Aarti Industries Ltd — FY 2023 Annual Report Analysis

Annual Report Analysis (Consolidated)

Investor Snapshot

#	Analytical point	Sentiment
1	Aarti Industries maintains a dominant global Top 3 position in benzene and toluene chemistries, leveraging a 48% export mix to provide a natural forex hedge and a structural moat.	—
2	***Revenue grew 8.76% YoY to 6,619 Cr, yet top-line momentum is currently offset by cyclical agrochemical headwinds and pricing power limitations against rising input costs.***	—
3	***Operating margins (OPM) experienced a severe contraction from 28.26% to 16.45%, primarily driven by a 44.58% surge in Power & Fuel expenses and RM inflation.***	—
4	***Profitability is under significant pressure with PAT at 545 Cr, as the company navigates a "J-curve" where heavy reinvestment has temporarily diluted ROCE to 10%.***	—
5	***The debt profile carries high refinancing risk with 77.91% of the 2,239 Cr total debt being short-term, exposing the balance sheet to interest rate volatility.***	—
6	**Earnings quality is exceptionally high, evidenced by a CFO of □1,319 Cr (2.42x PAT), bolstered by a disciplined □422 Cr release from receivables.**	—
7	***Capital expenditure remains aggressive with 1,326 Cr deployed this year and 3,000 Cr planned through FY26, though 244 Cr in aged CWIP (>3 years) suggests execution delays.***	—
8	**Working capital efficiency improved despite macro headwinds, with debtor days reducing from 65 to 52, reflecting superior collection discipline.**	—
9	***Governance is generally robust, but Related Party Transactions (RPT) have tripled to 12.85% of revenue post-demerger, requiring close monitoring of group interdependence.***	—
10	***Key risks include prolonged agrochemical downturns impacting interest coverage and the potential for future impairments if aged CWIP fails to commission.***	—
11	**Strategic supply security is enhanced via a long-term Nitric Acid deal with Deepak Fertilisers, de-risking feedstock without requiring further backward integration capital.**	—
12	**Investment View: ACCUMULATE; stance is predicated on high cash quality and "Aarti 4.0" value migration, with a focus on shifting short-term debt to long-term tenures.**	—

1. Business overview

- **Business Architecture:** Aarti Industries Ltd (AIL) is transitioning from a benzene-focused intermediate player to a multi-chemistry powerhouse ("Aarti 4.0"), focusing on the **Chlorotoluene value chain**.
- **Revenue Drivers:** Growth is driven by import substitution for Indian Agrochemical and Pharma players and deepening chemistry complexity (Photochlorination, Oxidation, and Speciality Fluorination) to increase customer switching costs.
- **Cost Drivers:** Key inputs include **Benzene** and Nitric Acid. A long-term strategic deal with Deepak Fertilisers for Nitric Acid secures supply while reducing capital-intensive backward integration.
- **Industry Position:** AIL maintains a "Top 3" global position in Nitration and Chlorination chemistries, serving as a cash cow for new value-added projects.

- **Expansion Plans:** A massive ₹3,000 Cr capex is underway, primarily at the 95-acre **Zone IV Jhagadia** site, targeting high-margin (25-30% EBITDA) niche products.
- **Acquisitions & Demergers:** Completed the demerger of **Aarti Pharmalabs** to focus exclusively on chemical engineering complexities, decoupling from the regulatory-heavy API/Formulation business.
- **Geographical Presence:** Strong export focus with **Export Sales** comprising 48.67% of total revenue, providing a natural hedge against domestic fluctuations.
- **Segment Performance:** Navigating a cyclical downturn in the global Agrochemical sector, leading to significant inventory destocking headwinds.

2. Management commentary & outlook

- Management has shifted to a "hunker down and build" stance, acknowledging significant headwinds in FY24 due to global Agrochemical inventory destocking.
- Strategic focus is on the **Chlorotoluene value chain**, described as a "blue ocean" opportunity to capture domestic demand currently met by imports.
- Guidance suggests a back-ended recovery in H2 FY24, with current earnings pressured by high-cost inventory and low utilization of new capacities.
- The company is doubling down on growth during the downturn, targeting ₹2,500–3,000 Cr investment in Zone IV Jhagadia through FY26.
- Management is signaling a foray into **Battery Chemicals and High-end Polymers** to de-risk from the Agrochemical cycle, though competition in these sectors is aggressive.
- The completion of the 3rd long-term contract facility and Speciality Chlorination Block at Jhagadia demonstrates on-track project execution despite macro volatility.
- R&D monetization is being explored by offering analytical and process safety testing services through the ARTC center.
- ESG is being positioned as a competitive tool to win MNC contracts, highlighted by the EcoVadis Gold Medal and 44% water recycling rate.
- **Management Tone Verdict:** Management's tone is **"Pragmatically Bullish."** They are transparent about H1 FY24 pain and cyclical pressures while maintaining a firm commitment to their "Golden Decade" thesis and long-term capex execution.

3. Financial analysis

3.1 Financial statements

P&L statement (□Cr)

Line item	Mar 2023	Mar 2022
Sales	6,619	6,086
Sales Growth %	8.76	35.05
Expenses	5,530	4,365
Material Cost %	49	39
Raw material cost	3,196	2,600
Change in inventory	66	-210
Manufacturing Cost %	22	20
Employee Cost %	6	6
Other Cost %	7	7
Operating Profit	1,089	1,720
OPM %	16	28
Other Income	1	1
Exceptional items	0.23	0.58
Other income normal	0.63	0.19
Interest	168	102
Depreciation	310	246
Profit before tax	611	1,372
Tax %	11	14
Net Profit	545	1,186
Profit from Associates	0	0
Minority share	0	0
Exceptional items AT	0	0
Profit excl Excep	545	1,185
Profit for PE	545	1,185
Profit for EPS	545	1,186
Profit Growth %	-54	127
EPS (□)	15.04	32.71
Dividend Payout %	17	11

Balance sheet (□Cr)

Line item	Mar 2023	Mar 2022
Equity Capital	181	181
Reserves	4,739	4,335
Borrowings	2,907	2,587
Long term Borrowings	635	930
Short term Borrowings	2,239	1,638
Lease Liabilities	33	19
Other Borrowings	0	0
Other Liabilities	754	748
Non controlling int	1	1
Trade Payables	216	345
Advance from Customers	67	72
Other liability items	470	330
Total Liabilities	8,581	7,851
Fixed Assets	4,861	3,595
Land	273	194
Building	638	489
Plant Machinery	5,166	4,149
Equipments	159	130
Furniture n fittings	45	51
Vehicles	23	33
Intangible Assets	0	1
Other fixed assets	2	0
Gross Block	6,306	5,048
Accumulated Depreciation	1,445	1,453
CWIP	1,096	1,346
Investments	17	28
Other Assets	2,607	2,882
Inventories	1,031	934
Trade receivables	940	1,092
Receivables over 6m	0	0
Receivables under 6m	943	1,092
Prov for Doubtful	-2	0
Cash Equivalents	201	174
Loans n Advances	114	159
Other asset items	320	524
Total Assets	8,581	7,851

Cash flow statement (□Cr)

Line item	Mar 2023	Mar 2022
Cash from Operating Activity	1,319	519
Profit from operations	1,089	1,720
Receivables	422	-498
Inventory	-97	-420
Payables	-4	-38
Working capital changes	321	-955
Direct taxes	-91	-246
Advance tax	0	0
Cash from Investing Activity	-1,330	-1,169
Fixed assets purchased	-1,326	-1,165
Fixed assets sold	0	0
Investments purchased	-4	-5
Investments sold	0	1
Interest received	0	0
Dividends received	0	0
Investment in group cos	0	0
Other investing items	0	0
Cash from Financing Activity	38	412
Proceeds from shares	0	1,187
Proceeds from borrowings	1,527	49
Repayment of borrowings	-1,221	-595
Interest paid fin	-168	-102
Dividends paid	-91	-127
Financial liabilities	-9	0
Other financing items	0	0
Net Cash Flow	27	-239
Free Cash Flow	-8	-646
CFO/OP	129	44

Key ratios

Line item	Mar 2023	Mar 2022
Debtor Days	52	65
Inventory Days	115	143
Days Payable	24	53
Cash Conversion Cycle	143	155
Working Capital Days	-29	22
ROCE %	10	22

3.2 Financial analysis summary

- **Revenue** grew by 8.76% YoY to □6,619.00 Cr, though organic growth is stronger than the headline suggests as FY22 included a one-time Termination Fee of □631.25 Cr; Export Sales were a key driver, growing 19.23% to □3,517.00 Cr.
- **EBITDA Margin** contracted sharply from 28.26% to 16.45% due to Raw Material Consumption rising 21.50% to □2,885.75 Cr and Power & Fuel costs surging 44.58% to □430.91 Cr, which outpaced the growth in net revenue.
- **Net Profit** fell 54% to □545.00 Cr, heavily impacted by the non-recurrence of the previous year's termination fee and a 63.28% spike in Finance Cost to □165.80 Cr, which includes □54.77 Cr in adverse exchange differences on borrowings.
- **CFO** improved significantly to □1,319.00 Cr from □519.00 Cr, primarily because Trade Receivables decreased by □157.05 Cr despite higher sales, indicating superior collection efficiency as reflected in Debtor Days improving from 65 to 52.
- **Inventory** levels rose 12.96% to □1,015.07 Cr, with Finished Goods specifically jumping to □336.50 Cr from □219.56 Cr, suggesting a potential slowdown in year-end off-take which absorbed □97.00 Cr of cash.
- **Total Debt** increased to □2,907.00 Cr, with a high-risk concentration in Short term Borrowings which now constitute 77.91% of the debt mix (□2,239.27 Cr), increasing refinancing sensitivity in a rising interest rate environment.
- **Fixed Assets** (Gross Block) expanded to □6,306.00 Cr following a massive Capex of □1,326.00 Cr, yet CWIP remains high at □1,096.00 Cr with □243.96 Cr languishing in the "More than 3 years" bucket, signaling potential project execution risks.
- **ROCE** diluted from 22.00% to 10.00% as the company is in a heavy investment phase where the expanding Total Assets base (□8,581.00 Cr) has not yet translated into commensurate Operating Profit growth.
- **Free Cash Flow** remained negative at -□8.00 Cr, indicating that despite the strong CFO, the business is not yet self-funding its aggressive expansion and remains dependent on external Borrowings (□1,527.00 Cr proceeds).
- **Other Assets** analysis reveals Balances with Statutory Authorities doubled to □148.92 Cr, indicating □148.92 Cr of cash is locked in GST/tax refunds, while Other Manufacturing Expenses at □188.02 Cr (up 14%) represents a large, vaguely defined cost bucket.
- The dominant financial theme of the year is a **"Transitionary Capex Phase,"** where strong operational cash generation and working capital release are being utilized to fund a massive, debt-reliant expansion cycle amidst severe margin compression and cyclical global headwinds.

3.3 Contingent liabilities & commitments

- **Claims not acknowledged as debt:** ₹124.62 Cr (FY23) vs ₹138.92 Cr (FY22).
- **Letters of Credit & Bank Guarantees:** ₹336.81 Cr.
- **Capital Commitments (Net):** ₹191.39 Cr pending for expansion projects.
- **Specific Note:** Bank Guarantees are specifically issued in favor of customers as security for long-term export advances (₹216.68 Cr), linking contingent liabilities directly to revenue-generating contracts.

3.9 Earnings quality & forensic checks

#	Check	Impact	Status	Notes detail
1	PAT vs CFO trend	Profit ↑ — high cash conversion	—	Receivables decreased by ₹422 Cr in CF statement, significantly boosting operating cash flow.
2	Receivables & channel-stuffing signal	Revenue ↑ — healthy collections	—	Note 6: Trade receivables decreased by 13.89% despite revenue growth, indicating no channel stuffing.
3	Revenue timing	Revenue ↑↓ — strong visibility	—	Note 19: Advances are secured by bank guarantees, signaling committed long-term customer contracts.
4	Revenue from related parties %	Revenue ↑↓ — concentration risk	—	Note 34: Significant inter-dependence post-demerger; Valiant alone accounts for ~5.5% of net revenue.
5	Inventory vs revenue growth	Profit ↓ — potential overstocking	—	Note 5: Finished goods inventory spiked to ₹336.50 Cr from ₹219.56 Cr, suggesting year-end slowdown.
6	Inventory valuation method change	Neutral — consistent policy	—	Note 1(h): Standard accounting policy maintained; no change in valuation methodology reported.
7	Exceptional items in operating profit	Profit ↓ — normalized base	—	Note 22.2: FY23 earnings represent a "clean" operational base after the prior year's one-off distortion.
8	Depreciation rate vs useful life policy	Profit ↑ — aggressive capitalization	—	Note 1(e): Broad useful life ranges (9-19 years) allow management discretion in annual expense timing.
9	Provision reversals boosting PAT	Profit ↑ — negligible impact	—	Balance sheet shows a small reversal/adjustment; not a material driver of the ₹545 Cr PAT.
10	Tax rate consistency + cash tax vs P&L tax	Profit ↑ — tax efficiency	—	Note 1(p): Recognition of MAT Credit Entitlement supports the bottom line and reduces cash tax outflow.
11	CWIP age and stalling projects	Profit ↓ — impairment risk	—	Note 1(a): Long-gestation projects risk future write-downs if they fail to become operationally productive.
12	Deferred tax asset recognition adequacy	Neutral — standard treatment	—	Note 1(p): Management continues to recognize MAT credits based on convincing evidence of future utilization.
13	RPT quantum and trend	Revenue ↑↓ — high related-party reliance	—	Note 34: Material transactions with Aarti Pharmalabs and Valiant indicate high operational circularity.
14	Dividend paid vs FCF adequacy	Neutral — debt-funded payouts	—	Cash flow statement: Dividend payout maintained via increased borrowings (Proceeds ₹1,527 Cr).
15	PPE & CWIP Accuracy (Auditor KAM)	Profit ↑ — risk of overstatement	—	Auditor focused on risk of incorrect timing of capitalization or overstatement of asset values.
16	Statutory Dues Lock-up	Neutral — cash flow drag	—	Significant cash (2.2% of revenue) locked in GST/tax refunds, doubling YoY.

4. Management & governance

A. Auditor report & key audit matters

- **Audit Opinion Type:** Unqualified.
- **Key Audit Matters (KAMs):**
  - ***PPE & CWIP Accuracy***: Auditor focused on the capitalization of ₹1,536.54 Cr. Concern involves the risk of incorrect timing of capitalization or overstatement of asset values given the high volume of projects.
  - ***Useful Life Estimation***: Significant judgment is involved in estimating the useful life of complex chemical plants (9-19 years), which directly impacts depreciation charges and asset carrying values.
- **Auditor Details:** Gokhale & Sathe, appointed in FY22 for a 5-year term. The auditor highlighted the capitalization of borrowing costs on qualifying assets as a focus area.

B. Related party transactions

Party	Relationship	Nature	Amount (₹ Cr)	Concern
Valiant Organics Limited	Group Entity	Sales of Goods	364.44 Cr	***Significant concentration (5.55% of Net Revenue)***
Aarti USA INC	Subsidiary	Sales of Goods	221.74 Cr	Material downstream routing
Aarti Pharmalabs Limited	Post-Demerger Entity	Sales of Goods	132.61 Cr	***Ongoing operational interdependence post-separation***
Ganesh Polychem Limited	Associate	Sales of Goods	132.14 Cr	High-volume associate transaction
Valiant Organics Limited	Group Entity	Purchase of Goods	147.46 Cr	Circular trade potential
Aarti Pharmalabs Limited	Post-Demerger Entity	Purchase of Goods	72.20 Cr	Supply chain dependency
Aarti Corporate Services	Subsidiary	Loan Outstanding	6.14 Cr	10% interest-bearing inter-corporate loan

RPT Verdict: **Monitor ** The quantum of RPT sales has tripled YoY, now consuming over 12% of revenue. While the demerger of the Pharma business explains some of this, the scale of transactions with Valiant Organics suggests significant group-level interdependence.

C. Shareholding

- **Promoter Pledged Shares:** 0.00%
- **Equity Capital:** ₹181.00 Cr (Stable YoY)

D. Board composition + KMP compensation

- **Total Directors:** 16 | **Independent %:** 50.00% | **Women Directors:** 3 (18.75%).
- **Family Dominance:** The Gogri family holds the majority of executive positions (CMD, VCMD, ED, and NED roles).
- **Compensation:** The company maintains a 3% net profit sharing policy for KMPs. Given the 54% drop in Net Profit, KMP commissions are expected to have corrected significantly. Total Employee Benefit expenses rose 8.34% to ₹383.10 Cr.

F. Capital allocation & capex

Action	FY current (□Cr)	FY prior (□Cr)	% of CFO	Signal
Dividends Paid	91.00 Cr	127.00 Cr	6.90%	**Positive**
Capex	1,326.00 Cr	1,165.00 Cr	100.53%	—
Net Debt Change	320.00 Cr	-270.00 Cr	24.26%	—
Working Capital Inv.	-321.00 Cr	955.00 Cr	-24.34%	**Positive**
Interest Payments	168.00 Cr	102.00 Cr	12.74%	—

CAPEX Analytical Notes: * **CFO Coverage of Capex: CFO (□1,319 Cr)** covers 99.4% of Capex (□1,326 Cr). The funding gap for dividends and interest is met through incremental debt. * **Nature of Capex:** Aggressive growth capex. □**3,000 Cr planned over the next two years** focusing on the Chlorotoluene value chain. * **Deployment Efficiency:** Revenue grew only 8.76% despite a □1,326 Cr investment, reflecting the lag between spending and commissioning. * **Key Takeaways: CWIP of □988.73 Cr contains □243.96 Cr aged over 3 years**, signaling significant execution delays in specific long-gestation projects.

H. Risks

- ***Regulatory (High):*** Changing global SH&E standards could lead to plant shutdowns or heavy penalties.
- ***Raw Material (High):*** Volatility in Benzene/Nitric Acid costs. RM costs grew 21.5% vs 8.7% revenue growth, compressing OPM.
- ***Liquidity (High):*** **77.91% of debt is short-term (□2,239.27 Cr)**, creating massive refinancing risk in a rising rate environment.
- ***CWIP Aging (High):*** **□243.96 Cr of CWIP is >3 years old**, risking future impairments if not commissioned.
- **Forex (Medium):** Exposure to USD/JPY/SGD; □1,270.89 Cr outgo creates net exposure despite export hedge.

5. Scorecard & verdict

Part a: scorecard

Dimension	Rating (1–5)	Delta	Key evidence	One-line rationale
Business quality	4	→	Top 3 global position; 48% exports	Strong moat in benzene/toluene chemistries but facing cyclical agrochem headwinds.
Financial health	3	↓	D/E 0.59x; 78% Short-term debt	Rising interest costs and heavy reliance on short-term debt during peak capex.
Earnings quality	4	↑	CFO □1,319 Cr > PAT □545 Cr	Excellent cash conversion and receivable management offset by CWIP aging concerns.
Management & governance	3	→	12.8% RPT Revenue; Family dominance	Generally compliant but high RPT concentration and family control require monitoring.
Capital allocation & earnings visibility	3	↓	ROCE 10%; CWIP □1,096 Cr	Massive reinvestment phase with temporary return dilution and long-gestation risks.

Business positives (for this company this year) * **Strong Cash Conversion: CFO (□1,319 Cr)** is 2.42x PAT (□545 Cr), driven by a □422 Cr release from receivables. * **Working Capital Efficiency: Debtor Days** improved from 65 to 52, showing superior collection discipline despite a tough macro environment. * **Strategic Supply**

Security: Long-term Nitric Acid deal with Deepak Fertilisers de-risks feedstock supply without capital-intensive backward integration. * **Export Growth: Export Sales** grew 19.23% to □3,517 Cr, increasing global footprint and providing a natural forex hedge. * **Structural Simplification:** Completion of the Pharma demerger allows 100% management focus on core chemical engineering complexities.

Business negatives / concerns (for this company this year) * **Margin Compression: OPM** crashed from 28.26% to 16.45% as Power & Fuel costs surged 44.58% and RM costs outpaced pricing power. * **Debt Profile Risk: 77.91%** of total debt (□2,239 Cr) is Short-term, exposing the balance sheet to extreme interest rate and refinancing volatility. * **CWIP Aging: □243.96 Cr** of CWIP is aged over 3 years, signaling execution delays and potential future impairment risks. * **Return Dilution: ROCE** plummeted from 22% to 10%, reflecting the "J-curve" risk where massive capex has not yet translated into earnings. * **RPT Concentration:** Sales to related parties (Valiant/Pharmalabs) now exceed **12% of revenue**, indicating high group-level interdependence.

Overall scorecard summary Aarti Industries is currently in a high-stakes transition phase, characterized by resilient operational cash flows but significant bottom-line pressure. While earnings quality is high (CFO > PAT), the financial health is being tested by a debt-heavy □3,000 Cr capex cycle and a risky reliance on short-term funding. Governance remains adequate, though the tripling of related-party transactions post-demerger warrants close scrutiny. The business is on a **stable but high-risk trajectory**, where the success of the "Aarti 4.0" strategy depends entirely on execution precision in H2 FY24 and FY25.

Part b: governance check matrix

#	Check	Status
1	Audit opinion clean?	—
2	Promoter pledge = 0?	—
3	KMP pay < 5% of PAT?	—
4	RPT quantum < 5% of revenue?	—
5	Board > 50% independent?	—
6	At least 1 woman director?	—
7	No statutory dues outstanding?	—
8	No fraud reported?	—
9	Audit trail enabled?	—
10	Frequent Auditor change	—

Final line: "Total: 9/10 — Governance Rating: 4"

Part c: investor verdict

Thesis: AIL is a dominant chemistry leader undergoing a massive value-chain migration that is temporarily depressing returns but building a long-term "import substitution" moat. **Overall stance: ACCUMULATE Rationale:** High cash quality (CFO/PAT 2.4x) and successful working capital release provide the liquidity needed to survive the peak capex "valley of death" before new capacities ramp up. **Re-evaluate when: ROCE** fails to cross 15% by FY26 or if CWIP > 3 years exceeds □400 Cr. **BULL CASE:** Successful commissioning of Zone IV Jhagadia leads to **EBITDA margins** rebounding to 22%+ and FCF turning positive by FY25. **BEAR CASE:** Prolonged Agrochemical downturn leads to **Interest Coverage** falling below 3x, forcing a dilutive equity raise. **Key monitorable: Short-term Debt %:** 77.91% → Watch for a shift toward long-term debt to reduce refinancing risk.

7. Year-over-year analysis

7.1 Changes

Metric / theme	Summary a status	Summary b status	Forensic takeaway
Capital Funding Source	QIP Equity (₹1,187 Cr)	Incremental Debt (₹1,527 Cr proceeds)	The company has shifted from equity-led de-leveraging to debt-funded growth as organic cash remains insufficient to cover aggressive capex.
Operating Margins	28% (Inflated by one-off fee)	16% (Cyclical/Cost pressure)	Margin collapse highlights the non-recurring nature of prior profits and extreme sensitivity to energy and raw material inflation.
Receivables Management	75% growth (Channel stuffing risk)	14% contraction (Collection efficiency)	A sharp reversal in receivable trends suggests a pivot toward cash recovery and disciplined collections over aggressive top-line recognition.
Debt Composition	50% Short-term	78% Short-term	Increasing reliance on short-term credit lines creates a precarious liquidity profile and high refinancing risk in a rising interest rate environment.
Management Tone	Aggressive scaling / "Golden Decade"	"Hunker down" / Pragmatic resilience	Management is tempering near-term expectations due to global destocking while refusing to scale back long-term capital commitments.
Earnings Quality	Low (Masked by ₹631 Cr one-off)	High (CFO is 2.4x PAT)	While reported profits fell, the quality of those profits improved significantly as they were backed by actual cash inflows from working capital release.

7.2 Persistent patterns

- **Negative Free Cash Flow** persists as aggressive capital expenditure consistently outstrips even improved operating cash generation.
- **Stalled Capital Work-in-Progress (CWIP)** remains a recurring red flag, with significant capital (₹169 Cr to ₹244 Cr) aged over 2-3 years, signaling execution bottlenecks.
- **High Promoter Family Concentration** in executive roles and the 3% net profit-sharing compensation policy remains a structural governance trait.
- **Strategic Global Leadership** in core benzene and nitration chemistries continues to serve as the "cash cow" for diversifying into new value chains.
- **Heavy Related Party Transaction (RPT) Interdependence** with group entities like Valiant Organics persists and has intensified in scale post-demerger.
- **Structural Energy Sensitivity** remains a core weakness, with power and fuel costs consistently acting as a primary driver of margin volatility.
- **Aggressive Reinvestment Strategy** continues unabated, with management maintaining a multi-thousand crore capex plan regardless of cyclical downturns.