Aarti Industries Ltd — Jun 2022 Quarterly Analysis

1. VERDICT & BUSINESS QUALITY SNAPSHOT

Result: Beat (Headline) / Inline (Core) **One-line:** Massive one-off termination income (□631 Cr) and effective pass-through of hyper-inflationary RM costs mask core margin compression, while providing a massive cash buffer for the aggressive □5,000 Cr capex cycle.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance	Strong Beat	Exceeded FY22 growth guidance of 25-35%; Core EBITDA grew 35% YoY.	□
Earnings Quality	Low (One-off driven)	Headline PAT (□1,307 Cr) is 47% comprised of a non-recurring termination fee.	□
Guidance Confidence	Neutral	Management cautioned FY23 will be a "consolidation" year with high single-digit EBITDA growth.	□
Management Credibility	Strong	Successfully commissioned 2nd Long-term contract; transparent about Nitric Acid supply risks.	□
Business Quality Signal	Stable	85% utilization across established blocks; volume growth remains the primary lever.	□
Key Q&A Exchange	Q#4 (Guidance)	Mgmt clarified that FY23 EBITDA growth will be "high single digit" due to the base effect of shortfall fees.	□
The Street's Primary Anxiety	Margin Compression	Analysts focused on the 250 bps YoY EBITDA margin contraction and RM availability.	□
Capital Cycle Stage	Investment	Massive □1,300 Cr capex in FY22; another □3,000 Cr+ planned through FY24.	□
Margin Trajectory	Deteriorating	EBITDA margins fell from 19.3% to 16.8% YoY as RM inflation outpaced value-add growth.	□
Pricing Power	Stable	50% revenue growth driven by "ability to pass on sharp increases" in crude/petrochem costs.	□
FCF Conversion	Distorted	High PAT but management flagged a "working capital cycle gap" due to RM inventory costs.	□
Competitive Moat	Stable	Deepening integration with new CNA concentration plant to de-risk supply chain.	□
Balance Sheet	Strong	Net Debt/EBITDA at 1.3x (FY22) vs 2.5x (FY21), aided by termination cash.	□
Working Capital	Deteriorating	"Deployed resources" increased due to 50-100% inflation in key input prices.	□
Mgmt Guidance Track Record	Reliable	Historically consistent on project commissioning and long-term scaling targets.	□
Key Vulnerability	RM Supply	Nitric Acid shortage remains a bottleneck for Nitro-based product volumes.	□
Management Tone	Cautiously Optimistic	Focused on long-term FY24/27 targets while managing short-term utility/logistics headwinds.	□

Sentiment: □Positive

Key Takeaways: * **Positives:** Aarti is successfully navigating a hyper-inflationary environment by passing on 50-100% raw material cost increases, maintaining absolute "delta margins" even if percentages contract. The ₹631 Cr termination fee acts as a strategic windfall, deleveraging the balance sheet (Net Debt/EBITDA 1.3x) just as the company enters a peak ₹5,000 Cr capex phase. Volume growth is robust, with Nitro-Toluene and Hydrogenated products showing significant YoY production increases. * **Negatives:** Core EBITDA margins (16.8%) are currently well below the long-term 25-30% target due to high utility/logistics costs and a lack of operating leverage on newly commissioned assets. The Nitric Acid supply constraint is a structural risk, forcing the company into a ₹150-200 Cr backward integration project that adds to the execution burden. * **The Street's Concern:** Analysts are wary of a "growth lull" in FY23. Management's response—guiding for only high single-digit EBITDA growth in FY23—confirmed that this is a transition year where depreciation and fixed costs will precede the full volume ramp-up of the 2nd and 3rd long-term contracts. * **Forward-looking Watchpoint:** Monitor the commercialization of the USFDA API expansion in Q1 FY23; this is the key catalyst for the Pharma segment's guided recovery.

---

2. BUSINESS PERFORMANCE

2A. KEY METRICS DATA SOURCE: PPT figures used as primary source. Concall used for Mgmt Commentary.

Metric	Current Qtr (Q4)	YoY Change	QoQ Change	Trend	Mgmt Commentary
Volume (NCB - MT)	19,551	↑ 2.3%	↑ 5.6%	↑	Stable demand; partially impacted by Nitric Acid shortages.
Volume (NT - MT)	5,155	↑ 75.6%	↑ 41.9%	↑	Significant ramp-up in Nitric-Toluene chain capacity utilization.
Volume (Hydro - MT)	3,029	↑ 56.5%	↑ 5.2%	↑	Strong demand for hydrogenated value-added products.
Realization	Increased	-	-	↑	Growth driven by "ability to pass on sharp increases" in RM costs.
Utilization (%)	~80-85%	→	↑	↑	NT reached 80% utilization; established blocks at high rates.
Gross Margin (%)	Not in Doc	-	-	-	Not explicitly provided; absolute delta margin maintained.
EBITDA (□Cr)	339	↑ 29.9%	↓ 46.5%	↓	Core growth 52% YoY (adj. for FY21 shortfall fee). QoQ ↓ due to Q3 termination income.
EBITDA Margin %	16.8%	↓ 250bps	↓ 110bps	↓	Pressured by RM inflation pass-through and higher utility costs.
PAT (□Cr)	194	↑ 39.6%	↓ 74.9%	↓	In-line with operational performance; Q3 had □631 Cr one-off.
ROCE (%)	19.0%	↑ 500bps	-	↑	FY22 full year; ROCE exc. CWIP is higher at 28%.
Cash Flow (OCF)	Not in Doc	-	-	-	Flagged working capital gap due to RM price spikes.
Net Debt / EBITDA	1.3x	↓ 1.2x	-	↑	Improved significantly due to termination fee cash inflow.
Interest Coverage	Not in Doc	-	-	-	Not explicitly provided for Q4.
R&D Spend (□ Cr)	~60-80	-	-	→	Focused on 40+ Chem and 50+ Pharma product pipeline.

2B. SEGMENT BREAKDOWN

Segment	Revenue (□ Cr)	YoY Growth	Margin (EBIT)	Trend	vs Co. Avg	Key Development
Specialty Chem	1,629	↑ 49%	15.1%	↓	Below	Commenced 2nd Long-term contract; Fixed costs/Depreciation up.
Pharmaceuticals	388	↑ 52%	17.2%	↓	Above	New USFDA API facility in final stages; Q1 FY23 launch.

3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate / Feasibility	Historical Delivery	Risk Flag
Guidance	Revenue (FY24)	1.7x - 2.0x of FY21 (₹5,023 Cr)	Needs ~₹8,500 - 10,000 Cr. Currently at ₹7,288 Cr (core). High feasibility.	Met FY22 guidance.	Low
Guidance	Margins	EBITDA Margin 25% - 30%	Requires 800-1000 bps expansion. Likely back-ended to FY25-27.	Currently missing.	High
Guidance	EBITDA (FY23)	High single-digit growth	Adjusted for ₹138 Cr shortfall fee in FY22 base. Feasible.	New guidance.	Low
Guidance	Capex Plan	₹4,500 - 5,000 Cr (FY22-24)	₹1,300 Cr spent in FY22. Needs ₹1,600-1,800 Cr/year. On track.	Delivered ₹1,300 Cr.	Medium
Strategy	Integration	Set up 250 tpd CNA concentration plant	Target completion: End of FY24. Reduces supply risk.	First entry.	Medium
Strategy	Expansion	40+ Chem / 50+ Pharma products	Diversifying into Chlorotoluenes and photo-chlorination.	On track (R&D focus).	Low
Macro	RM Pressure	Pass-through of RM spikes	Successfully passing costs but with a "time lag."	Demonstrated agility.	Medium
Balance	Leverage	Deleveraging post-termination fee	Net Debt/EBITDA at 1.3x provides huge capex runway.	Strong delivery.	Low

4. ANALYST Q&A

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
1	4.0	Umesh Patel	Capex	Capex	Details on the 250 tpd Nitric Acid backward integration.	Management plans a □150-200 Cr plant to convert weak nitric acid (importable) to concentrated nitric acid (non-importable) by FY24. This de-risks the most volatile supply chain bottleneck but adds to the short-term capex burden.	None	4.0	Clear and quantified
2	3.5	Umesh Patel	Pharma	Business Overview	Revenue potential and margins for the new USFDA API facility.	The facility has a $25-30 million revenue potential with 17-20% EBITDA margins, ramping up over the next three years. This supports the Pharma segment's return to historical margin profiles by FY24.	None	4.0	Specific timeline given
3	3.0	Umesh Patel	China	Business Overview	Impact of China lockdowns on Aarti's market leadership.	Management sees no significant impact from China lockdowns as they are fully backward integrated and primarily export value-added products. This reaffirms Aarti's "China+1" structural tailwind despite	None	3.5	Vague but consistent

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
						regional volatility.			
4	5.0	Surya Patra	Margins	Financials	How margins remained flat despite logistics/ utility cost spikes.	Management confirmed ocean freight and RM costs are passed through, while utility costs remained high but stable on a QoQ basis. This proves absolute margin protection but signals percentage-level compression until operating leverage kicks in.	None	4.0	Directional with evidence
5	4.5	Surya Patra	OpEx	Financials	Impact of adding 1,500 employees on the future cost structure.	The new hires are for upcoming projects (2nd and 3rd contracts), and their costs will be absorbed as volumes generate in FY23-24. This implies a temporary "cost-ahead-of-revenue" drag on FY23 earnings.	None	4.0	Clear and quantified
6	4.0	Surya Patra	Guidance	Management Commentary	Will absolute EBITDA growth targets be met for FY24?	Management re-iterated the 1.7x to 2.0x EBITDA growth target for FY24 despite RM and utility headwinds. This provides confidence in the structural	None	4.0	Specific timeline given

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
						thesis, even if FY23 is a transition year.			
7	3.5	Aditya Khetan	Pharma	Business Overview	Capacity increase details for the new API lines.	The new lines are dedicated high-volume lines for $200-$500/kg products, allowing multipurpose lines to be freed up for newer launches. This move improves overall site efficiency and segment throughput.	None	3.5	Directional with evidence
8	3.5	Aditya Khetan	China	Business Overview	Risk of China dumping raw materials at lower prices.	Management sees no risk for their integrated product lines as they are backward integrated and not dependent on Chinese intermediaries for core products. Reaffirms the "Integrated Operations" moat.	None	3.0	Deflected
9	4.5	Aditya Khetan	Growth	Financials	Split of FY22 growth between volume and realization.	FY22 saw 18-20% volume growth, with the remainder of the 58% revenue growth coming from RM price pass-throughs. This highlights that while topline is inflated by prices, core volume growth	None	4.0	Clear and quantified

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
						remains very healthy.			
10	4.0	Ritesh Gupta	Demand	Business Overview	Impact of US/EU recession on discretionary demand.	Agrochemical demand is strong due to high commodity prices, though dyes/pigments (discretionary) are seeing some pushback. This justifies Aarti's strategy of shifting product mix toward agrochemicals to sustain utilization.	None	3.5	Directional with evidence
11	4.5	Ritesh Gupta	Guidance	Management Commentary	Clarification on the doubling of EBITDA by FY24.	Management noted that FY22 EBITDA included a 138 Cr shortfall fee, which must be adjusted for when calculating the 1.7-2.0x growth target. This clarifies the "true" base for growth and sets realistic Street expectations for FY23.	None	4.0	Clear and quantified
12	4.5	Abhijit Akella	Guidance	Management Commentary	Guidance for FY23 Revenue and EBITDA growth.	Management guided for "high single-digit" EBITDA growth in FY23, citing the loss of the shortfall fee and the commencement of new project fixed costs. This reset of expectations is a critical signal that FY23 is a	None	4.0	Clear and quantified

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
						"build" year, not a "harvest" year.			
13	4.0	Archit Joshi	Products	Strategy	Rationale for 40+ new products and choice of chemistries.	New products focus on Chlorotoluene, photo-chlorination, and Grignard reactions for import substitution. This expands the addressable market into higher-margin complex chemistries beyond the traditional Benzene chain.	None	4.0	Specific timeline given
14	3.5	Rohit Nagraj	Financials	Financials	Status of the □400-450 Cr upfront payment for the 2nd contract.	Management has received approximately 80% of the upfront payment, which has significantly aided the debt profile. This demonstrates strong contract enforceability and customer commitment.	None	5.0	Verifiable
15	4.0	Siddharth Gadekar	Utilization	Business Overview	Timeline for reaching 70-90% utilization on new blocks.	Virtually all blocks commissioned between FY19-22 will hit the 70-90% utilization target by FY24. This provides a clear three-year visibility for volume-led EBITDA expansion.	None	4.0	Specific timeline given
16	4.0	Ranjit	Margins	Financials			None	3.0	

Q#	Relevance	Analyst	Theme	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verdict
					EBITDA margin profile of the new "advanced" chemistries.	Incremental products are expected to have EBITDA margins 4-5% higher than the current average (e.g., 25% vs 20%). This confirms that the long-term 25-30% margin target is dependent on this mix shift.			Vague but consistent

PATTERN FLAGS & SENTIMENT * **Nitric Acid Anxiety:** Analysts repeatedly questioned the supply shortage of Nitric Acid. Management's response was defensive but proactive, announcing a new backward integration plant. This resolve is likely to keep the concern alive until the plant is commissioned in FY24. * **FY23 Growth Lull:** There was clear friction regarding the "high single-digit" EBITDA guidance for FY23. Analysts were looking for more aggressive growth following the □1,300 Cr capex. Management remained firm that this is a "ramp-up" year, which may lead to short-term stock volatility as the Street recalibrates. * **Analyst Sentiment Verdict:** Analysts appeared cautiously convinced of the long-term story but skeptical of near-term margin expansion. The friction centered on why the massive capex hasn't yet translated to the bottom line (Q#12 and Q#15). Management's credibility remains high due to their transparency on the shortfall fee impact and project timelines, but FY23 is now viewed as an execution "overhang" year.

GUIDANCE GAPS REVEALED IN Q&A | Topic | What Mgmt Claimed (Opening) | What Q&A Revealed | Gap / Walk-back | Risk to Thesis | | :--- | :--- | :--- | :--- | :--- | | FY23 EBITDA | Robust growth momentum. | High single-digit growth only. | Adjustment for □138 Cr shortfall fee in the base creates a "optical" growth slowdown. | Low; structural growth intact. | | Margins | Focus on value-add. | Utility/Logistics costs are not fully passed through like RM. | EBIT percentage will remain suppressed in a high-inflation environment. | Medium; RoE compression. |

---

5. WHAT CHANGED vs PRIOR QUARTER

Comparison based on Q4 FY22 vs Q3 FY22 (Prior Context).

What Changed	Prior Quarter (Q3 FY22)	This Quarter (Q4 FY22)	Direction
Core Revenue	□1,657 Cr (Ex-one off)	□2,018 Cr (Ex-one off)	↑ Improving
Debt Profile	Net Debt/EBITDA ~2.5x (FY21)	Net Debt/EBITDA 1.3x	↑ Improving
Nitric Acid Strategy	Impacted operations (Bottleneck)	Announced □150-200 Cr CNA plant	↑ De-risking
Contract Status	1st Long-term terminated	2nd Long-term commissioned	↑ Improving
Growth Guidance	Re-iterated 25-35% (FY22)	Guided High single-digit (FY23)	↓ Cautious
Project Pipeline	Planning universal plants	100+ acre Jhagadia site work starting	↑ Improving
Pharma Milestone	Trial runs at Vapi	Tarapur USFDA API facility ready (Q1)	↑ Improving

STOP HERE.