INDIA

BUY

Aarti Drugs

CENTRUM

Initiating Coverage **15 January 2018**

Pharma

Benefits of economies of scale

We initiate coverage on Aarti Drugs (ADL), with Buy rating and TP of Rs940 (25% upside). ADL is a leading player in the domestic APIs and markets over 30 products. The company has strong presence in Asia, Latin America, Europe and Africa. ADL is the market leader in Ciprofloxacin, Metronidazole and Celecoxib in the domestic market. We expect ADL to achieve 14% revenue, 15% EBITDA and 19% net profit CAGR over FY17-FY20E. The company also supplies Specialty Chemicals and intermediates for APIs. We have valued the stock on our conservative 5-year AOCF/EV yield of 4.15% to arrive at target price of Rs940. Key risks to our assumptions include slowdown of the domestic pharma market and regulatory issues for its manufacturing facilities.

- **Leading domestic player:** ADL is a leading supplier of APIs and intermediates and derives 64% of its revenues from domestic market and 36% from exports. Its exports are to Asia (47% export revenues), L. America (28%), Europe (17%), Africa (7%) and N. America (1%). ADL has entered in the manufacture of formulations as forward integration strategy and derives 13% revenues from the formulation business. The company has strong presence in anti-infective, anti-diabetic, NSAIDs and gastro-intestinal segments with a range of products. ADL offers a basket of over 30 APIs and 10 intermediates and has developed a pipeline of 30 new APIs over last 5 years. The increase in capacity for Ciprofloxacin and Metformin would benefit the company. We expect the company to perform well due to overall growth across geographies and benefits of economies of scale.
- **EBIDTA to expand at 15% CAGR:** We expect 15% CAGR in EBIDTA during FY17-FY20E due to good growth of its existing products, new product launches and over 75% capacity utilisation. We expect the company's EBIDTA margin to decline from 15.8% in FY17 to 15.5% in FY18 due to GST issues and increase to 16.5% in FY20. The margin improvement in FY19 and FY20 would be due to the change in product mix, additional capacities of Ciprofloxacin and Metformin, economies of scale, high margin new product introduction and expected reduction in the material cost. ADL has commenced the manufacture of an intermediate of Ciprofloxacin which would significantly reduce the material cost of Ciprofloxacin.
- **Net profit to grow at 19% CAGR:** We expect ADL's net profit to grow by 19%CAGR during FY17-FY20E due to strong sales growth and margin expansion. We expect ADL to benefit from its presence over the entire pharma value chain. The appreciation of rupee against dollar is likely to reduce imported raw material cost. However, it would impact export revenues.
- **Valuation and key risks:** We see strong scope for re-rating and ADL using our conservative five-year AOCF/EV yield method to arrive at a TP of Rs940, implying an upside of 25% over CMP. We expect the company to report RoE of 23% and RoCE of 15% for FY20. ADL outscores many of its peers due to its efficacious presence in the domestic and emerging markets and its integration across the value chain. Key risks to our call include slowdown in the domestic market and regulatory risks for its manufacturing facilities located at Tarapur, Sarigam and Baddi.

Target Price	Rs940
CMP*	Rs755
Upside (Downside)	25%

Price Performance (%)*

	1M	6M	1Yr
ARTD IN	37.1	37.3	21.7
Nifty	4.3	9.0	28.3

Key Data	
Bloomberg Code	ARTD IN
Curr Shares O/S (mn)	23.9
Diluted Shares O/S(mn)	23.9
Mkt Cap (Rsbn/USDmn)	18/284.1
52 Wk H / L (Rs)	785/447.8
5 Year H / L (Rs)	874.9/64.7
Daily Vol. (3M NSE Avg.)	29800

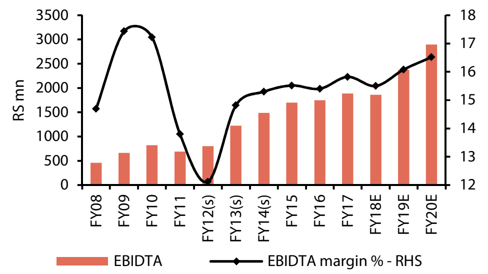
*as on 12th January 2018, Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Sept'17	June'17	Mar'17	Dec'16
Promoter	62.5	62.7	62.5	62.3
FIIs	4.5	4.5	4.5	4.1
DIIs	0.7	0.7	0.7	0.6
Others	32.3	32.1	32.3	33.0

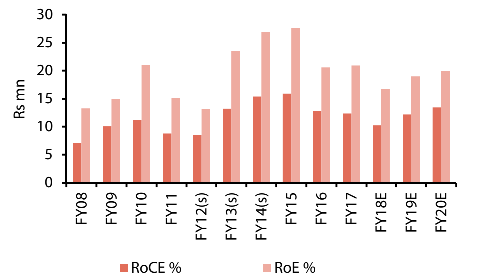
Source: BSE, *as on 12th January 2018

Trend in EBIDTA margin (%)



Source: Company, Centrum Research Estimates

RoCE and RoE %



Source: Company, Centrum Research Estimates

Rannjit Kapadia, ranjit.kapadia@centrum.co.in; 91 22 4215 9645

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBIDTA	EBIDTA (%)	Adj. PAT	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBIDTA (x)
FY16	11,349	3.7	1,748	15.4	686	(11.1)	29.3	20.6	12.8	20.2	10.8
FY17	11,952	5.3	1,891	15.8	805	17.3	34.4	21.0	12.4	16.2	9.4
FY18E	12,001	0.4	1,860	15.5	793	(1.5)	33.9	18.2	10.8	16.0	9.3
FY19E	14,769	23.1	2,375	16.1	1,065	34.3	45.6	21.3	12.9	16.6	9.4
FY20E	17,542	18.8	2,898	16.5	1,338	25.6	57.2	22.8	14.6	13.2	7.7

Source: Company Reports, Centrum Research Estimates

Table of Contents

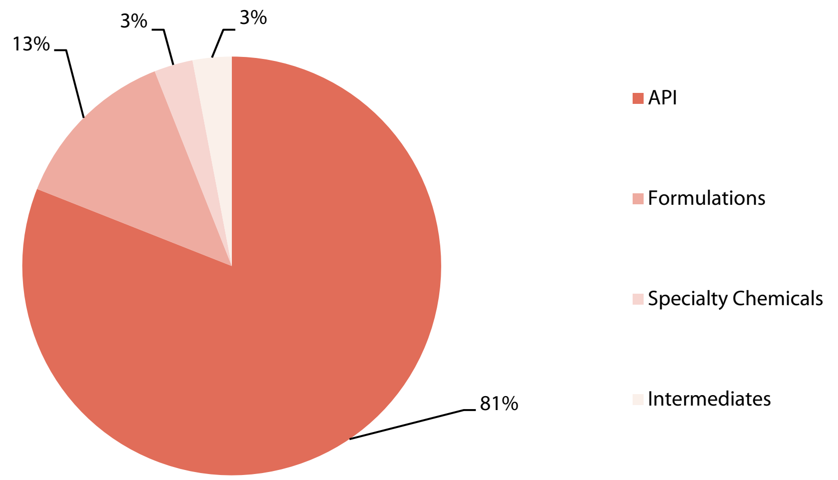
Presence over the entire value chain

Balanced business model

Aarti Drugs (ADL) has presence over the entire pharma value chain starting from chemicals to Intermediates to API and formulations. Being present over the entire value chain, the company derives benefits of vertical integration and hence can compete in the domestic and global markets. The company currently manufactures and markets over 30 APIs, ~ 20 Specialty Chemicals and Intermediates of 10 APIs. It has core competency in the manufacture of APIs. ADL has presence in over 10 therapeutic segments as a de-risking strategy. The list of Specialty Chemicals marketed by ADL is in Appendix-1.

Being a major player in API, the company commenced the manufacture of formulations as forward integration strategy. For FY17, ADL derived 81% of its revenues from API, 13% from Formulations, 3% from Intermediates and 3% from Specialty Chemicals. Hence, the majority of revenue of 81% is derived from the API business. The increase in capacities for Ciprofloxacin and Metformin would enhance its API revenues. We expect the increase in formulation business due to additional capacities and value addition for its customers. ADL has developed 30 new APIs through its R & D efforts which would get commercialised in future. Moreover, the company is working on import substitution. These initiatives would increase the overall margin of the company. The details of the sales composition in FY17 are shown in the following chart:

Exhibit 1: Sales Composition-FY17

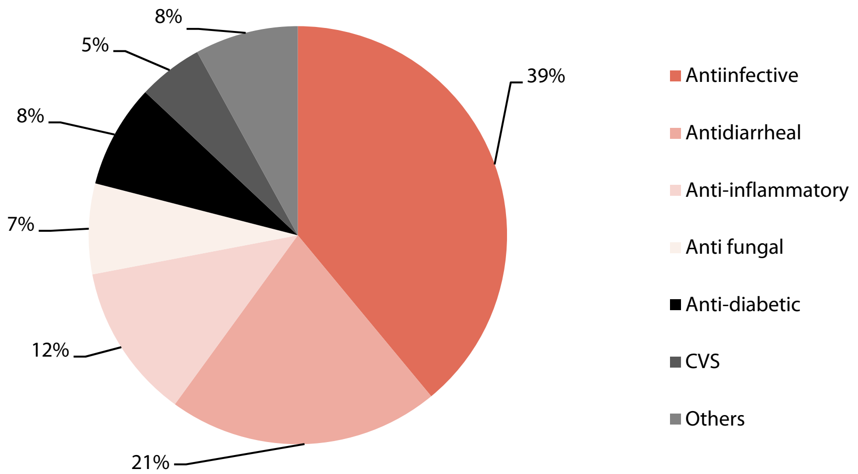


Source: Company Reports

ADL has presence in over ten therapeutic segments namely: anti-infective, antidiarrheal, anti-inflammatory (NSAIDs), anti-fungal, anti-diabetic and CVS. Out of these anti-fungal, anti-diabetic and CVS are lifestyle segments having good growth. ADL has developed various APIs over the years based on the demand forecast, technological development, product quality, competition and profitability. The company has created capacities to cater the domestic and global demand in these segments.

ADL derived 39% of its revenues from anti-infective segment, 21% from the antidiarrheal segment and 12% from anti-inflammatory segments. These three segments collectively contributed 72% of the FY17 revenues. The choice of therapeutic segments was based on the demand forecast, availability of cost effective technology, competing products and payback period. The therapeutic segment wise sales composition for FY17 was as follows:

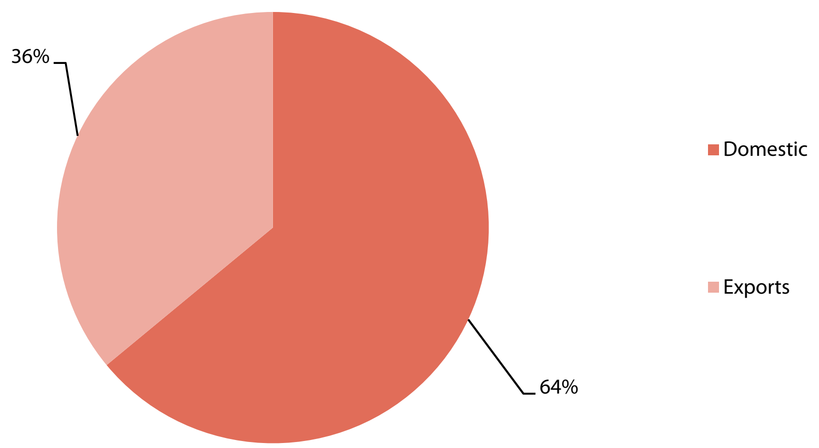
Exhibit 2: Therapeutic category wise sales-FY17



Source: Company Reports

ADL has a balanced business model and has strong presence in the domestic pharma market (64% of revenues) and global markets (36% of revenues). The company has global footprints in Asia, Latin America Europe and African pharma markets. Having presence over the entire value chain, several therapeutic categories and presence in over 100 global markets with over 300 customers, ADL is not dependent on any particular therapeutic category, geography or customer. For FY17, ADL derived 64% of its revenues from the domestic market and 36% from exports. The same has been indicated in the following chart:

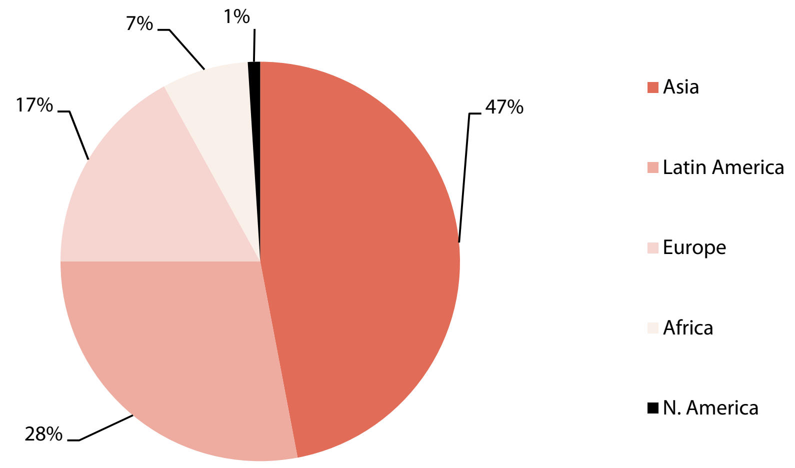
Exhibit 3: Export revenues-FY17



Source: Company Reports

The company derived 47% of its export revenues from Asia, 28% from Latin America, 17% from Europe, 7% from Africa and 1% from N. America in FY17. These four major regions contributed 99% of exports of ADL in FY17. The company currently exports its goods to over 100 countries globally and hence has low dependence on any particular country. ADL derived 1% of its revenue from N. America as its manufacturing facility at Tarapur is under Import Alert by US FDA from March'15. The following chart shows ADL's region wise exports in FY17 to major export destinations:

Exhibit 4: Region wise Exports-FY17



Source: Company Reports

Company Evolution

Background: ADL was set up in 1984 by the promoters who were classmates graduated in Chemical Engineering from University Department of Chemical Technology (UDCT), Mumbai. Being technocrats, the promoters were able to develop non-infringing, cost efficient manufacturing processes for several APIs namely Metronidazole, Metronidazole benzoate, Niacin, Niacinamide (vitamin B6) etc. During that period, majority of APIs were imported from European countries and China as the API industry was in the nascent stage in India. With the increase in revenues and profitability, the promoters ventured into new products and ploughed back the profits in the existing business to grow in size and attain economies of scale.

Entry into API manufacturing: ADL started gaining market share for the above mentioned APIs due to import substitution. The company also developed new APIs based on the technical capabilities of the promoters. ADL simultaneously introduced new products which were developed in- house. With the growing demand, consistent quality and timely supply, the company was able to enlarge the product portfolio, customer base, geographies and gained the market share. ADL also entered the global market and currently has presence in over 100 countries in Asia, Latin America, Europe and Africa.

Market leadership: Over the last 5 years, ADL has developed a basket of over 30 APIs and intermediates for 10 APIs. These APIs are in lifestyle therapeutic segments and hence have higher margin. We expect the company's margin to improve due to high margin new product launches and higher capacity utilisation. ADL is the market leader in Ciprofloxacin (antibacterial), Metronidazole (antidiarrheal) and Celecoxib (NSAIDs) and has developed several other products in these therapeutic segments. The company also supplies intermediates for 10 APIs and ~20 Specialty Chemicals. ADL is expanding its Ciprofloxacin and Metformin capacities to cater domestic and global demand. We expect the company to benefit from this expansion.

Strong chemistry background: ADL derives technical support from its promoters who are chemical engineers and have sound chemistry background. This helps them to undertake manufacture of complex APIs involving various chemical reactions. We expect the company to manufacture complex APIs in the lifestyle segments which face low competition in the domestic and global markets.

Backward integration: ADL commissioned the plant to manufacture Cyclopropylamine (CPA), which is used in the manufacture of Ciprofloxacin and Enrofloxacin. With this backward integration, ADL will be able to substantially reduce the material cost of Ciprofloxacin and Enrofloxacin.

Forward integration to formulations: During FY14, the company entered into the formulation segment as forward integration strategy and currently supplies generic formulations to its existing and new customers. The formulation business generated 13% of consolidated revenues in FY17. ADL's formulation facility is located at Baddi.

Environmental protection: ADL has installed effluent treatment plants at each of its manufacturing facility. The company treats all solid and liquid wastes to make them environmental friendly thereby protecting the ecology.

Core competency: ADL is pioneer in the manufacture of APIs , Intermediates and Specialty Chemicals. The promoters are technocrats with over 30 years of experience in the API industry in developing cost efficient, non-infringing manufacturing processes for APIs. The company manufactures patent-expired APIs and formulations and hence is not involved in the patent litigation. We expect the company to develop difficult to manufacture APIs , which would result in higher revenues and margin improvement. ADL's manufacturing facilities are approved by WHO GMP and hence can export to several countries.

Major products marketed

ADL manufactures and markets APIs across various therapeutic categories. For FY17, the company derived 39% of revenues from anti-infective segment, 21% from antidiarrheal segment, 12% from NSAIDs, 7% from antifungal, 8% from antidiabetic, 5% from CVS and 8% from other segments. The company markets a range of products across each of these segments and hence not dependent on any particular therapeutic category or product.

The company's products confirm to the specifications of various pharmacopoeia and hence have good export potential. ADL has filed Drug Master File (DMF) and Certificate of Suitability (CoS) to market its products in the developed markets. The company manufactures patent expired products using non-infringing process and hence is not subjected to patent litigation. ADL honours the patents across various countries. The company has developed over 30 new products in last five years and has a strong new product pipeline. As majority of new products are in the lifestyle segment, they command higher margin.

The new product selection is based on the disease profile in various countries, currently marketed products, market size, growth rate, patent status, competition-local and global, price control and affordability.

The details of major products marketed, their therapeutic category and registration details are tabulated in the following table:

Exhibit 5: Major products marketed

Product	Therapeutic category	Specifications	EDMF	COS	US DMF
Aceclofenac	anti-inflammatory	BP/EP	Y	Y	
Celecoxib	anti-inflammatory	EP/USP	Y	Y	Y
Diclofenac sodium	anti-inflammatory	BP/EP/USP	Y		
Diclofenac potassium	anti-inflammatory	BP/EP/USP	Y		
Diclofenac diethylamine	anti-inflammatory	BP	Y		
Diclofenac resinate	anti-inflammatory		Y		
Diclofenac epotamine	anti-inflammatory		Y		
Nimesulide	anti-inflammatory	BP/EP	Y	Y	Y
Clopidogrel bisulphate	Cardioprotectant	USP	Y		
Ticlopidine HCl	Cardioprotectant	BP/EP/USP	Y	Y	Y
Telmisartan	Cardioprotectant	BP/EP/USP			
Metronidazole	antidiarrheal	BP/EP/USP	Y		
Metronidazole benzoate	antidiarrheal	BP/EP/USP	Y		
Ornidazole	antidiarrheal		Y		
Secnidazole	antidiarrheal		Y		
Tinidazole	antidiarrheal	BP/EP/USP	Y		
Diloxanide furoate	antidiarrheal	BP			
Ketoconazole	antifungal	BP/EP/USP	Y		
Tolnaftate	antifungal	BP/EP/USP	Y		
Raloxifene HCl	anti-arthritis	BP/USP	Y		Y
Ciprofloxacin	anti-infective	BP/EP/USP	Y	Y	Y
Enrofloxacin base	anti-infective	EP/USP	Y		
Gatifloxacin sesquihydrate	anti-infective	IP			
Levofloxacin	anti-infective	USP	Y		
Moxifloxacin	anti-infective	BP/EP/USP	Y		
Norfloxacin	anti-infective	USP			
Ofloxacin	anti-infective	BP/EP/USP	Y		
Metformin	anti-diabetic	BP/EP/USP	Y	Y	Y
Pioglitazone HCl	anti-diabetic				
Rivastigmine tartrate	Alzeihmer's disease	USP	Y		Y
Zolpidem tartrate	sedative	BP/EP	Y	Y	
Niacin	vitamin	BP/EP/USP	Y		
Acamprosate	alcoholic addiction	BP/EP/USP	Y		

Source: Company Website

Capacity Expansion

ADL is increasing its Ciprofloxacin capacity to 2,100TPA from 1,620TPA (30% increase) and its Metformin capacity to 14,400TPA from 7,200TPA (100% increase) to cater the increasing demand for these products in the domestic and global markets. We expect the additional capacity of Ciprofloxacin to generate revenues of Rs343mn in FY18 and Rs686mn in FY19. We expect the additional capacity of Metformin to generate revenues of Rs378mn in FY18 and Rs756mn in FY19. The Ciprofloxacin API demand in the domestic market is growing at over 20% and Metformin at over 15% per annum. The demand for Ciprofloxacin is likely to increase due to unhygienic conditions, flood and drought situations, epidemics and contaminated food and water leading to various infections. The demand for Metformin is likely to increase due to the increase in the diabetic population. Moreover, Metformin would find additional demand from its anti-ageing properties.

The details of the same are as follows:

Exhibit 6: Capacity Expansion

Product (in TPA)	Current capacity	Expanded capacity	Revenues FY18	Revenues FY19
Ciprofloxacin	1,620	2,100	343	686
Metformin	7,200	14,400	378	756
Total	8,820	16,500	721	1,442

Source: Company, Centrum Research

Margin Expansion

We expect improvement in EBIDTA margin for ADL based on the following events:

- **Backward integration of manufacture of intermediates:** ADL has commissioned the plant to manufacture of Cyclopropylamine (CPA) which is an intermediate used in the manufacture of Q acid for Ciprofloxacin and Enrofloxacin. With CPA facility going on stream, ADL is likely to reduce its material cost for Ciprofloxacin and Enrofloxacin. Currently, Ciprofloxacin contributes ~19% to the revenues of ADL. We expect ADL to benefit from the backward integration.
- **Forward integration in the manufacture of formulations:** ADL has set up a manufacturing facility at Baddi for the manufacture of formulations as its forward integration strategy. As formulations involve value addition, the overall margins are likely to improve due to forward integration.
- **Benefits of economies of scale:** The company has created global size of manufacturing facilities and hence benefits from the economies of scale involving raw materials procurement, manufacturing expenses and distribution.
- **Technological breakthrough:** ADL has developed several non-infringing processes for the manufacture of APIs and Intermediates. The company has achieved higher yield and improved quality resulting in higher margins. We expect the company to continue cost control measures to improve the margins.
- **Optimise product mix:** ADL manufactures and markets over 30 APIs and intermediates across 100 countries of the globe. These products have different margin profile. We expect the company to optimise the margin through proper sales mix.
- **Increase in capacity utilisation for all its manufacturing facilities:** The capacity utilisation of ADL ranged from 66-81% during FY11 to FY17 with an average capacity utilisation of 76%. This has led to optimise the cost of manufacture for its products. We expect ADL margins to improve due to higher capacity utilisation. The company has over the years increased its capacities for various products in anticipation of higher demand. The increase in capacity utilisation would lead to better absorption of overheads resulting in margin improvement. ADL's capacity utilisation was 76% during FY11-FY17 and 79% during FY13-FY17 indicating higher capacity utilisation. We expect ADL to achieve over 75% capacity utilisation in future to optimise its cost. The details of capacity expansion is indicated in the following table:

Exhibit 7: Capacity Utilisation (%)

Year (in Kg)	Installed capacity	Production	*Cap. Utilisation %*	Captive cons.	Net of captive
FY17	22,582	17,463	*77.3*	4,053	13,410
FY16	18,584	14,288	*76.9*	2,717	11,571
FY15	15,065	12,069	*80.1*	2,637	9,432
FY14	14,460	11,482	*79.4*	2,358	9,124
FY13	29,544	23,964	*81.1*	2,277	21,687
FY12	29,016	20,963	*72.2*	2,250	18,713
FY11	26,280	17,434	*66.3*	1,363	16,071

Source: Company Reports, Centrum Research

Major growth drivers

The major growth drivers for ADL are as follows:

- **New product launches:** ADL currently markets over 30 APIs and has developed additional 30 APIs, Intermediates and Specialty Chemicals over the last five years. The company is likely to launch new APIs in the lifestyle segment thereby widening its product offerings and margins.
- **Approval for formulations in UK & Ireland:** ADL has received Marketing Authorisation (MA) for Zolpidem tablets and Celecoxib tablets in UK and Ireland. We expect these approvals to generate additional revenues for the company.
- **Entry into new segments:** The company has presence over a wide range of therapeutic segments ranging from anti-infective, antidiabetic, antifungal, antidiarrheal, NSAIDs and CVS. The company is likely to derive growth from the fast growing lifestyle segments namely anti-diabetic, antifungal, antiulcerant and CVS. We also expect the company to enter into new therapeutic segments, where it does not have presence.
- **Filing of DMFs and ANDAs:** The company has filed 17 DMFs with US FDA and few ANDAs with EU in order to serve the customers in the regulated markets. We expect the company to supply APIs and Intermediates to global generic formulators.
- **Long term supply arrangements:** We expect ADL to enter into long-term supply arrangements with domestic and global formulators for the supply of APIs, Intermediates and Specialty Chemicals for their formulation requirements.
- **Backward integration:** ADL has backwardly integrated for the manufacture of intermediates required for the manufacture of Ciprofloxacin, Enrofloxacin, Ofloxacin, Levofloxacin, Norfloxacin, Nimesulide, Celecoxib and Ketoconazole. This has led to lower dependence of intermediates from China. We expect the company to benefit from the captive use and sale of Intermediates.
- **Forward integration**: The company has entered into the manufacture of high margin formulations as forward integration thereby reducing the cost and offering value added products to its customers. ADL has entered into partnership with established distributor in UK. ADL's 100% subsidiary-Pinnacle has commenced filing ANDAs in UK and Ireland. We expect ADL margins to improve as the company is low cost producer of formulations.

Import Alert-US FDA

ADL currently derives 1% of its revenues by volume from the US generic market as its manufacturing unit at Tarapur received Import Alert from US FDA dated 23rd March'15 for one its manufacturing facilities. However, the company clarified that the second facility was delisted from the US FDA website couple of years ago. The Import Alert has impacted the company's plans to export APIs to the US market. ADL's E-22 facility at Tarapur is the US FDA compliant facility. This facility received warning letter from US FDA in July'13 and was re-inspected in August'14. The company had submitted four responses starting from August'14 to February'15 and has completed the remedial measures. ADL has carried out substantial automation and enhanced IT infrastructure for its US FDA facility to address data integrity issues and spent Rs10mn on the same. ADL has also conducted third- party audit by US based consultants. The company is likely to invite US FDA for re-inspection in Q4FY18.

The major issues raised by the US FDA in the warning letter dated 30th July'13 were:

- Failure to record all activities at the time they were performed. In two instances, the manufacturing step was recorded in the batch record before it occurred.
- The company failed to review and investigate production and QC Laboratory deviations. Deviations pertaining to laboratory equipment failures were not investigated.
- Failure to maintain laboratory control records with complete data derived from all tests conducted including examination and assays.
- Failure to implement access controls and audit trails for laboratory computer systems. The quality control personnel shared the same username and password for the operating systems.

In 2012, the company recorded more than 30 power interruptions during processes but quality officials did not investigate whether the power interruptions affected samples in the quality control stability chamber.

ADL has filed seventeen DMFs with US FDA and plans to partner in ANDAs filing after clearance of the manufacturing facility by US FDA. Majority of these DMFs are in the lifestyle segments and hence have higher margins. The details of the same are shown in the following table:

Exhibit 8: List of DMFs filed with US FDA

Sr. No.	Date of filing	Product	Therapeutic Category
1	16.5.2006	Zolpidem tartrate	CNS, sedative
2	1.6.2006	Metoprolol succinate	CVS
3	17.7.2006	Ciprofloxacin HCl	anti-infective
4	13.9.2006	Terbinafine HCl	dermatological
5	14.12.2006	Niacin	vitamin
6	30.4.2007	Loratadine	anti-allergic
7	28.8.2007	Nimesulide	NSAIDs
8	1.2.2008	Metformin HCl USP	anti-diabetic
9	22.5.2008	Raloxifen HCl	osteoporosis
10	6.10.2008	Hydroxyzine HCl	sedative
11	30.12.2008	Ticlopidine HCl	CVS
12	1.4.2009	Rivastigmine base	Alzheimer's disease
13	31.7.2009	Rivastigmine Hydrogen tartrate	Alzheimer's disease
14	9.10.2009	Celecoxib	osteoarthritis, NSAIDs
15	3.4.2012	Diclofenac epolamine	NSAIDs
16	3.7.2012	Pioglitazone HCl	anti-diabetic
17	29.9.2015	Rofecoxib	osteoarthritis, NSAIDs

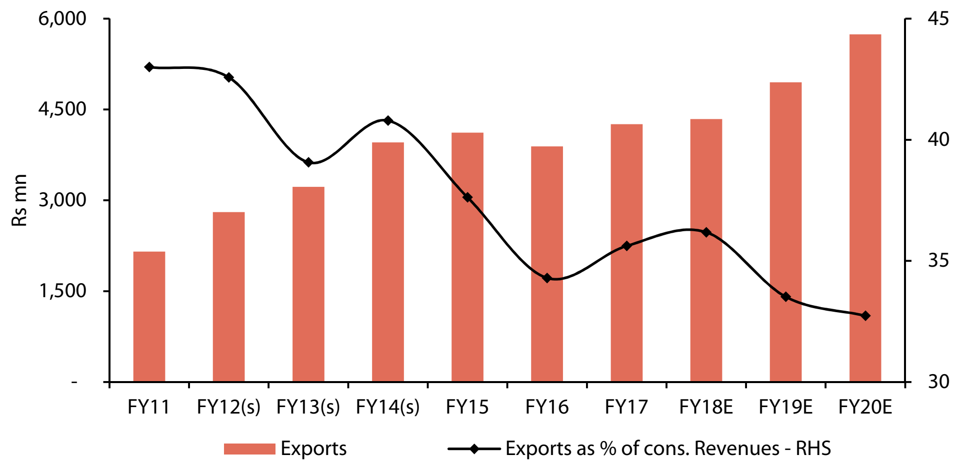
Source: US FDA website, Centrum Research

Global markets-good future potential

India is the second largest supplier of generic APIs to the US market with 25.4% market share. India is also increasing API supplies to Europe with 19.2% market share. API exports have grown at 14.7% between 2007-2008 and 2012-2013. India is emerging as preferred manufacturing hub for high quality APIs. The export of API to regulated markets is expected to grow to 51% by 2018-2019. India supplies 20% global generic drugs in terms of volume. ADL has launched various new products in the domestic and global markets. The company is one of the lowest cost producers in India and enjoys economies of scale.

ADL derived 36% of its revenues from Exports in FY17. The company's exports were 43% of consolidated revenues in FY11 and fell to 36% in FY17 due to higher sales in the domestic market and Import Alert imposed by US FDA in March'15 for the US market. We expect the export share at 36% in FY18 and decline to 33% of revenues in FY20 due to higher domestic growth. The same has been indicated in the following chart:

Exhibit 9: Exports & Export share %



Source: Company Reports, Centrum Research

ADL supplies its products to several global pharma companies. ADL's export was Rs4.2bn in FY17. The company's major customers are located in Asia, L. America , Europe and Africa. The top 10 global customer accounted for Rs1.0bn or ~25% of total exports in FY17. The largest customer Sanofi Aventis Pakistan accounted for 5.3% of exports. Hence, ADL does not have major dependence on any customer.

Leading supplier of APIs to MNC pharma

ADL has over 30 years of experience in API manufacturing and derived 81% of its revenues from API business and 13% from its formulations business in FY17. The company manufactures several APIs at its WHO GMP and EU GMP approved facilities at Tarapur and Sarigam and supplies to the domestic and MNC pharma companies. The company also manufactures and supplies Specialty Chemicals and intermediates. ADL has developed 30 new products in last 5 years. ADL's major API customers in the domestic market include: J.B. Chemicals & Pharmaceuticals, Abbott Healthcare Private Ltd, Medley Pharma, Cadila Healthcare, Cipla, Torrent Pharma, Hetero Pharma, Alkem Labs, Sanofi India, Merck, Teva Pharma, Pfizer, Bayer, Clariant Chemicals etc.

ADL generated Rs6.7bn from domestic sales in FY17. The top 10 domestic customers accounted Rs1.1bn or 17% of the domestic revenues. The largest domestic customer J.B. Chemicals & Pharmaceuticals contributed 3.3% to ADL's domestic revenues.

ADL derives ~13% of its revenues from the supply of formulations. The company has commenced manufacture of formulations for its existing clients as forward integration strategy in FY15. ADL supplies its formulations to the following pharma companies: Cipla, Abbott India, Merck, Alembic Pharma, Lupin and Wockhardt.

ADL's total revenues from the sale of APIs and formulations were Rs11.24bn in FY17 of which domestic sales accounted for Rs7.0bn and exports were Rs4.24bn. The top 10 product sales (API & Formulations) were 74% and hence the company has high dependence on the top 10 products. Among the top 10 products the anti-infective accounted for ~39% of total revenues.

New Products –Growth Drivers

ADL has a rich pipeline of 13 products under development. These products are difficult to manufacture and are in the lifestyle segment and hence command a higher margin.

The details of the new products, their brand names and patent holder are shown in the following table:

Exhibit 10: New Products under development

Product	Therapeutic category	Patented product	Patent holder
Atorvastatin	cholesterol reducer	Lipitor	Pfizer
Colesevelam	cholesterol reducer	Welchol	Daiichi Sankyo
Dabigatran	anticoagulant	Pradaxa	Boehringer Ingelheim
Dronedarone	CVS	Multaq	Sanofi Aventis
Olmesartan	CVS	Olmecip	Daiichi Sankyo
Valsartan	CVS	Diovan	Novartis
Sitagliptin	anti-diabetic	Januvia	MSD
Teneligliptin	anti-diabetic	Tenelia	Mitsubishi Pharma
Acamprosate	alcoholism treatment	Campral	Forest Labs
Sevelamer	kidney dialysis	Renagel	Sanofi Aventis
Duloxetine	anti-depressant	Cymbalta	Eli Lilly
Loxoprofen sodium	anti-inflammatory	Loxonin	Daiichi Sankyo
Mesalamine	anti-inflammatory	Mesalazine	Disphar International

Source: Company, Centrum Research

Infrastructure-complying global standards

World class manufacturing facilities

ADL has established 10 world class manufacturing facilities for API and intermediates of which 8 are in Tarapur and 2 in Sarigam. These facilities are approved by global regulatory agencies. The E-22 facility is built as per US FDA standards but has received Import Alert from US FDA in March'15. The company has submitted CAPA (Corrective and Preventive Action) to US FDA. In addition to these, the company has one formulation facility at Baddi. The details of manufacturing facilities and their regulatory approval status are indicated in the following table:

Exhibit 11: Manufacturing facilities

Unit no.	Location	Certification
E-22	Tarapur	TGA-Australia, EUGMP, WHO-GMP, FDA Canada, US FDA (import alert)
G-60	Tarapur	ANVISA-Brazil, WHO-GMP,COFEPRIS-Mexico, FDA Russia
E-21	Tarapur	WHO GMP, Korean FDA
N-198	Tarapur	EU GMP, WHO-GMP, ISO, Japanese Accreditation
K-40	Tarapur	WHO GMP, COFEPRIS-Mexico
W-61	Tarapur	EU GMP, WHO-GMP
E-120	Tarapur	WHO GMP
E-9/3	Tarapur	ISO
2902-04	Sarigam	WHO GMP
211/213	Sarigam	WHO GMP, COFEPRIS-Mexico

Source: Company website

Quality control-complying global standards

ADL has established state-of-the art Quality Control (QC) Laboratories with sophisticated analytical instruments at all of its manufacturing facilities. The company has received WHO GMP certification. ADL adheres to high quality standards as its products are competitive in the international markets. The QC labs carry out all types of analysis namely: raw materials, in-process samples, packing materials, finished products, stability study testing, impurity profile, method validation etc.

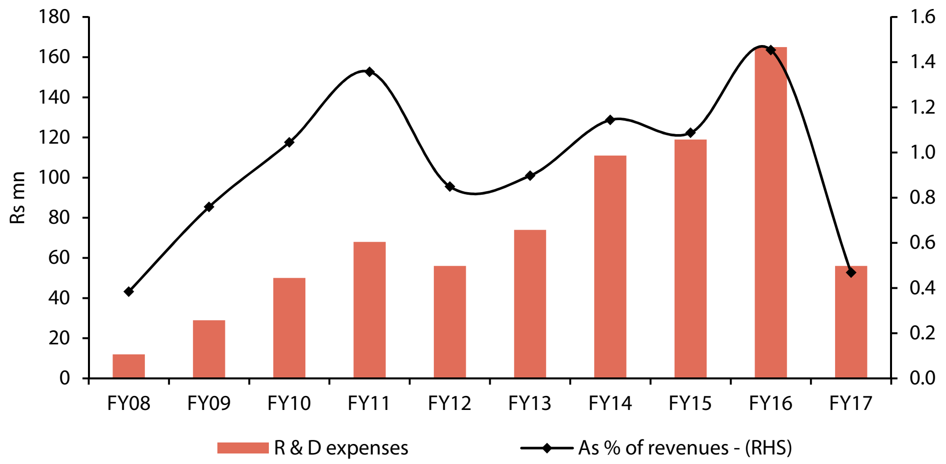
R & D-company's backbone

ADL's R & D centre is located at Tarapur is recognised by Department of Science & Industry Research, Government of India. The centre carries out R & D activities for product development, scale up and transfer to manufacturing and develops non-infringing routes of synthesis. It has developed over 30 new products in the last 5 years. ADL has currently 13 APIs under development at various stages. The company has recovered all inorganic salts from Metronidazole waste. ADL has over 30 years of experience and has developed expertise in various reactions. The company has over 50 scientists working in R & D.

The R & D expenditure for ADL was 0.9% of revenues between FY08-FY17. ADL is eligible for 150% weighted average deduction of R & D expenses. We expect the company to increase the R & D expenditure to create a strong pipeline of products for future growth.

The detail of R & D expenses is indicated in the following chart:

Exhibit 12: R & D Expenses



Source: Company Reports, Centrum Research

Effluent Treatment- preserving ecology

ADL has installed common facility for effluent treatment and is likely to achieve 'Zero discharge' for organic contaminated effluent. The company has installed 'Multiple Effect Evaporators' and Incinerator for treating liquid effluent. ADL has plans to develop 'Green Process' with the help of innovative technologies. All the ADL's plants are designed with appropriate waste management systems. The company carries out safe disposal of solid and liquid waste. ADL generates steam through a waste heat recovery plant. The company's effluent treatment plants are well-maintained. We expect the company to effectively treat the solid and liquid process effluents to protect the ecology.

Global API Industry structure

Global market-growth driven by pharmerging countries

The Global API market (including captive consumption) is expected to reach $185bn (Rs11,840bn) by 2020. The number of pharmerging countries has increased from 5 to 21 and healthcare improvement will be their priority. The Indian pharmaceutical market is the third largest in terms of volume and thirteen largest in terms of value. Its revenue is estimated to grow at 15% per annum during 2015-2020 thus outperforming global pharmaceutical industry. By 2020, India is likely to be among top three pharma markets in terms of growth.

India supplies 20% of global generic medicines in terms of volume to the US market. India's cost of production is significantly lower than that of the US and half of that of Europe. Indian pharma industry has advantage in terms of cost of production, good R & D and technical work force. Over 60,000 generic brands across 60 therapeutic categories, comprising over 500 APIs are marketed in India. Generic drugs are the largest segment of Indian pharma sector with over 70% market share in terms of revenues. India contributes ~2.4% of global pharma industry in value terms and 10% in volume terms. The Indian pharma industry grew at 17.5% CAGR from 2005-2015 and is expected to grow at 15.9% CAGR to $55bn (Rs3,520bn) by 2020.

Domestic market

The domestic pharma market has a healthy growth due to growing population, increasing health awareness, increase in healthcare insurance, increased aged population, changing lifestyle and increasing per capita income. The API industry has grown at direct offset of formulation growth worldwide.

SWOT analysis

ADL's SWOT analysis is summarised in the following table:

Strengths	Weakness
❍ Dedicated management team ❍ Amongst the lowest cost producer ❍ Benefits of economies of scale ❍ Benefits of vertical integration ❍ Efficient manufacturing systems ❍ Better documentation, reliability and quality ❍ Strong regulatory framework ❍ Customer diversification ❍ Effective environmental control ❍ Strong R & D team	❍ Limited product portfolio ❍ Late entry into formulation business ❍ Late entry in the largest US generic market ❍ Import Alert by US FDA for its Tarapur facility in March'15
Opportunities	**Threat**
❍ Chinese environmental rules getting stringent ❍ Exports to over 100 countries worldwide ❍ Commenced export of formulations ❍ Long-term supply arrangements ❍ Supply of Specialty Chemicals and Intermediates ❍ Tie up with European distributor for formulation supplies	❍ Competition from China ❍ Strengthening of the rupee against dollar

Source: Company Reports, Centrum Research

Competition-domestic & global

ADL faces stiff competition from API manufacturers in the domestic and global markets. **There are over five domestic producers for each API and over 30 formulators for each of the APIs manufactured by the company. ADL faces major global competition from Europe and China.** The key differentiating factors are: product quality, purity and timeliness of supplies. For majority of the clients, price is the last consideration. The details of domestic and global customers for each product manufactured by ADL are as follows:

Exhibit 13: Domestic & Global customers

Product	Domestic customers	Global customers
Ciprofloxacin	Cipla, Dr. Reddy's Labs, Sun Pharma, J B Chem, Wockhardt	Bayer-Germany, Uquifa Mexico, Mylan, Quimica Sintetica-France
Metronidazole/	Unichem Labs, FDC	Rhone Poulenc, Cordon Pharma,
Metronidazole Benzoate	Manav Drugs	Signa-Italy, Tianjin Hubei-China
Ofloxacin	Sun Pharma, Neuland, Cipla	Daiichi Sankyo, Bayer-Germany, Noramco, Sintetica-France
Metformin	USV, Wanbury, Sun Pharma, Ipca Labs, Granules India	Merck, Groupe Lipha, Tapi-Puerto Rico, Farmhispania
Ketoconazole	FDC, Gufic Biosciences, Piramal Enter, Sharon Bio	Quimica Sintetica, Janssen Pharma, Esteve Quimica, Albemarle Corp.
Enrofloxacin Base	Smruthi Organic, Triveni Interchem, S R Chemicals	Mylan
Levofloxacin Hemihydrate	Cipla, Dr. Reddy's Labs, Sun Pharma, Neuland, Cadila HC	Daiichi Sankyo, Quimica Sintetica, Teva Pharma, Mylan, Apotex
Clopidogrel Bisulphate	Cipla, Dr. Reddy's Labs, Aurobindo, Wanbury, Ipca Labs	Sanofi Aventis, Chinoin Pharma, BASF, Signa, Teva Pharma
Nimesulide	Nutraplus, Unimark Remedies, Vital Healthcare	Procos-Italy

Source: Centrum Research

Subsidiary –forward integration

ADL has a 100% subsidiary Pinnacle Life Science Private Limited (Pinnacle), which is engaged in the manufacture of formulations as a forward integration strategy. Pinnacle had reported minor loss of Rs32mn in FY15 and has turned profitable since FY16. The company generated net profit of Rs25mn and Rs65mn in FY16 and FY17 respectively. It has one formulation manufacturing facility at Baddi, Himachal Pradesh and caters to ADL's API customers. ADL has commenced formulation exports to cater global requirements. It has registered the formulations in various countries through Pinnacle. ADL has tied up with European distributor on profit sharing basis for its formulation sales. The company has filed two Dossiers with UK MHRA of which one is approved. On a consolidated basis, formulations contributed ~13% to the revenues in FY17. We expect the formulation business to pick up in future due to lower cost structure and benefits of backward integration.

The following table shows the subsidiary's performance from FY15-FY17:

Exhibit 14: Performance of Subsidiary

Particulars (Rs mn)	FY15	FY16	FY17
Share Capital	78	78	78
Reserves & Surplus	36	58	121
Debt & other Liability	330	534	743
Total Liability	**444**	**670**	**942**
Total Assets	**444**	**670**	**942**
Total Income	133	858	1,458
Profit/(Loss) before tax	(32)	25	84
Tax expenses	0	0	19
Profit/(loss) after tax	**(32)**	**25**	**65**

Source: Annual Reports

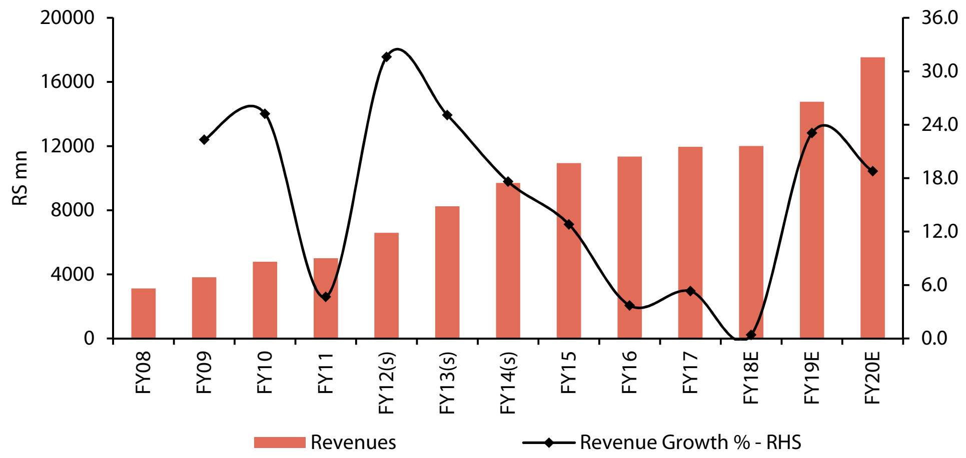
Financial Analysis

Strong growth of revenues, profitability and cash flow

On a consolidated basis, ADL has achieved 16% CAGR in revenues, 17% CAGR in EBIDTA and 21% CAGR in net profit over the past 9 years from FY08-FY17. Hence, the company has a good financial track record. We expect ADL's revenues to increase at 14% CAGR over FY17-20E due to good growth in its domestic business, good export growth, increase in capacity for Ciprofloxacin and Metformin and new product introduction. We expect additional capacities for Ciprofloxacin to generate revenues of Rs343mn in FY18 and Rs686mn in FY19 respectively. We expect additional capacities for Metformin to generate revenues of Rs378mn in FY18 and Rs756mn revenues in FY19.

In addition to the above, the Celecoxib and Ketoconazole expansion would add revenues in FY19. ADL is likely to generate additional revenues from multipurpose plant in FY20. The company is likely to manufacture new products in CVS, antiviral and antiulcerant segments where it does not have presence currently. The following graph indicates these numbers:

Exhibit 15: Revenue and revenue growth %



Source: Company Reports, Centrum Research Estimates

ADL derives 36% of its revenues from exports and the balance 64% from the domestic market. The company exports across 100 countries, and hence, does not depend on any particular geography. The company currently caters to 400 domestic clients and 300 global clients and is likely to serve the same customers with additional volume and new products. ADL has an order book of one month for the domestic clients and three months for global clients. ADL has added four new APIs in Europe namely Ciprofloxacin, Metformin, Celecoxib and Aciclofenac. These products have market potential of Rs1.0bn in the EU.

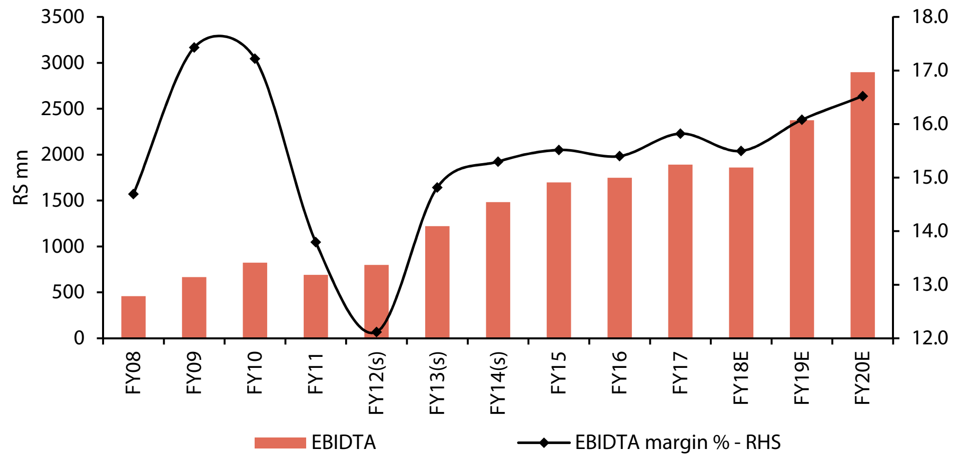
As the sale of API involves bulk sales, the company does not require field force unless it goes into branded formulations. Factors such as increase in demand due to increase in income level, change in the lifestyle, increase in medical insurance and increase in healthcare expenditure would drive future growth.

Margin improvement

ADL's EBIDTA grew from Rs459mn in FY08 to Rs1,891mn in FY17 at 17%CAGR and is expected to grow to Rs2,375mn in FY19 and Rs2898mn in FY20 due to strong revenue growth arising from additional capacities of Ciprofloxacin and Metformin going on stream and new product launches, change in product mix, process improvement and increase in yields.

We expect the company's EBIDTA margin to decline from 15.8% in FY17 to 15.5% in FY18E and improve to 16.1% in FY19E and 16.5% in FY20E. The decline in margin in FY18 would be due to the implementation of GST as well as the effect of demonetisation. The details are shown in the following chart:

Exhibit 16: EBIDTA and EBIDTA margin (%)



Source: Company Reports, Centrum Research Estimates

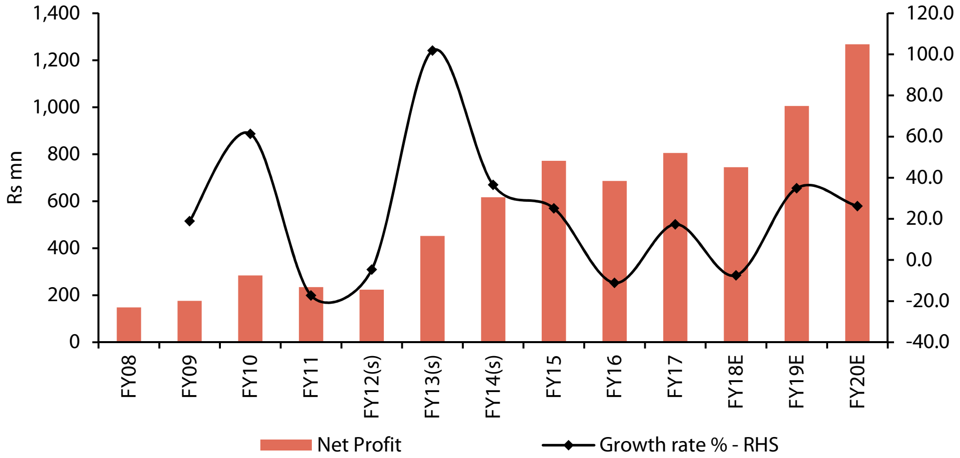
The margin expansion in FY19 and FY20 is likely to come from the following:

- Good domestic growth with increase in demand of Ciprofloxacin, Metformin , Norflocaxin, Clopidogrel, Ketoconazole and Celecoxib. Ciprofloxacin is the most widely used anti-infective drug in the treatment of several diseases. Metformin is the cheapest and most widely used drug in the treatment of type II diabetes. With the sharp increase in diabetes patients in India, the demand for Metformin is likely to grow rapidly. Moreover, the drug is likely to be used for anti-ageing and hence expected to show a rapid growth.
- Backward integration of manufacture of Cyclopropylamine (CPA) used in Q-acid, which is an intermediate for Ciprofloxacin. This is likely to reduce the material cost of Ciprofloxacin.
- Forward integration of manufacture of Formulations
- Change in process of manufacture using shorter routes
- Higher capacity utilisation of over 75%
- Import substitution of raw materials
- Improvement in yield for existing products
- By-product recovery from Metronidazole waste
- Benefits of economies of scale
- Improvement in operational efficiencies through automation
- Sourcing from low-cost manufacturing base in India

Net profit improvement

ADL's net profit expanded from Rs148mn in FY08 to Rs805mn in FY17 at 21%CAGR due to sales growth and margin improvement. The net profit growth declined from 18.9% in FY09 to 17.3% in FY17. We expect the net profit to grow to Rs1.34bn at growth rate of 25.6% in FY20. The same has been indicated in the following chart:

Exhibit 17: Net profit and net profit growth%



Source: Company Reports, Centrum Research Estimates

Healthy Return Ratios

ADL's RoCE enhanced from 7.1% in FY08 to 12.4% in FY17 due to the improvement in profitability. The company's RoE is has grown from 13.3% in FY08 to 21.0% in FY17. We expect ADL to report RoCE of 14.6% and RoE of 22.7% for FY20. The company would generate healthy return ratios of over the next two years. The same has been indicated in the following chart:

Exhibit 18: RoE and RoCE %

Source: Company Reports, Centrum Research Estimates

Capex-backbone of future growth

ADL has spent Rs1.09bn on capex in FY17. The company has invested Rs6.63bn on capex during the ten year period FY08-FY17 in augmenting additional capacities to gain from the economies of scale.

ADL's asset turnover ratio was 1.1x in FY08 reached to peak level of 1.7x in FY13 and declined to 1.4x in FY17. The gross block addition ranged from 91% to 290% of net profit indicating that the company is continuously creating capacities in anticipation of good demand for its products. The same has been shown in the following table:

Exhibit 19: Asset Turnover Ratio

Particulars (Rs mn)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Gross Block	2,778	3,099	3,325	3,934	4,394	4,791	5,812	6,854	7,255	8,516
Sales	3,124	3,821	4,785	5,009	6,593	8,247	9,700	10,943	11,349	11,952
Asset Turnover (x)	1.1	1.2	1.4	1.3	1.5	1.7	1.7	1.6	1.6	1.4
Gross Block Addition	222	202	257	681	473	600	1,065	1,070	997	1,088
Net Profit	148	176	284	235	224	452	617	772	686	805
Gross Block as % of PAT	*150.0*	*114.8*	*90.5*	*289.8*	*211.2*	*132.7*	*172.6*	*138.6*	*145.3*	*135.2*

Source: Company Reports, Centrum Research

Capex-future plans

ADL had expanded its capacity of Ciprofloxacin and set up new capacity of Cyclopropylamine (CPA) of 1,200TPA at capital outlay of Rs450mn to reduce its dependence on China. CPA is the raw material for its intermediate Q-Acid. ADL is setting up a new Multi Product plant with a capital outlay of Rs343mn and other capex outlay of Rs135mn. The total capex works out to be Rs928mn. ADL has spent Rs450mn on capex in FY17. The balance amount of Rs478mn is likely to be spent in FY18. The details of the historical capex and future capex plans during FY17-FY19 are shown in the following tables:

Exhibit 20: Capital Expenditure-Historical

Particulars (Rs mn)	Year	Earlier capacity	Expanded capacity	Capex-total
Ciprofloxacin-TPA	FY13	1200	1,620	585
Ofloxacin-TPA	FY13	0	480	
Metformin-TPA+ Routine	FY14	1,200	8,400	1,053
Levofloxacin-TPA	FY15	0	720	962
Norfloxacin-TPA	FY15	0	720	
Intermediates for Levo+ Nor+ofloxacin	FY15	0	2,160	
Ofloxacin-TPA	FY16	480	720	876
Ketoconazole-TPA	FY16	216	360	
Metronidazole-TPA	FY16	1,200	2,400	

Source: Company Reports

With the additional capacities of Ciprofloxacin and Metformin, we expect the improvement in ADL's revenues and profitability. Moreover, the backward integration to Ciprofloxacin intermediate is likely to generate savings in the material cost.

The year wise details of the capex are as follows:

Exhibit 21: Future capex plans

Particulars (Rs mn)	Year	Current capacity	Expanded capacity	Capex
Cyclopropylamine-TPA	FY17	-	1,200	450
Total	**FY17**	**-**	**1,200**	**450**
Multi Product Plant	FY18	-	-	343
Other Capex	FY18	-	-	135
Total	**FY18**	**-**	**-**	**478**
Metformin	FY19	8,400	14,400	350
Total	**FY19**	**8,400**	**14,400**	**350**

Source: Company, Centrum Research

Intangibles

ADL's intangibles (Process Development - R & D) accounted for 2.1% of GFA in FY08 and increased to 5.8% of GFA in FY09 and declined gradually to 0.9% of GFA in FY17 due to increase in Gross Fixed Assets. The intangibles were Rs74mn or 0.9% of GFA in FY17 which is not significant. This indicates that ADL does not have appreciable intangibles.

The details of the same are as follows:

Exhibit 22: Intangibles

Particulars (Rs mn)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Process Devt-R & D	57	179	179	179	179	179	143	143	74	74
Gross Fixed Assets	2,778	3,099	3,325	3,934	4,394	4,791	5,812	6,854	7,255	8,516
Intangibles as % GFA	***2.1***	***5.8***	***5.4***	***4.6***	***4.1***	***3.7***	***2.5***	***2.1***	***1.0***	***0.9***

Source: Company Reports, Centrum Research

Buyback of shares

During FY17, ADL bought back 0.36mn shares representing 1.5% of total equity at Rs750 per share (premium of Rs740 per share) aggregating to Rs270mn on a proportionate basis through tender offer. Post-buyback the equity capital has reduced to Rs238.6mn.

For FY18, ADL has announced buyback of 0.275mn shares representing 1.15% of total equity at Rs875 per share aggregating to Rs241mn on a proportionate basis through a tender offer. Post-buyback the equity capital would reduce to Rs236mn. For FY19 and FY20, we have assumed buyback of Rs250mn in each year. The details of buyback and dividend payout (%) are shown in the following table:

Exhibit 23: Buyback of shares

Particulars (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Buyback shares-mn	0	0.36	0	0	0
Equity Capital- no. of shares	24.2	23.9	23.6	23.4	23.2
% of Equity Capital	*0*	*1.5*	*0.0*	*0.0*	*0.0*
Amount per share Rs.	0	750	0	0	0
Buyback Amount	0	270	241	250	250
Dividend Amount	192	28	43	57	72
Total Payout	192	298	284	307	322
Net profit	686	805	793	1,065	1,338
Payout (%)	*28.0*	*37.0*	*35.8*	*28.9*	*24.0*

Source: Company, Centrum Research Estimates

Working Capital Cycle improvement

ADL's working capital cycle was 136 days in FY08, which came down to 95 days in FY17 with a reduction of 41 days in nine years. This clearly indicates the efficiency in WC Management. The company was able to achieve 13 days reduction in inventory level and 30 days in debtor level during FY08-FY17. The payable declined by 2 days during the similar period. With the reduction in working capital cycle, we expect the company to report healthy performance in the years to come. The details of WC Cycle are indicated in the following table:

Exhibit 24: Exhibit: Working Capital Cycle

Particulars (Rs mn)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Inventory	662	605	644	918	979	1409	1267	1642	1783	2098
Debtors	**1,033**	**1,136**	**1,160**	**1,214**	**1,806**	**2,157**	**2,766**	**3,143**	**3,317**	**2,968**
Payables	529	537	483	603	938	1,319	1,502	1,667	1,849	1,970
Cash conversion cycle	**1,166**	**1,204**	**1,321**	**1,529**	**1,847**	**2,247**	**2,531**	**3,118**	**3,251**	**3,096**
No. of days										
Inventory	77	58	49	67	54	62	48	55	57	64
Debtors	121	109	88	88	100	95	104	105	107	91
Payables	62	51	37	44	52	58	57	56	59	60
Cash conversion cycle	**136**	**115**	**101**	**111**	**102**	**99**	**95**	**104**	**105**	**95**

Source: Annual Reports, Centrum Research

Interest cost-likely to increase

We expect the increase in working capital for ADL due to the implementation of GST and increase in volumes. ADL's average interest cost is 7-8% and currently at ~2.8% of the revenues. The company borrows term loans from banks and loans and advances from its directors. All the loans are in Rupees. Any reduction in the interest rates is likely to benefit the company. The company does not have any major interest income.

Foreign Exchange Exposure

ADL derives 36% of its revenues from exports and also imports some of its raw materials, intermediates and capital goods. The company uses forward contracts, options and swaps to hedge against its foreign exchange exposures relating to these transactions. ADL does not enter into any derivative instruments for trading or speculation purposes. The foreign currency transactions are recorded at the exchange rate that approximates the actual rate prevailing on the date of the transaction. Monetary item denominated in foreign currency are translated at year end rates. The premium in case of forward contracts is dealt in P & L account proportionate to the period of contract.

During the year ended March'17, the company has hedged Rs3,480mn (FY16: Rs2,873mn) for its trade related operations aggregating to Rs8,103mn (FY16: Rs8,018mn) after considering natural hedge. We expect the company not to enter into any derivative instruments for trading or speculation. ADL derives the benefit of natural hedge as it imports raw materials, intermediates and capital goods. The imported raw materials and capital goods have risen from 28.0% of revenues in Fy11 to 35.3% of revenues in FY17. This gives a natural hedge against exports. The year wise import of raw materials and capital goods imports is shown in the following table:

Exhibit 25: Import of raw materials and capital goods

Particulars (Rs mn)	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Imported materials & cap. Goods	1,404	1,798	2,715	3,451	4,145	4,457	4,216
Material cost	3,342	4,536	5,554	6,625	7,500	7,668	7,805
as % of material cost	*42.0*	*39.6*	*48.9*	*52.1*	*55.3*	*58.1*	*54.0*
Revenues	5,009	6,593	8,247	9,700	10,943	11,349	11,952
as % of revenues	*28.0*	*27.3*	*32.9*	*35.6*	*37.9*	*39.3*	*35.3*

Source: Company data, Centrum Research

Quarterly Financials

Exhibit 26: Quarterly Financials-consolidated

Particulars (Rs mn)	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
P & L								
Total revenues	2,687	3,146	3,158	3,422	2,906	3,011	2,772	3,193
Material cost	1,747	2,169	1,913	2,069	1,904	1,919	1,623	2013
Personnel cost	110	122	126	132	127	155	136	143
Other expenses	398	397	638	715	443	464	659	511
Total expenses	2,255	2,688	2,677	2,916	2,474	2,538	2,418	2,667
EBIDTA	432	458	481	506	432	473	354	526
Other income	-	-	-	6	-	-	1	0
PBDIT	432	458	481	512	432	473	355	526
Interest	112	115	100	88	91	86	89	80
Depreciation	92	94	96	97	99	92	98	101
Profit before tax	228	249	285	327	242	295	168	345
Tax provision	58	63	86	106	63	88	54	109
PAT before minority interest	170	186	199	221	179	207	114	236
Minority interest	-	-	-	-	-	-	-	0
PAT after EO items	170	186	199	221	179	207	114	236
Growth (%)								
Revenues	*NA*	*NA*	*11.3*	*25.4*	*8.2*	*-4.3*	*-12.2*	*-6.7*
EBIDTA	*NA*	*NA*	*8.8*	*18.8*	*-*	*3.3*	*-26.4*	*4.0*
Net Profit	*NA*	*NA*	*14.4*	*40.8*	*5.3*	*11.3*	*-42.7*	*6.8*
Margin (%)								
EBIDTA	*16.1*	*14.6*	*15.2*	*14.8*	*14.9*	*15.7*	*12.8*	*16.5*
Profit before tax	*8.5*	*7.9*	*9.0*	*9.6*	*8.3*	*9.8*	*6.1*	*10.8*
Net margin	*6.3*	*5.9*	*6.3*	*6.5*	*6.2*	*6.9*	*4.1*	*7.4*

Source: Company, Centrum Research

Q2FY18- Performance affected by GST

For Q2FY18, on a consolidated basis, ADL reported 7%YoY decline in revenues to Rs3.19bn from Rs3.42bn due to uncertainties of GST implementation. ADL's three API were approved for European markets. The company has received Marketing Authorisation (MA) for Zolpidem tablets and Celecoxib tablets in the UK and Ireland.

ADL's EBIDTA margin grew by 170bps YoY to 16.5% from 14.8% due to the reduction in other expenses and better realisation of its formulations. The company's material cost grew by 250bps to 63.0% from 60.5% due to unfavourable product mix and rise in cost of crude based chemicals. Personnel expenses grew by 60bps to 4.5% from 3.9%. Other expenses declined by 490bps to 16.0% from 20.9% due to cost control measures. The company's interest cost declined by 9% YoY to Rs80mn from Rs88mn due to reduction in working capital. ADL's tax rate declined to 31.6% from 32.4% of PBT. Net profit grew by 7% YoY to Rs236mn from Rs221mn due to margin improvement and lower tax rate. We expect the company to perform better in H2FY18 as there is re-stocking of API and intermediates by its customers.

On a QoQ basis, there was a strong improvement. Total revenues grew 15%YoY to Rs3.19bn from Rs2.77bn. EBIDTA margin grew by 370bps to 16.5% from 12.8%. Net profit grew by 107% to Rs236mn from Rs114mn. The following table shows the details:

Exhibit 27: Q2FY18 results-Consolidated

PARTICULARS (Rs mn)	Q2FY18	Q2FY17	YoY%	Q1FY18	QoQ%
Total income	3,193	3,422	(6.7)	2,772	15.2
Expenditure					
Raw materials	2,013	2,069	(2.7)	1m623	24.0
as % of total income	63.0	60.5		58.5	
Personnel expenses	143	132	8.3	136	5.1
as % of total income	4.5	3.9		4.9	
Other expenses	511	715	(28.5)	659	(22.5)
as % of total income	16.0	20.9		23.8	
Total Expenditure	2,667	2,916	(8.5)	2418	10.3
EBIDTA	**526**	**506**	**4.0**	**354**	**48.6**
EBIDTA Margin (%)	*16.5*	*14.8*	*11.4*	*12.8*	*29.0*
Other income	0	6	NA	1	NA
PBDIT	526	512	2.7	355	48.2
Forex (gain)/ Loss					
Depreciation	101	97	4.1	98	3.1
Interest	80	88	(9.1)	89	(10.1)
PBT	345	327	5.5	168	105.4
Prov. For tax	109	106	2.8	54	101.9
% of PBT	*31.6*	*32.4*		*32.1*	*(1.7*
PAT	236	221	6.8	114	107.0
Minority Interest	0	0	NA	0	NA
Reported PAT	236	221	6.8	114	107.0
Equity capital	239	239	0.0	239	0.0
EPS Rs.(Rs. 10 Paid up)	9.87	9.25	6.8	4.77	107.0

Source: Company, Centrum Research

Exhibit 28: Sensitivity to key variables

Sensitivity to key variables-FY18E	% change	% impact on EBIDTA	% impact on EPS
Sales	*1*	*6.5*	*16.1*
Material cost	*1*	*(3.9)*	*(9.8)*

Source: Centrum Research Estimates

Exhibit 29: Key performance indicators

Key performance indicator	FY16	FY17	FY18E	FY19E	FY20E
Sales growth %	*3.7*	*5.3*	*0.4*	*23.1*	*18.8*
Material cost %	*67.6*	*65.3*	*61.0*	*60.7*	*60.4*

Source: Company, Centrum Research Estimates

Valuations, recommendation and risks

ADL is poised for a good growth due to its strong presence in the domestic API market and other markets of Asia, Latin America, Europe and Africa. We expect the company to report 14% CAGR in revenues, 15% CAGR in EBIDTA and 19% CAGR in net profit over three year period FY17-FY20E led by good growth in anti-infective and anti-diabetic products. We expect ADL to generate additional revenues of Rs343mn in FY18 and Rs686mnin FY19 from the capacity addition for Ciprofloxacin. We expect Rs378mn and Rs756mn revenues for the capacity addition of Metformin in FY18 and FY19 respectively.

We expect the company's EBIDTA margin to decline to 15.5% in FY18E from 15.8% in FY17 due to the GST impact. We expect the EBIDTA margin to improve to 16.1% in FY19E and improve further to 16.5% in FY20E due to the capacity expansion of Ciprofloxacin and Metformin. We expect ADL to report RoE of 22.7% and RoCE of 14.6% for FY20E. We anticipate the company to generate healthy return ratios in future.

We see strong scope for re-rating and value ADL using our conservative five-year AOCF/EV yield methodology to arrive at a target price of Rs940 with an upside of 25% over CMP.

Alternatively, we have valued ADL using P/E method. At the CMP of Rs755, the stock trades at 16.6x FY19E EPS of Rs45.6 and 13.2x FY20E EPS of Rs57.2. We have valued the stock at 17x March'20E EPS of Rs57.2, with a TP of Rs970. This is based on average P/E of 17.0 for last three years. ADL ranks better than its peers due to its wider product basket in the domestic market and presence in Asia, Latin America, Europe and African markets. ADL is a profit-making, dividend-paying company and is poised for good growth.

Cash flow method

We have used the AOCF/ EV Yield (%) method to capture the real operating earnings. The management has flexibility to utilise the operating cash flow towards capex, dividend pay-out, debt repayment and retained earnings for future use. The valuation tool is AOCF/EV Yield (%) values the company on an Enterprise Value basis which in turn is derived from operating earnings. We average the AOCF on a five-year basis to arrive at a normalised cash flow of the company which reveals the real earnings. Using the cash flow valuation method, we have arrived at a target price of Rs940.

Exhibit 30: Target price calculations

5 year adj. oper. cash flows (FY16-FY20E)	**1,107**
5 year adj. oper. cash flows / EV Yield (%)	*4.15*
Multiple assigned	24.09
EV	**26,671**
Net Debt-FY20	(4,782)
Market Cap	**21,889**
Current target Mkt Cap	18,000
Deviation from current TP	3,953
No. of shares (mn)	23.2
Target Price/share (Rs.)	**940**
Potential upside (%)	**25**

Source: Centrum Research Estimates

P/E method

We have alternatively valued ADL on P/E method by considering average P/E value of 17 for last three years and EPS of Rs57.2 to arrive at target price of Rs970.

Exhibit 31: Target price calculations

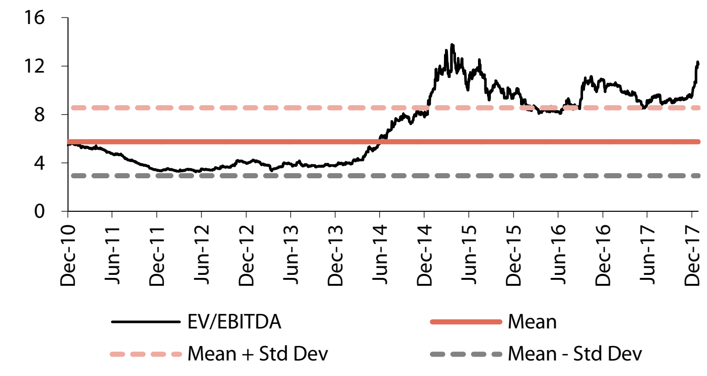
Average P/E of last 3 years	17.0
EPS for FY20E	57.3
Target price Rs.	970

Source: Centrum Research Estimates

Upside possibilities

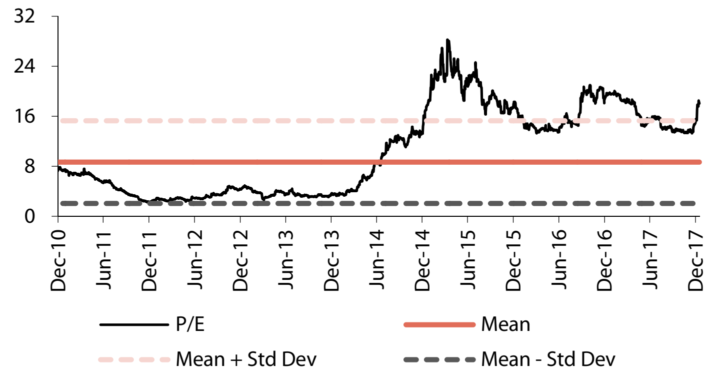
- The steady increase in cash flow would meet future capex requirements and strengthen the balance sheet.
- The Marketing authorisation (MA) for Zolpidem tablets and Celecoxib tablets in the UK and Ireland would improve sales and profitability of ADL.
- We expect margin improvement due to backward integration of Cyclopropylamine (CPA) for its intermediate Q acid. This is expected to reduce the raw material cost of Ciprofloxacin , which contributes ~19% to the total revenues of ADL.
- ADL has multiple revenue streams across the API-domestic and exports, Intermediates, Specialty Chemicals and Formulations and hence is not majorly dependent on any of the segments.

Exhibit 32: 1 year forward EV/EBITDA chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 33: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 34: Peer comparison

Sector	Mkt Cap (Rs mn)	CAGR FY17-FY19E (%)			EBITDA Margin (%)			PE (x)			EV/EBITDA (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Aarti Drugs	**18,000**	**11.1**	**12.1**	**15.0**	**15.8**	**15.5**	**16.1**	**16.2**	**16.0**	**16.6**	**9.4**	**9.3**	**9.4**	**21.0**	**18.2**	**21.3**	**2.2**	**2.2**	**1.7**
Granules India	36,497	21.2	21.4	27.3	20.8	19.7	20.9	19.3	15.3	10.9	10.5	8.6	6.5	21.0	16.1	17.0	0.6	0.6	0.8
Laurus Labs	57,908	20.1	23.9	32.0	21.9	21.3	23.3	23.7	27.1	17.7	15.2	14.1	11.0	17.9	14.5	17.8	0.3	0.3	0.3
Neuland Labs	7,552	9.0	10.7	13.0	15.4	12.9	15.8	25.9	36.3	18.8	11.6	NA	8.6	16.2	9.0	15.8	NA	0.4	0.5

Source: Company, Centrum Research Estimates Prices as on 12h January 2018; NA- Not Available

Business Risks

- ADL derives 36% of its revenues from exports and hence, is subjected to currency fluctuations. Any appreciation in rupee against the dollar would adversely affect the revenues and profitability of the company. However, the company has natural hedge from the import of raw materials.
- The company faces risk of non-compliance with cGMP regulations for its manufacturing facilities, which may result suspension of exports to some of its markets.
- ADL derives ~19% of its revenues from Ciprofloxacin and ~16% of its revenues from Metronidazole and its salt and has high dependence on these products. Any manufacturing, regulatory or marketing issue for these products may adversely impact sales and profitability of the company.
- The company manufactures patent-expired products for the domestic and global markets. ADL is prohibited to sell these products in the countries where the patents are still valid. Any supplies to the countries where the patents are valid would lead to patent infringement with financial liability.
- Majority of API manufactured by ADL uses crude based raw materials. Sudden increase in the crude price is likely to impact the raw material prices. ADL passes on the increase in raw material prices to its customers with a time lag of ~one quarter.
- ADL's Tarapur facility E-22 was inspected by US FDA in August'14 and is under Import Alert since March'15 due to non-compliance with cGMP regulations. The company has submitted CAPA (corrective action, preventive action) plan to US FDA and is likely to invite US FDA for re-inspection in Q4FY18.
- ADL faces stiff competition for some of its products from China.

Exhibit 35: Shareholding pattern *(%)*

% Holding	Sept'17	June'17	March'17	Dec'16
Promoters	*62.5*	*62.7*	*62.5*	*62.3*
FIIs	*4.5*	*4.5*	*4.5*	*4.1*
DIIs	*0.7*	*0.7*	*0.7*	*0.6*
Public	*32.3*	*32.1*	*32.3*	*33.0*

Source: BSE-Sept'17

None of the promoter's shares are pledged.

Company Background

Aarti Drugs (ADL) is a leading player manufacturing APIs, Intermediates and formulations for domestic and global markets. The company derived ~87% of its revenues from the API and intermediate business and 13% from the sale of formulations. ADL has ~1,200 employees. The company enjoys benefits of vertical integration and economies of scale. ADL's manufacturing facilities are approved by various regulatory agencies including WHO GMP. The company has filed 17 DMFs with US FDA.

ADL was established in 1984 by a group of technocrats from Mumbai. The company manufactures and markets over 30 APIs in the domestic and global markets. The company also supplies seventeen Specialty Chemicals and Intermediates to other API manufacturers. The details of the same are indicated in Annexure-1. The company has a strong R & D team engaged in the new product development, process improvement, yield enhancement and development of 'Green Chemistry.' ADL has a pipeline of thirteen APIs in the lifestyle segment. The details of the same are indicated in Annexure-2. The details of various brands and their manufacturers in the domestic market for the API marketed by ADL are indicated in Annexure- 3.

ADL conducts training programs for its employees in the area of: Technological Development, Quality System Management, Behavioural Change Modules, Individual and Operational safety, Personality Development, Computerisation of Systems etc. In addition to this, the employees are sent for training/seminars at prominent training institutions for upgrading their skills.

Exhibit 36: Key Management Personnel

Name	Position	Profile
Prakash M Patil	Chairman , Managing Director & CEO	He is a Chemical Engineer with over 40 years of experience in Chemical & Pharmaceutical industry. He has expertise in product identification, project implementation and manufacturing.
Rashesh C Gogri	Managing Director	He is an Industrial Engineer and holds Diploma in Business Management. He is the Managing Director of ADL and has over 17 years of experience in production, marketing and project management in chemical industry. He is also the Director of Aarti Industries.
Harshit M Savla	Jt. Managing Director	He holds Bachelor's Degree in Commerce and has over 30 years of experience in finance, exports and administration. He has played a crucial role in expanding the export market for the company's products.
Harit P. Shah	Whole Time Director	He holds Bachelor's Degree in Commerce. He has over 25 years of experience in handling commercial functions namely sales, purchase and exports. He looks after domestic sales and exports.
Uday M. Patil	Whole Time Director	He has good experience in the factory administration work and co-ordination with Government/ Semi-Government departments and agencies.
Rajendra V .Gogri	Non-Executive Director	He holds Bachelor's Degree in Chemical Technology from UDCT, Mumbai and Master's Degree in Science from USA. He has rich experience in handling the portfolio of marketing, purchase and other commercial matters. He is actively involved in export development. He has good knowledge of accounts, finance, taxation, legal and other commercial matters. He is also the Chairman of Aarti Industries.
Ramdas M. Gandhi	Independent Director	He holds L.L.M. Degree and is solicitor by profession. He practised in Bombay High Court for over 55 years. He is a corporate lawyer and has vast experience In commercial law and corporate law. He is also the Director of Aarti Industries.
Krishnacharya G. Akamanchi	Independent Director	He holds Master's Degree and Doctorate in Technology. He is the Professor and Head of Department at UDCT, Mumbai. He has vast experience in handling industrial projects involving complex processes. He is involved in the development of new technology. He provides consultancy in emerging areas for various industries.
Dr. Vilas G. Gaikar	Independent Director	He holds Doctorate in Technology and has wide experience of over 25 years in the chemical industry.
Bhavesh R. Vora	Independent Director	He is a Chartered Accountant by profession with over 27 years of experience in working in the areas of Stock Broking, Audit and Compliances, Derivatives, Futures & Options, Accounting Standards and Internal Management Control and Audit. He is also the Director of Aarti Industries.
Priti. P. Savla	Independent Director	She is a Chartered Accountant by profession. She is also the Director of Aarti Industries.
Navin C. shah	Independent Director	He is a Chartered Accountant by profession having over 27 years of experience.
Adhish P Patil	CFO	He holds Master's Degree in Business Administration in Finance along with Degree in Engineering in Information Technology. He has experience in project management and implementing of technology based solutions. He has over 12 years of experience in Finance, Forex, Risk Management and Hedging Strategies.

Source: Company Annual Reports

Corporate Governance-highlighting the finer points

Independent directors' representation on the company board

The board of ADL has equal stregth of independent and promoter directors indicating good corporate goverance. The independent directors add value from their broader business perspective which benefit the company. Higher independence and autonomy of Board of Directors is generally positive for all stakeholders and ADL dispays this trait consistently. We expect the independent directors to participate effectively in voting for Board Resolutions. The details of the same are indicated in the following table:

Exhibit 37: Representation of promoter and independent directors on the ADL Board

Particulars	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Aarti Drugs							
Total strength	12	12	12	12	12	12	12
Promoter Group directors	4	4	4	5	5	5	5
Promoter -Non Executive	2	2	2	1	1	1	1
Independent directors	6	6	6	6	6	6	6
% share of promoters	*50*	*50*	*50*	*50*	*50*	*50*	*50*
% share of independent	*50*	*50*	*50*	*50*	*50*	*50*	*50*

Source: Company Reports, Centrum Research

Compensation to promoters of ADL

ADL promoters drew 4.9% of PBT on an average as their compensation during FY11-FY17. The lowest being 4.1% of PBT in FY17 and the highest of 9.6% of PBT during FY12. The promoters have drawn lower remuneration in order to conserve the resources for future growth of the company. We expect ADL promoters to continue conserving the resources to derive good benefits in future. The details of the same are indicated in the following table:

Exhibit 38: promoter compensation

Name (Rs mn)	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY11-FY17Total
Aarti Drugs								
Prakash M. Patil	5.0	11.1	8.6	11.7	11.8	11.6	12.5	72.3
% share of PBT	*1.5*	*3.3*	*1.3*	*1.4*	*1.2*	*1.2*	*1.1*	*1.4*
Rashesh C. Gogri	0	0.0	7.9	4.9	11.3	10.7	11.4	46.2
% share of PBT	*0.0*	*0.0*	*1.2*	*0.6*	*1.1*	*1.1*	*1.0*	*0.9*
Harshit M.Savla	4.5	10.5	8.0	10.9	11.3	10.7	11.4	67.3
% share of PBT	*1.4*	*3.1*	*1.2*	*1.3*	*1.1*	*1.1*	*1.0*	*1.3*
Harit. P. Shah	4.2	10.2	7.8	10.9	11.3	10.7	11.4	66.5
% share of PBT	*1.3*	*3.1*	*1.2*	*1.3*	*1.1*	*1.1*	*1.0*	*1.3*
Uday M. Patil	0.4	0.4	0.4	0.5	0.6	0.6	0.6	3.5
% share of PBT	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*	*0.1*
Total	14.1	32.2	32.7	38.9	46.3	44.3	47.3	255.8
% share of PBT	*4.3*	*9.6*	*4.9*	*4.6*	*4.6*	*4.7*	*4.1*	*4.9*

Source: Company Reports, Centrum Research

Independent directors profile and compensation

ADL has six independent directors on its Board. Four of the directors are also on the Board of other pharma/ non-pharma companies. Three of the independent directors are also on the Board of Aarti Industries-a Group Company of ADL. The presence in other industries, gives the board a wider perspective to look beyound the industry. We expect the independent directors to effectively participate in the Board meeting to the best of their knowledge and ability. However, the compensation paid to the independent directors is lower compared to the profit generated by the company. The details of the same are as follows:

Exhibit 39: Independent directors profile and compensation

Name (Rs mn)	Since	No. of directorship in other cos.	Companies in which director in FY17	FY17 compensation	*as % of FY16 PBT*
Aarti Drugs					
Ramdas M. Gandhi	2012	2	Aarti Industries, Unichem Labs	0.14	*0.01*
Bhavesh. R. Vora	2012	3	Aarti Inds, Farry Industries, IGC Foils	0.1	*0.01*
Prof. Krishnacharya G. Akamanchi	2012	Nil	NA	0.1	*0.01*
Dr. Vilas G. Gaikar	2012	Nil	NA	0.0	*0.00*
Navin C. Shah	2012	3	Hind Aluminium Inds, Insecticides India, Anshuni Commercials	0.1	*0.01*
Priti P. Savla	2015	1	Aarti industries	0.1	*0.01*
Total				0.5	*0.05*

Source: Company Reports, Centrum Research

Related party transactions

ADL's related party transactions are with its subsidary company, related parties, KMP and relatives of KMP. The major transactions are under employee benefits ranging from 22-35% of the employee cost. Other major head is outstanding unsecured loan from KMP ranging from 0.3% to 7.6% of the loans & advances. We expect that ADL management would have adequate control over the related party transactions.

The details of the same are as follows:

Exhibit 40: Related Party Transactions

Particulars (in %)	Relationship	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Aarti Drugs								
Sales & income from operations	*subsidiary*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.2*
Manufacturing Expenses	*subsidiary*	*0.0*	*0.9*	*0.2*	*2.7*	*1.7*	*1.4*	*2.3*
Interest	*subsidiary*	*0.0*	*0.0*	*0.0*	*0.0*	*2.0*	*1.3*	*1.4*
Outstanding payable	*related parties*	*0.0*	*2.2*	*0.9*	*1.8*	*0.9*	*1.7*	*2.1*
Outstanding receivable	*related parties*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Outstanding unsecured loan	*related parties*	*0.0*	*0.0*	*0.0*	*0.0*	*5.2*	*4.4*	*4.7*
Employee benefits	*Relatives*	*0.0*	*0.6*	*1.1*	*1.0*	*0.8*	*0.9*	*0.7*
Employee benefits	*KMP*	*22.0*	*35.2*	*32.1*	*33.0*	*32.3*	*29.4*	*24.7*
Employee benefits	*Relatives of KMP*	*0.0*	*1.5*	*2.8*	*3.5*	*2.7*	*2.0*	*1.5*
Borrowing costs	*KMP*	*0.1*	*0.9*	*1.0*	*1.0*	*1.2*	*1.8*	*2.1*
Borrowing costs	*Relatives of KMP*	*0.0*	*1.7*	*1.4*	*1.3*	*1.2*	*0.0*	*0.0*
Unsecured loans accepted	*KMP*	*0.0*	*0.8*	*0.1*	*0.4*	*3.8*	*0.3*	*0.0*
Unsecured loans repaid	*KMP*	*0.0*	*0.0*	*0.4*	*0.0*	*0.8*	*0.0*	*0.0*
Unsecured loans repaid	*Relatives of KMP*	*0.0*	*0.2*	*0.3*	*0.0*	*3.4*	*0.0*	*0.0*
Outstanding unsecured loan	*KMP*	*0.3*	*4.6*	*2.9*	*4.2*	*7.4*	*7.0*	*7.6*
Total		***22.4***	***48.6***	***43.2***	***48.9***	***63.4***	***50.2***	***47.3***

Source: Annual Reports

Contingent liabilities

ADL has contingent liabilities amounting to 15% to 24% of its net worth during FY11-FY17. The same has declined from 23% in FY15 to 15% in FY17 due to the reduction in bank guarantees , letter of credit and demand under income tax dispute. The contingent liabilities are mainly arising from bank guarantee and letter of credit, which constitute 5% to 17% of net worth. Since these liabilities are the part of regular course of business, they are not significant. During FY16 and FY17, ADL has extended corporate guarantee of Rs185mn and Rs357mn respectively. This works out to be 5% to 9% of net worth. The corporate guarantee is also the part of the regular course of business. The bank guarantee, letter of ctredit and corporate guarantee are likely to increase with the increase in the size of the business. Excluding the same, the other liabilities are not significant. The details are as follows:

Exhibit 41: Contingent Liabilities

Particulars (Rs mn)	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Aarti Drugs							
Bank Guarantees, Letter of credit	151	226	269	427	458	379	189
Demand under Income tax dispute	3	25	49	120	113	35	29
Sales tax demand	0	0	0	0	0	2	2
Excise duty, fine and penalty	10	10	10	8	8	4	7
Liability on imported raw material	6	6	16	16	19	26	26
Capital account contracts	70	41	73	21	121	30	18
Corporate Guarantee	0	0	0	0	0	185	357
Total	**240**	**308**	**417**	**592**	**719**	**661**	**628**
% share of Net Worth	***14.7***	***17.5***	***20.1***	***23.6***	***23.3***	***18.5***	***15.3***

Source: Annual Reports, Centrum Institution Research

Promoter ownership trend

The promoter holding of ADL has increased gradually to 62.5%% in FY17 from 54.0% in FY11 with a 8.5% increase over a 8 year period. This indicated the faith and confidence of the promoters in the company and its future prospects. The promoter's holding in FY08 was 48.4% which increased to 53.1% in FY09 and declined to 50.0% in FY10.

The promoter's shareholding in J.B. Chemicals & Pharmaceuticals (JBCPL) has increased marginally to 55.8% from 55.4% during similar period. In case of FDC, it has increase to 68.9% from 66.4% due to buyback of shares. The promoter's holding in Unichem Labs has increased to 50.1% in FY17 from 48.7% in FY11 through creeping acquisitions. This indictes that all these pharma company promoters have increased their holdings over the six year period. All the companies have more than 50% promoter's holding which is comfortable. We expect the promoters of these companies to further consolidate their holdings to re-gain faith and confidence of the minority shareholders.

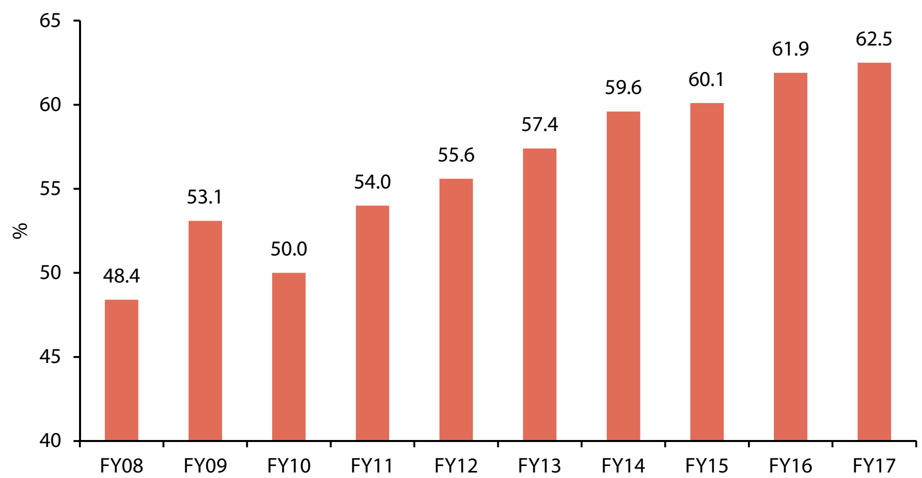
The details of the same are indicated in the following table:

Exhibit 42: Promoter Holding

Promoter Holding %	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Aarti Drugs	*54.0*	*55.6*	*57.4*	*59.6*	*60.1*	*61.9*	*62.5*
JBCPL	*55.4*	*55.9*	*55.9*	*55.9*	*55.8*	*55.8*	*55.8*
FDC	*66.4*	*67.0*	*67.6*	*68.9*	*68.9*	*68.9*	*68.9*
Unichem Labs	*48.7*	*49.6*	*50.0*	*50.2*	*50.1*	*50.1*	*50.1*

Source: Annual Reports

Exhibit 43: Promoter's Holdings %



Source: BSE website

Auditors

ADL paid 0.1% of PBT to its auditors in FY17. The company's auditors Gokhale & Sathe are also auditors of other renowned companies namely Aarti Industries, Dena Bank, IRB Infrastructure Development and MEP Infrastructure. ADL has also inducted cost auditor Girikrishna Maniar for the cost audit of its manufacturing activities. The company has appointed M/s GBCA & Associates-Chartered Accountants as auditors for the period of one year in August'17. GBCA & Associates are Auditors for Union Bank and Navneet Education currently. The details of the same are as follows:

Exhibit 44: Auditor remuneration

Company (Rs mn)	Auditors Name	Type	Other companies audited	Audit Fees -FY17	*as % of PBT*
Aarti Drugs	Gokhale & Sathe	Statutory	Aarti industries, Dena Bank, IRB Infra Devt, MEP Infrastructure	0.97	*0.1*
	Girikrishna. S. Maniar	Cost		0.3	*0.0*

Source: Annual Report, Centrum Research

CSR Activities

ADL has spent 2.1% of its net profit on CSR activities during FY15-FY17 in line with the industry. The company has spent the CSR amount in various social activities in education & skill development, healthcare, environment protection, social welfare and promotion of sports and allied trainings. These activities have been carried out at Boisar, Amravati, Palghar and Nashik in Maharashtra and in Vatrak in Gujarat. We expect the company to fulfill its CSR obligations in future for the welfare of the society.

The details of the same are as follows:

Exhibit 45: CSR Activities

Company (Rs mn)	Year	Amt. spent	Amt. Required to spent	*% of required amt.*	Net profit	*as % of net profit*
	FY15	11.0	12	*91.7*	772	*1.4*
Aarti Drugs	FY16	17.5	17	*102.9*	686	*2.6*
	FY17	18.5	18.5	*100.0*	805	*2.3*

Source: Annual reports

Annexures

Annexure-1

Exhibit 46: Specialty Chemicals and Intermediates marketed

Sr. No.	Product
Specialty chemicals	
1	Benzene sulphonamide
2	Benzene sulphonic acid
3	Benzene sulphonic acid methyl ester
4	Benzyl sulphonyl chloride
5	Cipro Q acid
6	Levofloxacin Q acid
7	Methyl nicotinate
8	N-methyl methane sulphonamide
9	N-phenyl benzene sulphonamide
10	Norfloxacin Q Acid
11	Ofloxacin Q acid
12	O-para toluene sulphonamide
13	Ortho/para toluene sulphonic acid methyl ester
14	Para chloro benzene sulphonamide
15	Para chloro benzene sulphonyl chloride
16	Para toluene sulphonamide
17	Para toluene sulphonic acid methyl ester
18	Para toluene sulphonyl chloride
19	Sodium benzene sulphonate
Intermediates for	
1	Ciprofloxacin
2	Metronidazole
3	Celecoxib
4	Clopidogrel
5	Diclofenac sodium
6	Ketoconazole
7	Nimesulide
8	Reloxifene
9	Zolpidem
10	Telmisartan

Source: Company website

Annexure-2

Exhibit 47: APIs under development

Product	Therapeutic category	Patented product	Patent holder
Atorvastatin	cholesterol reducer	Lipitor	Pfizer
Colesevelam	cholesterol reducer	Welchol	Daiichi Sankyo
Dabigatran	anticoagulant	Pradaxa	Boehringer Ingelheim
Dronedarone	CVS	Multaq	Sanofi Aventis
Olmesartan	CVS	Olmecip	Daiichi Sankyo
Valsartan	CVS	Diovan	Novartis
Sitagliptin	anti-diabetic	Januvia	MSD
Teneligliptin	anti-diabetic	Tenelia	Mitsubishi Pharma
Acamprosate	alcoholism treatment	Campral	Forest Labs
Sevelamer	kidney dialysis	Renagel	Genzyme
Duloxetine	anti-depressant	Cymbalta	Eli Lilly
Loxoprofen sodium	anti-inflammatory	Loxonin	Daiichi Sankyo
Mesalamine	anti-inflammatory	Mesalazine	Disphar International

Source: Company website, Centrum Research

Annexure-3

Exhibit 48: Major APIs and Domestic Brands

API	Domestic Brands & Manufacturers
Aceclofenac	Arflur-FDC, Aroff-Unichem, Signoflam SR-Lupin, Fortafen-Alembic, Zynac-Zydus Cadila
Celecoxib	Celact-Sun Pharma, Celedol-Ipca Labs, Zycel-Zydus Cadila, Revibra-Dr. Reddy's Labs
Diclofenac sodium	Delta K-Sun Pharma, Diclonac-Lupin,Voveran-Novartis, Jonac-Zydus Cadila
Diclofenac potassium	Cataspa-USV, Diclosef-Sun Pharma
Diclofenac diethylamine	Relaxyl-Franco Indian, Unigel-Unichem, Volini Gel-Sun Pharma
Nimesulide	Auronim-Aurobindo, Lupisulide-Lupin, Nimegesic-Alembic, Nise-Dr.Reddy's Labs
Clopidogrel bisulphate	Aptogrel-Aurobindo, Clodrel-Unichem, Clopilet-Sun Pharma, Clopitab-Lupin
Ticlopidine HCl	Ticlop-Zydus Cadila, Tikleen-Ipca Labs, Tilkon-FDC, Tyklid-Torrent
Telmisartan	Telday-Torrent, Telista-Lupin, Telma-Glenmark, Telsar-Unichem, Tetan-Alembic
Metronidazole	Ivmetro-Torrent,Flagyl-Abbott Healthcare, Metrogyl-J B Chem, Metron-Alkem Labs
Ornidazole	Dazolic-Sun Pharma, Entamizole-Abbott India, Orni-Zydus Cadila,Giro-Panacea HC
Secnidazole	Ambiform-Glaxo SK, Etisec-Novartis, Flagentyl-Sanofi India, Amitab-Wockhardt
Tinidazole	Fasigyn-Pfizer, Tiniba-Zydus Cadila, Tinibid-Sun Pharma
Diloxanide furoate	Metron DF-Alkem, Tiniba DF-Zydus Cadila, Wotinex-Wockhardt
Ketoconazole	Fungicide-Torrent, Ketozole-Sun Pharma, Nizral-Johnson & Johnson
Tolnaftate	Tinaderm-Fulford, Dermitop-Cadila Pharma
Raloxifene HCl	Bonmax-Zydus Cadila, Esserm-Torrent, Fiona-Dr. Reddy's Labs, Ralofen-Lupin
Ciprofloxacin HCl	Alcipro-Alkem, C OD-Glaxo SK Pharma, Cifran-Sun Pharma, Ciprolet-Dr. Reddy's Labs
Enrofloxacin base	Baytril Veterinary-Bayer
Gatifloxacin sesquihydrate	Gate-Ajanta Pharma, Gatilox-Sun Pharma, Zigat-FDC, Zymar-Allergan
Levofloxacin	Alevo-Alkem, Glevo-Glenmark, L Cin-Lupin, Leon-Dr. Reddy's Labs,Loxof-Sun Pharma
Moxifloxacin	Moxif-Torrent, Staxom-Sun Pharma, Moxicip-Cipla
Norfloxacin	Alflox-Alkem, Nitdin-lupin, Norbid-Alembic, Norflox-Cipla,Norilet-Dr. Reddy's Labs
Ofloxacin	Oflatoon-Zydus Cadila, Oflomil-Glenmark, Olfi-Ipca Labs, Tarivid-Sanofi India
Metformin HCl	Cetapin XR-Sanofi India, Dibeta-Torrent , Emnorm-Ipca Labs, Glycomet-USV
Pioglitazone HCl	Diavista-Dr. Reddy's Labs, G tase-Unichem, Glizone-Zydus Cadila, Pioglit-Sun Pharma
Rivastigmine tartarate	Exelon-Novartis India, Rivadem-Torrent
Zolpidem tartarate	Nitrest-Sun Pharma, Sove-Ipca Labs, Stilnoct-Sanofi India, Zolfresh-Abbott India
Niacin	Nialip-Dr.Reddy's Labs, Neasyn SR-Torrent
Acamprosate	Campral- Merck, Germany (imported)

Source: Centrum Research, IDR

Financials – consolidated-historical

Exhibit 49: Income Statement

Y/E Mar (Rs mn)	FY11	FY12*	FY13*	FY14*	FY15
Revenues	**5,009**	**6,593**	**8,247**	**9,700**	**10,943**
Material cost	3,342	4,536	5,554	6,625	7,500
% of revenues	*66.7*	*68.8*	*67.3*	*68.3*	*68.5*
Employee cost	215	249	286	324	380
% of revenues	*4.3*	*3.8*	*3.5*	*3.3*	*3.5*
Other Expenses	761	1,009	1,185	1,267	1,365
% of revenues	*15.2*	*15.3*	*14.4*	*13.1*	*12.5*
EBIDTA	**691**	**799**	**1,222**	**1,484**	**1,698**
EBIDTA margin (%)	*13.8*	*12.1*	*14.8*	*15.3*	*15.5*
Depreciation & Amortisation	191	242	260	282	310
EBIT	500	557	962	1,202	1,388
Interest Expenses	171	254	309	372	423
PBT from operations	329	303	653	830	965
Other income	2	31	9	18	32
PBT	331	334	662	848	997
Tax provision	96	110	210	231	225
Effective tax rate (%)	*29.0*	*32.9*	*31.7*	*27.2*	*22.6*
Net profit	235	224	452	617	772
Minority interest	-	-	-	-	-
Reported net profit	235	224	452	617	772
Adj. Net profit	**235**	**224**	**452**	**617**	**772**

*Source: Company, Centrum Research , * Standalone Results*

Exhibit 50: Key Ratios

Y/E Mar (Rs mn)	FY11	FY12*	FY13*	FY14*	FY15
Growth Ratios (%)					
Revenues	*4.7*	*31.6*	*25.1*	*17.6*	*12.8*
EBIDTA	*(16.1)*	*15.6*	*52.9*	*21.4*	*14.4*
Adj. Net Profit	*(17.3)*	*(4.7)*	*101.8*	*36.5*	*25.1*
Margin Ratios (%)					
EBIDTA margin	*13.8*	*12.1*	*14.8*	*15.3*	*15.5*
PBT from operations margin	*6.6*	*4.6*	*7.9*	*8.6*	*8.8*
Adj. PAT margin	*4.7*	*3.4*	*5.5*	*6.4*	*7.1*
Return Ratios (%)					
RoCE	*8.8*	*8.5*	*13.2*	*15.4*	*15.9*
RoE	*15.2*	*13.2*	*23.5*	*26.9*	*27.6*
RoIC	*8.9*	*8.1*	*13.2*	*15.2*	*15.6*
Turnover ratios (days)					
Gross Block Turnover (x)	1.4	1.6	1.8	1.8	1.7
Debtors	88	100	95	104	105
Creditors	44	52	58	57	56
Inventory	67	54	62	48	55
Cash Conversion Cycle	111	102	99	95	104
Solvency Ratio					
Debt-Equity	1.6	1.5	1.4	1.4	1.3
Net Debt-Equity	1.6	1.5	1.4	1.3	1.3
Current Ratio	3.7	2.4	2.2	2.1	2.2
Interest Coverage Ratio	0.3	0.5	0.3	0.3	0.3
Gross Debt/EBIDTA	3.9	3.4	2.4	2.3	2.4
Per Share (Rs)					
FDEPS (adjusted)	10.1	9.6	19.3	26.4	33.0
CEPS	18.2	19.9	30.5	38.5	46.3
Book Value	69.9	75.5	88.8	107.3	131.9
Dividend	5.0	5.0	10.0	13.0	8.0
Dividend Payout (%)	29.8	31.3	31.0	29.7	29.3
Valuations (x) (Avg Mkt Cap)					
PER	12.9	11.0	8.1	7.5	11.6
P/BV	1.9	1.4	1.8	1.9	2.9
EV/EBIDTA	6.1	5.0	4.0	3.9	7.9
Dividend Yield (%)	*4.5*	*5.5*	*7.4*	*7.6*	*2.4*
5-yr Avg AOCF/EV yield(%)	*NA*	*5.8*	*5.9*	*5.6*	*2.8*

*Source: Company, Centrum Research, * Standalone Results*

Exhibit 51: Balance Sheet

Y/E Mar (Rs mn)	FY11	FY12*	FY13*	FY14*	FY15
Share capital	121	121	121	121	242
Sh. Application money	-	-	-	-	-
Reserves & surplus	1,512	1,644	1,955	2,388	2,840
Total shareholders Funds	1,633	1,765	2,076	2,509	3,082
Total Debt	2,674	2,727	2,956	3,422	4,160
Minority interest	-	-	-	-	-
Deferred tax Liab.	227	245	276	311	350
Total Liabilities	**4,534**	**4,737**	**5,308**	**6,242**	**7,592**
Gross Block	3,934	4,394	4,791	5,812	6,854
Less: Acc. Depreciation	1,455	1,657	1,878	2,087	2,369
Net Block	2,479	2,737	2,913	3,725	4,485
Capital WIP	104	30	126	83	161
Net Fixed Assets	**2,583**	**2,767**	**3,039**	**3,808**	**4,646**
Investments	53	68	50	45	46
Inventories	918	979	1,409	1,267	1,642
Debtors	1,214	1,806	2,157	2,766	3,143
Loans & Advances	383	294	223	293	248
Cash & Bank Balance	53	50	29	43	36
Other assets	29	163	291	274	260
Total Current Assets	**2,597**	**3,292**	**4,109**	**4,643**	**5,329**
Trade payable	603	938	1,319	1,502	1,667
Other current Liabilities	66	362	403	555	538
Provisions	30	90	168	197	224
Net Current Assets	**1,898**	**1,902**	**2,219**	**2,389**	**2,900**
Total Assets	**4,534**	**4,737**	**5,308**	**6,242**	**7,592**

*Source: Company, Centrum Research , * Standalone Results*

Exhibit 52: Cash Flow

Y/E Mar (Rs mn)	FY11	FY12*	FY13*	FY14*	FY15
CF before WC changes	718	821	1,197	1,460	1,691
Working Capital Changes	(402)	(308)	(338)	(241)	(495)
CF from Operations	**205**	**443**	**723**	**953**	**1,047**
Adj OCF (OCF-Interest)	34	189	414	581	624
Change in fixed assets	(681)	(473)	(600)	(1,065)	(1,070)
Adj. FCF (AOCF-Capex)	(647)	(284)	(186)	(484)	(446)
CF from Investing	**(764)**	**(478)**	**(580)**	**(1,047)**	**(1,071)**
CF from Financing	**525**	**30**	**(163)**	**108**	**14**
Net change in Cash	**(34)**	**(5)**	**(20)**	**14**	**(10)**

*Source: Company, Centrum Research , * Standalone Results*

Financials -consolidated

Exhibit 53: Income Statement

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Revenues	**11,349**	**11,952**	**12,001**	**14,769**	**17,542**
Material cost	7,668	7,805	7,320	8,960	10,595
% of revenues	67.6	65.3	61.0	60.7	60.4
Employee cost	448	541	568	669	775
% of revenues	3.9	4.5	4.7	4.5	4.4
Other Expenses	1,485	1,715	2,253	2,765	3,274
% of revenues	13.1	14.3	18.8	18.7	18.7
EBIDTA	**1,748**	**1,891**	**1,860**	**2,375**	**2,898**
EBIDTA margin (%)	15.4	15.8	15.5	16.1	16.5
Depreciation & Amortisation	366	384	408	458	522
EBIT	1,382	1,507	1,452	1,917	2,376
Interest Expenses	480	400	325	375	450
PBT from operations	902	1,107	1,127	1,542	1,926
Other income	50	40	21	28	32
PBT	952	1,147	1,148	1,570	1,958
Tax provision	266	342	355	505	620
Effective tax rate (%)	27.9	29.8	30.9	32.2	31.7
Net profit	686	805	793	1,065	1,338
Minority interest	-	-	-	-	-
Reported net profit	686	805	793	1,065	1,338
Adj. Net profit	**686**	**805**	**793**	**1,065**	**1,338**

Source: Company, Centrum Research Estimates

Exhibit 54: Key Ratios

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Growth Ratios (%)					
Revenues	*3.7*	*5.3*	*0.4*	*23.1*	*18.8*
EBIDTA	*2.9*	*8.2*	*(1.6)*	*27.7*	*22.0*
Adj. Net Profit	*(11.1)*	*17.3*	*(1.5)*	*34.3*	*25.6*
Margin Ratios (%)					
EBIDTA margin	*15.4*	*15.8*	*15.5*	*16.1*	*16.5*
PBT from operations margin	*7.9*	*9.3*	*9.4*	*10.4*	*11.0*
Adj. PAT margin	*6.0*	*6.7*	*6.6*	*7.2*	*7.6*
Return Ratios (%)					
RoCE	*12.8*	*12.4*	*10.8*	*12.9*	*14.6*
RoE	*20.6*	*21.0*	*18.2*	*21.3*	*22.8*
RoIC	*12.5*	*12.1*	*10.8*	*12.9*	*14.6*
Turnover ratios (days)					
Gross Block Turnover (x)	1.6	1.5	1.3	1.5	1.6
Debtors	107	91	92	91	92
Creditors	59	60	61	61	61
Inventory	57	64	65	63	62
Cash Conversion Cycle	105	95	96	94	94
Solvency Ratio					
Debt-Equity	1.3	1.1	1.0	0.9	0.8
Net Debt-Equity	1.2	1.1	1.0	0.9	0.7
Current Ratio	2.2	2.1	2.1	2.1	2.1
Interest Coverage Ratio	0.3	0.3	0.2	0.2	0.2
Gross Debt/EBIDTA	2.6	2.4	2.5	2.0	1.7
Per Share (Rs)					
FDEPS (adjusted)	29.3	34.4	33.9	45.6	57.2
CEPS	45.0	50.9	51.4	65.2	79.6
Book Value	152.9	175.7	197.4	229.7	273.1
Dividend	6.8	10.7	1.5	2.0	2.5
Dividend Payout (%) incl. Buyback	*28.0*	*37.0*	*35.8*	*28.9*	*24.0*
Valuations (x) (Avg Mkt Cap)					
PER	20.2	16.2	16.0	16.6	13.2
P/BV	3.9	3.2	2.7	3.3	2.8
EV/EBIDTA	10.8	9.4	9.3	9.4	7.7
Dividend Yield (%)	*1.3*	*2.2*	*2.2*	*1.7*	*1.8*
5-yr Avg AOCF/EV yield(%)	*2.8*	*4.3*	*5.3*	*4.4*	*5.0*

Source: Company, Centrum Research Estimates

Exhibit 55: Balance Sheet

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	242	239	236	234	232
Sh. Application money	-	-	-	-	-
Reserves & surplus	3,332	3,869	4,378	5,136	6,152
Total shareholders Funds	3,574	4,108	4,615	5,370	6,384
Total Debt	4,497	4,463	4,630	4,850	4,920
Minority interest	-	-	-	-	-
Deferred tax Liab.	404	475	490	500	520
Total Liabilities	**8,475**	**9,046**	**9,735**	**10,720**	**11,824**
Gross Block	7,255	8,516	9,484	10,379	11,254
Less: Acc. Depreciation	2,320	2,706	3,114	3,572	4,094
Net Block	4,935	5,810	6,370	6,807	7,160
Capital WIP	340	143	100	110	120
Net Fixed Assets	**5,275**	**5,953**	**6,470**	**6,917**	**7,280**
Investments	46	36	39	41	43
Inventories	1,783	2,098	2,142	2,567	2,998
Debtors	3,317	2,968	3,040	3,700	4,420
Loans & Advances	241	268	285	310	355
Cash & Bank Balance	48	41	121	112	138
Other assets	312	411	475	479	530
Total Current Assets	**5,701**	**5,786**	**6,063**	**7,168**	**8,441**
Trade payable	1,849	1,970	2,010	2,480	2,910
Other current Liabilities	545	560	597	651	710
Provisions	153	199	230	275	320
Net Current Assets	**3,154**	**3,057**	**3,226**	**3,762**	**4,501**
Total Assets	**8,475**	**9,046**	**9,735**	**10,720**	**11,824**

Source: Company, Centrum Research Estimates

Exhibit 56: Cash Flow

Y/E Mar (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
CF before WC changes	1,745	1,887	1,875	2,395	2,920
Working Capital Changes	(212)	72	(120)	(590)	(758)
CF from Operations	**1,333**	**1,745**	**1,475**	**1,380**	**1,632**
Adj OCF (OCF-Interest)	853	1,345	1,150	1,005	1,182
Change in fixed assets	(997)	(1,071)	(925)	(905)	(885)
Adj. FCF (AOCF-Capex)	(144)	274	225	100	297
CF from Investing	**(988)**	**(1,070)**	**(922)**	**(899)**	**(877)**
CF from Financing	**(333)**	**(682)**	**(683)**	**(712)**	**(952)**
Net change in Cash	**12**	**(7)**	**(130)**	**(231)**	**(197)**

Source: Company, Centrum Research Estimates

Appendix A

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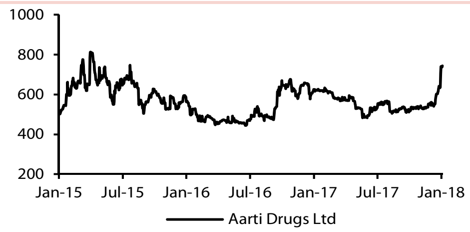
Aarti Drugs price chart



Source: Bloomberg, Centrum Research

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Hold	Upside between -20% to +20%	Upside between -15% to +15%	Upside between -10% to +10%
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