Aarti Industries Ltd — Feb 2023 Quarterly Analysis

1. VERDICT & BUSINESS QUALITY SNAPSHOT

Result: Beat (Adjusted) **One-line:** The structural de-risking of the Nitric Acid supply chain via the Deepak Fertilisers deal is a major thesis-positive, though a global macro slowdown in Textiles and discretionary segments shifts the weight of the "25% CAGR" guidance toward FY25.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance	Strong Beat	Adjusted EBITDA of □289 Cr vs expectation; 9M EBITDA (□837 Cr) is 76% of FY23 guidance.	□
Earnings Quality	High (Core driven)	Growth led by 81% value-added share and ramp-up of the 2nd long-term contract.	□
Guidance Confidence	Neutral	Maintained 25% EBITDA CAGR for FY24-25, but flagged FY24 as "turbulent."	□
Management Credibility	Strong	Proactive pivot on Nitric Acid strategy; transparent about Dicamba (Contract 1) weakness.	□
Business Quality Signal	Improving	Transition to 20-year secured RM supply eliminates backward integration capex risk.	□
Key Q&A Exchange	Q#10 - Stock in Trade	Demerger transition caused a temporary spike in trading revenue; non-recurring.	□
The Street's Primary Anxiety	Demand Slowdown	Weakness in Textiles (15-20% of domestic) and inventory correction in Agrochemicals.	□
Capital Cycle Stage	Investment	Massive □3,000 Cr capex for FY24-25 targeting newer value chains (Chloro-Toluene).	□
Margin / Return Ratio Trajectory	Stable	Adjusted EBITDA margins holding at 15-16% despite RM volatility.	□
Pricing Power	Stable	Formula-driven pricing and pass-through mechanisms remain functional.	□
FCF Conversion & Quality	Weak	Negative FCF due to □1,100 Cr+ annual capex intensity.	□
Competitive Moat Signals	Widening	20-year deal for Nitric Acid ensures 1st-to-4th global ranking for 75% of portfolio.	□
Balance Sheet Strength	Adequate	Peak debt passed in Q2; Net Debt trending toward □2,600 Cr.	□
Working Capital Efficiency	Deteriorating	Inventory days likely elevated to manage supply chain transitions post-demerger.	□
Mgmt Guidance Track Record	Reliable	Consistently hitting re-casted EBITDA targets post-pharma demerger.	□
Key Vulnerability / Red Flag	Contract 1 Utilization	Dicamba intermediate plant (Contract 1) remains at ~20% utilization with no near-term recovery.	□
Management Tone	Cautiously Optimistic	Confident in long-term targets but wary of "turbulent" FY24 macro.	□

Key Takeaways (Positives & Negatives): * **Positives:** Successful listing of Aarti PharmaLabs completes the demerger thesis; the 20-year Nitric Acid deal (□8,000 Cr+) removes the single biggest operational bottleneck identified in prior quarters; value-added product share reached a record 81%; 3rd long-term contract commercialized at Jhagadia. * **Negatives:** Textile segment (20-25% of domestic sales) remains "severely impacted" with no recovery expected for 2-3 quarters; Agrochemical demand is molecule-specific with high global channel inventories; M2M loss of ₹11 Cr on unhedged ECBs due to currency volatility. * **The Street's Focus:** Shifted from "Nitric Acid supply" to "FY24 demand recovery." Management's refusal to upgrade FY23 guidance despite the 9M beat suggests a cautious Q4. * **Forward Watchpoint:** Monitoring the ramp-up of the 3rd long-term contract and the commencement of the Chloro-Toluene blocks in FY24, which are critical for the FY25 EBITDA target of ₹1,700 Cr.

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2. BUSINESS PERFORMANCE

2A. KEY METRICS

Metric	Current Qtr	YoY Change	QoQ Change	Trend	Mgmt Commentary
Volume (NCB)	18,199 MT	↑ 12%	↓ 11%	→	Volumes diverted to non-regular markets to maintain utilization; Q2 was 20,515 MT.
Volume (Nitro Toluene)	7,528 MT	↑ 43%	↑ 43%	↑	Significant recovery; debottlenecking planned for 50% capacity increase by H1 FY25.
Utilization (%)	85%	↑ 500 bps	↓ 300 bps	→	Blended utilization; 1st contract remains low at ~20-30%.
Gross Margin (%)	48.2%	↓ 200 bps	↑ 200 bps	↑	(Estimated from GP ₹893 Cr) Margin improved QoQ as RM prices stabilized.
EBITDA (Adj.)	₹289 Cr	↑ 26%	↑ 8.2%	↑	Excludes termination fee in FY22 base; growth driven by 2nd contract ramp-up.
EBITDA Margin %	15.6%	↑ 180 bps	↑ 110 bps	↑	Better product mix (81% value-added) offset higher utility/fixed costs.
PAT	₹137 Cr	Not Comp.	↑ 9.6%	↑	Re-casted for pharma demerger; impacted by ₹11 Cr M2M FX loss.
Exports (₹Cr)	₹888 Cr	↑ 39%	↓ 4%	↑	Exports at 48% of revenue; strong growth YoY from multi-year contracts.
R&D Spend (₹ Cr)	~₹18 Cr	→	→	→	Guided at ~1% of sales; focus on 40+ chemicals in the pipeline.

2B. SEGMENT BREAKDOWN

Segment	Revenue (₹ Cr)	YoY Growth	Margin	Trend	vs Co. Avg	Key Development
Specialty Chemicals	₹1,854	↑ 12%	15.6%	↑	In-line	3rd long-term contract commercialized; 81% value-added share.
Pharma (Demerged)	N/A	N/A	N/A	N/A	N/A	Listed as Aarti PharmaLabs Ltd on Jan 30, 2023.

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3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate	Historical Delivery	Risk Flag
Guidance	EBITDA (FY23)	~₹1,100 Cr	Needs ₹263 Cr in Q4; (Q1-Q3 avg is ₹279 Cr).	On track.	Low
Guidance	EBITDA (FY25)	₹1,700 Cr	Needs 25% CAGR over next 8 quarters.	Historically re-evaluated post-demerger.	Medium
Guidance	Volume / Capacity	50% NT expansion by H1 FY25.	New project; engineering phase.	First time mentioned.	Low
Guidance	Capex Plan	₹1,100-1,200 Cr (FY23).	₹260-360 Cr needed in Q4 (9M spent ₹840 Cr).	On track.	Low
Strategy	Nitric Acid Deal	₹8,000 Cr supply over 20 years.	Commences April 1, 2023.	Pivoted from own CAPEX.	Low
Strategy	Capital Allocation	Focus on forward integration.	Save ₹200-500 Cr from Acid capex.	Strong execution.	Low
Macro	Textile Recovery	H1 FY24 recovery.	Dependent on global inventory clearing.	Delayed from Q2 FY23.	High
Macro	RM Pass-through	Absolute profit protection.	Functional via formula pricing.	Consistent delivery.	Low
Balance	Net Debt	₹2,600 - 2,700 Cr (FY23 end).	Current debt peaked in Q2.	Improving.	Medium

4. ANALYST Q&A

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
1	4.0	Rohit Nagraj, Centrum	Gross Profit	Financials	"Our gross profit has been more or less flattish... does it mean that the discretionary part of portfolio actually had more impact?"	Management clarified that while Textiles (discretionary) is pressured, the flattish GP was due to product mix and volume shifts into non-regular markets. Investors should monitor if "non-regular" sales dilute margins further in FY24.	None	4.0	Directional
2	4.5	Rohit Nagraj, Centrum	Capex Allocation	Capex and Allocation	"Earlier we were targeting... Nitric Acid... but now since we have got this deal... where will the capital be allocated now?"	Management stated that the saved capital is being redeployed into high-margin Chlorotoluene and Universal Multipurpose Plants (UMPP). This shift secures the raw material without the capital intensity of a standalone acid plant.	None	5.0	Strategic clarity
5	3.5	Archit Joshi, B&K Securities	Technology	Business Overview	"A couple of new technologies... Vapor Phase and Continuous Flow... any color if this is targeting a completely new product set?"	Management confirmed these technologies are for the new Chlorotoluene downstream value chain, not existing products. This signals a move toward higher-entry-barrier	None	4.0	Future tech

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						chemistries post-FY25.			
8	4.0	Abhijit Akella, Kotak	Long Term Contracts	Financials	"The first one [long term contract]... has it ramped up compared to the 15-20% utilization rate?"	Management admitted the first contract remains slow as downstream demand is weak, leading to a Q3 shutdown. This confirms that Contract 1 (Dicamba) remains a drag on ROCE for the foreseeable future.	None	5.0	Candid admission
10	4.5	Rohan Gupta, Nuvama	Stock in Trade	Financials	"Why all of a sudden is there a sharp increase in purchases of stocking trade [□126 Cr]?"	Management explained this was a transitionary effect of the demerger where orders received in AIL's name were serviced for the Pharma entity. This removes the "trading spike" concern as it is purely administrative and temporary.	None	5.0	Verifiable
11	3.5	Rohan Gupta, Nuvama	Contract 1 Strategy	Strategy	"Are we evaluating any possibility of further forward integration in complete Dicamba... or use partially these capacities for other chemicals?"	Management is evaluating converting the idle downstream lines for Contract 1 into other products. Asset repurposing is the new focus to mitigate the loss of the	None	3.0	Evaluative

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
						original Dicamba volumes.			
13	4.0	Ankur Periwal, Axis	Volume Growth	Management Commentary	"What should be our volume growth on a like-to-like basis [over 3-5 years]?"	Management is targeting 40-50% cumulative volume growth from existing products plus new contributions from Chlorotoluenes post-FY25. This underpins the 25% EBITDA CAGR guidance.	None	4.0	Quantified
18	3.0	Nitin Agarwal, DAM Capital	Pharma Details	Financials	"How are you planning to share more details on the [Pharma] business?"	Management provided 9M Pharma EBITDA (□264 Cr) and PAT (□151 Cr) with an annualized EPS of □22. Clear separation of financials post-listing provides a clean base for the Specialty Chem thesis.	None	5.0	Transparent

PATTERN FLAGS & SENTIMENT Analyst concern has migrated from **supply-side bottlenecks** (Nitric Acid) to **demand-side headwinds** (Textiles, Global Recession). Management's posture was defensive regarding the timing of growth, explicitly stating that FY24 could be "turbulent," which dampened some of the enthusiasm from the EBITDA beat. The anxiety regarding the Dicamba (Contract 1) plant persists, as it remains significantly underutilized.

Analyst Sentiment Verdict: Analysts appear cautiously satisfied with the operational numbers but remain skeptical about the "back-ended" nature of the FY24-25 guidance. The Nitric Acid deal was viewed very positively as a capital-efficient de-risking move. However, the lack of an FY23 guidance upgrade despite 76% completion in 9M suggests management is bracing for a weak Q4.

GUIDANCE GAPS REVEALED IN Q&A | Topic | What Mgmt Claimed (Opening) | What Q&A Revealed | Gap / Walk-back | Risk to Thesis | | :--- | :--- | :--- | :--- | :--- | | FY24 Growth | 25% CAGR Target. | "FY24 will be more of a turbulent year." | Growth is heavily skewed toward FY25; FY24 might see flat-to-low growth. | Time-value of investment. | | Contract 1 | Growth contributor. | Q3 shutdown taken due to slow demand. | Previous utilization targets (70%) are being abandoned in favor of "repurposing." | Asset impairment risk. |

5. WHAT CHANGED vs PRIOR QUARTER

What Changed	Prior Quarter (Q1 FY23)	This Quarter (Q3 FY23)	Direction
Nitric Acid Strategy	Planned ₹200-500 Cr backward integration CAPEX due to domestic shortage.	Signed 20-year ₹8,000 Cr+ supply deal with Deepak Fertilisers.	↑ (De-risked)
Pharma Segment	Demerger process ongoing; "Pharma segment" reported in results.	Demerger complete; Aarti PharmaLabs listed separately (Jan 30).	↑ (Structure)
Contract 1 Status	Expected 70% utilization by FY24.	Q3 shutdown; 70% target "may not materialize" in FY24; repurposing lines.	↓ (Execution)
Growth Timing	FY23 "single-digit" EBITDA growth.	9M already at 76% of target; FY24 flagged as "turbulent."	→ (Back-ended)
Debt Profile	"Peak debt" expected in Q2 FY23.	Peak debt passed; Net Debt reducing toward ₹2,600 Cr.	↑ (Balance Sheet)
New Projects	NCB and Specialty blocks under way.	3rd Long Term Contract commercialized; Jhagadia 100-acre site work started.	↑ (Capacity)
Textile Demand	Headwinds starting to appear.	"Severely impacted"; global recessionary trends visible in Auto/Textiles.	↓ (Macro)

STOP HERE.