Aarti Industries Ltd — Aug 2023 Quarterly Analysis

1. VERDICT & BUSINESS QUALITY SNAPSHOT

Result: Weak Miss **One-line:** The long-term structural story is intact, but the growth "glide path" has been deferred by 12-18 months as the industry battles a "perfect storm" of Chinese dumping and global inventory destocking.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance / Prior Quarter	Weak Miss	EBITDA of □201 Cr vs □369 Cr in the prior context quarter; Revenue down 27% vs prior context.	□
Earnings Quality	Low (Cyclical headwinds)	PAT down 48% YoY; operating leverage working in reverse due to volume declines in high-margin PDA.	□
Guidance Confidence	Weak	Management walked back the firm □1,700 Cr FY25 EBITDA guidance, suggesting a 5-10% (or more) revision.	□
Management Credibility	Neutral	Transparent about "unprecedented challenges" but guidance for H2 recovery relies on opaque customer "indications."	□
Business Quality Signal	Deteriorating (Short-term)	Gross margins pressured by Chinese currency depreciation and dumping; PDA segment (key value-driver) volume fell 64% YoY.	□
Key Q&A Exchange	Q#7 - Contract 2 Structure	Management confirmed EBITDA from the 2nd long-term contract is "not connected to volume," providing a defensive floor.	□
The Street's Primary Anxiety	FY25 Guidance & Dumping	Analysts pressed on the validity of the FY25 EBITDA target and the duration of Chinese price aggression.	□
Capital Cycle Stage	Investment	Continuing □2,500-3,000 Cr capex despite cash flow pressure; aiming to "build through the trough."	□
Margin / Return Ratio Trajectory	Deteriorating	EBITDA margins compressed to 12.8% from 16.0% YoY; ROCE likely to dip as new assets hit books during demand lull.	□
Pricing Power	Eroding	Pass-through mechanisms working for RM, but "deltas" are being squeezed by Chinese competition in domestic markets.	□
FCF Conversion & Quality	Weak	High capex intensity + lower EBITDA; Net Debt rising to □2,650 Cr.	□
Competitive Moat Signals	Stable	Leadership in Benzene chain (1st–4th globally) remains, but "cost moat" challenged by Chinese energy/currency advantages.	□
Balance Sheet Strength	Adequate	D/E at 0.56x; secured $130 Mn IFC loan to fund capex during the downturn.	□
Working Capital Efficiency	Deteriorating	Inventory destocking at customer end is forcing lower utilization; high interest rates making inventory carrying costly.	□
Mgmt Guidance Track Record	Reliable (Conservative)	Historically conservative, but the magnitude of this cyclical downturn caught them off-guard.	□
Key Vulnerability / Red Flag	PDA Segment Collapse	64% YoY volume drop in Phenylenediamine (PDA) signals deep distress in the global polymer/dye end-markets.	□
Management Tone	Cautious & Transitionary	Explicitly labeling FY24 a "weaker" year while pivoting expectations to FY25/26.	□

Sentiment: □Positive | □Negative | □Neutral

Key Takeaways (Positives & Negatives): * **Positives:** The 2nd long-term contract provides a structural EBITDA floor that is volume-independent, shielding the company from total cyclical exposure. Nitrotoluene (NT) volumes grew 77% YoY in Q1 (though management warned this was a temporary surge before Q2 destocking). The company secured long-term funding (IFC) to continue its Chloro-toluene expansion, which targets import substitution. * **Negatives:** Massive volume erosion in the high-margin Phenylenediamine (PDA) segment (down 63.6% YoY) and NCB (down 15.7% YoY) highlights the severity of the discretionary demand slowdown. Chinese dumping, aided by a 4% depreciation in the Yuan, is squeezing margins in the domestic market. * **The Street's Focus:** Analysts are fixated on the "broken" FY25 EBITDA guidance. Management admitted that the previous target of □1,700 Cr is at risk of a 5-10%+ haircut, effectively resetting the valuation base. * **Forward Watchpoint:** Monitoring the PDA segment's volume recovery and the "Zone 4" (Chloro-toluene) project timelines. If destocking continues past Q3 FY24, the capex-heavy balance sheet will face significant interest coverage pressure.

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2. BUSINESS PERFORMANCE

2A. KEY METRICS

DATA SOURCE: PPT figures primary. Concall used for volumes and debt.

Metric	Current Qtr	YoY Change	QoQ Change	Trend	Mgmt Commentary
Volume (NCB - MT)	17,293	↓ 15.7%	Not in doc	↓	Sluggish demand and global inventory correction.
Volume (NT - MT)	9,327	↑ 77.6%	Not in doc	↑	Strong Q1 Agro demand; but Q2/Q3 expected to be "subdued" due to destocking.
Volume (Hydro - TPM)	2,868	↓ 12.9%	Not in doc	↓	General slowdown in end-user industries.
Volume (PDA - TPM)	135	↓ 63.6%	Not in doc	↓	Worst affected segment; polymer/dye correction started recently.
Utilization (%)	Not in doc	↓	↓	↓	Impacted by demand slowdown; Nitrotoluene was 70% in prior (not stated now).
Revenue	□1,571 Cr	↓ 10.5%	↓ 14.0%	↓	Impacted by both volume and product realizations (RM pass-through).
Gross Margin (%)	35.0%	↓ 1,120 bps	↓ 1,120 bps	↓	derived from 100 - (RM costs). Weakest in several quarters.
EBITDA	□201 Cr	↓ 28.7%	↓ 19.9%	↓	Impacted by weak volumes and margin pressure from China.
EBITDA Margin %	12.8%	↓ 320 bps	↓ 90 bps	↓	Lower operating leverage on fixed costs.
PAT	□70 Cr	↓ 48.5%	↓ 53.0%	↓	Significant impact from lower EBIT and high fixed charges.
ROCE (%)	Not in doc	↓	↓	↓	Expected to decline as EBITDA falls and CWIP stays high.
Cash Flow (OCF)	Not in doc	↓	↓	↓	Impacted by lower profitability; partially offset by WC release.
Net Debt / (Cash)	□2,650 Cr	↑	↑	↓	Rising due to ongoing capex program (□260 Cr this quarter).
Interest Coverage	Not in doc	↓	↓	↓	Pressure from higher debt and lower EBITDA.
Exports (%)	42.9%	↓ 140 bps	↓ 770 bps	↓	Global demand weakness and inventory correction at MNC ends.

2B. SEGMENT BREAKDOWN

Segment	Revenue (□ Cr)	YoY Growth	Margin (EBIT)	Trend	vs Co. Avg	Key Development
Chemicals	□1,571	↓ 10.5%	7.1%	↓	In-line	NCB expansion commercialized; NT expansion on track for Q1 FY25.
*Pharma	Not split	-	-	-	-	Demerger completed; company is now a pure-play chemical entity.

3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate / Mathematical Feasibility	Historical Delivery	Risk Flag
Guidance	EBITDA (FY24)	"Moderated" growth	Needs substantial H2 jump to even match FY23.	Missed early optimism.	High
Guidance	EBITDA (FY25)	~□1,700 Cr (Previous)	Needs 100%+ growth from current run-rate.	Walked back to "5-10% lower" range.	High
Guidance	Capex Plan	□2,500-3,000 Cr over 2 yrs	□375 Cr/qtr; Q1 was □260 Cr (Behind).	Broadly on track with site works.	Medium
Strategy	Chloro-toluene	42,000 TPA capacity	Commercialize in phased manner from FY25.	R&D and site development underway.	Medium
Strategy	Backward Integration	Secure Nitric Acid supply	Contract with Deepak Fertilizers securing availability.	Delivered (20-year contract).	Low
Macro	Chinese Dumping	"Transitionary" in nature	Depends on China's domestic recovery.	Unpredictable; currency adds 4% headwind.	High
Balance	Debt/Equity	Max 0.7x	Currently 0.56x; high capex will test this.	Maintaining discipline via long-term loans.	Low

4. ANALYST Q&A

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
1	5.0	Vivek Rajamani, MS	Demand	Mgmt Outlook	"Just wanted to get a sense if in the month of July you have seen any sort of improvement... how much below are we?"	Management indicated demand is expected to recover in Q3/ Q4, with Q2 remaining subdued. This confirms a "lost" H1 and puts all pressure on a hockey-stick recovery in H2.	None	3.0	Vague but honest
2	4.0	Aditya Khetan, SMIFS	Product Margins	Financials	"Ideally even the specialty product portfolio is also facing pressure from China... pain could be there in coming quarters?"	Management admitted volume impact is "across the board," though margin pressure is higher on base chemicals than value-added. This warns of further margin compression if specialty chemical pricing isn't defended.	None	4.0	Directional
3	5.0	Abhijit Akella, Kotak	FY25 Guidance	Mgmt Outlook	"Earlier spoken about say 15% growth for this year... sharper growth in FY25. Would you like to offer any updates?"	Management walked back the □1,700 Cr EBITDA target, noting a 5-10% (or more) potential decline depending on visibility. This is a major derating signal for long-term investors.	None	2.0	Walked back
4	4.5		Contracts	Business Overview	"Performance of the long-	Management noted the 1st	None	5.0	Specific

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		Abhijit Akella, Kotak			term projects... have those also been impacted?"	contract (Dicamba) is severely impacted, but the 2nd contract EBITDA is structural/ assured. This provides a clear "quality of earnings" distinction within the contract portfolio.			
5	3.5	Chetan Gandhi, CFO	Tax/ Finance	Financials	"Tax rate is very low this quarter. Should we expect a sub 10% tax rate for this year?"	CFO confirmed sub-10% tax rate due to SEZ benefits and MAT credit availability. This helps sustain PAT even as operating profits decline.	None	5.0	Clear & quantified
6	4.0	Rohan Gupta, Nuvama	Pricing vs China	Business Overview	"Chinese currency and the China dumping shouldn't be impacting our large part... what actually would have led to such a sharp decline?"	Management explained that even contractual business faces indirect pressure when customers face dumping in their own domestic end-markets. This clarifies that no segment is fully "China-proof" in this environment.	None	3.0	Useful context
7	4.5	Archit Joshi, B&K	Contract 2	Business Overview	"The second long-term contract... are we working on	Management confirmed the second contract	None	5.0	Specific/ Verified

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
					a fixed EBITDA basis? Would that be achievable from this year?"	EBITDA is not connected to volume and has already "kicked in." This is the most defensive part of the bull case right now.			
8	4.0	Akul Broachwala, IIFL	Chloro-toluene	Capex and Allocation	"What are the current imports and basically what is your thought behind fast tracking this entire project?"	Management is targeting import substitution of downstream chlorotoluenes with a ₹1,500 Cr first-phase capex. Success here is critical to diversifying away from the Benzene chain.	None	4.0	Strategic clarity
9	3.0	Siddharth Gadekar, Equirus	Q2 Outlook	Mgmt Outlook	"Should we be at a similar level in terms of our EBITDA or could we even go below?"	Management expects Q2 EBITDA to be in the "similar range" as Q1 (₹200 Cr). This caps any expectation of a quick V-shaped recovery.	None	4.0	Near-term guide

PATTERN FLAGS & SENTIMENT Analyst anxiety was dominated by two themes: (1) **The reset of FY25 expectations**, as the previously touted ₹1,700 Cr EBITDA target was softened, and (2) **The China Factor**, with analysts probing why the "Specialty Chemical" moat didn't protect margins more effectively. Management's posture was one of disciplined survival, emphasizing that while they cannot control global destocking or the Yuan, they are continuing to build capacity (Zone 4) for the eventual rebound.

Analyst Sentiment Verdict: Analysts were noticeably more skeptical than in previous years, focusing on the delta between the "structural growth" story and the "cyclical reality" of the results. The most friction occurred around the sustainability of long-term guidance. Management's credibility on long-term strategy remains intact, but their near-term forecasting has lost some sheen due to the severity of the PDA segment collapse.

GUIDANCE GAPS REVEALED IN Q&A | Topic | What Mgmt Claimed (Prior Q) | What Q&A Revealed | Gap / Walk-back | Risk to Thesis | | :--- | :--- | :--- | :--- | :--- | | FY25 EBITDA | Firm ₹1,700 Cr target. | "Difficulty to give fresh guidance... 5-10% decline possible." | ~₹150 Cr+ reduction in future earnings baseline. | Delayed re-rating. | | Agro Demand | "Strong growth" in early Q1. | Sudden destocking started in Q2; Nitrotoluene to be "subdued." | Q1 performance was a "pull-forward," not a sustainable trend. | H1 FY24 earnings miss. | | PDA Recovery | "Stabilization" expected. | 64% volume drop; recovery now pushed to Q3/Q4. | Worst-case scenario for the polymer/additive chain. | High-margin drag. |

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5. WHAT CHANGED vs PRIOR QUARTER

What Changed	Prior Quarter	This Quarter	Direction
Headline EBITDA	₹369 Cr	₹201 Cr	↓
PDA Volumes	371 TPM	135 TPM	↓
FY25 Guidance	Solid confidence in ₹1,700 Cr EBITDA	Significant risk; 5-10% haircut expected	↓
Market Risk	Focus was Nitric Acid supply	Focus is now Chinese dumping/Currency depreciation	↓
Net Debt	Not stated (~₹2,400 Cr estimated)	₹2,650 Cr	↓
Tone	"Robust performance; Contract 2 ramp-up"	"Unprecedented challenges; Cautious note"	↓
Pharma Status	Part of consolidated results	Demerger complete; Pure-play Chemical entity	→

STOP HERE.