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TINY TREASURE

April 2020

The Trick Is To **Spot Them** At The **Larval Stage**

BSE Code	:	**524348**
Time Duration	:	**1 year**
CMP	:	**₹663.10 (as on 23 April, 2020)**
Target Price	:	**₹875**

AARTI DRUGS LTD.

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Our Tiny Treasure for the month of April is Aarti Drugs Limited (ADL). The company is engaged in the manufacturing of active pharmaceutical ingredients (APIs), pharma intermediates and speciality chemicals. It also manufactures formulation through its wholly-owned subsidiary, Pinnacle Life Science Private Limited. The products under APIs include Ciprofloxacin Hydrochloride, Metronidazole, Metformin HCL, Ketoconazole, Ofloxacin, Diclofenac derivatives and so on. Meanwhile, specialty chemicals include Benzene Sulphonyl Chloride, Methyl Nicotinate etc.

API segment – strong revenue driver

The company's API range covers therapy such as antibiotics, anti-inflammatories, cardioprotectants, anti-diarrhoeals, antifungals, anti-diabeties, etc. Its API portfolio consists of 50+ API molecules with a monthly API capacity of 2,480 MT. Within the API segment, antibiotic therapeutic category contributed to around 41 per cent, anti-protozoals around 17 per cent, anti-inflammatory around 13 per cent, followed by anti-diabetic, anti-fungal and cardio-protectant therapeutic categories in FY19. In Q3FY20, the domestic sales of API segment grew by 26.4 per cent and exports by 5.3 per cent, which was entirely driven by volume growth. Additionally, ADL's wholly-owned subsidiary named Pinnacle Life Science Private Limited (PLSPL) has been utilising its API strengths at the optimum level. PLSPL contributes around 9.7 per cent of revenue and has opened more avenues of exports for the company. It started commercial operations in Latin America as well as selective African markets with new registration for export and government tenders. ADL has shown tremendous value addition through the formulation to existing API products.

Expansion plans carried out

The company's anti-diabetic facility went for the expansion, which will double the capacity and make the company, one of the largest Metformin players in the world. This segment is expected to generate good double digit growth in revenue in the upcoming years. It is also a leading manufacturer of Fluoro-quinolones led through backward integration process. Ciprofloxacin, which is one of its top 10 products, has 40-50 per cent global market share. In anti-protozoal, it has further increased its capacity to curtail the imports. Civil construction is in progress for its multi-purpose facility of vitamins/anti-inflammatory segment to target highly regulated markets, where the proposed installed capacity is likely to contribute Rs 35-50 crore per annum. Another facility designed for European markets can manufacture a range of products from anti-inflammatory, anti-fungal, anti-diarrheal, cardiovascular etc. Also, it has done incremental expansion of multipurpose chloro-sulphonation in the existing block and commissioned another dedicated speciality line simultaneously. It is planning capex of Rs 100 crore for FY21, which it plans to fund through a mix of debt and internal accruals.

Reducing dependence on China

The company imports around 35 per cent of its raw material from China due to the price advantage. Due to environmental issues in China during the last year, there were shortages of few raw materials which led to the increased input costs, leading to a pressure on margins. Also, due to the recent Coronavirus pandemic which started in China, the supply chain got disrupted. However, the company had enough raw material inventories that it did not affect its operations. It had also made arrangements to have alternative supplier in India if the situation had got worst in China. To reduce the overall dependence on China for raw materials, it is setting up a plant to produce CPA, which is its major raw material. This step is expected to bring down its overall input cost leading to the expansion in its operating margins.

Exports are rising

For the last several years, ADL has expanded its operation worldwide and continue to expand further in European continent along with a positive synergy through tie-ups. In FY19, Aarti Drugs' exports unit contributed around 38 per cent to the total revenue and posted 27.33 per cent YoY growth in its export revenue. It expects to file new drug master files (DMFs) and update

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the existing ones with global regulatory authorities, which would help it increase exports of generic APIs to the regulated markets with better margins. Also, the export markets are opening up for the formulation division and it will drive the margins for that division as well as boost its profitability.

Stable outlook by CRISIL & CARE ratings

Both CRISIL and CARE ratings have reaffirmed ADL's long-term ratings stating stable outlook on the back of the company's established position in API business with its strong and diverse product portfolio, sound operating efficiencies, long standing relationship with clients and geographically diversification of revenue. The ratings also favourably factors in comfortable debt coverage indicators with a moderate leverage.

Financial performance

The company's consolidated revenue for the quarter Q3FY20 came in at Rs 473.51 crore, as against Rs 380.11 crore in the corresponding quarter last year, registering 24.6 per cent YoY increase. EBITDA for the quarter grew by 30.1 per cent YoY to Rs 67.49 crore as against Rs 51.86 crore in the corresponding quarter last year, with a corresponding margin expansion of 61 bps. EBITDA margin for the quarter stood at 14.3 per cent. PAT for the quarter came in at Rs 27.78 crore as against Rs 20.89 crore in the corresponding quarter last year, with a YoY increase of 33.1 per cent.

The company has reduced its debt recently, which has resulted in D/E of 0.7x by the end of December 2019 as against 0.9x in March 2019. It has been paying regular dividend to its shareholders since the past several years.

Valuation

The company is trading at TTM P/E of 13.9x with TTM EPS of Rs 47.2. In FY19, it delivered ROE and ROCE of 18.3 per cent and 17.3 per cent, respectively. The company's strong API portfolio will continue to be its revenue driver led by volume growth. The steady contribution by its subsidiary in API and formulations segments would further strengthen its position in domestic and international markets. Also, its focus on high margin export business, coupled with backward integration and expansion would be beneficial for the company over the upcoming years. Considering all these factors, we see a potential upside of 32 per cent with a target price of Rs 875 over a period of one year.

Inc/Exp Statement (Consolidated)

Description	201903	201803	201703	201603	201503
Net Sales	1560.94	1243.63	1195.17	1139.84	1096.88
Total Income	1567.12	1244.68	1199.18	1139.84	1097.53
Total Expenditure	1350.03	1041.76	1004.68	960.02	924.51
PBIDT	217.09	202.92	194.49	179.82	173.02
PAT	89.75	82.31	81.8	68.72	77.25
Dividend %	10	10	10	67.5	130
Adj. EPS(Rs)	38.06	34.9	34.29	28.38	31.9

Quarter On Quarter (Consolidated)

Particulars	201912	201909	Q on Q Var %	201812	Y on Y Var %
Net Sales	473.51	477.5	-0.84	380.11	24.57
Total Expenditure	406.02	409.2	-0.78	328.26	23.69
PBIDT (Excl OI)	67.49	68.3	-1.19	51.85	30.16
PAT	27.78	32.31	-14.02	20.87	33.11
PBIDTM% (Excl OI)	14.25	14.3	-0.35	13.64	4.47
PBIDTM%	14.31	14.34	-0.21	13.68	4.61
PATM%	5.87	6.77	-13.29	5.49	6.92
Adj. EPS(Rs)	11.92	13.87	-14.06	8.86	34.54

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