

## Volume Growth Offset by Low Realizations

**Est. Vs. Actual for Q1FY24:** Revenue – **MISS**; EBITDA Margin – **MISS** PAT – **MISS**

### Changes in Estimates post Q1FY24

**FY24E/FY25E:** Revenue -3.8%/-3.8%; EBITDA Abs. -3.7%/-3.8%; PAT -4.7%/-4.8%

### Recommendation Rationale

- Aarti Drugs' Q1FY24 results stood below our expectations, which was primarily on account of fall in exports that comprised Formulations (+6% YoY) and Speciality Chemical segment (-18% YoY).
- While the API volume offtake in the domestic market posted a good pick-up at 18%, realisations declined by 8% YoY. The company reported revenue of Rs 742 Cr, registering a growth of 7% YoY and was led by an encouraging growth of 10% in the API segment on a YoY basis.
- The company's gross margins improved by 200bps QoQ as overall input costs reduced and stabilised during the quarter.
- EBITDA margins improved by 200bps YoY due to operating leverage in the last quarter.
- Reported PAT stood at Rs 48 Cr and beat the estimates by 37.8%.

### Sector Outlook: Positive

**Company Outlook & Guidance:** Most of the API players reported a volume uptick, backed by improved demand and stable realisations. Keeping this in view, we expect demand for API to continue in the upcoming quarters easing supply chain bottlenecks. We believe that Aarti Drugs, being a leader in the domestic industry, is well-placed to capitalize on prevalent as well as future growth opportunities.

**Current Valuation:** PE 20x for FY25 earnings (Earlier Valuation: PE 18x)

**Current TP:** Rs 665/share (Earlier TP: Rs 600/share)

**Recommendation:** BUY

### Financial Performance

Aarti Drugs' reported Q1FY24 results stood below our expectations due to a fall in exports which comprised Formulations (+6%YoY) and Speciality Chemical segment (-18% YoY). Its reported revenue stood at Rs 661 Cr, up 6.3% YoY and the growth was led by the API segment which grew by 9% YoY. There has been a good pick up in the API volume offtake in the domestic market at 18% but realisations declined by 8% on a YoY basis.

From Jan'23 and onwards, there has been a good pick-up in API Volume offtake across the API industry and we expect the momentum to continue in the upcoming quarters. The company's gross margins improved by 200bps QoQ as overall input costs got reduced and stabilised during the quarter. EBITDA margins improved by 200bps YoY due to operating leverage in the last quarter. Moreover, the company's reported PAT stood at Rs 48 Cr and beat the estimates by 37.8%.

The company has incurred a Capex of Rs 315 Cr in the last 2 years mainly towards capacity expansion, backward integration, and new product launches. In this view, FY24 revenue growth may be supported by Tarapur Greenfield Capex for Dermatology, and specialty chemicals are expected to commence operations in Q3FY24 and Q1FY24 respectively. The company has plans to incur an additional Capex of Rs 250-300 Cr in FY24.

**Outlook:** Most API players reported a volume uptick, backed by improved demand and stable realisations. We expect demand for API to continue in the upcoming quarters with the ease of supply chain bottlenecks. An increase in volumes fall in solvent prices, and operating leverage also led to improvement in the EBITDA margins. We believe Aarti Drugs, being the leader in the domestic industry, is well-placed to grab this opportunity in future.

**Valuation & Recommendation:** We recommend a BUY rating on the stock.

### Key Financials (Consolidated)

(Rs Cr)	Q1FY24	QoQ (%)	YoY (%)	Axis Est.	Variance %
Net Sales	661	-10.9	6.3	735	-10.1
EBITDA	84	-10.0	25.2	95	-11.4
EBITDA Margin	12.7%	13	192	12.9%	-
Net Profit	48	-14.5	37.8	55	-12.6
EPS (Rs)	5.2	-14.5	37.8	5.9	-12.6

Source: Company, Axis Research

(CMP as of 24 July 2023)

CMP (Rs)	603
Upside /Downside (%)	10.3%
High/Low (Rs)	612/310
Market cap (Cr)	5,600
Avg. daily vol. (6m)Shrs.	15,000
No. of shares (Cr)	9.52

### Shareholding (%)

	Dec-22	Mar-23	Jun-23
Promoter	59.7	59.6	58.7
FII's	1.9	1.9	2.0
MFs/UTI	3.8	4.0	4.6
Banks/FIs	0.0	0.0	0.0
Others	34.6	34.5	34.7

### Financial & Valuations

Y/E Mar (Rs)	FY23	FY24E	FY25E
Net Sales	1,685	2,043	2,349
EBITDA	537	731	857
Net Profit	374	428	487
EPS (Rs)	27.5	31.4	35.8
PER (x)	23.3	20.4	17.9
P/BV (x)	4.4	3.4	3.2
EV/EBITDA (x)	3.9	3.4	3.0
ROE (%)	18.6	18.4	18.2

### Change in Estimates (%)

Y/E Mar	FY24E	FY25E
Sales	-3.8%	-3.8%
EBITDA	-3.7%	-3.8%
PAT	-4.7%	-4.8%

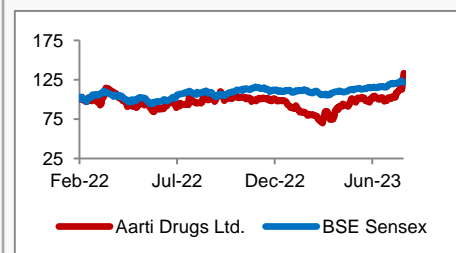
### ESG disclosure Score\*\*

Environmental	N.A.
Social Disclosure Score	N.A.
Governance Disclosure	N.A.
Total ESG Disclosure	N.A.

Source: Bloomberg, Scale: 0.1-100

\*\*Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

### Relative performance



Source: ACE Equity, Axis Securities

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### Anti-diabetic in the API and Specialty Chemicals to support growth

The API segment witnessed a fall in realizations for most of the API products along with a fall in the input costs. The antibiotic therapeutic category contributed ~48%, antiprotozoal ~17%, anti-inflammatory ~11%, anti-diabetic ~13%, antifungal ~7%, and the rest contributed ~4.0% to total consolidated sales. Growth in API business was led by volume growth of 18% driven by domestic market demand uplift. Moreover, exports have been a laggard for API this quarter due to USD shortages for some of the export geographies.

**Capex:** The company has incurred a Capex of Rs 315 Cr in the last 2 years, mainly towards capacity expansion, backward integration, and new product launches. FY24 revenue growth is expected to be aided by Tarapur Greenfield Capex for Dermatology and specialty chemicals are expected to commence operations in Q2FY24 and Q1FY24 respectively. The company has plans to incur additional Capex of Rs 250-300 Cr in FY24E.

### Key Risks to our Estimates and TP

- Global Economic slowdown may lead to low demand for APIs.
- A fall in realization may impact the profitability of the company.
- An increase in debt levels may impact the profitability of the company.

### Change in Estimates

	New		Old		% Change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	3,010	3,446	3,128	3,582	-3.8%	-3.8%
EBITDA	403	498	419	518	-3.7%	-3.8%
PAT	232	305	244	320	-4.7%	-4.8%

Source: Company, Axis Securities

**Q1FY24 Results Review: Aarti Drugs Ltd**

Particulars (INR Crore)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
Net Sales	622	688	664	742	661	6.3	-10.9
Growth (%)	7.2%	18.7%	4.6%	6.9%	6.3%		
Total Expenditure	555	613	593	649	577	4.0	-11.1
Raw Material Consumed	461	447	415	446	409	-11.3	-8.5
Purchase of stock in trade	29	46	25	22	39		
Stock Adjustment	-61	-11	23	47	-2		
% of sales	69.0%	70.0%	69.7%	69.4%	67.5%		
Gross margins (%)	31.0%	30.0%	30.3%	30.6%	32.5%	145	193
Employee Expenses	21	22	24	25	25	22.1	-0.2
% of sales	3.3%	3.2%	3.6%	3.4%	3.8%		
Other Expenses	105	110	107	108	105	0.2	-2.5
% of sales	16.9%	16.0%	16.1%	14.5%	15.9%		
<b>EBITDA</b>	<b>67</b>	<b>74</b>	<b>71</b>	<b>94</b>	<b>84</b>	25.2	-10.0
<b>EBITDAM (%)</b>	<b>10.8%</b>	<b>10.8%</b>	<b>10.7%</b>	<b>12.6%</b>	<b>12.7%</b>	192	13
Interest	7	8	9	9	9		
Depreciation	13	13	13	13	13	0.5	0.8
Other Income	0	0	1	1	1		
Exceptional Items	0	0	0	0	0		
<b>PBT</b>	<b>48</b>	<b>53</b>	<b>50</b>	<b>73</b>	<b>64</b>	32.2	-13.2
Tax	13	15	13	17	16		
Tax (%)	27.5%	27.5%	26.1%	23.3%	24.5%		
<b>Reported PAT</b>	<b>34.9</b>	<b>38.7</b>	<b>36.8</b>	<b>56.2</b>	<b>48.1</b>	37.8	-14.5

Source: Company, Axis Securities

**Revenue Breakup**

Particulars (INR Crore)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
APIs	480	545	557	631	525	9.2	-16.9
Formulations	85	83	50	57	90	5.8	58.3

Source: Company, Axis Securities

## Financials (consolidated)

### Profit & Loss

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Net Sales	2,489	2,716	3,010	3,446
Growth (%)	15.5%	9.1%	10.8%	14.5%
Total Expenditure	2,159	2,410	2,607	2,948
Raw Material Consumed	1,689	1,888	2,047	2,309
<b>Gross margins</b>	<b>32.1%</b>	<b>30.5%</b>	<b>32.0%</b>	<b>33.0%</b>
Employee Expenses	83	92	102	121
% of sales	3.3%	3.4%	3.4%	3.5%
Other Expenses	388	430	458	518
% of sales	15.6%	15.8%	15.2%	15.0%
<b>EBIDTA</b>	<b>330</b>	<b>306</b>	<b>403</b>	<b>498</b>
<b>EBITDAM (%)</b>	<b>13.2%</b>	<b>11.3%</b>	<b>13.4%</b>	<b>14.5%</b>
Depreciation	50	50	63	69
EBIT	280	255	340	429
EBITM (%)	11.2%	9.4%	11.3%	12.5%
Interest	21	33	39	36
Other Income	11	2	5	8
<b>PBT</b>	<b>270</b>	<b>224</b>	<b>306</b>	<b>401</b>
Tax Rate (%)	24.0%	24.0%	24.0%	24.0%
Tax	65	58	73	96
<b>Reported PAT</b>	<b>205</b>	<b>167</b>	<b>232</b>	<b>305</b>

Source: Company, Axis Securities

### Balance Sheet

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
Share Capital	92.6	92.6	92.6	92.6
Reserves & Surplus	944	1,100	1,323	1,618
<b>Shareholders Fund</b>	<b>1,036</b>	<b>1,193</b>	<b>1,416</b>	<b>1,711</b>
Total Debt	538	609	655	605
- Deferred Tax (Net)	72	71	71	71
- Trade Payables	469	480	536	614
Provisions	13	12	10	10
Others	79	57	103	116
<b>Total Liabilities</b>	<b>2208</b>	<b>2421</b>	<b>2790</b>	<b>3126</b>
<b>Gross Block</b>	<b>1,181</b>	<b>1,219</b>	<b>1,669</b>	<b>1,819</b>
Depreciation	496	546	609	679
% of GB	42.0%	44.8%	36.5%	37.3%
Net Block	686	673	1,060	1,141
CWIP	77	210	10	10
<b>- Fixed Assets</b>	<b>766</b>	<b>887</b>	<b>1,074</b>	<b>1,155</b>
Investment	19	19	19	19
- Deferred Tax (Net)	0	0	0	0
Loans & Advances	13	12	13	13
Others	111	114	97	110
- Inventories	526	516	577	661
- Trade Receivables	750	865	957	1,095
<b>- Cash</b>	<b>22</b>	<b>9</b>	<b>54</b>	<b>74</b>
<b>Total Assets</b>	<b>2,207</b>	<b>2,421</b>	<b>2,791</b>	<b>3,128</b>

Source: Company, Axis Securities

**Cash Flow**

(Rs Cr)

Y/E March	FY22A	FY23E	FY24E	FY25E
PBT	270	224	306	401
Add: depreciation	50	50	63	69
Add: Interest	21	33	39	36
Cash flow from operations	341	308	409	506
Change in working capital	255	119	37	145
Taxes	65	58	73	96
Miscellaneous expenses	0	0	0	0
Net cash from operations	21	131	298	265
Capital expenditure	(134)	(172)	(250)	(150)
Change in Investments	(2)	1	(1)	0
Net cash from investing	(136)	(171)	(250)	(150)
Increase/Decrease in debt	234	71	46	(50)
Dividends	(10)	(9)	(9)	(9)
Proceedings from equity	(1)	0	0	0
Interest	(21)	(33)	(39)	(36)
Others	(67)	(0)	0	(0)
Net cash from financing	135	27	(3)	(96)
Net Inc./(Dec.) in Cash	20	(13)	45	20
Opening cash balance	10	22	9	54
Closing cash balance	30	9	54	74

Source: Company, Axis Securities

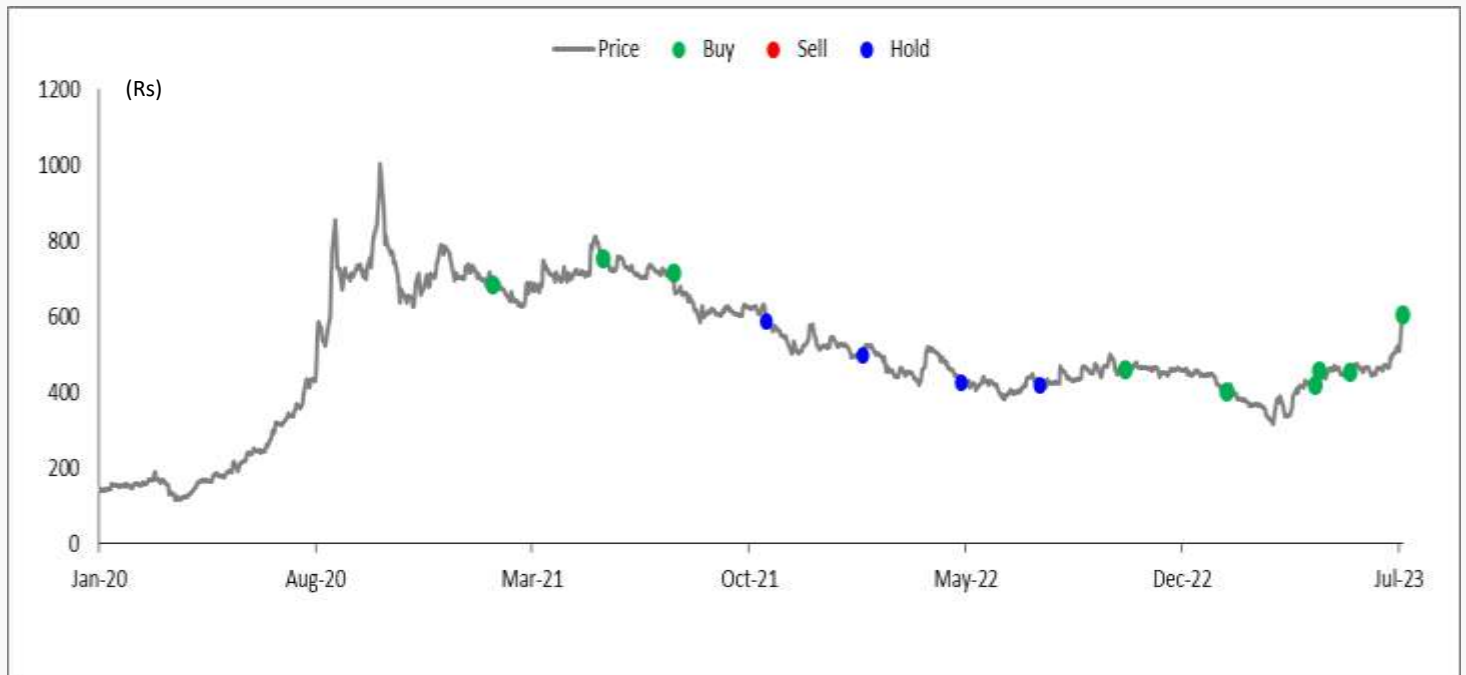
**Ratio Analysis**

(%)

Y/E March	FY22A	FY23E	FY24E	FY25E
<b>Sales growth</b>	<b>15.5</b>	<b>9.1</b>	<b>10.8</b>	<b>14.5</b>
<b>OPM</b>	<b>13.2</b>	<b>11.3</b>	<b>13.4</b>	<b>14.5</b>
Oper. profit growth	(24.6)	(7.2)	31.9	23.6
COGS / Net sales	67.9	69.5	68.0	67.0
Overheads/Net sales	18.9	19.2	18.6	18.5
Depreciation / G. block	4.2	4.1	3.8	3.8
Effective interest rate	24.0	24.0	24.0	24.0
Net wkg.cap / Net sales	0.3	0.4	0.3	0.3
Net sales / Gr block (x)	2.1	2.2	1.8	1.9
<b>RoCE</b>	<b>17.8</b>	<b>14.2</b>	<b>16.4</b>	<b>18.5</b>
Debt / equity (x)	0.5	0.5	0.5	0.4
Effective tax rate	24.0	24.0	24.0	24.0
<b>RoE</b>	<b>19.8</b>	<b>14.0</b>	<b>16.4</b>	<b>17.8</b>
Payout ratio (Div/NP)	10.3	10.2	10.2	10.2
<b>EPS (Rs.)</b>	<b>22.2</b>	<b>18.0</b>	<b>25.1</b>	<b>32.9</b>
EPS Growth	(26.8)	(18.8)	39.5	31.1
CEPS (Rs.)	27.6	23.4	31.9	40.4
DPS (Rs.)	1.0	1.0	1.0	1.0

Source: Company, Axis Securities

## Aarti Drugs Price Chart and Recommendation History



Date	Reco	TP	Research
28-Jan-21	BUY	812	Result Update
18-May-21	BUY	840	Result Update
28-Jul-21	BUY	780	Result Update
29-Oct-21	HOLD	675	Result Update
01-Feb-22	HOLD	540	Result Update
11-May-22	HOLD	450	Result Update
28-Jul-22	HOLD	435	Result Update
21-Oct-22	BUY	550	Result Update
31-Jan-23	BUY	490	Result Update
02-May-23	BUY	600	Top Picks
01-Jun-23	BUY	600	Top Picks
01-Jul-23	BUY	600	Top Picks
25-Jul-23	BUY	665	Result Update

Source: Axis Securities

**About the analyst**

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**Sector:** Midcaps/ Pharma Sector

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**Analyst Bio:** Ankush Mahajan is MBA (Finance) from SMVDU with over 12 years of research experience in the Midcaps/ Pharma Sector

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