VENTURA

Kyon ki bhaiya, sabse bada rupaiya.

Aarti Drugs Ltd.
BUY

STOCK POINTER

Target Price ₹675	CMP ₹ 527	FY17E P/E 12.9x

Index Details

Sensex	25,858
Nifty	7,856
Industry	Pharma

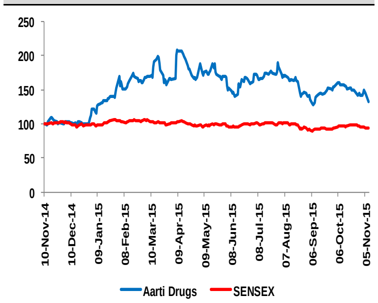
Scrip Details

MktCap (₹ cr)	1,277.6
BVPS (₹)	125.4
O/s Shares (Cr)	2.4
AvVol	6141
52 Week H/L	874/350
Div Yield (%)	1.4
FVPS (₹)	10.0

Shareholding Pattern

Shareholders	%
Promoters	61.9
DIIs	3.1
FIIs	0.1
Public	34.9
Total	100.0

ADL vs. Sensex



In existence since 1984, Aarti Drugs Limited (ADL), part of the USD 500 million Aarti Group of Industries is a known brand in the API space. Expertise in various chemistries along with backward integration has enabled it to be a cost competent player in a large number of products. WHO and USFDA certified manufacturing facilities at Tarapur and Sarigam have propelled exports (16% CAGR over 4 years) to ~40% of revenues over the last 5 years. The company manufactures Vitamins, Anti-arthritis, Anti-fungal, Antibiotics, ACE inhibitors, besides its range in anti-diabetic, anti-inflammatory, sedatives and anti-depressant drugs.

We expect Aarti Drugs's revenues to grow at a 2 year CAGR of 16% to Rs 1481 crores by FY17E while earnings are expected to grow at a CAGR of 19% to Rs 109 crore over the same period. The EBITDA margins (ex OI) and PAT margins are expected to be at 15.9% and 7.4% respectively.

We are upbeat on the prospects on the company given that:

- **ADL will be adding Norfloxacin to its antibiotic portfolio in FY16. For the new antibiotic facility, ADL expects to get WHO/GMP approvals in 3 – 4 months and will be targeting semi-regulated markets for its products. The revenues of its antibiotics segment are expected to grow at a CAGR of 21% by FY17. Therapeutically, antibiotics contribute almost half of the total revenues of ADL, with margins in the range of 14-16%.**

- **ADL is aggressively increasing its Metronidazole (an Anti-protozole) capacity from 100 to 200 tons per month (which will be the largest in the world) and already has WHO/GMP approvals for the same. The anti-protozole segment revenues are expected to grow at a CAGR of 16% by FY17.**

- **ADL has a capacity of 120 tons to manufacture Celecoxib (Anti inflammatory). Currently the company is utilizing ~67% of its Celecoxib manufacturing capacity. For regulated markets another plant is lined up in Tarapur with 12 - 14 tons per month of capacity of Celecoxib.**

of Key Financials (₹ in Cr)

Y/E Mar	Net Sales	EBITDA	PAT	EPS (₹)	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2014	971.8	150.1	60.8	25.1	-33.4	24.6	20.6	11.6	11.8
2015	1096.9	172.4	77.3	31.9	27.1	25.1	19.6	18.2	10.7
2016E	1251.2	198.3	87.6	36.2	13.4	23.3	20.5	16.1	9.1
2017E	1481.0	234.7	109.1	45.0	35.3	23.7	21.5	12.9	7.8

Saturday, 21st November, 2015

On the back of this, Anti-inflammatory revenues (which constitute 10% of total revenues) to grow at a robust CAGR of 20% by FY17.

- **Antifungals (Ketoconazole) capacity has increased from 6-7 tons in FY11 to 26-28 tons in FY15. We expect the revenues from Antifungal to grow at a rapid rate of 18% CAGR by FY17.**

- **Significant expansion of its Metformin plant from 100 tpm to 600 tpm (scalable to 1200 tpm) is expected to boost revenues of the anti-diabetic segment. We expect the revenue of anti diabetics to grow at a CAGR of 17% by FY17.**

- **Diversified product portfolio and client base augurs well for risk reduction.**

We initiate coverage on Aarti Drugs Ltd as a BUY with a price objective of Rs 675 representing a potential upside of 28% from the CMP of Rs 527 over a period of 16 months. We have used the PE multiple approach to value Aarti Drugs and assigned a multiple of 15x on FY17 EPS of Rs 45 crore to arrive at the target price.

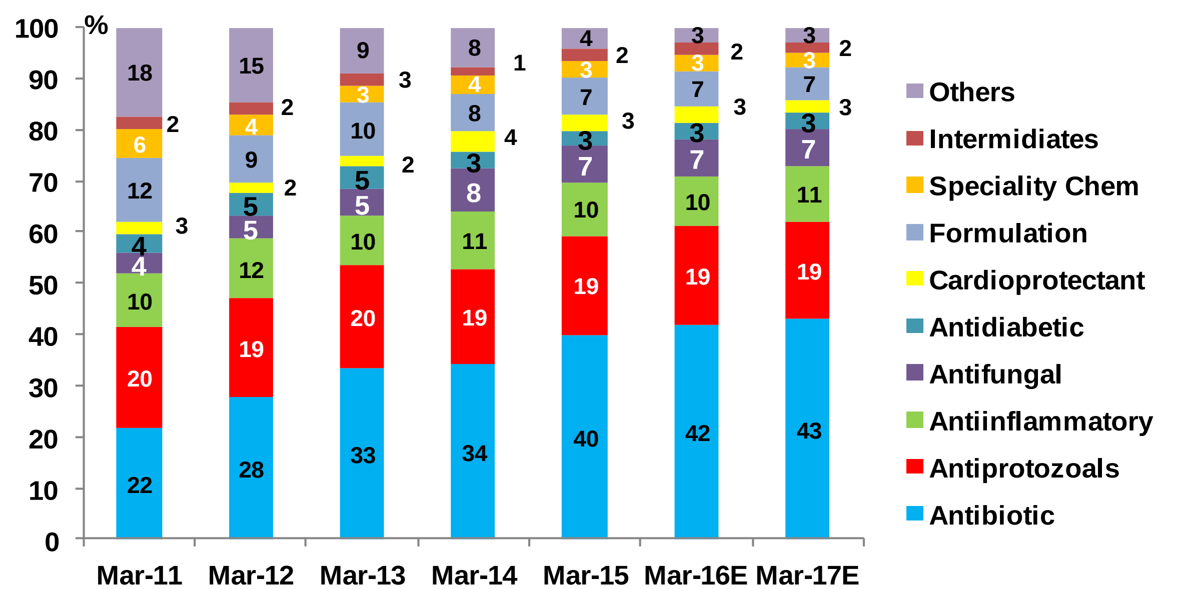
❖ Company Background

Aarti Drugs Limited (ADL), established in 1984, is part of the USD 500 million Aarti Group of Industries. With its manufacturing facilities at Tarapur and Sarigam, the company manufactures Vitamins, Anti-arthritis, Anti-fungal, Antibiotics, ACE inhibitors, besides its range in anti-diabetic, anti-inflammatory, sedatives and anti-depressant drugs.

The company manufactures tablets and is involved in the formulation business with Cipla, Lupin, Abbot, Wockhard, Alcan, Alembic, etc. ADL does toll manufacturing for only those businesses where they are the API suppliers. ~40% of the APIs for the combination formulation is sourced from outside.

On a segmental basis, the company derives more than 80% of its income from its Active Pharmaceutical Ingredients (APIs), 7% of income is from the Formulation business and balance is from specialty chemicals and other intermediates.

Segmental break up of revenues



Source Aarti Drugs Ltd, Ventura Research

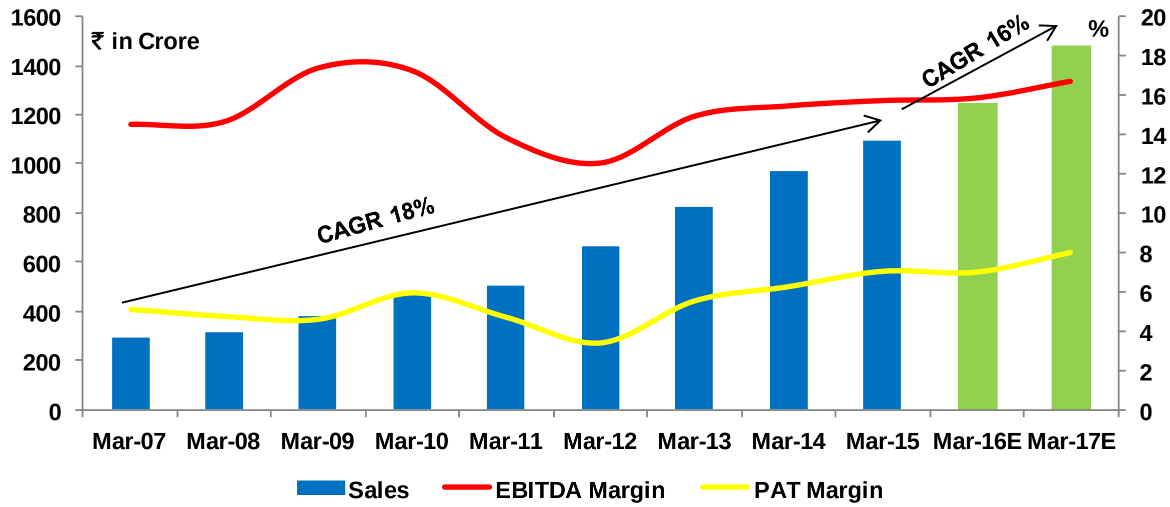
❖ Key Investment Highlights

➢ Revenue and profit margins are expected to grow

Over the period FY07-FY15, ADL has clocked YoY revenue growth of above 18% with revenues having grown from Rs 289 crore in FY07 to Rs 1,096.9 crore in FY15. This exponential growth has been driven by

- ~40% exports historically (at least last 5 years) indicating good global presence
- backward integration giving cost competitiveness,
- big product basket (many of them dedicated facilities), and
- huge client diversification which helps in cross selling whenever ADL launches new products

Strong sales growth over the years



Source Aarti Drugs Ltd, Ventura Research

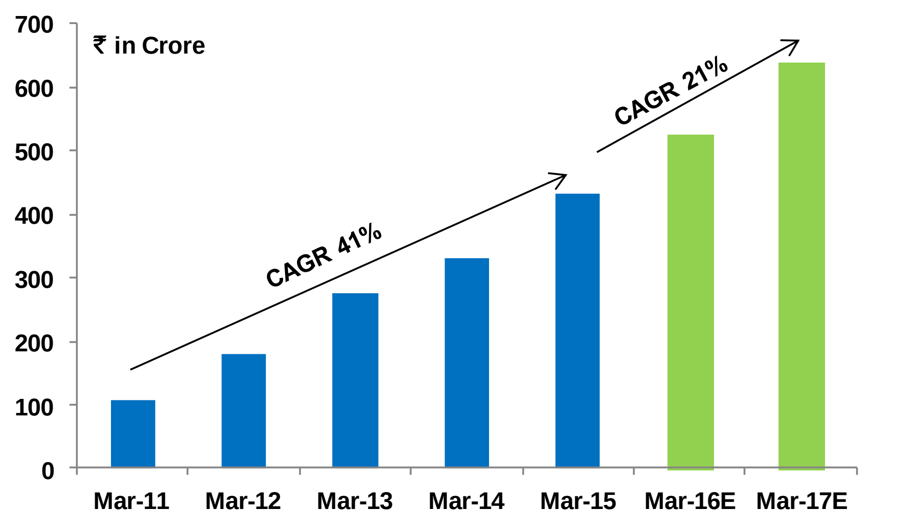
Going forward, we expect revenues to grow at a CAGR of 16% to Rs 1599.6 crore by FY17. The key growth drivers will be Antibiotic and Antiprotozole segments which we expect to grow at a CAGR of 20% in the upcoming years while antifungals and antidiabetic segment are expected to clock a CAGR growth of 17%.

- ### Antibiotic to be the highest contributor

Launching of new products, targeting new global markets and commencement of its new facility at Tarapur, is expected to propel the revenues of its antibiotics segment at a CAGR of 21%. Therapeutically, antibiotics contribute almost half of the total revenues of ADL, with margins in the range of 14-16%.

The recent growth in the antibiotic business has primarily been from the launch of two products viz. Ofloxacin (launched in FY12) and Levofloxacin (launched in FY14). ADL is the second largest global producer of Ciprofloxacin and it contributes 20% to its overall revenue. Enrofloxacin (contributes 5% - 7% to overall sales) is another antibiotic products which the company manufactures. ADL will be adding Norfloxacin to its antibiotic portfolio in FY16. For the new antibiotic facility, ADL expects to get WHOGMP approval in 3 – 4 months and will be targeting semi-regulated markets for its products. However, for the old facility of Ceprofloxacin, ADL will be applying for COS approval from European authorities.

Antibiotics to be the highest contributor

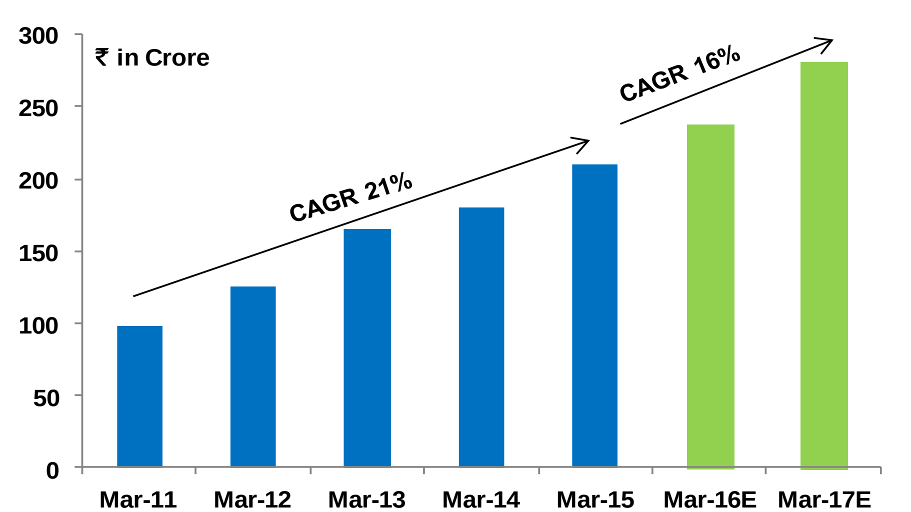


Source Aarti Drugs Ltd, Ventura Research

- **Antiprotozoles to witness expansion in capacity on the back of global demand**

Currently Antiprotozoles contribute to ~20% of the total revenue of ADL. Apart from Metronidazole (manufactures 100 tpm). ADL produces Ornidazole, Secnidazole, and Tinidazole.

Metronidazole to propel growth of Anti-protozoles segment



Source Aarti Drugs Ltd, Ventura Research

ADL is aggressively increasing its Metronidazole capacity from 100 to 200 tons (which will be largest in the world) and already has WHOGMP approval for the same. On the back of this facility, total revenues from Antiprotozoles segment is expected to grow at a CAGR of 16% by FY17.

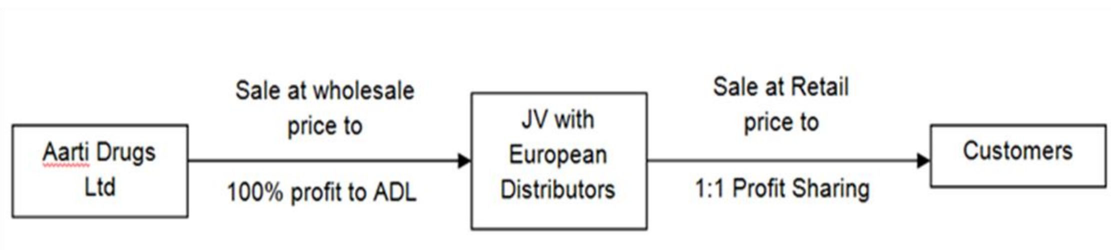
- **Celecoxib to lead the growth for Anti-inflammatory**

The Anti-inflammatory business has grown at a CAGR of 21% from Rs 51 crore in FY11 to Rs 114 crore in FY15. ADL manufactures this product at a WHOGMP certified facility and another USFDA certified facility which suffices the current demand. However, due to an import alert, the production from USFDA approved plant was stopped. However, the company is hopeful that the import alert will be lifted shortly. Once the Celeoxib resumes, we expect the growth of the Anti-inflammatory segment to clock CAGR of 20% by FY17.

Celecoxib is currently a Pfizer API. Its patent is about to expire in a couple of years. Pfizer manufactures ~500-600 tons of Celecoxib. ADL will be targeting highly regulated markets for sale of Celecoxib. ADL has a capacity of 120 tons to manufacture Celecoxib. Currently the company is utilizing ~67%of its Celecoxib manufacturing capacity. For regulated markets another plant is lined up in Tarapur with 12 - 14 tons per month of capacity of Celecoxib. Installed capacity will give revenues of ~Rs. 35 crores to Rs. 50 crores per annum.

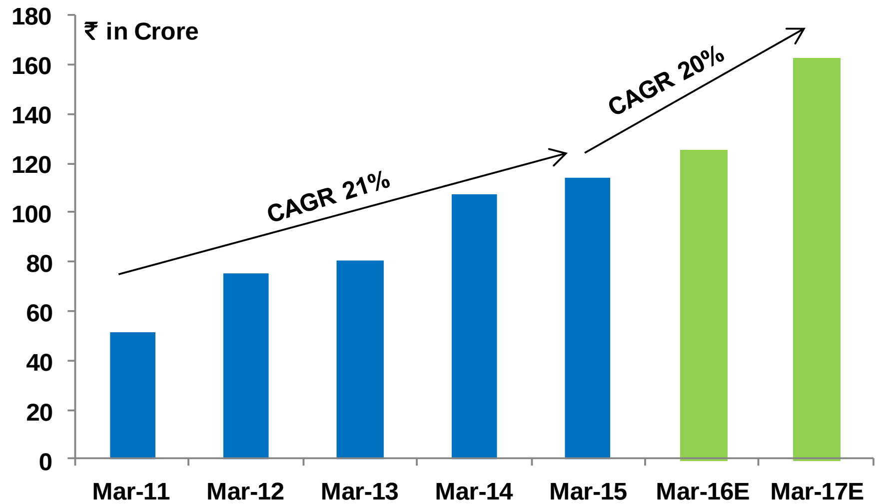
For Celecoxib, new distribution strategy being tested in Europe

The company has tie-ups with European distributors on a profit sharing basis. The European distributors will buy the dossiers at wholesale prices and will retail the same.



They command around 8-10% of market share in UK. 3 dossiers (Celecoxib, Zolpidem Tartrate (Sedative) and acanprosate calcium (for alcoholism treatment) are ready. ADL has partnered with a US company for formulation (Rivastigmine product manufacturing) wherein ADL would be supplying API.

Celecoxib to boost the growth of Anti-inflammatory segment

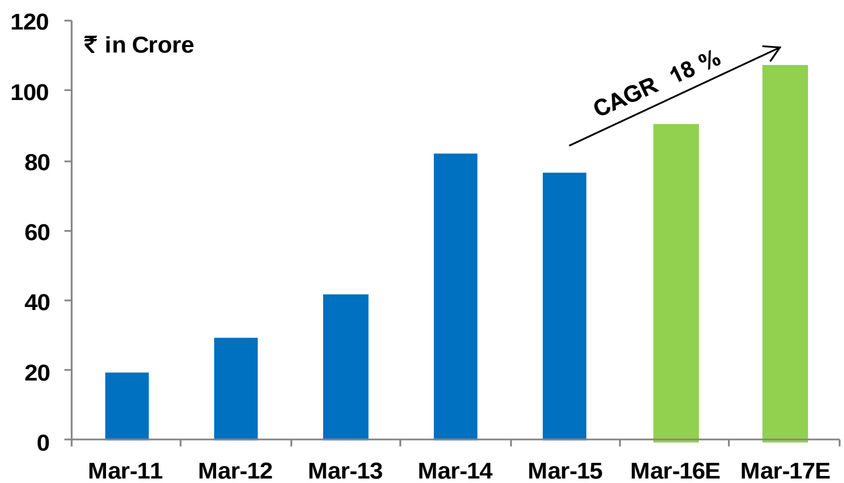


Source Aarti Drugs Ltd, Ventura Research

- ## New markets to open up for Antifungal drugs

Antifungals contribute ~7% to the top line of ADL. ADL expects growth in the antifungal segment to come from the opening up of new markets Brazil and South East Asia. ADL is optimistic about acquiring 1-2 customers in next couple of years in both Brazil and South East Asian markets. Antifungal (Ketoconazole) capacity has increased from 6-7 tons in FY11 to 26-28 tons in FY15. The company also manufactures, exports and supplies to its competitors, cistosylate an intermediate of Ketoconazole.

New markets to Antifungal segment



Source Aarti Drugs Ltd, Ventura Research

With the opening of new markets and increase in capacity in its existing plants, we expect the revenues from Antifungal to grow at a rapid rate of 18% CAGR by FY17.

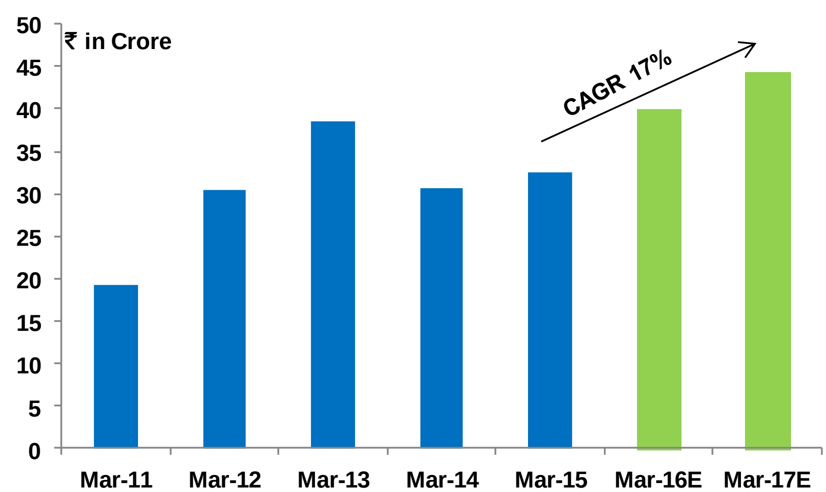
- **Capacity expansion to help revenues from Ant-diabetic drugs to expand**

Anti-diabetic is a small business segment for ADL. It contributes only 3-4% of its total revenue share. However significant expansion of its Metformin plant from 100 tpm to 600 tpm (scalable to 1200 tpm) is expected to boost revenues from this segment. The 600 tpm capacity of Metformin manufacturing is expected to deliver revenue of ~Rs. 150 crores per annum. The company expects realizations to go up once regulated sales start post FY17.

The Sarigam Metformin facility which started in March 2014 received WHOGMP approval in the end Q1FY15. Recently the facility has been successfully inspected by Mexican authorities and the certification is awaited. The old Tarapur facility has received Brazil and Mexican certifications and is an overbooked facility. The company went from batch manufacturing to continuous manufacturing which has reduced the capex. Raw material costs have been lowered by 10%.

Pioglitazone is another niche diabetic product of ADL. We expect the revenue of anti diabetics to grow at a CAGR of 17% by FY17.

Metformin capacity expansion to propel Anti-diabetics

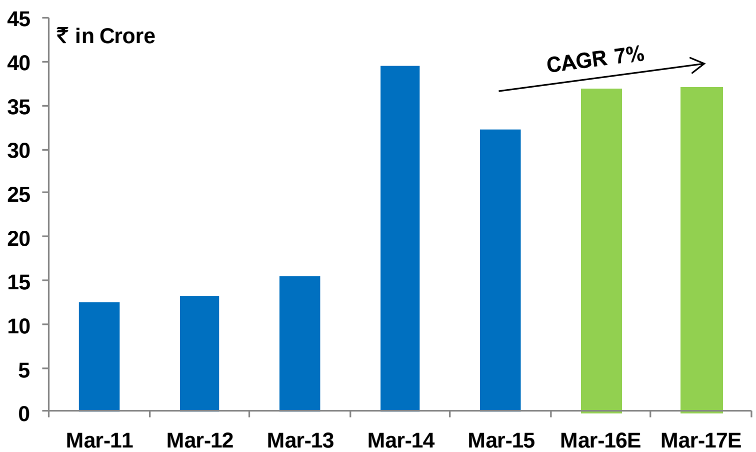


Source Aarti Drugs Ltd, Ventura Research

- **Other Segments**

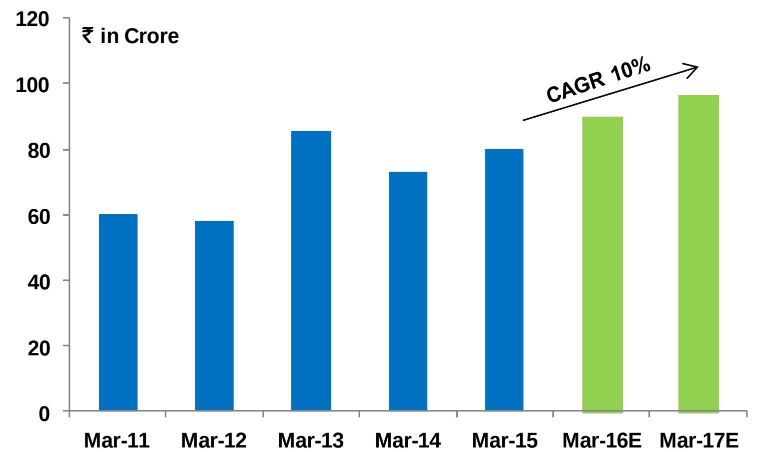
The ADL product portfolio does contain various other smaller products viz APIs for Cardioprotectants (3% of the total revenue), formulation (7% of revenues), specialty chemicals (3%), intermediates (2%) and others (4%).

Cardioprotectants constitute 3% of revenues



Source Aarti Drugs Ltd, Ventura Research

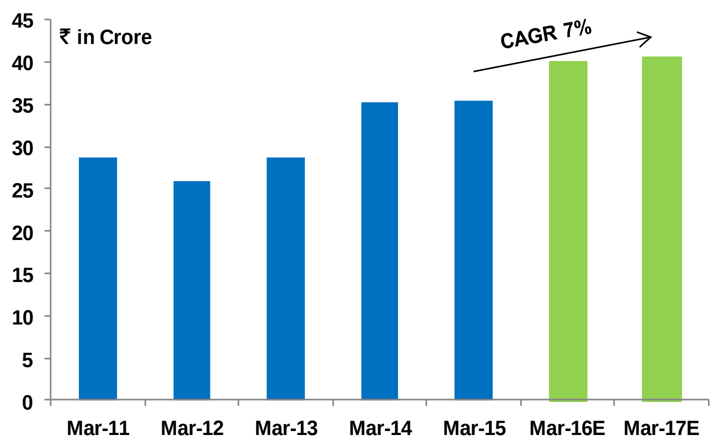
Formulations at a fledgling state of growth

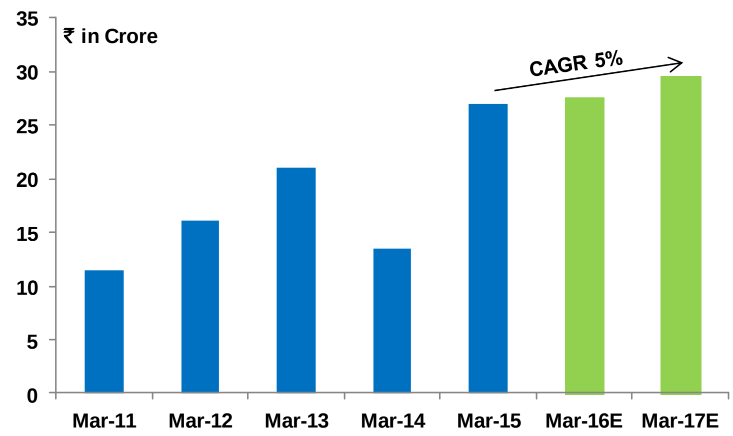


Source Aarti Drugs Ltd, Ventura Research

This helps the company in mitigating risk of dependency on a single product and also helps in reduction of its wastages as the "waste" is used as an input in the formulation of other products.

Specialty Chemicals and Intermediates to experience tepid growth



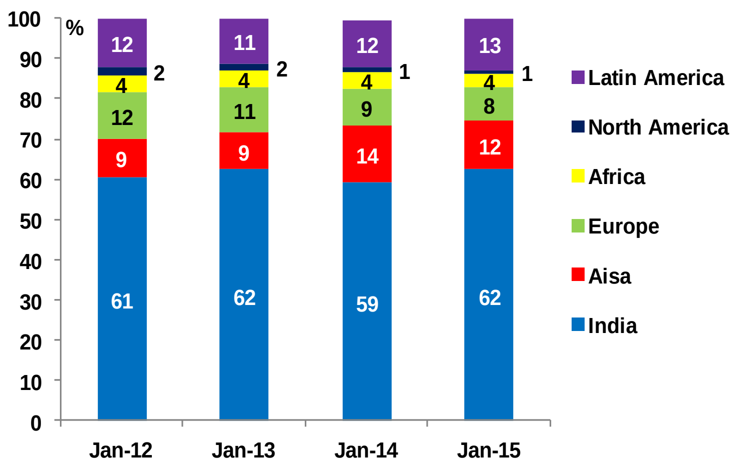


Source Aarti Drugs Ltd, Ventura Research

➢ Well diversified product and client portfolio augurs well to risk reduction

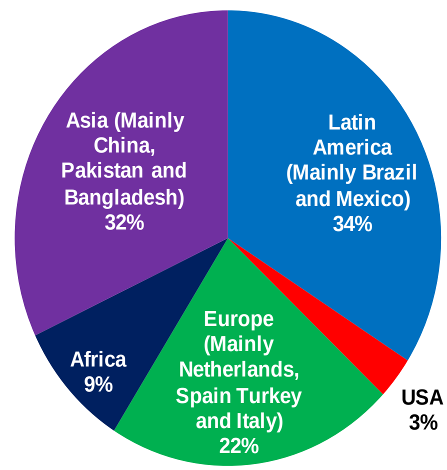
ADL is a leader in most of its top 10 products domestically. The top 10 local clients contribute around 28% of total sales. The topmost client contributes ~4.5% of total local sales. Export clientele is also well diversified with the topmost client contributing 3.8% of total exports. Top 10 export clients contribute 25% of total exports.

Regionwise sales over last 4 years



Source Aarti Drugs Ltd, Ventura Research

Export sales of ADL in FY15



Source Aarti Drugs Ltd, Ventura Research

➢ Acquisition of new facility to contribute in the upcoming years

ADL purchased one small formulation facility in Baddi in Sep'14 for a total consideration of Rs. ~10.5 crore (including outstanding liabilities). This facility is now a 100% subsidiary and enjoys tax incentive benefits till 2019. It has the capacity to manufacture 7.0 crore tablets / capsules annually and ADL plans to transfer its entire toll manufacturing activities for formulations to this unit over the next year.

ADL manufactures formulations for large domestic companies using third party manufacturers. Management expects improved margins in addition to scaling up the formulation business going forward. The company also plans additional capex of Rs. 8-10 crore in the next fiscal to scale up and modernize the facility. Q4FY15 sale from this subsidiary was ~Rs. 11.5 crores and Q1FY16 sales was ~Rs. 26.5 crores.

❖ Key Risks

➢ Volatile crude prices

Variation in crude oil prices will always be an area of concern. ADL has already installed greener technologies like briquette fired boilers, economizers etc. to save power and fuel costs, which reflects in the financial results of the Company. ADL was able to cope up with these pressures due to strong operational efficiency and increased market share of its products.

➢ Foreign exchange fluctuations

Extreme volatility of exchange rate of the Rupee against the US dollar can have a significant impact on ADL operations because approximately 40% of its total revenues consist of exports. However, natural hedges mitigate the risk to a large extent due to the imports. ADL has a strict policy of hedging all of its foreign currency loans to mitigate the risk of volatility of exchange rate.

❖ Financial Performance

In Q2FY16, the revenue of ADL showed a de growth of 4.7% YoY to Rs 272.8 crore on account of a fall in crude prices. However, it managed to maintain its EBIDTA levels at Rs 42.6 crore (Rs 42.4 crore in Q2FY15). PAT showed a decline on account of increased finance cost, rise in depreciation and higher tax expenses from Rs 9.4 crore in Q2FY15 to Rs 10.8 crore during the quarter. PAT margin reported in Q2FY16 is 5.8%.

For FY15, revenue increased by 12% YoY from Rs 971.8 crore in FY14 to Rs 1087.2 crore in FY15. The EBITDA grew by 15% YoY to Rs 169 crore. In FY15, EBIT margins increased to 13% as compared to 12% in FY14. PAT rose by 25.8% YoY to Rs 77.6 crore. The PAT margin showed a growth of 70 bps to 7.1%.

Consolidated Quarterly Financial Performance (Rs crores)				
Description	**Q2FY16**	**Q2FY15**	**FY201503**	**FY201403**
Net Sales	**272.8**	**286.3**	**1087.2**	**971.8**
Growth (%)	*-4.7*		*11.9*	
Total expenditure	230.3	243.8	918.3	825.4
EBITDA	**42.6**	**42.4**	**169.0**	**146.4**
Margin (%)	*15.6*	*15.3*	*15.5*	*15.1*
Depreciation	9.1	7.5	30.7	28.1
EBIT (Ex. OI)	33.5	35.0	138.3	118.2
Non-Operating Income			0.7	0.0
EBIT	**33.5**	**35.0**	**139.0**	**118.3**
Margin (%)	*12.3*	*12.2*	*12.8*	*12.2*
Finance Cost	10.8	9.4	38.9	33.5
Extraordinary Items			0.0	0.9
PBT	**22.7**	**25.5**	**100.1**	**85.7**
Margin (%)	*8.3*	*8.9*	*9.2*	*8.8*
Provision for Tax	7.0	6.8	22.5	24.0
Profit after Tax	**15.7**	**18.8**	**77.6**	**61.7**
Margin (%)	*5.8*	*6.6*	*7.1*	*6.4*

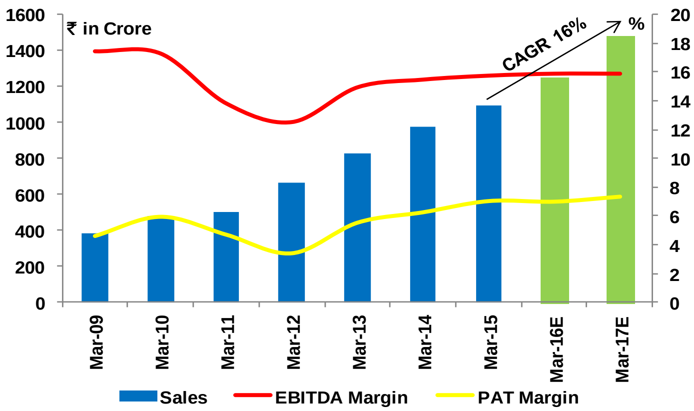
Source Aarti Drugs Ltd, Ventura Research

❖ Financial Outlook:

With expansion plans in place, the growth trajectory in revenues (2 Yr CAGR of 16% to Rs 1,481 by FY17) should continue. ADL has diversity in its product profile as well as in its cliente portfolio which reduces the dependency of the company on a single product or a single client. In addition effective working capital management, new FDA approvals and opening of new export markets augur well for the future growth for Aarti Drugs.

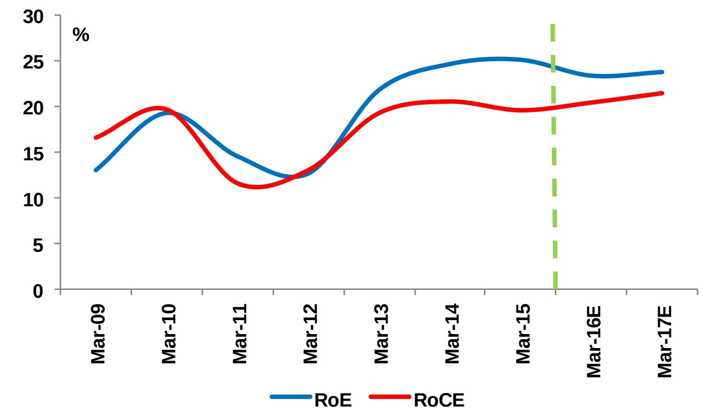
We expect Aarti Drugs's revenues to grow at a 2 year CAGR of 16% to Rs 1481 crores by FY17E while earnings are expected to grow at a CAGR of 19% to Rs 109 crore over the same period. The EBITDA margins (ex OI) and PAT margins are expected to be at 15.9% and 7.4% respectively.

Consolidated Revenue, Gross & PAT margins



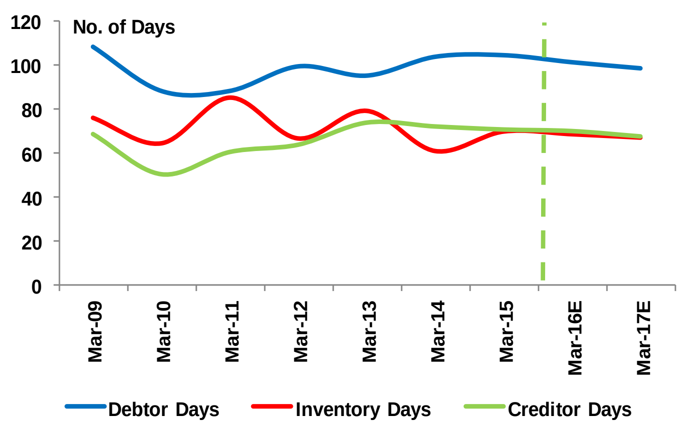
Source: Aarti Drugs Ltd, Ventura Research

Strong RoCE & RoE margins



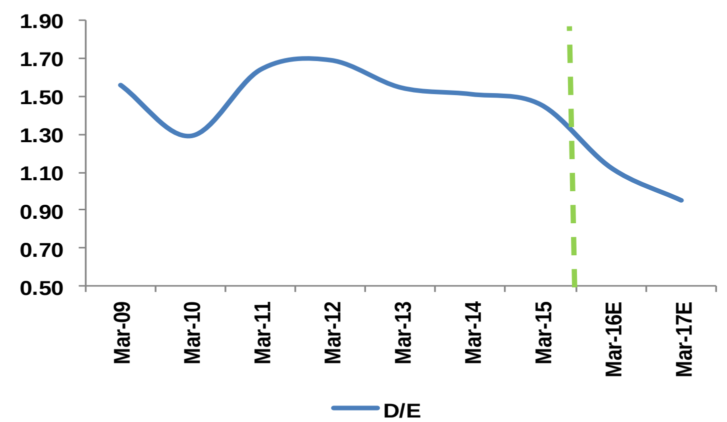
Source: Aarti Drugs Ltd, Ventura Research

Net working capital days to remain flat



Source: Aarti Drugs Ltd, Ventura Research

D/E ratio expected to be around 0.95



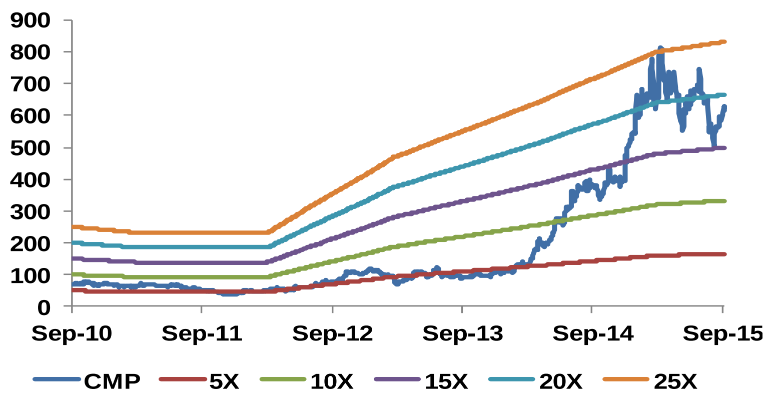
Source: Aarti Drugs Ltd, Ventura Research

➢ Valuation

We initiate coverage on Aarti Drugs Ltd as a BUY with a price objective of Rs 675 representing a potential upside of 28% from the CMP of Rs 527 over a period of 16 months. We have used the PE multiple approach to value Aarti Drugs and assigned a multiple of 15x on FY17 EPS of Rs 45 to arrive at the target price. We are upbeat on the company due to the following aspects :

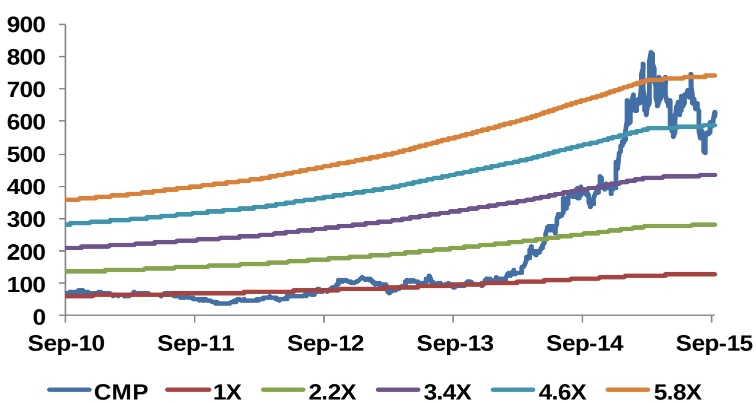
- Capacity expansion to drive volume growth
- Diversified product portfolio significantly reduces risk
- Opening of new export markets and receipt of FDA approvals for new drugs will lead to growth in revenues
- Margins to expand due to efficient working capital management and sufficient cash generation from operations.

ADL P/E Trend



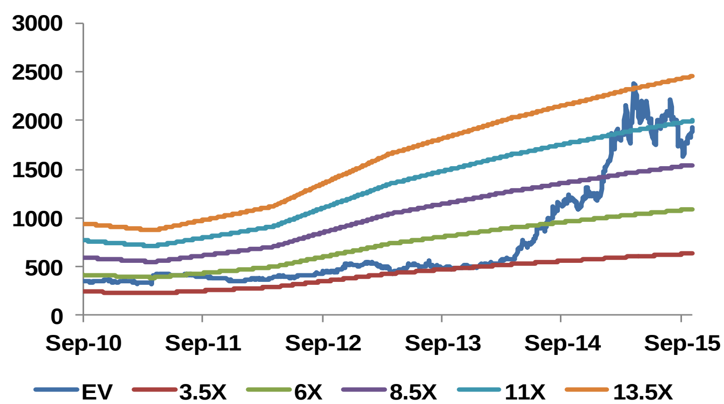
Source : Aarti Drugs Ltd, Ventura Research

ADL P/BV Trend



Source : Aarti Drugs Ltd, Ventura Research

ADL EV/EBITDA Trend



Source : Aarti Drugs Ltd, Ventura Research

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Kyon ki bhaiya, sabse bada rupaiya.

Financials and Projections

Y/E March, Fig in ₹ Cr	FY14	FY15	FY16E	FY17E
Profit & Loss Statement				
Net Sales	**971.8**	**1096.9**	**1251.2**	**1481.0**
% Chg.		*12.9*	*14.1*	*18.4*
Total Expenditure	821.7	924.5	1052.9	1246.3
% Chg.		*12.5*	*13.9*	*18.4*
EBDITA	150.1	172.4	198.3	234.7
EBDITA Margin %	*15.4*	*15.7*	*15.9*	*15.9*
Other Income	0.0	0.6	0.4	0.4
PBDIT	**150.1**	**173.0**	**198.7**	**235.1**
Depreciation	28.1	31.0	35.9	43.1
Interest	37.2	42.3	46.0	46.9
Exceptional items	0.0	0.0	0.0	0.0
PBT	**84.8**	**99.7**	**116.8**	**145.2**
Tax Provisions	24.0	22.5	29.2	36.3
Reported PAT	**60.8**	**77.3**	**87.6**	**108.9**
Minority Interest	0.0	0.0	0.0	0.0
PAT	**60.8**	**77.3**	**87.6**	**108.9**
PAT Margin (%)	*6.3*	*7.0*	*7.0*	*7.4*
Other opr Exp / Sales (%)	*0.0*	*0.1*	*0.0*	*0.0*
Tax Rate (%)	*28.3*	*22.5*	*25.0*	*25.0*
Balance Sheet				
Share Capital	12.1	24.2	24.2	24.2
Reserves & Surplus	238.8	283.9	351.0	434.4
Minority Interest	0.0	0.0	0.0	0.0
Long Term Borrowings	76.6	163.5	188.5	203.5
Deferred Tax Liability	31.0	35.0	32.3	38.8
Other Non Current Liabilities	11.5	12.5	12.5	12.3
Total Liabilities	**370.1**	**519.2**	**608.5**	**713.2**
Gross Block	581.1	685.2	781.1	884.2
Less: Acc. Depreciation	208.6	236.7	272.6	315.7
Net Block	372.5	448.5	508.5	568.5
Capital Work in Progress	8.3	16.1	3.3	6.0
Other Non Current Assets	4.6	4.6	4.6	4.6
Net Current Assets	-22.4	42.8	84.9	126.9
Long term Loans & Advances	7.0	7.2	7.2	7.2
Total Assets	**370.1**	**519.2**	**608.5**	**713.2**

Y/E March, Fig in ₹ Cr	FY14	FY15	FY16E	FY17E
Per Share Data (Rs)				
Adj. EPS	25.1	31.9	36.2	45.0
Cash EPS	37.1	44.7	51.0	62.7
DPS	6.5	8.0	7.2	9.0
Book Value	103.6	127.2	154.9	189.4
Capital, Liquidity, Returns Ratio				
Debt / Equity (x)	1.5	1.5	1.1	1.0
Current Ratio (x)	1.0	1.1	1.2	1.2
ROE (%)	24.6	25.1	23.3	23.7
ROCE (%)	20.6	19.6	20.5	21.5
Dividend Yield (%)	1.1	1.4	1.2	1.5
Valuation Ratio (x)				
P/E	11.6	18.2	16.1	12.9
P/BV	5.6	4.6	3.7	3.1
EV/Sales	1.8	1.7	1.5	1.2
EV/EBIDTA	11.8	10.7	9.1	7.8
Efficiency Ratio (x)				
Inventory (days)	60.9	69.7	68.5	67.0
Debtors (days)	103.9	104.6	101.4	98.6
Creditors (days)	72.2	70.8	70.1	67.6
Cash Flow Statement				
Profit Before Tax	**84.8**	**99.7**	**116.8**	**145.2**
Depreciation	28.1	30.9	35.9	43.1
Working Capital Changes	-24.1	-49.6	-19.2	-45.8
Others	6.6	23.6	16.8	10.5
Operating Cash Flow	**95.4**	**104.6**	**150.3**	**152.9**
Capital Expenditure	-106.5	-107.0	-95.9	-103.1
Other Investment Activities	1.8	0.0	0.0	0.0
Cash Flow from Investing	**-104.7**	**-107.0**	**-95.9**	**-103.1**
Changes in Share Capital	0.0	0.0	0.0	0.0
Changes in Borrowings	58.2	63.1	5.0	15.0
Dividend and Interest	-47.4	-61.6	-56.4	-68.6
Cash Flow from Financing	**10.8**	**1.5**	**-51.4**	**-53.6**
Net Change in Cash	**1.5**	**-1.0**	**3.0**	**-3.7**
Opening Cash Balance	**2.9**	**4.4**	**3.5**	**6.5**
Closing Cash Balance	**4.4**	**3.5**	**6.5**	**3.0**

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Ventura Securities Limited

Corporate Office: C-112/116, Bldg No. 1, Kailash Industrial Complex, Park Site, Vikhroli (W), Mumbai – 400079