



Aarti Drugs

STOCK INFO.
BSE Sensex:28,420

BLOOMBERG
ARTD:IN

S&P CNX:8,603

REUTERS CODE
ADRG:NS

(INR CRORES)

Y/E MARCH	FY15E	FY16E	FY17E
Revenue	1085	1273	1526
EBITDA	166	193	234
EBITDA Margin	15.3%	15.1%	15.3%
NP (Adj.)	76	87	114
EPS (Adj.)	31.3	35.9	47.2
EPS Growth	24%	15%	31%
BV/share	125	150	183
ROE (%)	25	24	26
ROCE (%)	18	19	21
P/E (x)	21.6	18.9	14.3
P/BV (x)	5.4	4.5	3.7

KEY FINANCIALS

Diluted Shares (cr)	2.4
Market Cap. (Rs cr)	1090
Market Cap. (US\$ m)	173
Past 3 yrs Sales Growth (%)	18%
Past 3 yrs NP Growth (%)	53%

STOCK DATA

52-W High/Low Range (INR)	294/874
Major Shareholders (as of March 2015)	
Promoter	60.1
Non Promoter Corp Holding	2.1
Public & Others	37.8
Average Daily Turnover(6 months)	
Volume	14069
Value (Rs cr)	1.1
1/6/12 Month Rel. Performance (%)	7/11/120
1/6/12 Month Abs. Performance (%)	13/12/131

Maximum Buy Price :INR720

21 July 2015

Buy

Initiating Coverage

INR677

We recommend a BUY on Aarti Drugs with a target of INR 850 - valuing the company at 18x FY17E EPS.

Proxy play on the domestic and global pharma industry: Aarti Drugs is a high quality API supplier to formulation companies across domestic and international markets. Over the last decade, the company has gained scale by growing its revenues from INR 200cr to over INR 1000cr at an annual growth of 16%. Further the company is the market leader in most of its top 10 products thereby enabling it to enjoy economies of scale. The company's domestic clients comprise all major formulation companies like Cipla, Dr Reddy's, Cadilla, Ranbaxy, Glaxo, Alembic, etc. The company exports to over 97 countries with exports constituting 38% of its revenues.

Focus on higher value products driving return ratios: Much of the incremental capex of the company is strategically being allocated towards high value import substitute products in segments of Antibiotic, Antifungal, Cardio and Antidiabetic. The margin commanded by these new products will be in line with those of other categories however owing to their higher realizations the company will be able to increase its asset turnover thereby driving the return ratios. Over the last few years, the company has increased its ROCE from 11% in FY11 to 18% in FY15 which we expect to rise to 21%/23% by FY17/18E.

Insulated from currency movements: The company is insulated from movement in the currency inspite of exports constituting 38% of revenue as import of raw materials form 36% of revenue. Thus the net currency exposure of the company is at barely 2% of its revenue.

Robust expansion plans to drive 23% earnings growth over FY15-17E: In order to tap opportunities unfolding in the domestic and global pharmaceutical industry, the company plans to incur an annual capex of around INR 100cr in coming years. We expect the company to grow its revenues and profits at 19% and 23% respectively over FY15-17E.

Valuations & View: Given the robust revenue visibility that the company enjoys from its dependence on the domestic and global pharmaceutical industry, aggressive expansion plans in high value segments, a 23% CAGR in profits over FY15-17E along with consistently expanding return ratios and dividend payout of 30%; we believe company is available at attractive valuations at 14.3x FY17E. We value the business at 18.0x FY17E EPS which is a 20% discount to the mean multiple of 22.6x commanded by midcap formulation companies and recommend a BUY rating on the stock with a target price of INR 850/share.

Well diversified product and client profile: Aarti Drugs derives two-thirds of its revenue from antibiotics and antiprotzoal while the balance is contributed by segments like anti-inflammatory, antifungal, cardio and antidiabetic. Among products, the highest revenue share is derived from Ciproflaxacin contributing 18% of the revenues while the top 10 products together account for 60% of the revenues. In all of these products, the company is the leader in terms of production either domestically or globally. The huge scale of operations along with high market shares in each of these products enables the company to command impressive EBITDA margins of around 15% inspite of being an API player. Further, the company's clientele is also well diversified with the top 10 contributing to just 28% of the revenues. Cipla, J.B.Chemicals and Abbot are among the major clients contributing around 4% each to the company's revenues.

Promoter shareholding on the rise: The promoters have consistently increased their stake from 50.0% in FY10 to 60.1% currently. However, actual promoter holding is at 68% as around 5% is held by Mr Harit Shah (and his family) who joined the company later as a promoter and around 3% is held by relatives of Mr Harshit Savla (Joint M.D), the holdings of which are not included in the promoter group.

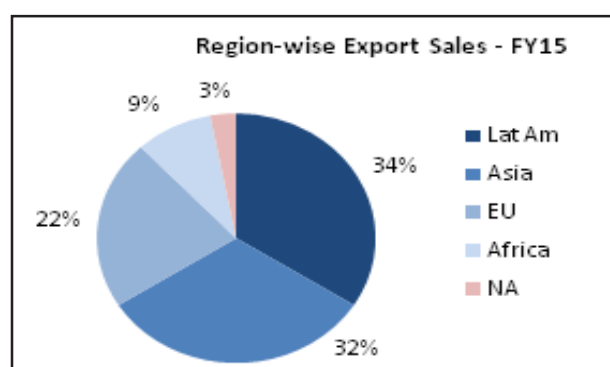
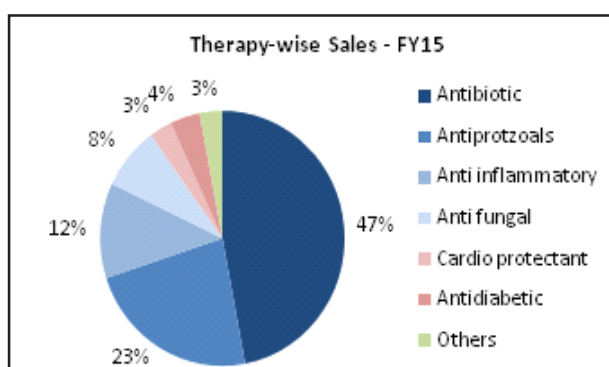
CONCERN:

Adverse pricing action under DPCO: Any action by the government under the DPCO (Drug Price Control Order) to add more drugs under the price control mechanism could act as a dampener for the sector which could have an impact on the company as well. However, since Aarti Drugs has a basket of over 35 products, it shall be able to wither such an impact in case it were to happen.

Import alert: One of Aarti Drugs' Tarapur facility was issued an import alert in March 2015. However this won't have any major impact on the company as US forms less than a percent of the company's revenue. Further, the import alert was issued due to data integrity reasons as USFDA requires the minutest of details to be furnished. We believe the company follows robust manufacturing practices as audits are carried out by its customers on one-third of the days on an average.

Company Background

Aarti Drugs Ltd (ADL), an Aarti Group company, was established in 1984 by four engineering batch mates of UDCT (now Institute of Chemical Technology) and is owned by these four families who form the promoter group. The company is engaged in manufacturing APIs, pharma intermediates and specialty chemicals with ten GMP compliant facilities including one USFDA approved facility. Eight facilities are located in MIDC Tarapur, Maharashtra while two are located in GIDC Sarigam, Gujarat. The company exports 38% of its revenues to over 97 countries with strong presence in regulated markets including Brazil, Mexico, Netherlands and Spain.



Aarti Drugs Financials & Valuation

INCOME STATEMENT (Consolidated)						RATIOS (Consolidated)					
Y/E MARCH	FY13	FY14	FY15	FY16E	FY17E	Y/E MARCH	FY13	FY14	FY15	FY16E	FY17E
Revenues	825	970	1085	1273	1526	Adjusted EPS (INR)	18.8	25.2	31.3	35.9	47.2
Growth	25%	18%	12%	17%	20%	Book Value	171	207	125	150	183
COGS	555	664	742	871	1044	Div Per Share	10.0	13.0	8.0	9.5	12.5
Gross Profit	270	306	343	402	482	Dividend Payout	31%	30%	30%	31%	31%
GP Margin	32.7%	31.6%	31.6%	31.6%	31.6%	Net Debt / Equity	1.5	1.5	1.4	1.3	1.2
Employee Cost	29	32	37	44	52	Valuation					
Other Expenses	122	129	139	166	196	P/E			21.6	18.9	14.3
EBITDA	119	145	166	193	234	P/BV			5.4	4.5	3.7
EBITDA Margin	14.5%	14.9%	15.3%	15.1%	15.3%	EV/EBITDA			9.9	8.5	7.0
Depreciation	26	28	31	34	36	EV/Sales			1.5	1.3	1.1
Other Income	1	2	1	2	2	Dividend Yield			1.2%	1.4%	1.8%
PBIT	94	118	137	161	200	Return Ratios					
E/O. Inc/(Loss)	(0)	1	1	1	1	ROCE	18%	19%	18%	19%	21%
Interest Cost	28	33	39	44	48	ROE	22%	24%	25%	24%	26%
PBT	66	86	99	117	153	W.Cap. Ratios					
Tax	21	24	22	30	38	Debtor days	95	104	104	103	101
Rate	31%	28%	23%	25%	25%	Inventory days	74	56	60	62	64
Adjusted PAT	46	61	76	87	114	Creditor days	87	83	74	78	82
Growth	115%	34%	24%	15%	31%	W.Cap cycle	83	78	90	87	83
PAT Margin	5.5%	6.3%	7.0%	6.8%	7.5%						

BALANCE SHEET (Consolidated)						CASH FLOW (Consolidated)					
Y/E MARCH	FY13	FY14	FY15	FY16E	FY17E	Y/E MARCH	FY13	FY14	FY15	FY16E	FY17E
Share Capital	12	12	24	24	24	EBITDA	119	145	166	193	234
Reserves	196	239	279	340	419	Adjustments	0	-2	-6	-1	1
Networth	208	251	304	364	444	(Inc)/Dec in W.Cap	(33)	(27)	(47)	(41)	(51)
Loans	321	379	439	486	521	Pre Tax OCF	86	115	113	151	184
SOURCES OF FUNDS	528	630	742	850	965	Tax Paid	(21)	(24)	(19)	(31)	(39)
Gross Fixed Assets	479	581	684	783	880	CF from Operations	66	91	94	120	144
Less: Depreciation	188	209	239	273	309	(Inc)/Dec in FA	(49)	(98)	(95)	(98)	(98)
Net Fixed Assets	291	373	445	510	572	Invst in Bank Deposits	0	0	0	0	0
Capital WIP	13	8	0	0	0	Interest Received	1	2	1	2	2
Inventories	141	127	153	186	231	CF from Investing act.	(48)	(96)	(93)	(97)	(96)
Debtors	216	277	308	358	420	Inc/(Dec) in Debt	23	58	60	47	36
Cash & Investments	8	9	15	15	16	Interest Paid	(28)	(33)	(39)	(44)	(48)
Loans & Advances	22	29	22	23	24	Divd Paid (incl Tax)	(14)	(18)	(23)	(27)	(35)
Other Curr Assets	29	27	25	24	23	CF from Financing act.	(20)	6	(1)	(24)	(48)
Curr. Assets	416	469	522	606	714	Inc/(Dec) in Cash	(2)	1	(1)	(1)	1
Creditors and Prov.	164	189	189	232	288	Add: Opening Balance	5	3	4	3	3
Net Current Assets	252	280	333	374	426	Closing Balance	3	4	3	3	4
Less Net Def. Tax Liab	28	31	35	34	32						
APPLICATION OF FUNDS	528	630	742	850	965						

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