

## Aarti Industries Ltd — Aug 2022 Quarterly Analysis

### 1. VERDICT & BUSINESS QUALITY SNAPSHOT

*The punchline. Read this first — it frames everything below.*

**Result:** Inline / Beat (Adjusted) **One-line:** Strong volume growth and raw material pass-through drove a headline beat, but underlying margins are being squeezed by a 2-3 month lag in price hikes and critical domestic shortages of Nitric Acid.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance / Prior Quarter	Strong Beat	Revenue grew 45% YoY; EBITDA grew 30% (adj. for one-offs) vs single-digit guidance.	☐
Earnings Quality	High (Core driven)	Growth led by volume ramp-up in long-term contracts and realization gains.	☐
Guidance Confidence	Neutral	Management refused to upgrade FY23 single-digit EBITDA guidance despite Q1 beat.	☐
Management Credibility	Strong	Transparent about Nitric Acid shortages and proactive in backward integration.	☐
Business Quality Signal	Improving	Value-added product share at 74%; transition to higher-margin chemistries.	☐
Key Q&A Exchange	Q#10 - Nitric Acid Capex	Evaluation of ₹500 Cr+ WNA plant to secure long-term supply.	☐
The Street's Primary Anxiety	Margin Volatility & Supply Chain	Impact of RM lags and Nitric Acid availability; mgmt provided supply timelines.	☐
Capital Cycle Stage	Investment	Massive ₹3,000 Cr capex plan for FY23-24 to drive FY25+ growth.	☐
Margin / Return Ratio Trajectory	Deteriorating (Short-term)	EBITDA margins dropped to 17% from 20.9% YoY due to RM inflation/lag.	☐
Pricing Power	Stable	Contractual pass-through is functional, though lag-dependent.	☐
FCF Conversion & Quality	Weak	High capex intensity and working capital build-up (inventory).	☐
Competitive Moat Signals	Widening	Backward integration into CNA/WNA to insulate from domestic shortages.	☐
Balance Sheet Strength	Adequate	D/E at 0.4x (FY22); expected to rise with new Nitric Acid capex.	☐
Working Capital Efficiency	Deteriorating	Inventory levels elevated to manage supply chain disruptions.	☐
Mgmt Guidance Track Record	Reliable	Conservative guidance; typically delivers on volume ramp-ups.	☐
Key Vulnerability / Red Flag	Nitric Acid Supply Chain	Domestic shortage causing production volatility in Nitro chains.	☐
Management Tone	Confident but Cautious	Optimistic on long-term but wary of global recession and RM lags.	☐

**Key Takeaways (Positives & Negatives):** \* **Positives:** Strong volume growth (15-20%) across segments; successful commissioning and ramp-up of the 2nd long-term contract; Pharma segment showing robust 46% EBIT growth; high value-added product share (74%). \* **Negatives:** Sharp gross margin compression due to RM price spikes (Benzene, Sulphur) and a 2-3 month pass-through lag in exports; severe domestic shortage of Nitric Acid impacting H1 utilization; MTM Forex loss of ₹30 Cr on foreign debt; slowdown in the Indian dyestuff/textile sector (10-20% exposure). \* **The Street's Focus:** Analysts are fixated on the "Nitric Acid problem." Management's response is a shift from sourcing to manufacturing, which secures the moat but adds capital intensity. \* **Forward Watchpoint:** Monitoring the construction commencement of the CNA (Concentrated Nitric Acid) plant and the upcoming Pharma demerger listing.

## 2. BUSINESS PERFORMANCE

**2A. KEY METRICS DATA SOURCE:** PPT figures primary; Concall for commentary.

Metric	Current Qtr	YoY Change	QoQ Change	Trend	Mgmt Commentary
Revenue	₹2,173 Cr	↑ 45.5%	↑ 7.7%	↑	~25% from realization (RM pass-through), 15-20% from volume growth.
Volume (NCB)	20,515 MT	First entry	First entry	→	Running at nearly 100% capacity despite RM constraints.
Volume (Nitro Tol.)	5,252 MT	First entry	First entry	↑	Improving; operating at 70%+ utilization.
Volume (Hydrogen.)	3,295 MT/mo	First entry	First entry	→	Steady performance.
Gross Margin (%)	46.2%	↓ 1,220 bps	↓ 750 bps	↓	Compression due to RM spikes (Benzene ₹77 to ₹94) and pass-through lag.
EBITDA	₹369 Cr	↑ 17.7%	↓ 8.9%	↓	Adj. for ₹32 Cr shortfall fee in base, YoY growth is ~30%.
EBITDA Margin %	17.0%	↓ 390 bps	↑ 20 bps	→	Impacted by high RM and utility costs; absolute EBITDA protected.
PAT	₹189 Cr	↑ 14.7%	↓ 2.4%	↓	Impacted by ₹30 Cr MTM loss on ECB debt due to USD appreciation.
ROCE (%)	19% (FY22)	First entry	First entry	→	Ex-CWIP ROCE is 28% (FY22 data).
Exports (%)	46.2%	↑ 400 bps	↑ 900 bps	↑	Driven by 100% export nature of the 2nd long-term contract.
R&D Spend (₹ Cr)	Not stated	-	-	-	Focusing on 40+ Chem and 50+ Pharma pipeline products.

## 2B. SEGMENT BREAKDOWN

Segment	Revenue (₹ Cr)	YoY Growth	Margin (EBIT)	Trend	vs Co. Avg	Key Development
Specialty Chemicals	₹1,766	↑ 44%	14.1%	↑	Lower	74% Value-added products; 2nd contract ramping up.
Pharmaceuticals	₹407	↑ 48%	18.7%	↑	Higher	New API block at Tarapur; USFDA audit at Dombivli completed (2 obs).

### 3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate	Historical Delivery	Risk Flag
Guidance	Revenue (FY24)	1.7x to 2.0x of FY21 (₹5,000 Cr base)	Needs ~₹8,500-10,000 Cr FY24 rev.	On track; Q1 annualized is ₹8,692 Cr.	Low
Guidance	EBITDA (FY23)	Single-digit growth (adj. for termination fee)	Needs ~₹1,000 Cr adj. EBITDA.	Q1 adj. EBITDA ₹369 Cr (ahead of pace).	Low
Guidance	Volume / Capacity	1st/2nd contracts to hit 70-80% utilization by FY24.	1st contract needs to jump from 25% to 70%+.	2nd contract already at 40% in Q1.	Medium (RM supply)
Guidance	Capex Plan	₹3,000 Cr over FY23-FY24.	~₹375 Cr per quarter (Q1 was ₹200 Cr).	Spending behind schedule in Q1.	Medium
Strategy	Backward Integration	Commission CNA plant by Q4 FY24.	1.5 years from engineering to commissioning.	New initiative; technology partner tied up.	High (Execution)
Macro	Sector Demand	Dyestuff/Textile is "very, very severe" slowdown.	Recovery expected in "next few months."	New headwind; 10-20% rev impact.	Medium

## 4. ANALYST Q&A

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Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
1	4.5	Surya Patra, PhillipCap	Long-term Contracts	Business Overview	"First of all, about the second multiyear supply contract, I just wanted to understand what is the level of ramp-up that we have witnessed?"	Management confirmed the 2nd contract reached ~40% utilization in Q1 and targets 70-80% by FY24. This validates the revenue bridge for the next 18 months despite macro headwinds.	None	5.0	Specific and verified
1a	4.0	Surya Patra, PhillipCap	Margins	Financials	"Is there any impact, i.e., the sequential 100 basis points kind of weakness in the gross margin that we are witnessing – is it because of [2nd contract]?"	Gross margin compression was attributed to raw material spikes in Benzene and Sulphur rather than contract mix. Investors should expect margin recovery as RM pass-through lags normalize.	None	4.0	Directional
2	4.0	Rohan Gupta, Edelweiss	Contract Strategy	Business Overview	"Would like to understand more in terms of if the Company is planning to sell the intermediate to Bayer in the international market and if you are still selling it in the open market?"	AIL is selling intermediates to various domestic and export customers and is in talks for long-term tie-ups. This de-risks the 1st contract which saw the cancellation of its original end-user commitment.	None	4.0	Directional
2a	3.5	Rohan Gupta, Edelweiss	Guidance	Mgmt Outlook	"Do you see that the guidance	Management maintained the "single-digit"	None	3.0	Conservative

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					remains intact or is there a possibility that you would like to guide for a higher number at the bottom-line for the current year?"	EBITDA growth guidance for FY23, citing demand slowdown in certain segments. This conservatism suggests H2 might face volume pressure in traditional lines.			
3	4.0	Aditya Khetan, SMIFS	Sector Headwinds	Business Overview	"In this quarter, most of the FMCG companies like HUL and Nestle have witnessed good volume growth. Where is the Company feeling that pain in FMCG now?"	Pain is specific to the dyestuff/ pigment chain used in textiles and certain FMCG packaging/ housing applications. This identifies a clear 10-20% revenue pocket that will likely underperform in the short term.	None	3.5	Specific sectors
4	5.0	Rohit Nagraj, Centrum	Supply Chain	Capex and Allocation	"When do we expect that this [Nitric Acid] project will probably come to fruition given that we have faced this challenge from the past maybe 3 or 4 quarters?"	Construction for the CNA plant begins shortly with a Q4 FY24 commissioning target. This means the supply-side overhang on the Nitro-toluene/NCB chains will persist for another 18 months.	None	5.0	Quantified timeline

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5	4.5	Akul Broachwala, IIFL	Leverage	Financials	"What would be the peak debt-to-equity ratio that you would be looking at?"	Target D/E is 0.7-0.9x, but could move higher if the ₹500 Cr+ Weak Nitric Acid plant is approved. This signals a potential increase in interest costs and a delay in deleveraging.	None	4.0	Verifiable
6	3.5	Nitin Agarwal, DAM Cap	Backward Integration	Strategy	"What are the factors that will make you go for it [WNA plant] versus not just staying with a concentration plant?"	AIL is weighing the security of an ammonia-based WNA plant vs. the volatility of sourcing intermediate WNA. A decision to build would lock in long-term margins at the cost of immediate FCF.	None	4.0	Strategic clarity
7	4.0	Vishnu Kumar, Spark	Working Capital	Financials	"What would have been the inventory gain, if any? On the reversal also, should we expect anything in Q2?"	Management indicated that RM pass-through lags (2-3 months for exports) negate inventory gains/losses over time. This implies Q2 margins might benefit if RM prices stabilize or drop.	None	3.0	Vague

**PATTERN FLAGS & SENTIMENT** Analyst anxiety is concentrated on the **Nitric Acid bottleneck** and its impact on the massive capital expansion plan. Management responded with a clear "build vs. buy" strategy, showing they are willing to sacrifice short-term balance sheet lightness to secure long-term production stability. This was a defensive but logically sound posture.

**Analyst Sentiment Verdict:** Analysts were broadly convinced of the growth trajectory (1.7x-2.0x by FY24) but remain skeptical about the **margin floor** during the RM pass-through lag. The friction point was the refusal to upgrade guidance despite a strong Q1. Management's credibility remains high, but the "Nitric Acid shortage" is a recurring ghost that will haunt the stock until the CNA plant breaks ground.

**GUIDANCE GAPS REVEALED IN Q&A** | Topic | What Mgmt Claimed (Opening) | What Q&A Revealed | Gap / Walk-back | Risk to Thesis | |-----|-----|-----|-----| | EBITDA Guidance | Beat is likely given Q1. | Maintaining "single-digit" growth. | Management is more worried about the dyestuff/FMCG slowdown than the opening remarks suggested. | Volume risk in legacy business. | | Nitric Acid Supply | Situation "eased" in June. | Shortage will persist until Q4 FY24 (new plant). | "Easing" is relative; the structural deficit remains a multi-quarter headwind. | Utilization caps. |

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## 5. WHAT CHANGED vs PRIOR QUARTER

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*First entry — no prior quarter to compare.*

What Changed	Prior Quarter	This Quarter	Direction
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