Aarti Industries Ltd — FY 2022 Annual Report Analysis

Annual Report Analysis (Consolidated)

Investor Snapshot

#	Analytical point	Sentiment
1	**Maintains a dominant global Top 3 position in key benzene chemistries with a high-margin, value-added product mix now exceeding 70% of total sales.**	Positive
2	**Consolidated revenue grew 35% YoY to □6,086 Cr, though growth was significantly bolstered by a □631 Cr one-time contract termination fee.**	Neutral
3	***Core operational margins faced severe headwinds from a 71% surge in logistics costs and a 100% spike in fuel expenses, impacting underlying profitability.***	Negative
4	***Reported PAT of 1,186 Cr is of low quality, as over 50% of earnings are derived from non-recurring items rather than core chemical operations.***	Negative
5	**Balance sheet strength improved as Debt/Equity fell from 0.82x to 0.57x, primarily due to a successful □1,200 Cr QIP rather than organic deleveraging.**	Positive
6	***Cash flow conversion is poor with CFO/PAT at 0.44x, driven by a massive divergence between reported profits (1,186 Cr) and actual cash from operations (519 Cr).***	Negative
7	**Aggressive capital allocation continues with □1,165 Cr deployed this year and a □3,000 Cr+ capex pipeline for FY23-24 to achieve FY27 EBITDA targets.**	Positive
8	***Asset efficiency is under scrutiny as 169 Cr of Capital Work-in-Progress (CWIP) is aged over 2 years, indicating potential execution delays or impairment risks.***	Negative
9	***Working capital stress is evident as Trade Receivables surged 75% YoY, more than double the rate of revenue growth, suggesting credit relaxation or channel stuffing.***	Negative
10	***Governance flags include a 313% explosion in Related Party Sales and high promoter-family pay concentration, with KMP compensation capturing windfalls from one-off gains.***	Negative
11	Management has guided for a "consolidation year" in FY23 with high single-digit growth as the company integrates new capacities like the Chlorotoluene chain.	Neutral
12	Investment Stance: Watch; long-term structural moat is intact, but entry requires normalization of cash flows and a reduction in receivable days.	Neutral

1. Business overview (In Bullet Points)

- **Business Segments:** Aarti Industries (AIL) is transitioning from a benzene-based chemistry specialist into a diversified multi-chemistry powerhouse, currently structured into Specialty Chemicals and Pharmaceuticals.
- **Revenue Drivers:** Growth in FY22 was driven by strong volume growth and an "RM-plus" pricing model that allows the pass-through of inflationary pressures in raw materials, fuel, and logistics.
- **Cost Drivers:** Major costs include raw materials (up 68% YoY), fuel consumption (doubled YoY), and logistics/freight (up 71% YoY).
- **Industry Position:** Globally ranked among the top 3 players in chlorination, nitration, ammonolysis, and hydrogenation.

- **Expansion Plans:** Massive ₹3,000 Cr+ investment committed over FY23 and FY24, focusing on the new Chlorotoluene value chain and Universal Multi-Purpose Plants (UMPP).
- **Acquisitions & Demergers:** A demerger of the Pharma business into "Aarti Pharmalabs Limited" is underway to unlock segmental synergies and eliminate capital allocation friction.
- **Capacity Additions:** Key projects include the 3rd long-term contract unit at Jhagadia, NCB capacity expansion at Vapi, and USFDA-approved API facility expansions.
- **Segment Performance:** Specialty Chemicals remains the dominant driver at 83.58% of total gross revenue, while Pharmaceuticals contributes 16.42%.
- **Geographical Presence:** Well-balanced mix between Domestic (56%) and Exports (44%), serving over 200 countries and leveraging the "China Plus One" strategy.

2. Management commentary & outlook

- Management views the business as being in the "investment phase" of a classic J-curve, focusing on long-term structural scaling over quarterly smoothing.
- The demerger of the Pharma business is intended to eliminate "segmental overlaps" and optimize corporate structure for the next decade of growth.
- FY23 is labeled a year of "consolidation and operationalization," with guidance for high single-digit growth due to fixed costs hitting the P&L before volume ramp-up.
- Management has set an aggressive long-term target for FY27, aiming for 3x to 4x growth in EBITDA and PAT compared to the FY21 base.
- The entry into the Chlorotoluene value chain is a strategic pivot into a "blue ocean" opportunity in India aimed at import substitution.
- The R&D pipeline is robust, with 40+ products in Specialty Chemicals and 50+ in Pharma, focusing on niche chemistries like photochlorination and specialty fluorination.
- Management views the "China Plus One" shift as a structural realignment that could double the size of the Indian specialty chemical industry.
- There is a clear strategic shift toward "Manufacturing Outsourcing" and "Strategic Alliances" through dedicated toll manufacturing facilities.
- Management exhibits high confidence in long-term demand, supported by the successful ₹1,200 Cr QIP and aggressive capex deployment.
- **Management Tone:** Management exhibits high confidence in long-term demand visibility, evidenced by their willingness to deploy ₹3,000 Cr in Capex despite global macro uncertainty. However, they are refreshingly transparent about the "fixed cost drag" expected in FY23. They are not over-promising immediate returns on new capacities, acknowledging the 3-4 year ramp-up period. The tone is that of a "builder" focusing on the FY27 horizon rather than quarterly smoothing.

3. Financial analysis

3.1 Financial statements

P&L statement (□Cr)

Line item	Mar 2022	Mar 2021
Sales	6,086	4,506
Sales Growth %	35.05	7.64
Expenses	4,365	3,525
Material Cost %	39	40
Raw material cost	2,600	1,855
Change in inventory	-210	-53
Manufacturing Cost %	20	22
Employee Cost %	6	8
Other Cost %	7	8
Operating Profit	1,720	982
OPM %	28	22
Other Income	1	1
Exceptional items	0.58	0.34
Other income normal	0.19	0.36
Interest	102	86
Depreciation	246	231
Profit before tax	1,372	665
Tax %	14	19
Net Profit	1,186	535
Profit from Associates	0	0
Minority share	0	-12
Exceptional items AT	0	0
Profit excl Excep	1,185	535
Profit for PE	1,185	523
Profit for EPS	1,186	523
Profit Growth %	127	-1
EPS (□)	32.71	15.02
Dividend Payout %	11	10

Balance sheet (□Cr)

Line item	Mar 2022	Mar 2021
Equity Capital	181	87
Reserves	4,335	3,416
Borrowings	2,587	2,857
Long term Borrowings	930	1,268
Short term Borrowings	1,638	1,224
Lease Liabilities	19	13
Other Borrowings	0	352
Other Liabilities	748	1,282
Non controlling int	1	12
Trade Payables	345	576
Advance from Customers	72	190
Other liability items	330	503
Total Liabilities	7,851	7,642
Fixed Assets	3,595	3,593
Land	194	244
Building	489	458
Plant Machinery	4,149	4,142
Equipments	130	155
Furniture n fittings	51	55
Vehicles	33	35
Intangible Assets	1	40
Other fixed assets	0	27
Gross Block	5,048	5,155
Accumulated Depreciation	1,453	1,563
CWIP	1,346	1,298
Investments	28	64
Other Assets	2,882	2,688
Inventories	934	936
Trade receivables	1,092	794
Receivables over 6m	0	0
Receivables under 6m	1,092	794
Prov for Doubtful	0	0
Cash Equivalents	174	412
Loans n Advances	159	31
Other asset items	524	515
Total Assets	7,851	7,642

Cash flow statement (□Cr)

Line item	Mar 2022	Mar 2021
Cash from Operating Activity	519	873
Profit from operations	1,720	977
Receivables	-498	-25
Inventory	-420	-111
Payables	-38	129
Working capital changes	-955	-7
Direct taxes	-246	-97
Advance tax	0	0
Cash from Investing Activity	-1,169	-1,322
Fixed assets purchased	-1,165	-1,315
Fixed assets sold	0	0
Investments purchased	-5	-8
Investments sold	1	0
Interest received	0	0
Dividends received	0	0
Investment in group cos	0	0
Other investing items	0	0
Cash from Financing Activity	412	614
Proceeds from shares	1,187	0
Proceeds from borrowings	49	752
Repayment of borrowings	-595	-6
Interest paid fin	-102	-86
Dividends paid	-127	-45
Financial liabilities	0	0
Other financing items	0	0
Net Cash Flow	-239	165
Free Cash Flow	-646	-442
CFO/OP	44	99

Key ratios

Line item	Mar 2022	Mar 2021
Debtor Days	65	64
Inventory Days	143	190
Days Payable	53	117
Cash Conversion Cycle	155	137
Working Capital Days	22	-36
ROCE %	22	13

3.2 Financial analysis summary

- **Revenue** growth of 35.05% to □6,086.00 Cr is significantly bolstered by a non-recurring Termination Fee of □631.25 Cr and Contract Shortfall Fees of □173.01 Cr, which together represent 11.5% of total gross revenue; excluding these, core operational growth is more modest.
- **Operating Profit** surged to □1,720.00 Cr with OPM % expanding to 28.00%, yet this margin strength is artificial due to the high-margin termination fee; meanwhile, Raw material cost rose 68.47% to □2,713.18 Cr, outpacing net revenue growth and signaling severe input price pressure.
- **Net Profit** growth of 127% to □1,186.00 Cr was aided by a lower Tax % of 14.00% (vs 19.00% in FY21) and the one-time income, but CFO fell to □519.00 Cr, creating a massive divergence where CFO / PAT dropped from 1.63 to 0.44.
- **Trade Receivables** grew by 75.18% to □1,390.50 Cr, far exceeding Revenue growth and consuming □498.00 Cr of cash, which suggests aggressive credit terms or collection delays as undisputed receivables under 6 months rose to □440.44 Cr.
- **Inventory** levels remained high at □934.00 Cr, with a 74.69% jump in Finished Goods to □484.83 Cr, indicating a potential buildup of unsold stock or strategic stocking that absorbed □420.00 Cr in CFO.
- **Trade Payables** decreased by 14.96% to □490.08 Cr despite higher production, signaling faster payments to suppliers to secure raw materials, which further strained Working Capital by □38.00 Cr.
- **Fixed Assets** remained flat at □3,595.00 Cr, but CWIP is substantial at □1,346.00 Cr, with □168.95 Cr of projects aged over 2 years, posing a risk of capital inefficiency or future impairments.
- **Total Debt** decreased to □2,587.00 Cr, and Debt / Equity improved to 0.57, primarily due to a QIP that raised □1,187.00 Cr rather than organic cash generation, as Free Cash Flow remained deeply negative at -□646.00 Cr.
- **Finance Cost** increased to □102.00 Cr, and Short term Borrowings now comprise 50% of total debt (□1,287.21 Cr), increasing exposure to interest rate volatility and liquidity risk with □1,846.87 Cr in liabilities maturing within one year.
- **ROCE %** improved to 22.00% and ROE % to 26.26%, but these returns are likely peak-cycle and unsustainable as they are heavily influenced by the one-time termination fee and the equity infusion from the QIP.
- **Other Expenses** were impacted by a 71% surge in logistics costs to □345.71 Cr and a doubling of fuel consumption costs to □349.19 Cr, reflecting high energy sensitivity; "Other Manufacturing Expenses" of □209.88 Cr acts as a large "dumping bucket" with limited granular disclosure.
- **Other Assets** were impacted by Capital Advances of □103.83 Cr and Advance Tax of □255.59 Cr, while Other Liabilities saw a 160% jump in Short-term Provisions for employee benefits to □100.74 Cr, signaling a massive scale-up in human capital.

- The dominant financial theme of the year is a significant disconnect between record reported **Net Profit** and deteriorating CFO health, as one-time termination fees masked severe input cost pressures and a massive Working Capital absorption that necessitated a QIP to maintain Balance Sheet stability.

3.3 Contingent liabilities & commitments

- **Claims not acknowledged as debt:** ₹138.92 Cr (increased by 104% YoY, indicating rising litigation or tax dispute risks).
- **LCs, Bank Guarantees & Bills Discounted:** ₹450.92 Cr (reflecting increased scale and raw material imports).
- **Capital Commitments (Net of advances):** ₹419.06 Cr (tripled YoY, signaling an aggressive expansion phase).
- **Total Contingent Exposure:** ₹1,008.90 Cr.

3.9 Earnings quality & forensic checks

#	Check	Impact	Status	Notes detail
1	PAT vs CFO trend	Profit ↑ — non-cash termination fees and working capital drag decouple PAT from cash generation.	—	Note 18.1: ₹631.25 Cr termination fee is non-operational.
2	Receivables & channel-stuffing signal	Revenue ↑↓ — receivables growing 75% vs sales 55% suggests potential aggressive revenue recognition.	—	Note 5: Significant jump in unsecured trade receivables.
3	Revenue timing	Revenue ↑ — recognition of prior advances as revenue while new customer inflows slow down.	—	Note 12: Long-term export advances provide interest-free funding.
4	Revenue from related parties %	Revenue ↑ — related party sales surge 313% potentially inflating top-line through intra-group transactions.	—	Note 27: RPT sales growth far exceeds overall revenue growth.
5	Inventory vs revenue growth	Profit ↑ — finished goods build-up of 75% absorbs overheads, potentially overstating current margins.	—	Note 4: Inventory buildup suggests potential overproduction or sales slowdown.
6	Inventory valuation method change	Neutral — consistent valuation policy using cost or NRV with standard overhead allocation.	—	Note 1h: Valuation includes appropriate allocation of manufacturing overheads.
7	Exceptional items in operating profit	Profit ↑ — non-recurring termination fees of ₹631 Cr significantly inflate reported operating EBITDA.	—	Note 18.1: One-time compensation for a cancelled long-term contract.
8	Depreciation rate vs useful life policy	Profit ↑↓ — wide 9-19 year useful life range allows management discretion in expense timing.	—	Note 1e: Useful lives based on internal technical estimates.
9	Provision reversals boosting PAT	Profit ↓ — increased employee benefit provisions of ₹100 Cr act as a conservative drag.	—	Note 17: Significant scale-up in human capital provisions.
10	Tax rate consistency + cash tax vs P&L tax	Profit ↑ — lower effective tax rate of 14% boosts PAT despite higher cash outflows.	—	Note 13: Deferred Tax Liability increased to ₹250.23 Cr.
11	CWIP age and stalling projects	Profit ↓ — stalled CWIP of ₹169 Cr aged over 2 years risks future impairment charges.	—	Note 1(iii): Significant portion of CWIP is slow-moving or stalled.
12	Deferred tax asset recognition adequacy	Neutral — net deferred tax liability indicates conservative book depreciation relative to tax laws.	—	Note 13: DTL primarily due to book vs tax depreciation.
13	RPT quantum and trend	Profit ↓ — director commissions spiked 137% due to profit-sharing on one-time termination fee income.	—	Note 27: Linked to 3% net profit sharing policy.
14	Dividend paid vs FCF adequacy	Neutral — dividends of ₹127 Cr paid despite negative FCF, funded by QIP proceeds.	—	Note 31: QIP of ₹1,192.98 Cr supported liquidity and dividends.
15	Accounting Policy Discretion	Profit ↑↓ — wide 9-19 year useful life for P&E and capitalization of R&D based on "probability" of benefits.	—	Note 1f/1e: Management discretion in expense timing and capitalization.

4. Management & governance

A. Auditor report & key audit matters

- **Audit Opinion Type:** Unqualified.
- **Key Audit Matters (KAMs):** Not disclosed in the provided Annual Report snippets.
- **Auditor Change:** Gokhale & Sathe, Chartered Accountants, appointed for a 5-year term starting FY22, replacing Kirtane & Pandit LLP.
- **Internal Controls:** The company maintains an adequate internal financial control system; no material weaknesses noted.
- **Going Concern:** No adverse remarks; accounts prepared on a going concern basis.

B. Related party transactions

Party	Relationship	Nature	Amount (□ Cr)	Concern
Related Entities	Group Companies	Sales to Related Parties	264.20 Cr	***313% surge YoY suggests aggressive revenue routing***
Related Entities	Group Companies	Purchases from Related Parties	46.63 Cr	Significant increase from 15.36 Cr in FY21
Directors/ KMPs	Management	Commission	44.97 Cr	Linked to 3% net profit sharing policy; benefited from one-off fee
KMPs	Management	Remuneration	8.80 Cr	Stable YoY
Relatives of MD	Family	Remuneration (Mirik Gogri)	0.80 Cr	Proposed increase highlights ongoing family employment

- **RPT Risk:** Total RPT value (□364.60 Cr) consumes 70.25% of **CFO**, signaling potential cash leakage. Sales to related parties grew from □63.84 Cr to □264.20 Cr, far outpacing consolidated growth.

C. Shareholding

- **Pledged Shares:** 0% (Assumed based on high credit ratings AA/Stable).
- **Promoter Holding:** High concentration within the Gogri family.

D. Board composition + KMP compensation

- **Total Directors:** 16 | **Independent %:** 50.00% | **Women Directors:** 3 (18.75%).
- **Family Compensation:** The **Gogri** family (Rajendra, Rashesh, Hetal, and Renil) accounts for 83% of total executive remuneration.
- **YoY Growth:** Total KMP Commission + Remuneration surged 96.17% YoY, perfectly correlated with the 96.54% growth in Consolidated EBITDA.
- **Revenue Correlation:** Compensation is heavily skewed by a 3% net profit sharing policy, which allowed KMPs to capture a windfall from the non-recurring □631.25 Cr termination fee.

F. Capital allocation & capex

Action	FY current (□Cr)	FY prior (□Cr)	% of CFO	Signal
Dividends	127.00 Cr	45.00 Cr	24.47%	—
Capex	1,165.00 Cr	1,315.00 Cr	224.47%	—
Equity Issuance	1,187.00 Cr	0.00 Cr	228.71%	**Positive**
Net Debt Change	-270.00 Cr	746.00 Cr	-52.02%	—
Working Capital Investment	955.00 Cr	7.00 Cr	184.01%	—

CAPEX Analytical Notes: * **CFO Coverage:** CFO/Capex ratio is **0.45**, indicating the company cannot self-fund expansion and relies on external capital (QIP). * **Nature of Capex:** Primarily growth-oriented, focusing on long-term contracts and NCB capacity expansion. * **Deployment Efficiency:** Capex of □**1,165 Cr** against a revenue increase of □3,413 Cr suggests high asset turnover potential. * **Key Takeaways:** □**3,000 Cr planned capex** signals aggressive scaling, but CWIP of □1,447.41 Cr with □168.95 Cr aged >2 years indicates execution bottlenecks.

H. Risks

- **Regulatory (High):** Changing global SH&E norms could halt exports (44% of revenue).
- **Raw Material (High):** Volatility in benzene/feedstock; RM costs grew 68% vs 55% revenue growth.
- **Liquidity (High):** Short-term liabilities of □**1,846.87 Cr** due within 1 year require substantial refinancing.
- **Litigation (Medium):** Claims not acknowledged as debt increased 104% to □**138.92 Cr**.
- **Forex (Medium):** Exposure to USD/EUR/GBP impacts 44% of the top-line.
- **Innovation (Medium):** Risk of product redundancy in specialty chemicals if R&D lags.

5. Scorecard & verdict

Part a: scorecard

Dimension	Rating (1–5)	Delta	Key evidence	One-line rationale
Business quality	4	→	Top 3 global player; 70% value-added mix	Strong moat in benzene chain and successful multi-chemistry diversification.
Financial health	3	↓	D/E 0.57x; CFO/PAT 0.44x	Balance sheet stable due to QIP, but organic cash flow is currently weak.
Earnings quality	2	↓	□631 Cr one-off fee; 75% Receivables growth	Reported profits are heavily inflated by non-recurring items and aggressive WC.
Management & governance	3	→	313% RPT sales growth; 83% pay to one family	Transparent strategy but high family concentration and RPT surge are concerns.
Capital allocation & earnings visibility	4	↑	□3,000 Cr Capex; FY27 3x-4x EBITDA target	Disciplined long-term scaling with high visibility from long-term contracts.

Business positives (for this company this year) * **[Revenue Growth]** Consolidated revenue grew 35% to □6,086 Cr, driven by strong volume and pricing power. * **[Strategic Diversification]** Entry into the Chlorotoluene value chain targets import substitution in a "blue ocean" domestic market. * **[De-leveraging]** Debt/Equity improved from 0.82x to 0.57x following a successful □1,200 Cr QIP. * **[Market Position]** Maintained Top 3 global

position in key chemistries, benefiting from the "China Plus One" structural shift. * **[Value-Added Shift]** High-margin, value-added products now contribute over 70% of total sales.

Business negatives / concerns (for this company this year) * **[Earnings Quality]** ₹631.25 Cr termination fee accounts for over 50% of reported Net Profit, masking core operational trends. * **[Cash Flow Divergence]** CFO (₹519 Cr) is significantly lower than PAT (₹1,186 Cr), resulting in a poor cash conversion of 0.44x. * **[Working Capital Stress]** Trade Receivables grew 75% vs 35% sales growth, signaling potential channel stuffing or credit relaxation. * **[RPT Surge]** Sales to related parties exploded by 313% YoY, raising concerns about revenue routing. * **[Execution Risk]** ₹168.95 Cr of CWIP is aged over 2 years, indicating stalled projects or capital inefficiency.

Overall scorecard summary Aarti Industries is in a high-intensity growth phase, characterized by aggressive capital expenditure and a strategic pivot toward multi-chemistry leadership. While the balance sheet has been bolstered by a ₹1,200 Cr QIP, the quality of current earnings is low due to a massive reliance on a one-time termination fee and deteriorating working capital efficiency. Governance is stable but marked by high promoter-family compensation and a sharp spike in related-party transactions. The business is on a **stable** trajectory long-term, but investors should expect a "consolidation" period in the near term as new capacities ramp up.

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: Aarti Industries is a high-moat chemical utility transitioning into a multi-chain powerhouse, currently using one-time gains and equity to fund a massive J-curve expansion.

Overall stance: Watch

Rationale: While long-term growth is visible, the current year's earnings are low-quality and working capital is under significant stress. Re-evaluate when: CFO/PAT returns to >0.8x and CWIP aged >2 years reduces by 50%. BULL CASE: Successful commissioning of the Chlorotoluene chain leading to a 20% sustainable EBITDA margin expansion. BEAR CASE: Prolonged working capital cycle and fixed-cost drag leading to ROCE falling below 15% during the consolidation phase. Key monitorable: Trade Receivables Growth: 75% → Watch threshold: < Revenue Growth.