13 October 2015

Aarti Drugs

Rating: **Buy**
Target Price: ₹815
Share Price: ₹616

High growth-momentum visibility; initiating, with a Buy

We initiate coverage on Aarti Drugs, with a Buy rating and a target price of ₹815, based on 14x FY18e earnings. We believe that the company is poised to accelerate its growth momentum over the next two years, driven by product launches, expanded capacity and market-share gains in existing products. We expect a strong, 22.2%, PAT CAGR over FY15-18, powered by steady revenue growth (high-teens) and an expansion of 85bps in the EBITDA margin.

API business, the key growth driver. APIs bring 85% to the company's revenue and we expect this business to register a 17.3% CAGR over FY15-18 through market-share gains in existing products (metformin, metronidazole, fluoroquinolones, etc), the recently-added capacity and the launch of products. Segment-wise, anti-diabetics, antibiotics and anti-protozoals would drive most of the growth; together they contribute ~74% of API sales.

Formulations to pick up. The company now generates ~7% of revenue from formulations, that too, primarily from contract manufacturing. In order to boost this business, it recently acquired Pinnacle Life Sciences (with a formulations plant). We expect this business to register a 35% revenue CAGR over FY15-18, thereby bringing ~11% to revenue by FY18.

Better financials. We expect a strong 18.2% CAGR in revenue over FY15-18, with an expansion of 85bps in the EBITDA margin, aided by a better product-mix. This would lead to strong, 22.2%, profit CAGR, which would help strengthen the balance sheet by reducing leverage to 1x by FY18 (from 1.3x net debt-equity now) and by the better interest-coverage ratio, to 4.5x by FY18 (from 3.5x now).

Valuation. The stock trades at 13.6x FY17e and 10.6x FY18e earnings. We value it at ₹815, based on 14x FY18e earnings, in line with peer API companies. **Risks:** Delay in the ramp-up of the recently-added capacity and more-than-expected competition in generic APIs.

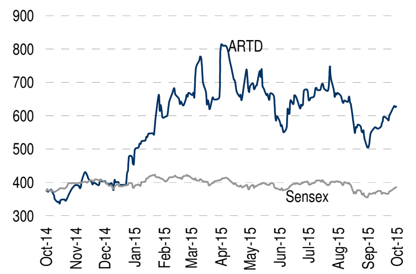
Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	9,717	10,969	12,571	15,112	18,113
Net profit (₹ m)	611	773	835	1,096	1,410
EPS (₹)	25.2	31.9	34.5	45.2	58.2
Growth (%)	34.1	26.5	8.1	31.2	28.7
PE (x)	24.4	19.3	17.9	13.6	10.6
PBV (x)	3.0	4.8	4.1	3.4	2.8
RoE (%)	26.6	27.6	24.8	27.1	28.6
RoCE (%)	15.1	15.0	14.8	16.1	17.2
Dividend yield (%)	2.2	1.4	1.5	1.9	2.5
Net debt/equity (x)	1.3	1.3	1.2	1.1	1.0

Source: Company, Anand Rathi Research

Key data	ARTD IN IN / ADRG.BO
52-week high / low	₹874 / ₹334
Sensex / Nifty	27080 / 8190
3-m average volume	$0.6m
Market cap	₹14.9bn / $228m
Shares outstanding	24.2m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	60.0	60.1	60.6
- of which, Pledged	-	-	-
Free Float	40.0	39.9	39.4
- Foreign Institutions	0.2	0.3	0.3
- Domestic Institutions	2.1	1.8	0.1
- Public	37.8	37.8	39.1

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	9,717	10,969	12,571	15,112	18,113
Revenue growth (%)	17.7	12.9	14.6	20.2	19.9
- Oper. expenses	8,254	9,279	10,623	12,694	15,170
EBIDTA	**1,464**	**1,690**	**1,949**	**2,418**	**2,943**
EBITDA margins (%)	15.1	15.4	15.5	16.0	16.3
- Interest	335	389	443	506	551
- Depreciation	281	310	368	418	468
+ Other income	0	6	6	6	6
- Tax	240	225	309	405	521
Effective tax rate (%)	28.0	22.5	27.0	27.0	27.0
+ Associates/(minorities)	-	-	-	-	-
Adjusted PAT	611	773	835	1,096	1,410
+ Extraordinary items	7	-	-	-	-
Reported PAT	617	773	835	1,096	1,410
Adj. FDEPS (₹/sh)	25.2	31.9	34.5	45.2	58.2
Adj. FDEPS growth (%)	34.1	26.5	8.1	31.2	28.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	121	242	242	242	242
Reserves & surplus	2,388	2,839	3,424	4,190	5,177
Net worth	2,509	3,082	3,666	4,432	5,419
Total debt	3,422	4,159	4,709	5,409	5,609
Minority interest	-	-	-	-	-
Def. tax liab. (net)	310	350	350	350	350
Capital employed	**6,242**	**7,591**	**8,725**	**10,192**	**11,378**
Net fixed assets	3,808	4,645	5,278	5,860	6,392
Intangible assets	-	-	-	-	-
Investments	46	46	46	46	46
- of which, Liquid	-	-	-	-	-
Working capital	2,343	2,863	3,259	3,869	4,598
Cash	44	36	142	416	341
Capital deployed	**6,242**	**7,591**	**8,725**	**10,192**	**11,378**
Working capital (days)	88	95	95	93	93
Book value (₹/sh)	207.2	127.2	151.4	183.0	223.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Adjusted PAT	611	773	835	1,096	1,410
+ Non-cash items	316	350	368	418	468
Cash profit	927	1,123	1,203	1,513	1,878
- Incr./(decr.) in WC	153	520	396	610	729
Operating cash-flow	774	602	807	903	1,148
- Capex	978	1,118	1,000	1,000	1,000
Free-cash-flow	(205)	(516)	(193)	(97)	148
- Dividend	184	233	251	329	423
+ Equity raised	-	121	-	-	-
+ Debt raised	466	737	550	700	200
- Investments	(5)	0	-	-	-
- Misc. items	67	117	-	-	-
Net cash-flow	15	(8)	106	274	(75)
+ Op. cash & bank bal.	29	44	36	142	416
Cl. Cash & bank bal.	44	36	142	416	341

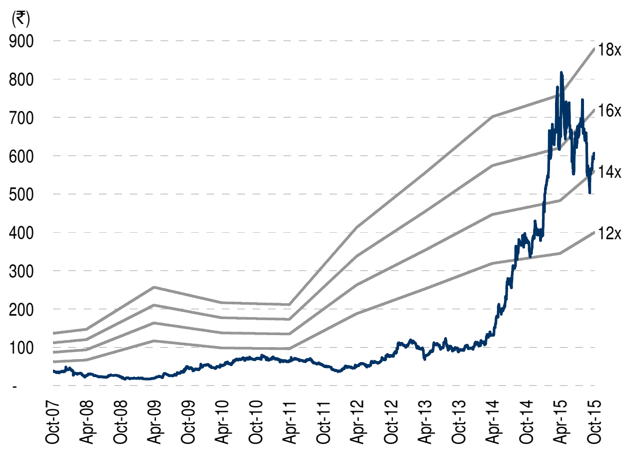
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹616

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	24.4	19.3	17.9	13.6	10.6
Cash P/E (x)	16.7	13.8	12.4	9.9	7.9
EV/EBITDA (x)	12.5	11.3	10.0	8.2	6.9
EV/sales (x)	1.9	1.7	1.5	1.3	1.1
P/B (x)	3.0	4.8	4.1	3.4	2.8
RoE (%)	26.6	27.6	24.8	27.1	28.6
RoCE (%)	15.1	15.0	14.8	16.1	17.2
Dividend yield (%)	2.2	1.4	1.5	1.9	2.5
Dividend payout (%)	0.7	0.8	0.8	0.7	0.6
Net debt/equity (x)	1.3	1.3	1.2	1.1	1.0
Interest coverage (x)	3.5	3.5	3.6	4.0	4.5
Debtor (days)	104	105	105	105	105
Inventory (days)	48	55	55	54	54
Payables (days)	56	55	55	55	54
Fixed Asset T/O (x)	2.8	2.6	2.5	2.7	3.0

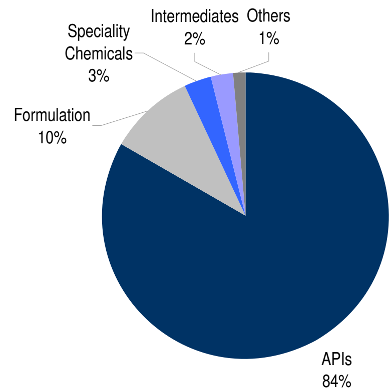
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – FY16e revenue break-up



Source: Anand Rathi Research

API business, the prime growth driver

- **Aarti Drugs is a high-quality API supplier to formulations companies, domestically and internationally.**
- **APIs constitute 85% of its revenue and we expect this business to record a 17.3% CAGR over FY15-18.**
- **Growth would be driven by market-share gains in existing products (metformin, metronidazole, fluoroquinolones, etc), the recently-added capacity and the launch of products.**

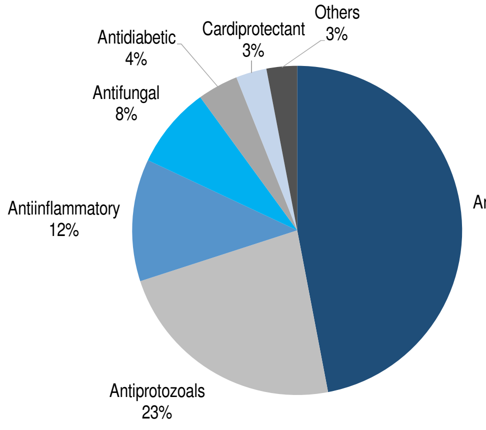
Business model

Because of its high-quality API supplies to formulations companies in domestic and overseas markets, Aarti leads the market in most of its top-10 products, enabling economies of scale. Its domestic clients comprise all major formulations companies: Cipla, Dr Reddy's, Cadila, Ranbaxy, Glaxo, Alembic, etc. It exports to more than 97 countries (exports constitute 35% of its revenue).

Well-established API player

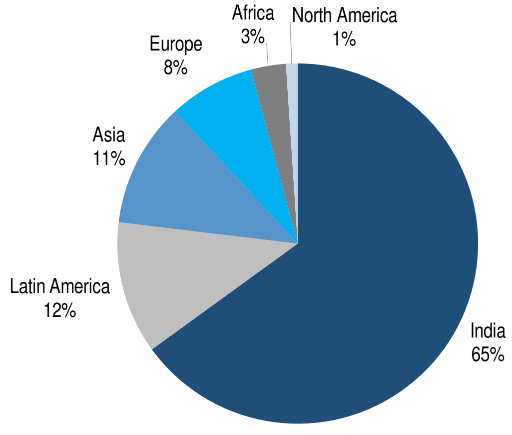
A high degree of processing efficiency, a high standard of quality and large capacity have given it a good brand name in antibiotics, anti-diabetics, antifungals, anti-diarrhoeals, anti-inflammatories and anti-hypertensive therapeutic segments. The company has incurred capital expenditure to construct facilities for three antibiotic products (fluoroquinolones) and intermediates, and doubled the capacity of one of its major anti-protozoal products. Both these projects would be commercially operational by Q3 FY16.

Fig 7 – Segment-wise revenue mix in APIs (FY15)



Source: Company

Fig 8 – Geographical revenue mix (FY15)



Source: Company

Properly diversified product profile

Of Aarti's API sales, 74% comes from anti-diabetics, antibiotics and antiprotozoals; the balance from anti-inflammatories, anti-fungals, cardio, etc. Of its products, the most revenue comes from ciprofloxacin (18%). The top-10 products together account for 60% of revenue. In all these products, the company leads in production, domestically and globally. The huge scale of operations, along with high market shares in each of these products, give the company an impressive EBITDA margin of around 15% despite being a mere API operator.

Fig 9 – Product Profile

Therapeutic Segment	APIs
Anti-inflammatories	Aceclofenac, Diclofenac Sodium, Diclofenac Potassium, Diclofenac Diethylamine, Diclofenac Resinate, Diclofenac Epolamine, Nimesulide, Celecoxib
Cardio-protectants	Clopidogrel Bisulphate, Ticlopidine HCL, Telmisartan
Anti-diarrhoeals / anti-protozoals	Metronidazole, Metronidazole Benzoate, Ornidazole, Secnidazole, Tinidazole, Diloxanide Furoate
Anti-fungals	Ketoconazole, Tolnaftate
Anti-arthritis/ osteoporosis	Raloxifene HCL
Antibiotics	Ciprofloxacin HCL, Enrofloxacin base, Ofloxacin, Levofloxacin
Anti-diabetics	Metformin HCL, Pioglitazone HCL
Alzheimer's treatment	Rivastigmine Hydrogen Tartrate
Anti-BPH	Tamsulosin HCL
Sedatives	Zolpidem Tartrate
Vitamins	Niacin

Source: Company

Fig 10 – Products being developed

Therapeutic Segment	Products
Alcoholism treatment	Acamprosate
Anti-coagulants	Dabigatran
Anti-hyperphosphatemia	Sevelamer
Anti-cholesterols	Colsevelam
Cardiovasculars	Drondarone
Cardiovasculars	Olmesartan
Cardio-protectants	Valasartan
Anti-diabetics	Sitagliptin

Source: Company

Fig 11 – Products in the pipeline for future development

Therapeutic segment	Products
Anti-inflammatories	Mesalamine / Mesalazine
Anti-inflammatories	Loxoprofen Sodium
Cardiovasculars	Dronedarone
Cardiovasculars	Olmesartan
Anti-coagulants	Dabigatran
Anti-depressants	Duloxetine
Anti-diabetics	Sitagliptin
Anti-cholesterols	Colesevelam
Anti-hyperphosphatemia	Sevelamer

Source: Company

Diversified clientele

Aarti's top-10 local clients contribute just 28% of its domestic revenues and the top-10 export clients contribute only 24.8% of export sales. Therefore, none of the customers contribute a significant portion of revenue, indicating a diversified customer base. There is no concentration risk.

Fig 12 – Key local clients

Client	% Contribution to domestic revenue
J.B. Chemicals & Pharmaceuticals	4.48
Cipla	4.43
Alkem Laboratories	3.66
Abbot Healthcare	3.33
Zydus Healthcare	2.43
Hetero Labs	2.28
Zoetis India (Pfizer)	2.12
Micro Labs	1.89
Acme Formulation	1.60
Medley Pharmaceuticals	1.57

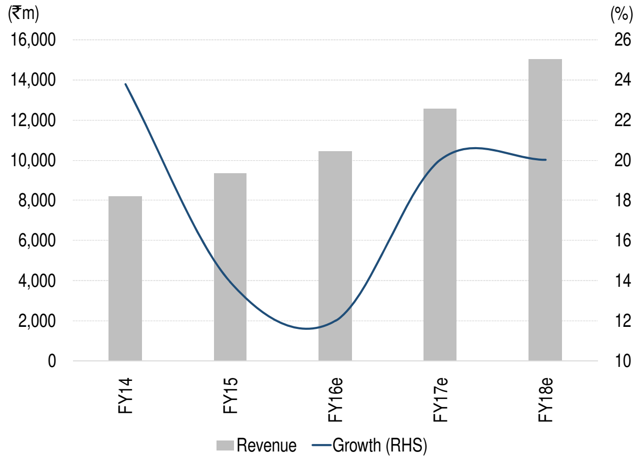
Source: Company, Anand Rathi Research

The company has a diversified clientele: Cipla, J.B. Chemicals and Abbot are some of its major clients, contributing around 4% each to revenues. Others are MNCs: Abbott, Sanofi-Aventis, Merck, Teva, Searle, Pfizer, Bayer and Clariant.

API to see a 17.3% revenue CAGR over FY15-18

We expect the API business to register a 17.3% revenue CAGR over FY15-18, driven by market-share gains in existing products (metformin, metronidazole, fluoroquinolones, etc), the recently-added capacity and the launch of products. Segment-wise, anti-diabetics, antibiotics and antiprotozoals, which together bring in ~74% of API sales, would drive most of the growth.

Fig 13 – API growth momentum



Source: Company, Anand Rathi Research

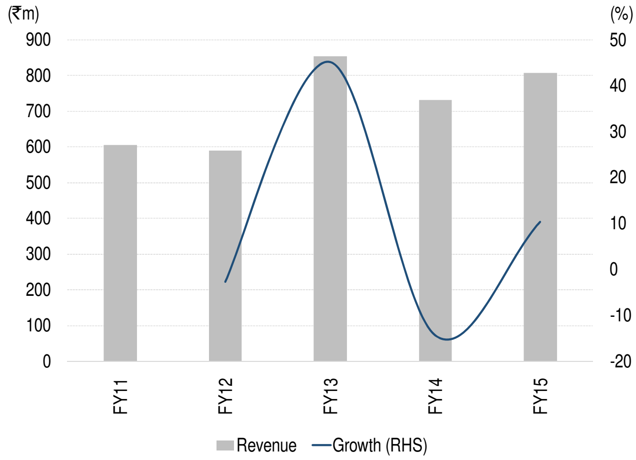
Formulations to pick up

- **Formulations currently contribute 7% of revenue, mainly from contract manufacturing.**
- **From formulations, we estimate a 35% revenue CAGR over FY15-18 to ₹2bn. Formulations would then (by FY18) make up ~11% of revenue. The company's recently-acquired Pinnacle Life Sciences (together with a formulations plant) would boost this business.**

Business currently at a nascent stage

The formulations business currently contributes very little revenue (~7%) to Aarti (consolidated), and such revenue has been flattish in the past three years due to lack of focus and capacity constraints. It has come down from 10% three years ago. Aarti has largely been conducting contract manufacturing of formulations for generics customers. In the absence of adequate capacity, this was difficult to scale up, and margins were lower because it had only a contract-manufacturing business.

Fig 14 – Flattish revenue in the past few years from the formulations business

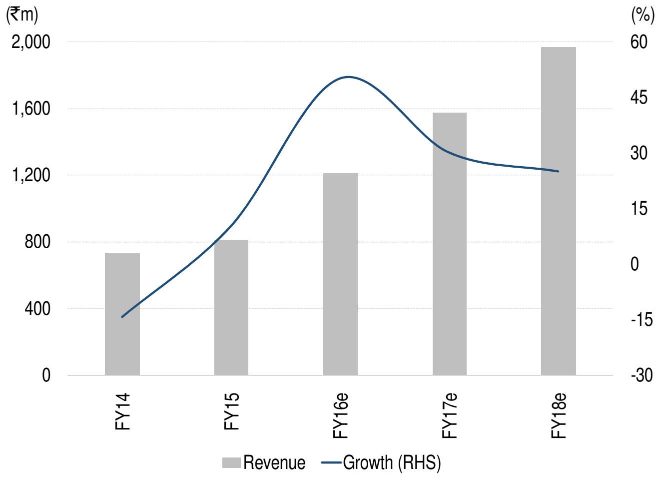


Source: Company

Acquisition to boost the formulations business

Aarti recently acquired a small company (Pinnacle Life Sciences) for an insignificant amount along with a manufacturing unit. Prior to the acquisition, Aarti was largely engaged in contract manufacturing of formulations, which command very low margins. However, with this acquisition, it would be able to make formulations in-house in large quantities. This would boost revenue from the formulations business and offer better margins. We expect revenue from the formulations business to pick up from FY16 and to register a 35% CAGR over FY15-18 to ₹2bn.

Fig 15 – Formulations-business revenue to rise



Source: Company, Anand Rathi Research

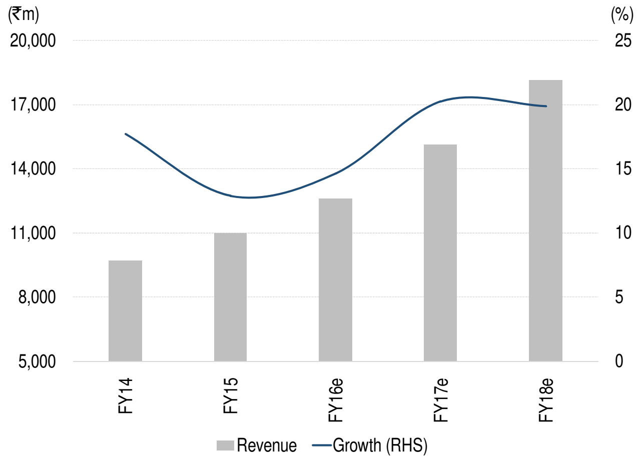
Financials

- **We expect Aarti Drugs to register an 18.2% revenue CAGR over FY15-18, fuelled by healthy growth in its API business and a scaling up of its formulations business. Within API, anti-diabetics, antibiotics and anti-protozoals would drive most of the growth.**
- **We estimate its adjusted PAT to record a strong 22.2% CAGR, driven by strong revenue growth and better margins over FY15-18.**
- **Its balance sheet would also be strengthened by reducing leverage to 1x by FY18, from 1.3x debt-equity now, in our view.**

18.2% revenue CAGR over FY15-18

Strong growth across segments (driven by the recently-added capacity and the launch of new products) lead us to estimate an 18.2% CAGR in consolidated revenue over FY15-18, to ₹18.1bn. This growth would be fuelled by a 17% CAGR in API revenue, 35% in formulations, 15% in intermediates and 10% in specialty chemicals.

Fig 16 – Revenue growth trend



Source: Company, Anand Rathi Research

Fig 17 – Revenue break-up

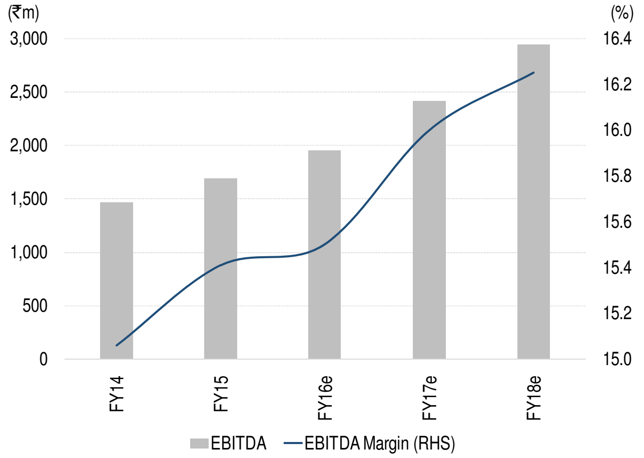
(₹m)	FY14	FY15	FY16e	FY17e	FY18e
APIs	8,185	9,325	10,444	12,533	15,040
% of sales	84.4	85.2	83.3	83.1	83.2
yoy %	23.8	13.9	12.0	20.0	20.0
Formulation	731	807	1,211	1,574	1,967
% of sales	7.5	7.4	9.7	10.4	10.9
yoy %	(14.3)	10.3	50.0	30.0	25.0
Specialty chemicals	353	358	394	433	476
% of sales	3.6	3.3	3.1	2.9	2.6
yoy %	23.4	1.4	10.0	10.0	10.0
Intermediates	135	272	313	360	414
% of sales	1.4	2.5	2.5	2.4	2.3
yoy %	(35.6)	102.1	15.0	15.0	15.0
Others	295	181	181	181	181
% of sales	3.0	1.6	1.4	1.2	1.0
yoy %	3.3	(38.8)	-	-	-
Total	**9,699**	**10,943**	**12,542**	**15,081**	**18,078**

Source: Company, Anand Rathi Research

EBITDA margin to be steady

We expect the EBITDA margin to be steady, in the range of 15.5% to 16.5% over FY15-18, with an 85-bp improvement over the same period; in absolute terms we expect EBITDA to register a 20.3% CAGR over FY15-18, led by the better product mix and greater capacity utilisation.

Fig 18 – EBITDA and EBITDA margin trend

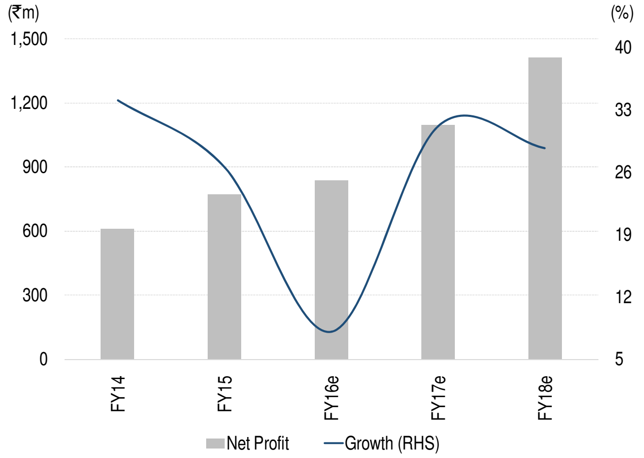


Source: Company, Anand Rathi Research

22.2% adjusted-net-profit CAGR

We expect a 22.2% CAGR in adjusted net profit over FY15-18, to ₹1.4bn, led by strong revenue growth and better EBITDA margins. The net profit margin is likely to improve 75bps over FY15-18, to 7.8%, fuelled by strong profit growth.

Fig 19 – Strong PAT growth

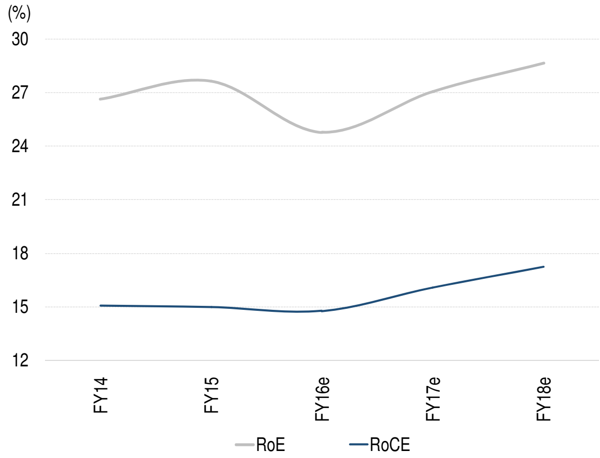


Source: Company, Anand Rathi Research

Improving return ratios

Considering the strong net-profit growth and stable margins in the next three years, we estimate the RoE and RoCE in FY18 to improve to 28.6% and 17.2%, respectively, from the current 27.6% and 15%.

Fig 20 – Improving return ratios

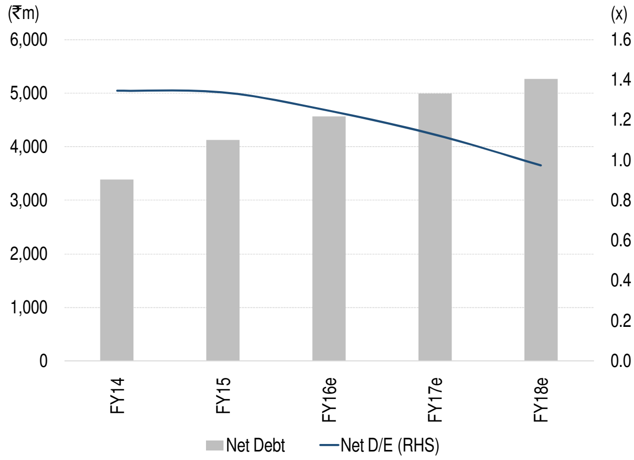


Source: Company, Anand Rathi Research

Strengthening balance sheet

We expect Aarti's balance sheet to be strengthened by shrunken leverage, to 1x by FY18, from the present 1.3x debt-equity, driven by strong bottom-line growth. We expect the interest-coverage ratio to improve to 4.5x in FY18, from 3.5x now.

Fig 21 – Leverage position



Source: Company, Anand Rathi Research

Fig 22 – Income statement (₹ m)

Y/E March	FY14	FY15	FY16e	FY17e	FY18e
Revenues	**9,717**	**10,969**	**12,571**	**15,112**	**18,113**
Growth in revenues (%)	*17.7*	*12.9*	*14.6*	*20.2*	*19.9*
Raw materials	6,625	7,499	8,517	10,163	12,090
% of sales	*68.2*	*68.4*	*67.8*	*67.3*	*66.8*
Personnel expenses	324	379	471	604	770
% of sales	*3.3*	*3.5*	*3.8*	*4.0*	*4.3*
Selling and other expenses	1,305	1,401	1,634	1,927	2,309
% of sales	*13.4*	*12.8*	*13.0*	*12.8*	*12.8*
EBITDA	**1,464**	**1,690**	**1,949**	**2,418**	**2,943**
EBITDA margin (%)	*15.1*	*15.4*	*15.5*	*16.0*	*16.3*
Depreciation	281	310	368	418	468
PBIT	**1,182**	**1,380**	**1,581**	**2,000**	**2,476**
Interest expenses	335	389	443	506	551
PBIT from operations	**847**	**991**	**1,138**	**1,494**	**1,925**
Other non-operating income	0	6	6	6	6
PBT before extraordinary items	848	997	1,144	1,501	1,931
Extraordinary income / (expenses)	9	-	-	-	-
PBT	**857**	**997**	**1,144**	**1,501**	**1,931**
Provision for tax	240	225	309	405	521
Effective tax rate (%)	*28.0*	*22.5*	*27.0*	*27.0*	*27.0*
PAT	**617**	**773**	**835**	**1,096**	**1,410**
Minority Interest	-	-	-	-	-
PAT after minority interest	**617**	**773**	**835**	**1,096**	**1,410**
Adjusted PAT	**611**	**773**	**835**	**1,096**	**1,410**
Growth in PAT (%)	*34.1*	*26.5*	*8.1*	*31.2*	*28.7*
PAT margin (%)	*6.3*	*7.0*	*6.6*	*7.3*	*7.8*

Source: Company, Anand Rathi Research

Fig 23 – Balance sheet (₹ m)

Y/E March	FY14	FY15	FY16e	FY17e	FY18e
Equity share capital	121	242	242	242	242
Reserves	2,388	2,839	3,424	4,190	5,177
Shareholders' fund	2,509	3,082	3,666	4,432	5,419
Minority interest	-	-	-	-	-
Debt	3,422	4,159	4,709	5,409	5,609
Deferred tax liability	310	350	350	350	350
Capital employed	**6,242**	**7,591**	**8,725**	**10,192**	**11,378**
Gross block	5,811	6,852	7,852	8,852	9,852
Accumulated depreciation	2,086	2,367	2,735	3,153	3,620
Net block	3,725	4,485	5,117	5,699	6,232
Capital WIP	83	161	161	161	161
Total fixed assets	3,808	4,645	5,278	5,860	6,392
Investments	46	46	46	46	46
Inventories	1,267	1,642	1,880	2,246	2,684
Debtors	2,765	3,143	3,602	4,330	5,190
Cash and bank balances	44	36	142	416	341
Loans and advances	292	249	285	343	411
Other current assets	274	258	258	258	258
Total current assets	4,643	5,328	6,167	7,594	8,885
Current liabilities and provisions	2,256	2,429	2,766	3,309	3,946
Net current assets	2,387	2,899	3,401	4,285	4,939
Misc. expenditure	-	-	-	-	-
Total assets	**6,242**	**7,591**	**8,725**	**10,192**	**11,378**

Source: Company, Anand Rathi Research

Fig 24 – Cash-flow statement (₹ m)

Y/E March	FY14	FY15	FY16e	FY17e	FY18e
Cash flow from operating activities					
Profit before tax	857	997	1,144	1,501	1,931
Depreciation	281	310	368	418	468
Interest expenses	335	389	443	506	551
Operating profit before working capital change	**1,473**	**1,697**	**1,955**	**2,424**	**2,950**
Working capital adjustment	(153)	(520)	(396)	(610)	(729)
Gross cash generated from operations	**1,320**	**1,176**	**1,559**	**1,814**	**2,221**
Direct taxes paid	(205)	(185)	(309)	(405)	(521)
Cash generated from operations	**1,115**	**992**	**1,250**	**1,409**	**1,699**
Cash flow from investing activities					
Capex	(978)	(1,118)	(1,000)	(1,000)	(1,000)
Investment	5	(0)	-	-	-
Cash generated from investment activities	**(973)**	**(1,118)**	**(1,000)**	**(1,000)**	**(1,000)**
Cash flow from financing activities					
Proceeds from share capital and premium	-	121	-	-	-
Borrowings/ (repayments)	466	737	550	700	200
Interest paid	(335)	(389)	(443)	(506)	(551)
Dividend paid	(184)	(233)	(251)	(329)	(423)
Cash generated from financing activities	**(54)**	**236**	**(144)**	**(135)**	**(774)**
Other / misc	(73)	(117)	-	-	-
Net cash increase/ (decrease)	**15**	**(8)**	**106**	**274**	**(75)**

Source: Company, Anand Rathi research

Fig 24 – Ratio analysis @ ₹616

Y/E March	FY14	FY15	FY16e	FY17e	FY18e
Margin ratios (%)					
EBITDA margin	15.1	15.4	15.5	16.0	16.3
PBIT margin	12.2	12.6	12.6	13.2	13.7
PBT margin	8.8	9.1	9.1	9.9	10.7
PAT margin	6.3	7.0	6.6	7.3	7.8
Growth ratios (%)					
Revenues	17.7	12.9	14.6	20.2	19.9
EBITDA	21.6	15.5	15.3	24.1	21.7
Net profit	34.1	26.5	8.1	31.2	28.7
Return ratios (%)					
RoCE	15.1	15.0	14.8	16.1	17.2
RoIC	13.7	14.2	13.5	15.0	16.4
RoE	26.6	27.6	24.8	27.1	28.6
Turnover ratios (x)					
Asset turnover ratio (x)	2.8	2.6	2.5	2.7	3.0
Working capital cycle (days)	95	104	104	104	105
Average collection period (days)	104	105	105	105	105
Average payment period (days)	56	55	55	55	54
Inventory holding (days)	48	55	55	54	54
Per share (₹)					
EPS	25.2	31.9	34.5	45.2	58.2
CEPS	73.6	44.7	49.7	62.5	77.5
Book value	207.2	127.2	151.4	183.0	223.8
Solvency ratios (x)					
Debt/ equity	1.3	1.3	1.2	1.1	1.0
Interest coverage	3.5	3.5	3.6	4.0	4.5
Net Debt/ EBITDA	2.3	2.4	2.3	2.1	1.8
Valuation parameters (x)					
P/E	24.4	19.3	17.9	13.6	10.6
P/BV	3.0	4.8	4.1	3.4	2.8
EV/ EBITDA	12.5	11.3	10.0	8.2	6.9
EV/ Sales	1.9	1.7	1.5	1.3	1.1
M-Cap/ Sales	1.5	1.4	1.2	1.0	0.8

Source: Company, Anand Rathi Research

Valuations

Considering Aarti's continuing strong growth momentum (a 22% PAT CAGR over FY15-18, a sturdy business model [an established API operator]), and improving RoEs and RoCEs, we are sanguine about its mid- to long-term prospects. We believe that it is poised to accelerate its growth momentum over the next two years, driven by product launches, expanded capacity and market-share gains in existing products.

The stock has experienced significant valuation re-rating in the recent past as the company has been consistently delivering strong growth along with margin expansion. Further, its formulations business is expected to scale up from FY16, fuelled by the recent acquisition, adding to the growth momentum, in our view.

At present, the stock trades at 13.6x FY17e and 10.6x FY18e earnings. We initiate coverage on Aarti Drugs, with a price target of ₹815 based on 14x FY18e earnings. Our target PE multiple is in line with the valuations of peer pharmaceutical companies, considering our expectations of the high-growth momentum, strong balance sheet, free-cash-flows and healthy return ratios.

Fig 25 – One-year-forward mean PE and standard deviation

Source: Bloomberg, Anand Rathi Research

Company Background & Management

Company Overview

Established in 1984, Aarti Drugs manufactures APIs, pharma intermediates and specialty chemicals. It has a comprehensive product range, and is strong in therapeutic groups such as antibiotics, anti-protozoals, anti-inflammatories, anti-fungals, anti-diabetics, cardio-protectants, vitamins, anti-arthritis and sedatives.

It markets its products in more than 94 countries, with strong operations in regulated markets, including Brazil, Mexico, the Netherlands and Spain, and has a strong clientele, including MNCs such as Abbott, Sanofi-Aventis, Merck, Teva, Searle, Pfizer, Bayer and Clariant.

It has ten multi-ton, multi-location GMP-compliant plants. Eight are located in industrial MIDCs at Tarapur, Maharashtra, and two at the industrial GIDC at Sarigam, Gujarat.

Fig 26 – Key management personnel

Name	Position	Profile
Mr Prakash M. Patil	Chairman, MD & CEO	Founder director, bachelor of chemical engineering; excels in an array of promotional activities: product identification, project conceptualisation, planning, project engineering & implementation
Mr Harshit M. Savla	Joint MD	Commerce graduate, Mumbai University; excels in all areas of finance, accounts, exports\ & Internal control
Mr Harit P. Shah	Whole-time director	Commerce graduate, Mumbai University; over 25 years' experience in handling commercial functions encompassing sales, purchases & exports
Mr Rajendra V. Gogri	Non-executive director	Chemical engineer from UDCT, master of science (chemical engineering) from Iowa State University, USA; founder director of Aarti Industries
Mr Rashesh C. Gogri	Whole-time director	Production engineer, Mumbai University; over 16 years' experience in production, marketing and project implementation

Source: Company