Aether Industries Ltd

Visit Note | **Specialty Chemical**

DALAL & BROACHA

Equity Research Desk

25 April 2024

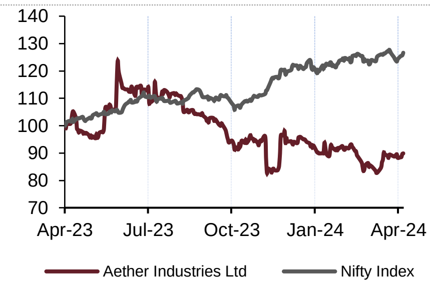
During our visit to Aether Industries' manufacturing site in Sachin, Surat, we had the opportunity to visit both its Pilot facility and CRAMS facility as well as its Site 2, 3 & 4 and engage in discussions with the management team. It was evident that the company is currently undergoing an expansion phase. However, the company's performance in the first nine months of the fiscal year 2024 has been lackluster. This can be attributed mainly to the significant decline in prices of commodity chemicals, which resulted from Chinese dumping, as well as a fire outbreak at Site 2 during the third quarter of the fiscal year 2024. These unforeseen circumstances have undoubtedly impacted the company's operations and financial performance.

Rating	TP (Rs)	Up/Dn (%)
Not Rated		

Market Data		
Current price	**Rs**	**847**
Market Cap (Rs.Bn)	(Rs Bn)	112
Market Cap (US$ Mn)	(US$ Mn)	1,348
Face Value	Rs	10
52 Weeks High/Low		Rs 1210.8 / 761.55
Average Daily Volume	('000)	85
BSE Code		543534
Bloomberg		

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	**Mar-24**	**Dec-23**
Promoters	81.79	81.81
Public	18.21	18.19
Total	**100**	**100**

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20	FY21	FY22	FY23
Net sales	2,012	3,018	4,498	5,900	6,511
EBIDTA	475	718	1,122	1,681	1,862
Margins	23.6	23.8	24.9	28.5	28.6
PAT (adj)	233	400	711	1,089	1,304
Growth (%)	-	-	78.0	53.2	19.7
EPS	2.5	4.2	7.4	9.7	10.5
P/E (x)	341.8	199.6	115.1	87.6	80.9
P/B (x)	206.9	101.9	47.0	24.7	8.5
EV/EBITDA (x)	170.5	113.5	74.6	58.3	56.2
RoE (%)	60.5	51.0	40.8	28.2	10.5
ROCE (%)	19.9	21.3	22.3	19.8	11.8

Source: Dalal and Broacha

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Aether - Saudi Partnership for Converge Polyols (under CRAMS)

On June 8, 2023, the company finalized a licensing agreement with Saudi Aramco Technologies Company for the commercialization of converge polyols technology. Aether had been collaborating with the Saudi company for several years to develop the converge technology. The agreement entails Saudi Aramco allowing the use of polyol technology to Aether, who will then utilize its chemistry expertise for product manufacturing under CASE (Coatings, Adhesives, Sealants, Elastomers) segments. The agreement covers a production capacity of 2 KTA, with a pilot plant capacity set at 500 MT. It spans over 5 years, during which Aether will handle manufacturing and marketing for the products manufactured using the Polyol Technology.

The planned capex for the 2 KTA capacity is expected to range between Rs 40-50 crore and according to our estimates when fully utilized annual revenue potential can be in the range of Rs 180-200 crore.

First Commercialization with H.B. Fuller

Aether announced its inaugural commercialization of converge polyols with H.B. Fuller, a leading American adhesives manufacturer. The initial sale will cover a capacity of approximately 200-300 TPA.

About Converge Polyols

Converge Polyols represent a state-of-the-art technology for manufacturing more sustainable polyols capable of containing about 40% of carbon dioxide from the environment, thereby reducing carbon emissions. The Polyols market size is estimated at around 10,800 KTA, with applications in CASE (Coatings, Adhesives, Sealants, Elastomers). Aether will primarily focus on CASE, which has a market size of about 2,200 KTA wherein the company will target CAS.

The realization for converge polyols can range from $8 and can go upto $13 per kg, Aether commenced the development of this product in 2020.

Future Plans

With governments worldwide pushing for reduced carbon emissions, management envisions significant potential for converge polyols. It is our expectation that going forward the orders for this product is only going to increase and having already established a strong presence with experience, Aether stands to benefit from the increase in demand.

‘Novoloop collaboration with Aether

- Novoloop, a leading player in plastic circular economy technology, announced plans for a pilot plant construction in collaboration with Aether. Accordingly, on April 10,2024, the plant had passed equipment testing & solvent runs & had started operations.
- The innovative technology enables the conversion of post-consumer plastic waste into high-performance materials.
- These materials offer an impressive carbon footprint reduction of up to 91% compared to traditional methods.
- According to Fortune Business Insights, The plastic waste management market is anticipated to reach $41.58 billion by 2027, with a compound annual growth rate (CAGR) of 3.1%.
- Management expresses optimism regarding the potential for securing contract manufacturing opportunities in the future.

LoI with Oilfield service company

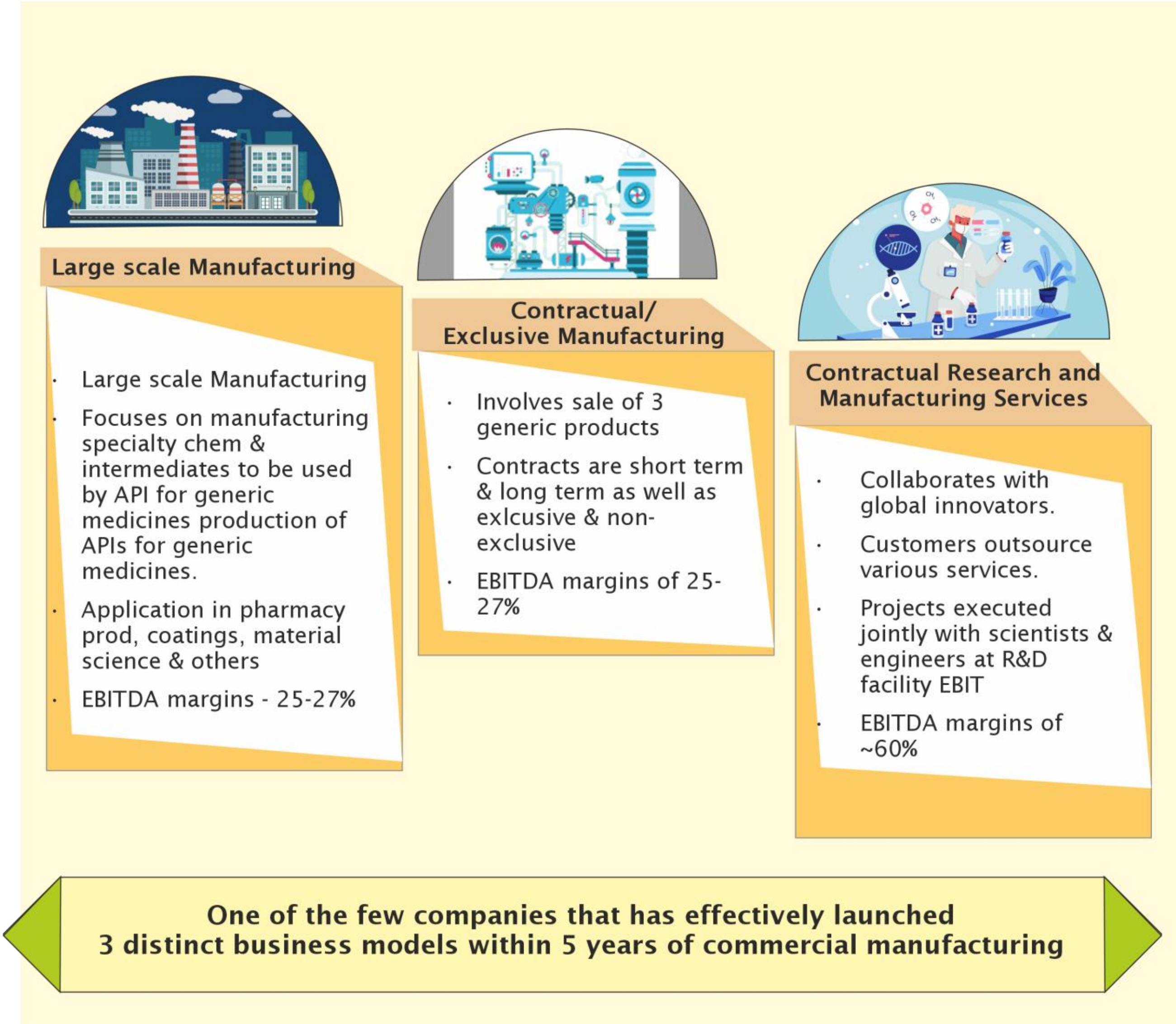
- On June 7, 2023, Aether signed a Letter of Intent (LoI) with one of the top three leading global Oil Field Services companies based in the USA.
- The LoI sets the stage for the execution of a strategic supply agreement between the two entities within a few months of the LoI's execution.
- Four strategic products of the new customer are specified in the LoI, which will be contract-manufactured by Aether as the initial product offerings.
- The total annual volume of these four products, as outlined in the LoI, amounts to 16,000 MT.
- The anticipated EBITDA margins from this contract will be in the north of the current margins of the company.

Partnership with Global Lithium Ion battery producer

- Aether Industries is poised to make its foray into the electrolyte additives and battery space through a strategic partnership.
- Within this collaboration, the company will manufacture additives essential for electrolyte production, catering to one of the largest Lithium Ion Battery Producer.
- This partnership operates under a contract manufacturing model, building upon Aether's existing capabilities in Contract Research and Manufacturing Services (CRAMS).
- Although the initial order volume is not substantial, securing a partnership with a major OEM represents a significant milestone for Aether.
- Management acknowledges the current inadequacy of EV infrastructure in the country but anticipates explosive growth opportunities in the next 4-5 years.

Business Model

Exhibit 1: Aether has presence across 3 business verticals



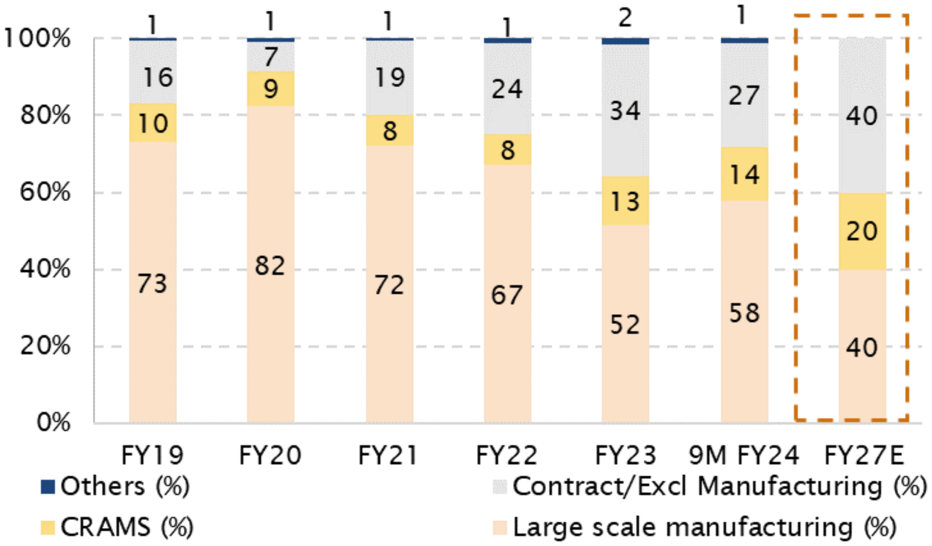
Source: Company, Dalal & Broacha

Aether majorly manufactures its own specialty chemicals under Large scale manufacturing model.

Currently, Contractual manufacturing faces some pressure due to challenges in the agrochemical sector, resulting in delayed orders but no cancellations. However, management is optimistic about the situation improving. 3 products are manufactured under this model – MMBC (15%), BFA (14.2%) & MCT (5.1%).

CRAMS also serves as a first step through which customers shift to contractual manufacturing. Historically, there has been a 12-15% likelihood of customers transitioning from CRAMS to contract manufacturing.

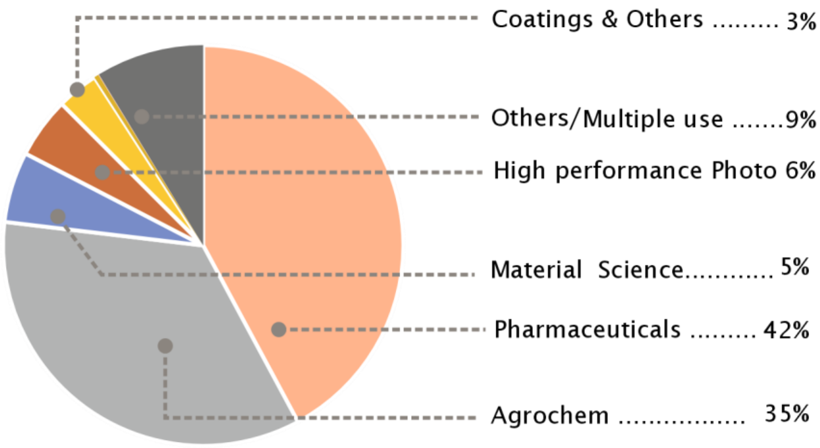
Exhibit 2: Increasing proportion for CRAMS to boost margins going forward



Source: Company, Dalal & Broacha Research

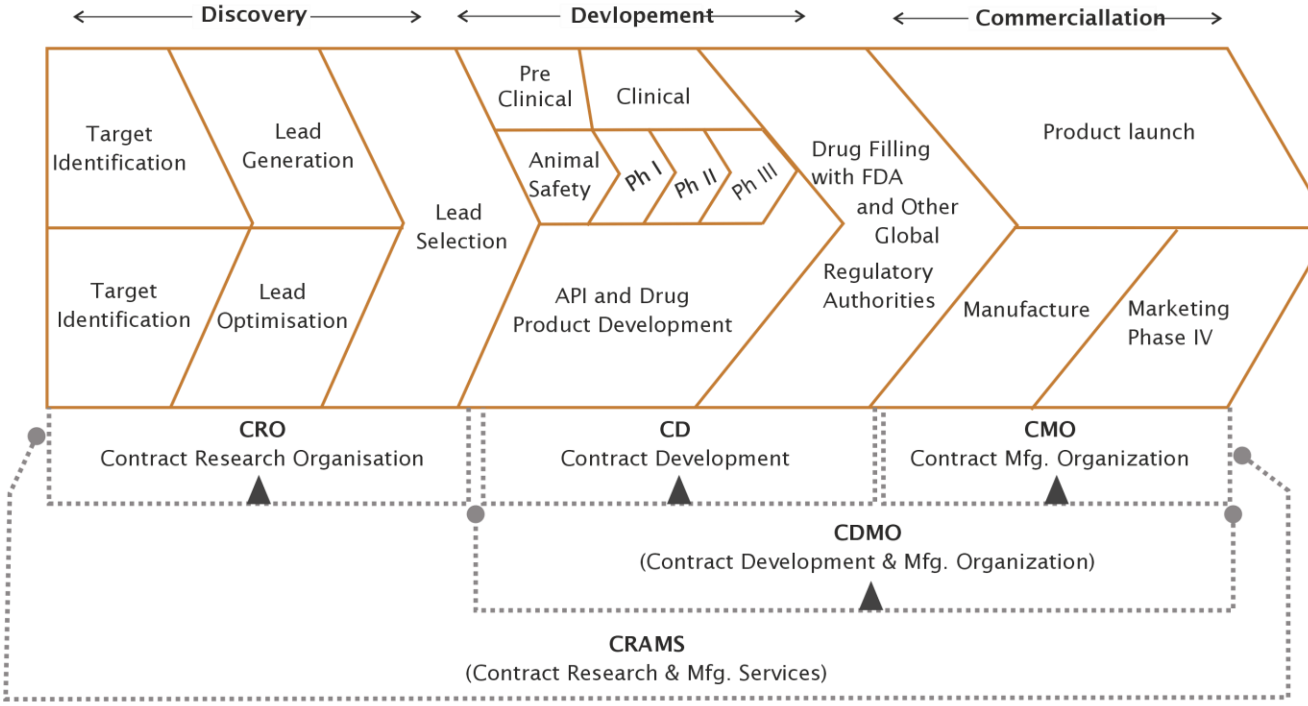
Looking ahead, management aims to maintain a ratio of 40:40:20 for LSM: Contract/Exclusive manufacturing: CRAMS, respectively, in order to optimize revenue distribution.

Exhibit 3: Revenue mix from various industry segments



Source: Company, Dalal & Broacha Research

Exhibit 4: CRAMS value chain

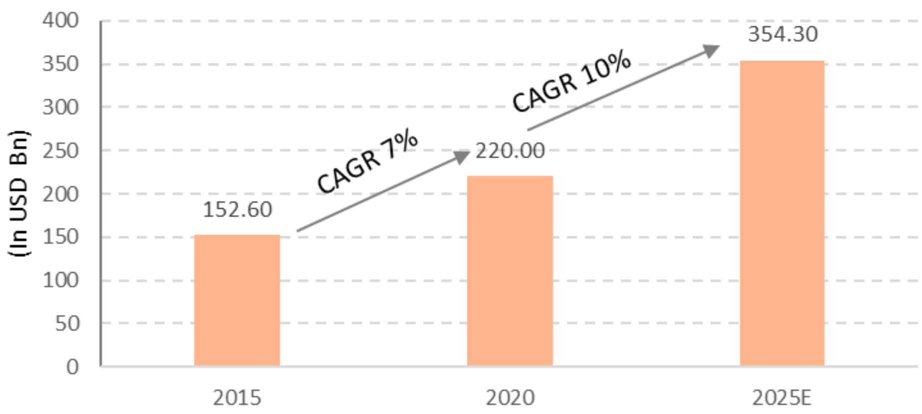


Source: The Tycoon Mindset blog, Industry report

Contract Research and Manufacturing Services (CRAMS) entail delegating services or products to cost-effective providers. These providers uphold quality benchmarks that align with international regulatory standards. Pharmaceutical industries have traditionally subcontracted diverse components, including APIs, intermediates, and Formulations to CRAMS providers.

Globally CRAMS was valued at $ 220 Bn in 2020 & this industry is expected to grow at a CAGR of 10% till 2025. Companies are now increasing the proportion of their spending towards R&D.

Exhibit 5: Global CRAMS market size



Source: Company, Frost & Sullivan Industry report

CRAMS in India

CRAMS, is experiencing rapid growth within the pharmaceutical and biotechnology sectors. This growth is driven by the industry's reliance on outsourcing through entities like contract research organizations (CROs) and contract manufacturing organizations (CMOs).

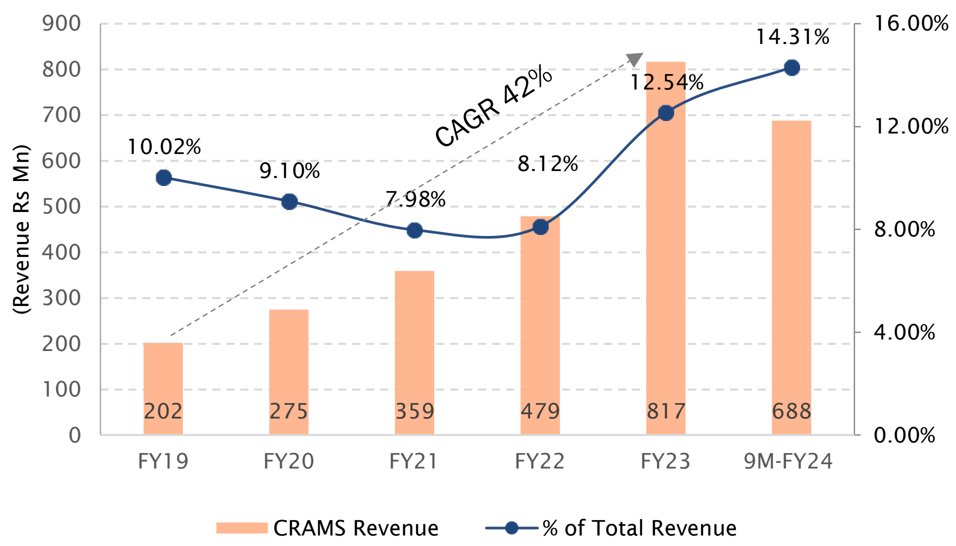
Many pharmaceutical and biotech companies are leaning towards in-house manufacturing to boost their return on investments. However, the uncertainty surrounding the success of a product exposes these firms to risks when deciding on the size of a plant to build and allocate resources for achieving economies of scale. As a result, rising costs in research and development, along with challenges in productivity and profitability, have led many major pharmaceutical companies worldwide to seek external support by outsourcing aspects of their research and manufacturing processes to countries like India, known for its cost-effectiveness.

CRAMS to drive margin growth for Aether

Aether generated 12.6% of its revenue from its CRAMS division in FY23. The company has been able to scale up its business from CRAMS at a robust rate of 42% (4-Year CAGR). Aether's CRAMS service entails contract research, pilot scale-up services, Contract manufacturing, Full time Equivalent service (FTE), technology development & process development and optimization. Additionally no companies in the peer set have this capability which places Aether as the only player with scale in the industry.

This business vertical commands highest margin among the 3 business model, which is more than 60%. Management has been emphasizing and aims to increase its share of revenue from this vertical. In the long run it is expected that this vertical will contribute ~20% of the company's revenue. Currently, CRAMS have a base of ~30 customers/projects. Of these 200 projects are from repeat customers. Every year the company adds 4 to 5 customers under CRAMS and targets to maintain this pace going forward.

Exhibit 6: CRAMS growing at robust rate of 42% and increasing contribution to total revenue



Source: Company, Dalal & Broacha

Exhibit 7: Manufacturing Capabilities

Site	Size	Capacity	Capex	Description
Site 1	3,500 Sq.M		~125-150 cr	R&D Facility, Pilot Plant, CRAMS
Site 2	10,500 Sq.M	6,096 MT	280 cr (Incl Land cost of 8 cr)	LSM Facility + Contractual Manufacturing
Site 3	5,250 Sq.M	3,500 MT	225 cr	Site 3 primarily for LSM
Site 3++	5,250 Sq.M	3,500 MT	200 cr	For LSM
Site 4	18,500 Sq.M	16,000 MT	125 cr (Only for 30% of the land bank currently utilized)	Currently used for manufacturing 4 products for Oilfield service company
Site 5	125,875 Sq.M	> 65,000 MT	450-500 cr (1st Phase)	Planned investment of Rs 2500 cr over next 5-6 years

Source: Dalal & Broacha Research, Company

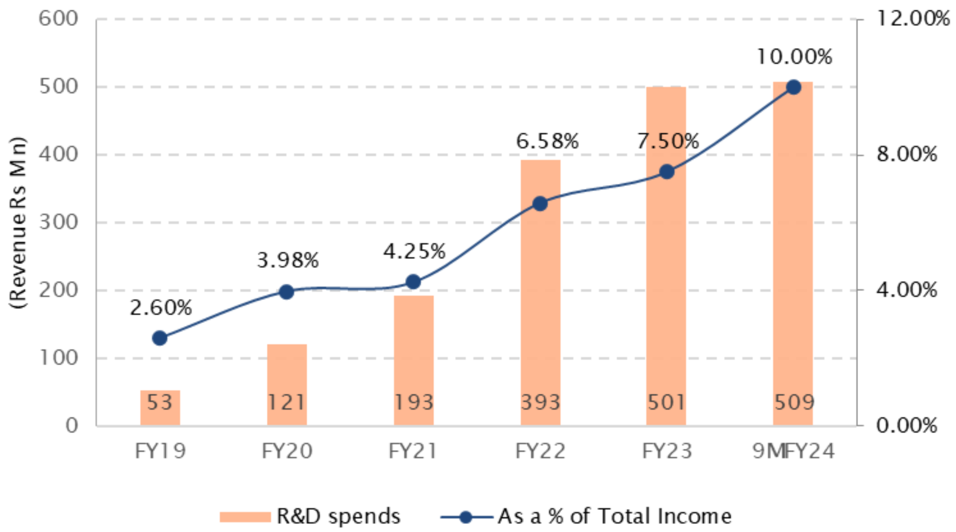
R&D at the helm

R&D plays a crucial role in the success of specialty companies, facilitating the development of product capabilities through increased investment. Aether's growth narrative is deeply intertwined with its R&D endeavors.

Initially, the company dedicated three years solely to R&D efforts before generating any revenue. Aether now boasts expertise in eight chemistries, cultivated by its in-house R&D team. With a continuous stream of products in development, Aether consistently expands its R&D portfolio, aiming to launch 4-5 new products annually from its current pipeline of approximately 45.

The R&D team has experienced significant growth, expanding from 164 (92 scientists, 72 engineers) in FY22 to 233 (111 scientists, 122 engineers) in FY23. Notably, Aether has demonstrated an impressive 75% CAGR in its R&D spending from FY19 to FY23, reflecting management's commitment to increasing the proportion of resources allocated to R&D over the years. For 9MFY24, company has spent ~10% of total revenue towards R&D which is the highest since past 5 years.

Exhibit 8: Forging the future through increasing spends in R&D

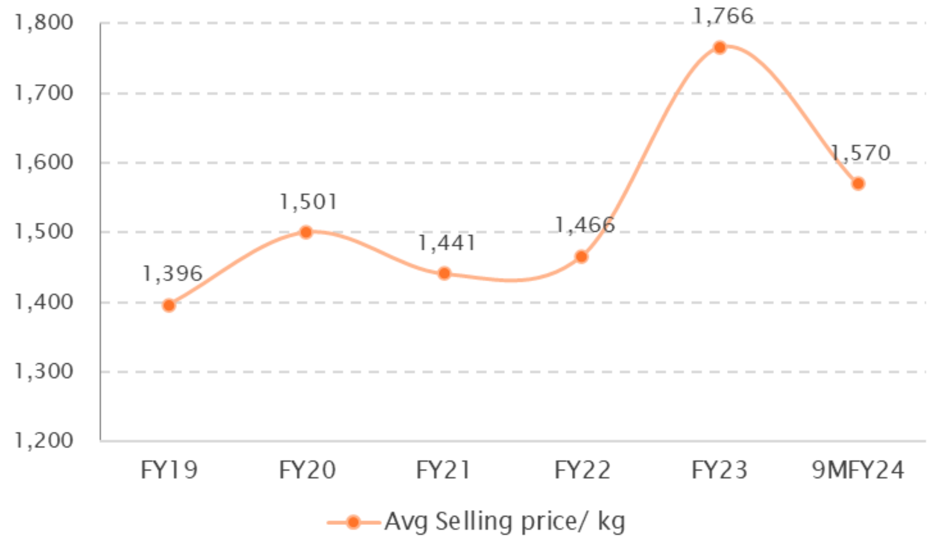


Source: Company, Dalal & Broacha Research

Industry leading average selling price

With focus on developing high value products & being the sole or among very few suppliers for certain products, average selling price per kg of the products in case of Aether is relatively higher than other players. Aether's products require more number of steps to manufacture which gives them a competitive edge over others and act as a barrier to entry for peers.

Exhibit 9: Average selling price under pressure in FY24, now stabalising



Source: Company, Dalal & Broacha Research

Exhibit 10: Aether's high value product commanding higher price vs other products

Product	Commodity	Regular Speciality Chemicals	Aether Speciality Cheimicals
Blended Price	Rs 200-300 per kg	Rs 400-700 per kg	Rs 1,440.85 per kg
Steps in manufacturing process	1 - 2	2 - 3	4 - 10

Source: Company RHP, Dalal & Broacha Research

Fire Accident – Update

11 fatalities were tragically reported, with several others sustaining injuries. In response, the company provided compensation of Rs 50 lakh per family of the casualty, along with job opportunities. Fortunately, the losses incurred were covered by the insurance company. Despite the unfortunate events, the company's sales remained largely unaffected due to its inventory stocking practices, which allowed it to meet customer demand without interruption. However, the incident did impact gross margins, with Q3FY24 showing a gross margin of 41.3%, compared to 52.7% in Q3FY23.

Manufacturing operations have resumed at Site 2, and it is anticipated that operations will return to normal by Q2FY25. The company is committed to addressing the challenges posed by the incident and is focused on restoring its operational efficiency and financial performance.

Dilution going forward

As per MPS (Minimum Public Shareholding) rule, a listed company in India should have at least 25% of their equity shares to be held by Non-promoter (public). Currently, Aether's promoters hold ~81.79% of the total equity which needs to be diluted to 75%.

Management has indicated to dilute their stake through fresh issue by the start of CY2025. Accordingly it is expected that there will be a fund raising of ~Rs 1,000 cr which the management intends to utilize it to fund further capex plans (largely towards the expansion of Site 5).

Exhibit 11: Working for the above strategy is given below:

Current Shareholding pattern		
Category	**No.of shares held**	**%**
Promoters & group	**10,84,16,402**	**82%**
Public	**2,41,33,871**	18%
Total	**13,25,50,273**	100

After dilution		
Category	**No.of shares held**	**%**
Promoters & group	10,84,16,402	*75%*
Public	3,61,38,801	*25%*
Total	14,45,55,203	*100%*
New shares issued	1,20,04,930	
Current Price	847	
Issue size expected at CMP (Mn)	**10,168**	

Source: Dalal & Broacha Research

Exhibit 12: Key Products Portoflio (Source F&S report & RHP)

Product	Market Position Global	Market Posn India	Volume sold in FY23 (MT)	Revenue (FY23) (Mn)	Decription/ Application	Expected growth - CAGR (2020-25)	Global Industry Size 2020 (MT)
4MEP	Largest manufacturer in the world (28% share in 2020)	Only manufacturer in India	564.91	926.88	1 Used to produce Metoprolol 2 ~0.7MT used to produce 1MT of Metoprolol derivative 3 Metoprolol is used in high blood pressure medicine	3.90%	1,750
MMBC	Second largest manufacturer in the world (14% share in 2020)	Only manufacturer in India	331.20	976.42	1 Used as an insecticide & pesticide	5.60%	1,750
T2E	Largest manufacturer in the world (50% share in 2020)	Only manufacturer in India	422.89	498.47	1 Application in pharmaceutical (Medicine)	12.70%	780
NODG	Largest manufacturer in world (46% share in 2020)	Only manufacturer in India	NA	221.38	1 Biotech - solubilize protein 2 Personal care - used in shampoo, shower gels, etc 3 Agri - herbicide & pesticide	6.70%	845
HEEP	Largest manufacturer in world (34% share in 2020)	One of the 3 major manufacturer in India & only manufacturer to be backward integrated	NA	288.3	Acidic catalyst	2.80%	500
DVL	Second largest manufacturer in world (13% share in 2020)	Only manufacturer in India	159.47	218.35	1 Used as intermediate in production of polyesters 2 Also used as building block in Active ingredients	6.50%	650
Bifenthrin Alcohol	Negligible	Only manufacturer in India	342.18	925.45	Agrochemical - used against certain Mite species	1.80%	3,250

Source: Company, Frost & Sullivan Industry report

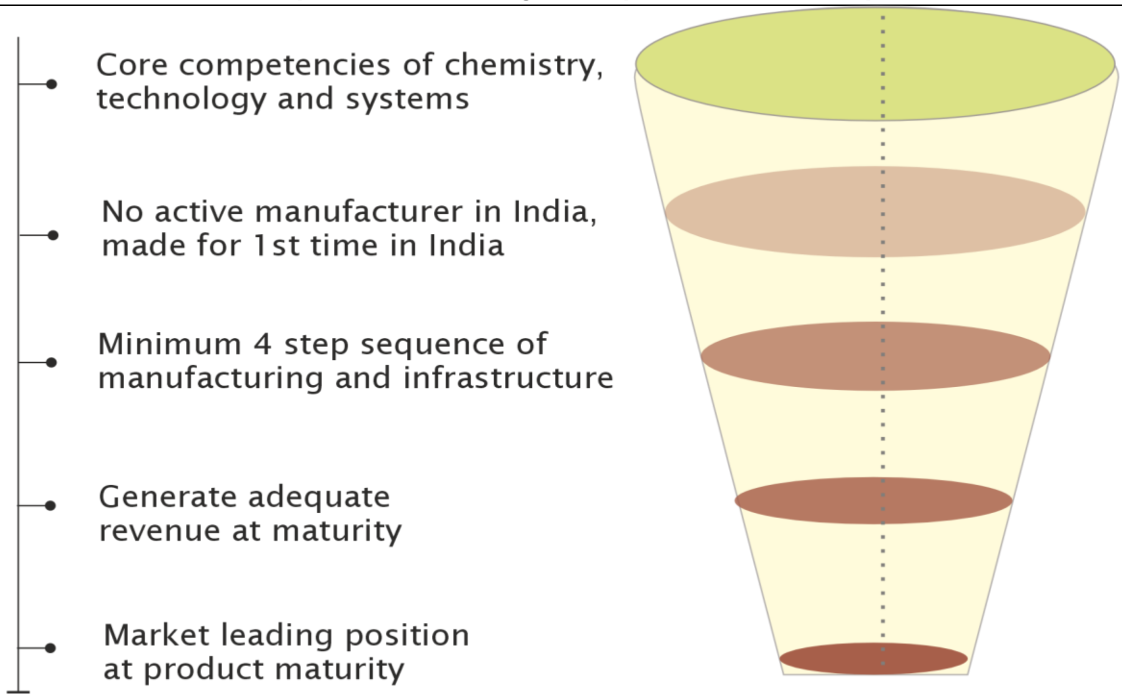
Apart from new products under development, the company has a strong base of existing products, some for which Aether is the sole supplier in India or has a significant market share globally. This aligns with its product selection strategy as mentioned below.

Product selection process

Aether specifically follows a particular process as to which products they intend to manufacture/develop. Looking for products that fit the core competencies of chemistry, technology & system. Further narrowing down the selection process leads to manufacturing of products that are infrastructure oriented, that falls into a specialty chemical field with 4-synthetic step sequence. Aether emphasizes on manufacturing of only those products that are not actively manufactured by any other company in the country. Financially all the products manufactured should have potential to generate at least Rs 50 crores and the company should have a significant market share at products maturity.

Currently the company manufactures close to 28 products under LSM & contractual/exclusive manufacturing. In 2024-25, there are plans to launch 4-5 products and continue this pace of launching new products every year going forward. At the moment, Aether has close to 45 products under development in R&D of which 20-25 are company's own products. Of these 45, about 6 to 7 products are in such advanced stage that they can be launched within a span of next 6-8 months.

Exhibit 13: Product selection process, focusing on import substitution products



Source: Dalal & Broacha Research, Company

Quarterly Snapshot

Particulars	Q3FY24	Q3FY23	YoY Growth %	Q2FY24	QoQ Growth %
Revenue from operations	1553.64	1671.31	-7.0%	1641.69	-5.4%
Other Income	112.58	33.98	231.3%	141.36	-20.4%
Cost of goods sold	912.43	790.34	15.4%	759.73	20.1%
Employee benefit Exp	91.98	93.23	-1.3%	93	-1.1%
Other expense	235.96	314.7	-25.0%	329.21	-28.3%
Total Expense	1240.37	1198.27	3.5%	1181.94	4.9%
EBITDA	**313.27**	**473.04**	**-33.8%**	**459.75**	**-31.9%**
Depreciation & Amortization	103.28	63.97	61.5%	97.42	6.0%
PBIT	322.57	443.05	-27.2%	503.69	-36.0%
Finance cost	20.62	4.41	367.6%	16.41	25.7%
PBT (Before exceptional)	**301.95**	**438.64**	**-31.2%**	**487.28**	**-38.0%**
Exceptional Item	-63.74	0		0	
PBT (after exceptional item)	238.21	438.64	-45.7%	487.28	-51.1%
Tax expense	63.93	88.28	-27.6%	120.51	-47.0%
PAT	**174.28**	**350.36**	**-50.3%**	**366.77**	**-52.5%**
Adjusted PAT	**220.91**	**350.36**	-36.9%	**366.77**	-39.8%
Adjusted EPS	**1.67**	**2.81**	**-40.8%**	**2.77**	**-39.8%**
Margins (%)			**bps**		**bps**
Gross margins	41.3%	52.7%	-1144	53.7%	-1245
EBITDA margins	20.2%	28.3%	-814	28.0%	-784
PAT margins	10.5%	20.5%	-1009	20.6%	-1011
As a % of sales			**bps**		**bps**
RM as % of sales	58.7%	47.3%	1144	46.3%	1245
EE as % of sales	5.9%	5.6%	34	5.7%	26
Other exp as % of sales	15.2%	18.8%	-364	20.1%	-487

Source: Dalal & Broacha Research, Company

Other KTAs

- Customer concentration: Top 5/10/20 customer contributes 37%/57%/81% and ~12% is generated from the top customer.
- Raw materials are largely sourced locally & the balance requirement is made up through imports from Japan, Europe & China. However dependence on imports from China is very low.
- For CRAMS & Contractual manufacturing model, company has a pass-through cost structure. For large scale manufacturing model too the company has a pass-through structure but with a lag effect.
- In July,2022, Aether commissioned a 16MW Solar power plant in Bharuch, Gujarat. The project has been developed with the assistance of KPI green. 40-45% of the electricity load supplied at Site 1,2,3 comes from this providing savings from major overheads. A new agreement with KPI has been signed for 15MW which is much more advanced that will lead to consumption of 90% of company's electricity requirement coming from renewable sources.
- For this purpose, company will be incurring cost of Rs 50 cr on solar panels for which the payback period is expected to be around 3-4 years.

Outlook

The company anticipates that its performance will be a drag for another quarter or two before showing signs of improvement. Despite the current challenges, the company is proactively addressing the situation by focusing on the development of multiple niche products. These products serves as import substitutes and the company is strategically manufacturing only those items that are not widely produced by other players in the country. Moreover, the company has forged several agreements and letters of intent (LOIs) with prominent conglomerates, positioning itself alongside leading companies in their respective industries on a global scale. These collaborations signify a promising trajectory for the company's growth and expansion, reflecting its commitment to innovation and market competitiveness.

Margins are expected to expand going forward due to change in business mix. Management aims to increase the share of business from CRAMS model, which gives highest margin.

Financials

P&L (Rs mn)	FY19	FY20	FY21	FY22	FY23
Net Sales	2,012	3,018	4,498	5,900	6,511
Raw Material Cost	(1,096)	(1,562)	(2,307)	(2,880)	(3,173)
Employee Cost	(109)	(134)	(221)	(270)	(345)
Other Expenses	(332)	(605)	(849)	(1,069)	(1,130)
Operating Profit (EBITDA)	**475**	**718**	**1,122**	**1,681**	**1,862**
Depreciation	(64)	(78)	(110)	(155)	(232)
PBIT	411	639	1,011	1,526	1,630
Other income	21	20	40	70	166
Interest	(106)	(94)	(113)	(131)	(51)
PBT	326	565	938	1,465	1,745
Share of Profit from JV	-	-	-	-	-
Profit before tax (post exceptional)	326	565	938	1,465	1,745
Provision for tax	(93)	(166)	(227)	(375)	(441)
Reported PAT	**233**	**400**	**711**	**1,089**	**1,304**
Adjusted Profit (excl Exceptionals)	**233**	**400**	**711**	**1,089**	**1,304**

Balance Sheet	FY19	FY20	FY21	FY22	FY23
Equity capital	86	86	101	1,127	1,245
Other Equity	300	697	1,642	2,742	11,201
Net worth	**385**	**783**	**1,743**	**3,869**	**12,446**
MI					
Non Current Liabilites	794	1,043	1,167	1,408	413
Current Liabilites	888	1,179	1,619	2,422	940
Total Equity & Liabilities	**2,067**	**3,005**	**4,529**	**7,698**	**13,799**
Non Current Assets	**1,106**	**1,527**	**2,194**	**3,600**	**7,047**
Fixed Assets	1,000	1,378	2,067	2,933	5,705
Intangible assets under development	-	-	-	-	-
Financial Assets	22	22	17	25	29
Right to use asset	68	82	92	211	1,123
Other intangible asset	7	6	6	4	6
Other Non Current Assets	8	39	12	427	185
Current Assets	961	1,478	2,335	4,098	6,752
Current investments	0	0	221	170	10
Inventories	398	719	847	1,627	2,488
Trade Receivables	482	630	1,082	1,635	2,590
Cash and Bank Balances	13	36	56	180	1,023
Short Term Loans and Advances	5	7	8	8	11
Other Current/financial Assets	63	86	121	477	630
TOTAL ASSETS	**2,067**	**3,005**	**4,529**	**7,698**	**13,799**

Source: Dalal & Broacha Research, Company

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