Aarti Industries Ltd — May 2023 Quarterly Analysis

1. VERDICT & BUSINESS QUALITY SNAPSHOT

Result: Miss (on EBITDA) / Inline (on guidance update) **One-line:** The long-term thesis is undergoing a "stress test" as management sacrifices near-term margins for volume utilization, shifting the bulk of the earnings recovery to FY25.

Dimension	This Quarter	Signal / Evidence	Sentiment
Beat/Miss vs Guidance	Weak Miss	EBITDA of □252 Cr was marginally below the □1,100 Cr FY23 guidance (reached □1,089 Cr).	□
Earnings Quality	Moderate	PAT includes a one-time tax provision write-back; EBITDA impacted by maintenance (□10 Cr).	□
Guidance Confidence	Neutral	Maintained FY25 target (□1,700 Cr) but warned FY24 EBITDA growth (~15%) will lag volumes (25%).	□
Management Credibility	Strong	Transparent about "non-regular" market sales (margin dilution) to maintain plant utilization.	□
Business Quality Signal	Stable	High entry barrier in Chloro-toluene chain starting FY25, but currently battling global inventory correction.	□
Key Q&A Exchange	Q#4 - Non-regular markets	Management admitted selling to China/non-regular markets at 10-15% lower gross margins to clear inventory.	□
The Street's Primary Anxiety	Margin Erosion	Can AIL protect absolute EBITDA while selling excess capacity into a global glut?	□
Capital Cycle Stage	Investment	Peak investment phase with □3,000 Cr capex planned over FY24-25.	□
Margin / Return Ratio Trajectory	Deteriorating	EBITDA margins compressed to 13.8% (vs 15.6% QoQ) due to mix shift and higher utility costs.	□
Pricing Power	Stable	Formula-based RM pass-through remains intact for regular contracts.	□
FCF Conversion & Quality	Weak	Negative FCF as □1,300 Cr FY23 capex exceeds OCF; high debt reliance for growth.	□
Competitive Moat Signals	Stable	Maintaining global 1st-4th ranking; Chloro-toluene expansion targets 20% global capacity.	□
Balance Sheet Strength	Adequate	Net Debt stable post-demerger; working capital improved (110 days) due to Pharma exit.	□
Working Capital Efficiency	Improving	DIO/DSO reduced significantly following the Pharma business demerger.	↑
Mgmt Guidance Track Record	Reliable	Historically accurate on long-term targets, though FY24 is being "reset" for macro conditions.	□
Key Vulnerability / Red Flag	Non-regular market sales	High risk of pricing pressure if the "non-regular" market sales (5-10% of volume) become sticky.	□
Management Tone	Cautiously Realistic	Acknowledging "challenging" macro while pitching the "Golden Decade" for Indian chemicals.	□

Key Takeaways (Positives & Negatives): * **Positives:** The Pharma demerger is complete, leaving a leaner balance sheet and better working capital metrics (110 days cycle); Nitric Acid supply is de-risked for 20 years; NCB and Nitro-toluene expansions are on track to drive 25% volume growth in FY24. * **Negatives:** Management has effectively "down-guided" FY24 EBITDA growth to ~15% (lower than the 25% CAGR target) due to margin dilution in non-regular markets; discretionary segments like Dyes/Pigments/Textiles remain weak; heavy capex (□3,000 Cr) will keep the company FCF negative through FY25. * **The Street's Concern:** Analysts are focused on the "math gap" between 25% volume growth and only 15% EBITDA growth. Management's response—that they prefer keeping plants running even at lower margins—suggests a defensive posture against global dumping from China. * **Forward Watchpoint:** Monitoring the utilization of Contract 1 (Dicamba) and the commissioning of Zone 4 Chloro-toluene projects in FY25, which are the primary bridges to the □1,700 Cr EBITDA target.

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2. BUSINESS PERFORMANCE

2A. KEY METRICS

Metric	Current Qtr	YoY Change	QoQ Change	Trend	Mgmt Commentary
Volume (NCB)	18,842 MT	↑ 3.5%	↑ 3.5%	→	Utilization high; capacity expansion to be commercialized in Q1 FY24.
Volume (NT)	6,130 MT	↓ 18.5%	↓ 18.5%	↓	Impacted by maintenance shutdown; debottlenecking planned for FY25.
Hydrogenation (TPM)	3,315 TPM	↓ 17%	↓ 17%	↓	Linked to discretionary demand slowdown in textiles/ pigments.
Revenue (□Cr)	1,826	↑ 11.2%	↓ 1.5%	→	Growth driven by volumes; absolute value hit by lower RM prices passed through.
Gross Margin (%)	41.2%	↓ 300 bps	↓ 200 bps	↓	(Estimated) Impacted by sales to lower-margin "non-regular" markets.
EBITDA (□Cr)	252	↓ 3.8%	↓ 12.8%	↓	Missed □263 Cr internal target; impacted by □10 Cr maintenance cost.
EBITDA Margin %	13.8%	↓ 210 bps	↓ 180 bps	↓	Diluted by product mix and energy costs; guidance of recovery in FY24.
PAT (□Cr)	149	↑ 2.1%	↑ 8.8%	↑	Includes write-back of prior period tax provision.
EPS (□)	4.10	↑ 2.2%	↑ 8.8%	↑	Reflects core operational performance and one-off tax benefit.
ROCE (%)	~10%	↓ 200 bps	↓ 100 bps	↓	Impacted by massive capital work-in-progress (CWIP).
Net Debt / Equity	0.58x	↓	↓	↑	Improved following Pharma demerger; peak debt levels managed.
Working Capital (Days)	110	↓	↓	↑	Drastic improvement post-Pharma demerger (historically 140-150 days).

2B. SEGMENT BREAKDOWN

Segment	Revenue (₹ Cr)	YoY Growth	Margin	Trend	vs Co. Avg	Key Development
Specialty Chemicals	1,826	↑ 11.2%	13.8%	↓	In-line	Two new process blocks commercialized at Jhagadia.
Exports	888	↑ 4.1%	N/A	→	Below Avg	Exports at 48.6% of total; impacted by global demand slowdown.
Value Added Prod.	~1,479	↑	N/A	↑	Above Avg	Value-added share continues to increase despite macro headwinds.

3. MANAGEMENT OUTLOOK & EXECUTION TRACKER

Dimension	Category	Management Target / Claim	Required Run-Rate	Historical Delivery	Risk Flag
Guidance	EBITDA (FY24)	~₹1,250 Cr (15% growth)	Needs ~₹310 Cr/quarter.	Q4 was ₹252 Cr; requires 23% jump.	High
Guidance	EBITDA (FY25)	₹1,700 Cr	Needs 36% growth in FY25.	Back-ended; depends on Zone 4.	High
Guidance	Volume Growth	25% for FY24	High utilization in new blocks.	Q4 saw volume growth; on track.	Low
Guidance	Capex Plan	₹1,500 Cr (FY24)	₹375 Cr per quarter.	Spent ₹1,300 Cr in FY23; on track.	Medium
Strategy	Non-regular mkts	5-10% of volumes	Tactical shift.	New strategy to counter slowdown.	High
Strategy	Chloro-toluene	20% global capacity	Commissioning H1 FY25.	Engineering work initiated.	Medium
Macro	Inventory Cycle	Recovery in 2-3 quarters	Dependent on interest rates.	Worse than guided in Q3.	High
Balance	Tax Rate	15-17% for FY24	N/A	Consistent with new regime.	Low

4. ANALYST Q&A

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verd
1	4.0	Rohit Nagraj, Centrum	New Capacity	Business Overview	"Which industry these [two specialty chemical] complexes will be catering to? Is it discretionary or nondiscretionary?"	Management confirmed these blocks produce intermediates for agrochemicals, pigments, and additives, with a portion for captive use. This increases vertical integration and should support margins in the 25-30% range post-ramp-up.	None	4.0	Clea quan
2	4.5	Vivek Rajamani, Morgan Stanley	Demand Trends	Mgmt Commentary	"Could you just elaborate what exactly you mean by these nonregular markets? What is the margin differential?"	Management explained non-regular markets (like China) are used to maintain utilization when regular Western markets slow down. The 10-15% gross margin differential implies a deliberate sacrifice of profitability to prevent plant idling, which will weigh on FY24 EBITDA margins.	None	5.0	Canc admi
3	4.0	Rohan Gupta, Nuvama	Agrochemicals	Business Overview	"How much of our portfolio is catering to... generics? How much would be under patented products?"	Management noted that generics form the majority of their agrochemical basket and are seeing slowdowns due to	None	3.0	Vagu cons

Q#	Relevance	Analyst / Firm	Theme Cluster	Category	Underlying Concern	Management Response & Investment Implication	Evaded	Credibility	Verd
						inventory correction. This signals that AIL is not immune to the global destocking cycle affecting generic pesticide players.			
4	3.5	Aditya Khetan, SMIFS	Capex Revision	Capex and Allocation	"Earlier we were targeting... INR2,500 crore capex... Now we have given a guidance of INR3,000 crore?"	Management clarified that the 3,000 Cr is a combined guidance for FY24 and FY25 (1,500 Cr each). This confirms high capital intensity will persist, keeping free cash flow under pressure for the next 24 months.	None	4.0	Spec timel
5	4.5	Abhijit Akella, Kotak	Margin Delta	Financials	"In the non-traditional [markets]... are we indicating that [margins] will be 10 points lower, like, say, 5% to 8%?"	Management clarified the 10-15% difference is at the Gross Margin level, not EBITDA percentage points. This suggests the impact on the bottom line is manageable but will still prevent significant operating leverage in FY24.	None	4.0	Quar
6	4.0	Siddharth Gadekar, Equirus	FY25 Outlook	Mgmt Commentary	"What will drive this EBITDA growth in FY25?"	Management expects FY25 to benefit from	None	3.0	Direc

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						a reversal of the non-regular market shift and a further 15-20% volume growth from new capacities. This reinforces that the investment thesis is "back-ended," with FY24 being a transitional year.			
7	4.5	Ritesh Gupta, Morgan Stanley	Guidance Math	Financials	"If you're doing INR125 of volume next year... it still implies more than 40% [EBITDA] growth. Where is the math failing?"	Management did not provide a direct reconciliation but suggested the opex run rate and the specific mix of "non-regular" sales would offset the volume gains. This evasion suggests management is being ultra-conservative or bracing for higher opex than previously admitted.	Direct math reconciliation	2.0	Evas on op
8	4.0	Aditya Khetan, SMIFS	Working Capital	Financials	"Working capital has drastically gone down... any particular reason?"	Management attributed the improvement to the exit of the Pharma business (which had higher inventory/ receivables) and a shift toward products with shorter credit	None	5.0	Verifi

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						cycles. This is a structural positive for cash flow, partially offsetting the heavy capex burden.			
9	3.5	Aditya Khetan, SMIFS	Contract 1	Capex and Allocation	"Currently, I believe [Contract 1] is operating at 20%, 25% utilization... Gogri sir mentioned it would be at around 70% by FY25?"	Management confirmed the low current utilization but expressed confidence in a ramp-up to 30-50% in FY24. The delay in Dicamba (Contract 1) remains a primary ROCE drag, though asset repurposing is being explored.	None	3.0	Follo clarit

PATTERN FLAGS & SENTIMENT * **Theme 1: "Utilization over Margins":** Multiple analysts (Morgan Stanley, Kotak, Nuvama) probed the decision to sell into "non-regular" markets. Management was defensive but firm, prioritizing plant utilization and market share over quarterly margin protection. This concern is likely to resurface if Q1/Q2 FY24 margins don't show a floor. * **Theme 2: The "FY25 Bridge":** Questions on FY25 guidance (Equirus, YES Securities) revealed that the ₹1,700 Cr target is heavily reliant on the Chloro-toluene expansion. Posture was confident but the timeline remains 18 months away, leaving a "valuation air pocket" in the interim. * **Analyst Sentiment Verdict:** Skeptical on the FY24 bridge but constructive on the long-term structural changes. The demerger's positive impact on working capital was well-received, but the "evasive" math on how 25% volume growth only yields 15% EBITDA growth (Ritesh Gupta's query) left a lingering doubt about hidden cost escalations or severe pricing pressure in the core portfolio.

GUIDANCE GAPS REVEALED IN Q&A | Topic | What Mgmt Claimed (Opening) | What Q&A Revealed | Gap / Walk-back | Risk to Thesis | | :--- | :--- | :--- | :--- | :--- | | FY24 EBITDA | 25% CAGR Target | ~15% EBITDA growth | 1,000 bps gap vs volume growth. | Time-value of money; lower IRR on FY24 expansions. | | Opex Run-rate | "Should not increase much" | Q4 opex remains high | Analysts struggled to reconcile flat opex with low EBITDA growth. | Potential opex underestimation or pricing erosion. | | Contract 1 | Ramp-up to support growth | Current utilization only 20-25% | Delayed from original FY23 targets. | Continued ROCE sub-performance. |

5. WHAT CHANGED vs PRIOR QUARTER

What Changed	Prior Quarter (Q3 FY23)	This Quarter (Q4 FY23)	Direction
FY24 EBITDA Guidance	Implied 25% CAGR	Explicitly guided to ~15% growth	↓
Market Strategy	Focus on "regular" Western markets	Tactical shift to "non-regular" markets (China)	↓
Working Capital	Improving (post-demerger expectation)	Actualized at 110 days (Structural shift)	↑
Capex Visibility	□2,500 Cr for Chemicals	Revised to □3,000 Cr over 2 years	□
Maintenance Impact	Normal operations	□10 Cr one-time impact in Q4	↓
Tax Strategy	Standard provisions	Write-back of prior period provisions	↑
Textile Demand	"Severely impacted"	"Green shoots visible" / Uptick in inquiries	↑

STOP HERE.