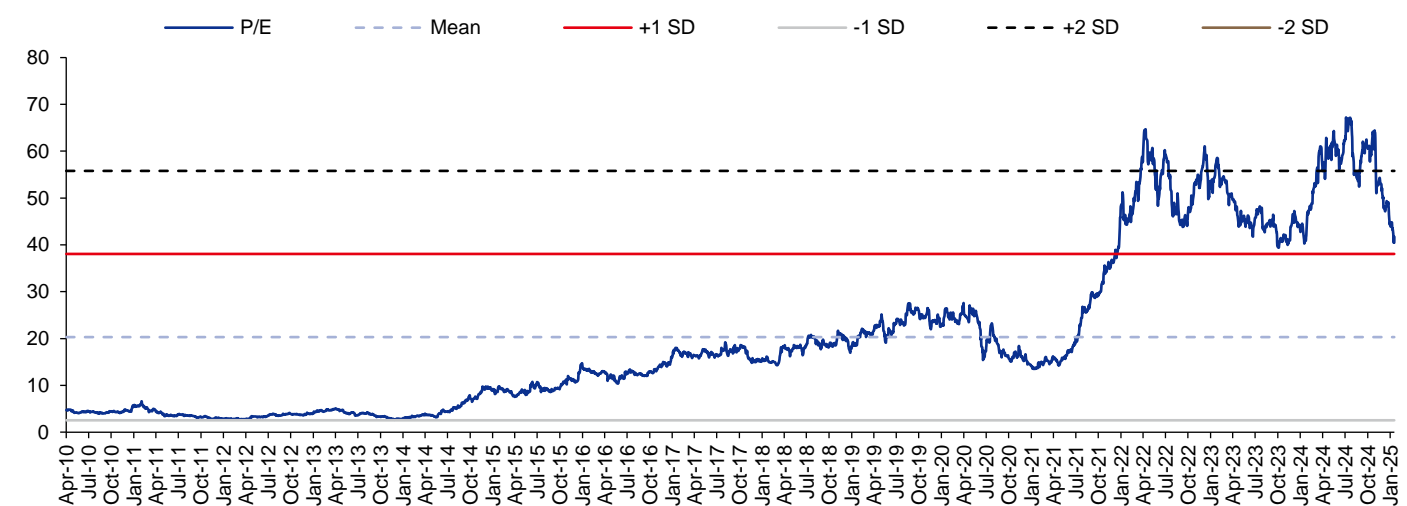
Figure 13: ... and so is the case with RoCE



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Stock is costly from all valuation parameters ➤

Figure 14: Aarti Industries' stock is trading well above its historical mean P/E



SOURCE: INCRED RESEARCH, COMPANY REPORTS

We have valued the stock at its historical mean P/E to arrive at our lower target price of Rs281 ➤

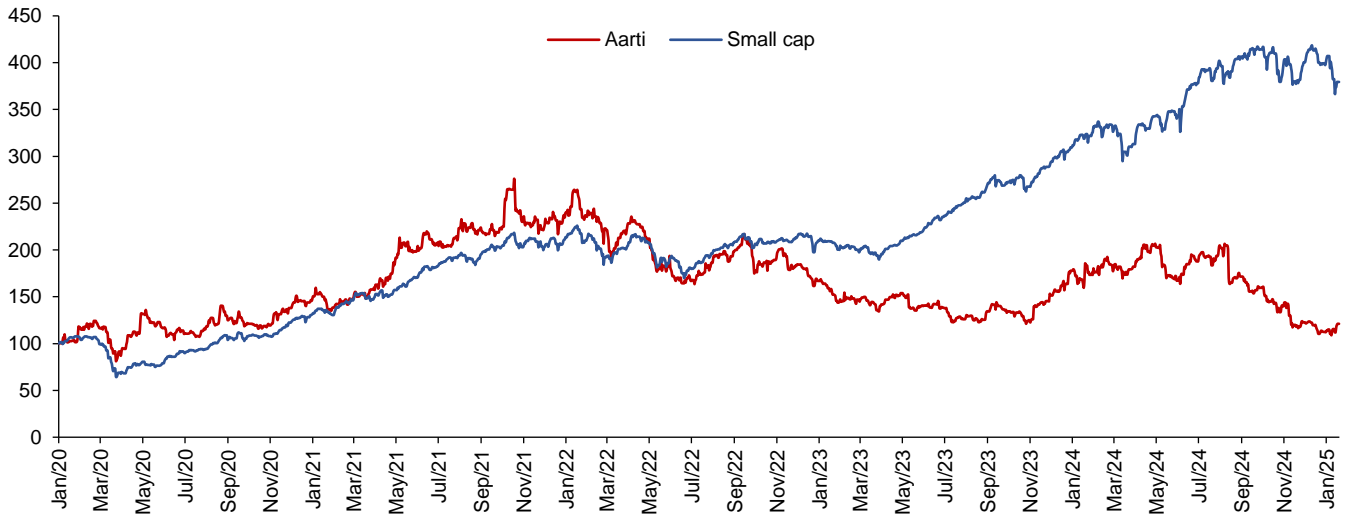
Figure 15: We value the stock at its historical mean to arrive at our target price of Rs 281

Target Price Methodology

Item	Unit	Valuation
FY27F EPS	Rs/share	14.0
P/E Multiple	x	20.0
Target Price	Rs/share	281

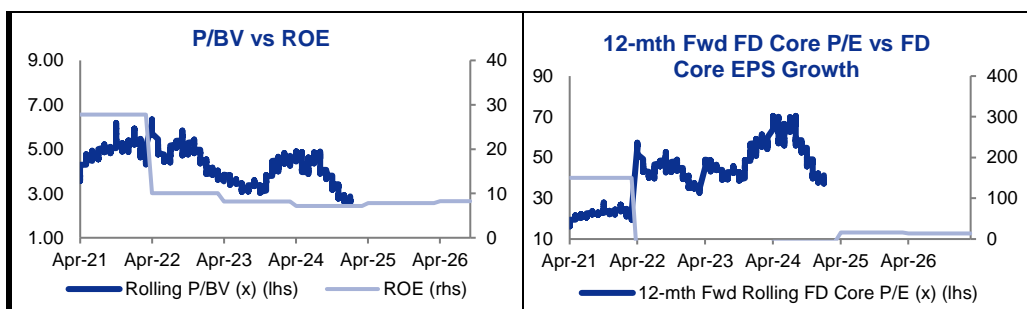
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 16: The stock has underperformed hugely; however, given that earnings are unlikely to recover, this underperformance may continue for a long time



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Net Revenues	66,186	63,720	70,092	76,169	79,243
Gross Profit	27,769	24,920	26,635	28,944	30,112
Operating EBITDA	10,890	9,760	10,375	12,042	12,536
Depreciation And Amortisation	(3,105)	(3,780)	(4,193)	(4,471)	(4,749)
Operating EBIT	7,785	5,980	6,182	7,571	7,787
Financial Income/(Expense)	(1,683)	(2,110)	(2,392)	(2,392)	(2,218)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	9	80	530	828	1,228
Profit Before Tax (pre-EI)	6,111	3,950	4,320	6,006	6,797
Exceptional Items					
Pre-tax Profit	6,111	3,950	4,320	6,006	6,797
Taxation	(659)	210	(433)	(1,514)	(1,713)
Exceptional Income - post-tax					
Profit After Tax	5,452	4,160	3,887	4,493	5,084
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	5,452	4,160	3,887	4,493	5,084
Recurring Net Profit	5,452	4,160	3,887	4,493	5,084
Fully Diluted Recurring Net Profit	5,452	4,160	3,887	4,493	5,084

Cash Flow

(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
EBITDA	10,890	9,760	10,375	12,042	12,536
Cash Flow from Invt. & Assoc.					
Change In Working Capital	3,118	7,114			
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	(9)				
Other Operating Cashflow	(126)	2,610	2,056	193	20
Net Interest (Paid)/Received	(1,683)	(2,110)	(2,392)	(2,392)	(2,218)
Tax Paid	909	(210)	433	1,514	1,713
Cashflow From Operations	13,098	17,164	10,472	11,356	12,051
Capex	(13,263)	(10,491)	(5,000)	(5,000)	(5,000)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(35)	(61)			
Cash Flow From Investing	(13,298)	(10,552)	(5,000)	(5,000)	(5,000)
Debt Raised/(repaid)		3,098	5,000	(5,000)	
Proceeds From Issue Of Shares	3,061				
Shares Repurchased					
Dividends Paid	(906)	(906)	(906)	(906)	(906)
Preferred Dividends					
Other Financing Cashflow	(1,683)	(2,110)	(2,392)	(2,392)	(2,218)
Cash Flow From Financing	472	82	1,702	(8,298)	(3,124)
Total Cash Generated	272	6,693	7,174	(1,942)	3,927
Free Cashflow To Equity	(200)	9,709	10,472	1,356	7,051
Free Cashflow To Firm	1,483	8,722	7,864	8,748	9,269

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Total Cash And Equivalents	2,007	1,300	7,009	3,670	6,891
Total Debtors	9,405	8,260	9,086	9,874	10,272
Inventories	10,311	11,600	12,760	13,866	14,426
Total Other Current Assets	2,870	3,529	3,529	3,529	3,529
Total Current Assets	24,593	24,689	32,384	30,939	35,118
Fixed Assets	58,499	67,014	67,821	68,350	68,601
Total Investments	172	233	233	233	233
Intangible Assets					
Total Other Non-Current Assets	2,545	4,219	4,219	4,219	4,219
Total Non-current Assets	61,216	71,466	72,273	72,802	73,053
Short-term Debt	22,393	15,239	10,239	5,239	5,239
Current Portion of Long-Term Debt					
Total Creditors	3,075	5,213	5,734	6,231	6,483
Other Current Liabilities	2,365	5,313	5,313	5,313	5,313
Total Current Liabilities	27,833	25,764	21,285	16,783	17,034
Total Long-term Debt	6,347	16,599	26,599	26,599	26,599
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	2,421	887	887	887	887
Total Non-current Liabilities	8,768	17,486	27,486	27,486	27,486
Total Provisions					
Total Liabilities	36,601	43,250	48,772	44,269	44,520
Shareholders Equity	49,201	52,898	55,878	59,465	63,643
Minority Interests	7	7	7	7	7
Total Equity	49,208	52,905	55,886	59,472	63,650

Key Ratios					
	Mar-23A	Mar-24A	Mar-25F	Mar-26F	Mar-27F
Revenue Growth	(5.4%)	(3.7%)	10.0%	8.7%	4.0%
Operating EBITDA Growth	(43.5%)	(10.4%)	6.3%	16.1%	4.1%
Operating EBITDA Margin	16.5%	15.3%	14.8%	15.8%	15.8%
Net Cash Per Share (Rs)	(73.75)	(84.24)	(82.29)	(77.71)	(68.82)
BVPS (Rs)	135.72	145.92	154.15	164.04	175.57
Gross Interest Cover	4.63	2.83	2.58	3.16	3.51
Effective Tax Rate	10.8%		10.0%	25.2%	25.2%
Net Dividend Payout Ratio	16.6%	21.8%	23.3%	20.2%	17.8%
Accounts Receivables Days	64.27	50.59	45.16	45.43	46.40
Inventory Days	116.03	103.06	102.30	102.90	105.09
Accounts Payables Days	(37.89)	(38.98)	(45.97)	(46.24)	(47.23)
ROIC (%)	10.0%	7.1%	7.2%	8.6%	8.7%
ROCE (%)	9.6%	7.4%	7.0%	8.2%	8.3%
Return On Average Assets		6.9%	6.3%	6.6%	6.9%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.