Aarti Drugs Ltd

Pharma

BUY
Target Price
535

API Prices Bottomed Out

Est. Vs. Actual for Q2FY25: Revenue – **INLINE**; EBITDA Abs.– **INLINE** PAT – **INLINE**

Changes in Estimates post Q2FY25

FY25E/FY26E: Revenue: 1.6%/1.6%; EBITDA Abs: 0.6%/1.4%; PAT: 1.2%/2.0%

Recommendation Rationale:

Revenue, EBITDA, and PAT declined by 6.7%, 12.3%, and 11.8% YoY, respectively. EBITDA margins contracted by 71 bps YoY, primarily due to negative operating leverage from lower capacity utilization.

In Q2FY25, the company's volumes remained relatively flat compared to the same quarter last year, which saw a 10% YoY growth.

Since Q1FY25, API prices have stabilized, supporting a volume increase that led to a 9% QoQ growth in API segment revenue.

Sector Outlook: Positive

Company Outlook & Guidance: In the API sector, prices have bottomed out and are now stable. The export landscape is expected to improve in the near future, driven by optimal capacity utilization, low stock levels, and an upswing in demand.

Current Valuation: PE 20x for H1FY27E earnings (**Earlier Valuation:**PE 20x)

Current TP: Rs 535/share (Earlier TP: Rs 555/share)

Recommendation: BUY

Financial Performance

Aarti Drugs' Q2FY25 results were largely in line with expectations. Revenue, EBITDA, and PAT declined by 6.7%, 12.3%, and 11.8% YoY, respectively. Despite lower realizations due to negative rate variance and subdued demand in the API business, the company's gross margins improved by 103bps YoY. However, EBITDA margins contracted by 71bps YoY, impacted by negative operating leverage from lower capacity utilization. The Formulations business saw a notable YoY decline of 21%, while the specialty chemicals segment (down 7.1% YoY) is now focusing on expanding into more international markets.

In Q2FY25, the company's volumes were relatively flat compared to the same quarter last year, which saw a 10% YoY growth. Since Q1FY25, API prices have stabilized, supporting a volume increase that drove a 9% QoQ growth in API segment revenue. Expectations are positive for further improvements in API pricing going forward. Additionally, the greenfield specialty chemicals project in Gujarat is set to commence operations this quarter, enhancing operating leverage in the year's second half. Salicylic Acid production has already begun, with plans to ramp up to over 300 tons by October 2024. Total capacity is expected to reach 1,800 tons through FY25E and FY26E.

During H1FY25, the company invested ~Rs 90 Cr in Capex for capacity expansion, backward integration, and new product launches, with a full-year target of ~Rs 200 Cr, primarily funded through internal accruals and partially through term loans.

Key Financials (Consolidated)

(Rs Cr)	Q2FY25	QoQ (%)	YoY (%)	Axis Est.	Variance %
Net Sales	598	7.7	-6.7	584	2.5
EBITDA	67	3.1	-12.3	68	-1.4
EBITDA Margin	11.2%	-51	-71	11.6%	
Net Profit	35	4.9	-11.8	36	-1.5
EPS (Rs)	3.8	4.9	-11.8	3.8	-0.8

Source: Company, Axis Securities Research

(CMP as of 28th October 2024)

CMP (Rs)	482
Upside /Downside (%)	11%
High/Low (Rs)	635/431
Market cap (Cr)	4,390
Avg. daily vol. (6m)Shrs.	15,000
No. of shares (Cr)	9.52

Shareholding (%)

	Mar-24	Jun-24	Sep-24
Promoter	57.1	55.7	55.6
FIIs	2.6	3.0	2.5
MFs/UTI	5.1	5.7	6.3
Banks/FIs	0.0	0.0	0.0
Others	35.2	35.7	35.6

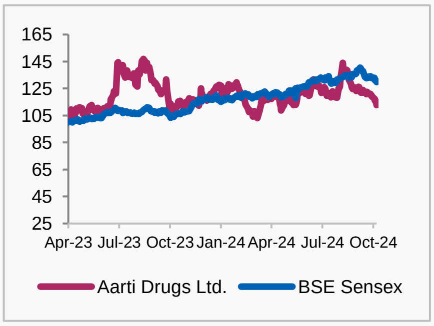
Financial & Valuations

Y/E Mar (Rs Cr)	FY24	FY25E	FY26E
Net Sales	2,529	2,663	2,925
EBITDA	317	338	377
Net Profit	172	186	216
EPS (Rs)	19	20	24
PER (x)	25.7	23.7	20.4
P/BV (x)	15.7	14.6	12.8
EV/EBITDA (x)	3.4	3.0	2.7
ROE (%)	13.4	12.8	13.0

Change in Estimates (%)

Y/E Mar	FY25E	FY26E
Sales	1.6%	1.6%
EBITDA	0.6%	1.4%
PAT	1.2%	2.0%

Relative performance



Source: ACE Equity

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Outlook

The pharma API manufacturing industry is evolving, and the company has focused on maintaining a competitive edge by expanding capabilities and investing in new technologies to enhance efficiency. Despite short-term challenges, the company remains committed to adapting and achieving long-term growth. Growth is anticipated across both API and non-API segments, with ongoing projects and increased exports in the formulations segment supporting future expansion.

Key Highlights of Concall

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

Within the API business, the antibiotic therapeutic category constituted ~40% of total sales, while anti-diabetic products contributed ~18%. Anti-protozoal products made up ~17%, anti-inflammatory products around 10%, and antifungal products roughly 10% of total API sales for Q2FY25. The remaining 4% was attributed to other categories.

Capex

During H1FY25, the company invested ~Rs 90 Cr in Capex for capacity expansion, backward integration, and new product launches, with a full-year target of ~Rs 200 Cr, primarily funded through internal accruals and partially through term loans.

Guidance

According to management, with current pricing levels and existing capacity, the company has a potential standalone revenue of approximately Rs 2,750 Cr for FY25E, covering both the API and Spectrum segments.

New Projects

The greenfield project at Sayakha, Gujarat, for specialty chemicals is progressing on schedule and is expected to commence this quarter. This development is anticipated to enhance operating leverage in the year's second half through improved capacity utilization and increased backward integration. Salicylic Acid production began at the start of this fiscal year, though the company is still ramping up to full capacity. Currently, production stands at around 100 tons per month; despite some initial challenges, the company expects to increase output to over 300 tons per month by the end of this quarter. The total capacity of 1,800 metric tons per month will be scaled up gradually over FY25E and FY26E.

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	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Sales	2,663	2,925	2,622	2,880	1.6%	1.6%
EBITDA	338	377	336	372	0.6%	1.4%
PAT	186	216	184	212	1.2%	2.0%

Source: Company, *Axis Securities Research*

Q2FY25 Results Review: Aarti Drugs Ltd

Particulars (INR Crore)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	YoY (%)	QoQ (%)
Net Sales	**642**	**606**	**620**	**555**	**598**	**-6.7**	**7.7**
Growth (%)	-6.7%	-8.7%	-16.5%	-16.0%	-6.7%		
Total Expenditure	565	536	534	490	531	-6.0	8.4
Raw Material Consumed	396	401	367	348	346	-12.7	-0.6
Purchase of stock in trade	42	-22	20	18	30		
Stock Adjustment	-9	26	10	-6	19		
% Of Sales	66.9%	66.9%	64.0%	64.8%	65.8%		
Gross margins (%)	**33.1%**	**33.1%**	**36.0%**	**35.2%**	**34.2%**	**103**	**-107**
Employee Expenses	25	26	26	26	27	4.4	0.5
% of sales	4.0%	4.2%	4.2%	4.8%	4.4%		
Other Expenses	111	105	111	104	111	0.1	6.3
% of sales	17.2%	17.3%	17.9%	18.8%	18.5%		
EBITDA	**76**	**70**	**86**	**65**	**67**	**-12.3**	**3.1**
EBITDAM (%)	**11.9%**	**11.6%**	**13.9%**	**11.7%**	**11.2%**	**-71**	**-51**
Interest	8	8	9	9	9		
Depreciation	13	13	14	13	14	8.8	2.5
Other Income	1	2	1	1	1		
Exceptional Items	0	0	0	0	0		
PBT	**56**	**52**	**64**	**44**	**46**	**-18.5**	**4.2**
Tax	17	15	15	11	11		
Tax (%)	29.6%	28.8%	23.1%	24.3%	23.8%		
Reported PAT	39.6	36.7	49.4	33.3	35.0	-11.8	4.9

Source: Company, Axis Securities

Revenue Breakup

Particulars (INR Crore)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	YoY (%)	QoQ (%)
APIs	513	485	501	443	485	-5.6	9.5
Formulations	83	79	68	71	66	-21.1	-6.6

Source: Company, *Axis Securities Research*

Financials (consolidated)

Profit & Loss

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E
Net Sales	2,716	2,529	2,663	2,925
Growth (%)	9.1%	-6.9%	5.3%	9.8%
Total Expenditure	2,410	2,212	2,325	2,547
Raw Material Consumed	1,888	1,678	1,744	1,933
Gross margins	30.5%	33.7%	34.5%	33.9%
Employee Expenses	92	102	117	117
% of sales	3.4%	4.0%	4.4%	4.0%
Other Expenses	430	432	463	497
% of sales	15.8%	17.1%	17.4%	17.0%
EBIDTA	306	317	338	377
EBITDAM (%)	11.3%	12.5%	12.7%	12.9%
Depreciation	50	51	66	68
EBIT	255	265	272	309
EBITM (%)	9.4%	10.5%	10.2%	10.6%
Interest	33	34	33	27
Other Income	2	4	9	6
PBT	224	236	248	288
Tax Rate (%)	25.8%	27.1%	25.0%	25.0%
Tax	58	64	62	72
Reported PAT	167	172	186	216

Source: Company, *Axis Securities Research*

Balance Sheet

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E
Share Capital	92.6	91.9	91.9	91.9
Reserves & Surplus	1,100	1,190	1,367	1,574
Shareholders Fund	**1,193**	**1,282**	**1,459**	**1,666**
Total Debt	609	564	564	464
- Deferred Tax (Net)	71	76	76	76
- Trade Payables	480	425	445	489
Provisions	12	6	6	6
Others	57	79	80	88
Total Liabilities	**2421**	**2432**	**2629**	**2788**
Gross Block	**1,199**	**1,386**	**1,786**	**1,836**
Depreciation	526	577	643	711
% of GB	43.9%	41.7%	36.0%	38.8%
Net Block	673	808	1,142	1,124
CWIP	210	225	25	25
- Fixed Assets	**887**	**1,072**	**1,206**	**1,188**
Investment	19	20	20	20
- Deferred Tax (Net)	0	0	0	0
Loans & Advances	12	0	0	0
Others	114	140	113	137
- Inventories	516	486	511	561
- Trade Receivables	865	705	744	817
- Cash	**9**	**9**	36	65
Total Assets	**2,421**	**2,432**	**2,630**	**2,788**

Source: Company, *Axis Securities Research*

Cash Flow

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E
PBT	224	236	248	288
Add: Depreciation	50	51	66	68
Add: Interest	33	34	33	27
Cash flow from operations	308	321	347	383
Change in working capital	119	(138)	17	96
Taxes	58	64	62	72
Miscellaneous expenses	0	0	0	0
Net cash from operations	131	394	268	216
Capital expenditure	(172)	(201)	(200)	(50)
Change in Investments	1	(1)	0	0
Net cash from investing	(171)	(202)	(200)	(50)
Increase/Decrease in debt	71	(45)	0	(100)
Dividends	(9)	(9)	(9)	(9)
Proceedings from equity	0	(1)	0	0
Interest	(33)	(34)	(33)	(27)
Others	(1)	(104)	0	(0)
Net cash from financing	27	(192)	(42)	(136)
Net Inc./(Dec.) in Cash	(14)	0	27	29
Opening cash balance	22	9	9	36
Closing cash balance	9	9	36	65

Source: Company, *Axis Securities Research*

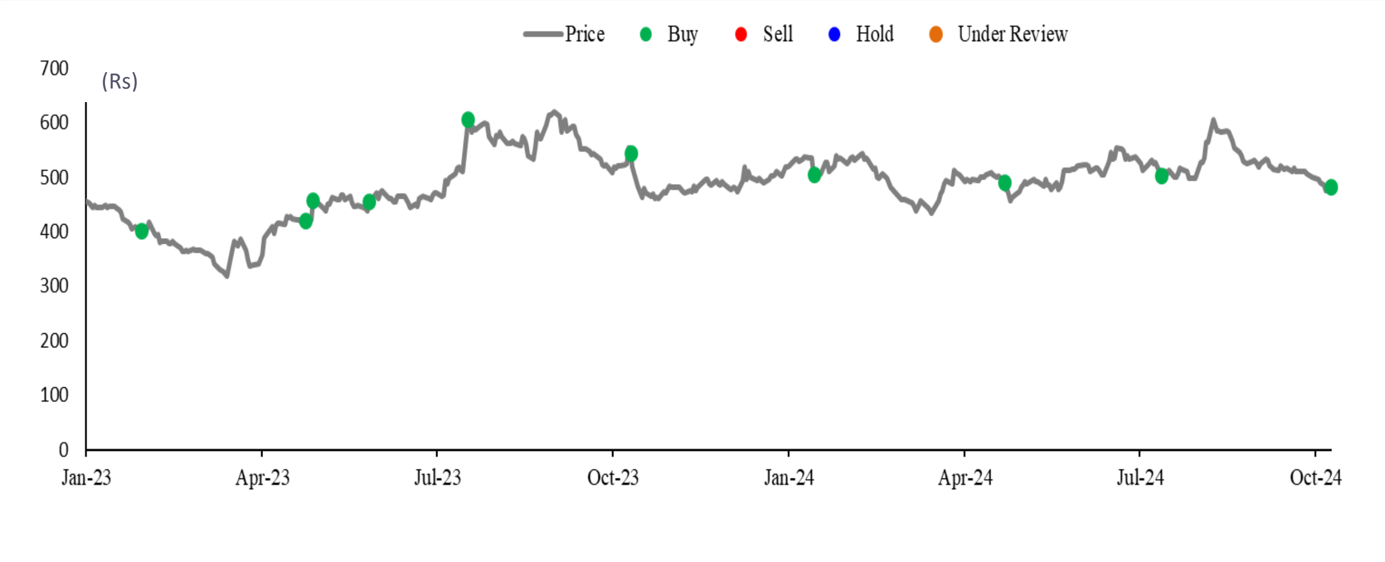
Ratio Analysis

(%)

Y/E March	FY23	FY24	FY25E	FY26E
Sales growth	**9.1**	**(6.9)**	**5.3**	**9.8**
OPM	**11.3**	**12.5**	**12.7**	**12.9**
Oper. profit growth	(7.2)	3.6	6.8	11.6
COGS / Net sales	69.5	66.3	65.5	66.1
Overheads/Net sales	19.2	21.1	21.8	21.0
Depreciation / G. block	4.2	3.7	3.7	3.7
Effective interest rate	25.8	27.1	25.0	25.0
Net wkg. cap / Net sales	0.4	0.3	0.3	0.3
Net sales / Gr block (x)	2.3	1.8	1.5	1.6
RoCE	**14.2**	**14.4**	**13.4**	**14.5**
Debt/equity (x)	0.5	0.4	0.4	0.3
Effective tax rate	25.8	27.1	25.0	25.0
RoE	**14.0**	**13.4**	**12.8**	**13.0**
Payout ratio (Div/NP)	10.2	10.1	10.1	10.1
EPS (Rs.)	**18.0**	**18.7**	**20.3**	**23.5**
EPS Growth	(18.8)	3.2	8.4	16.1
CEPS (Rs.)	23.4	24.3	27.4	30.9
DPS (Rs.)	1.0	1.0	1.0	1.0

Source: Company, *Axis Securities Research*

Aarti Drugs Price Chart and Recommendation History



Date	Reco	TP	Research
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
20-Oct-23	BUY	610	Result Update
29-Jan-24	BUY	570	Result Update
07-May-24	BUY	570	Result Update
30-Jul-24	BUY	555	Result Update
29-Oct-24	BUY	535	Result Update

Source: Axis Securities Research

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