Result Update

Aarti Drugs

Accumulate

Pharmaceuticals | Q2FY24 Result Update

DART
DOLAT ANALYSIS & RESEARCH THEMES
IN-DEPTH• PRECISE• ACTIONABLE

Sluggish export demand impacts API sales

- **Q2FY24 earnings were below our estimates due to lower than expected API sales impacted by negative rate variance & sluggish demand.**
- **Revenue of Rs6.4bn in Q2 declined by 6.7%/3.0% YoY/QoQ mainly on account of decline in API/intermediate sales. EBITDA margin at 11.9% (below est) expanded by 110bps YoY mainly due to gross margin expansion on stabilizing input cost while contracted 80bps QoQ on lower sales.**
- **We downgrade our EPS estimates by 13.8%/14.2% for FY24E/FY25E, assuming lower-than-expected sales & EBITDA margin. Rolling over to FY26, maintain Accumulate with the revised TP of Rs610 at 16xFY26P/E.**

Demand slowdown in exports & lower realisation impacts API growth

Growth in APIs was lower than anticipated at 6.3% declined YoY in Q2FY24 due to lower volume growth of 10% (volume growth in Q1FY24 was 18%) coupled with lower realisations, geopolitical uncertainties and macro-economic volatilities led to sluggish export market demand for APIs. Formulation sales grew by 4.9% for Q2FY24 largely driven by new business gains while contribution in exports (49% of sales) was lower compared to previous quarter (67%). We believe, despite pricing pressure, pick-up in volume growth driven by capacity additions & backward integration would lead to API/formulation revenue CAGR of 10% over FY23-26E.

Expect recovery in specialty chemical segment

Specialty chemical sales declined 57.8% YoY due to absence of campaign based products in Q2, coupled with global industry experiencing weaker demand. However, we believe growth to pick up in specialty chemical business with the higher utilization of existing capacities and new plants coming on stream by Q4FY24, expect specialty chemical revenue CAGR of 20% over FY23-26E.

Valuation

We believe that with input cost stabilizing, coupled with benefits from ramp -up of existing and new facilities, earnings will grow at 29% CAGR over FY23-26E. We maintain our Accumulate rating and introduce FY26 estimates, roll forward our valuation to FY26E with a revised target price of Rs610 at 16x FY26E P/E. Key risks: delay in capacity expansion plan, hindrance in sourcing KSM, higher than expected input cost.

Q2FY24 Result (Rs Mn)

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	6,415	6,877	(6.7)	6,611	(3.0)
Total Expense	5,651	6,135	(7.9)	5,770	(2.1)
EBITDA	765	743	2.9	841	(9.1)
Depreciation	126	127	(0.4)	126	0.1
EBIT	638	616	3.6	715	(10.7)
Other Income	7	1	1280.0	6	15.0
Interest	83	85	(2.6)	85	(3.4)
EBT	563	532	5.8	635	(11.4)
Tax	167	145	15.3	156	7.1
RPAT	396	387	2.3	479	(17.4)
APAT	396	387	2.3	479	(17.4)
			(bps)		(bps)
Gross Margin (%)	33.1	30.0	309	32.5	64
EBITDA Margin (%)	11.9	10.8	112	12.7	(80)
NPM (%)	6.2	5.6	54	7.3	(108)
Tax Rate (%)	29.6	27.2	243	24.5	511
EBIT Margin (%)	10.0	9.0	99	10.8	(86)

CMP	Rs 545
Target / Upside	Rs 610 / 12%
NIFTY	19,625

Scrip Details

Equity / FV	Rs 926mn / Rs 10
Market Cap	Rs 50bn
	USD 614.2mn
52-week High/Low	Rs 646/ 314
Avg. Volume (no)	7,98,148
Bloom Code	ARTD IN

Price Performance	1M	3M	12M
Absolute (%)	(6)	7	18
Rel to NIFTY (%)	(5)	8	6

Shareholding Pattern

	Mar'23	Jun'23	Sep'23
Promoters	59.6	58.7	58.6
MF/Banks/FIs	4.1	4.7	5.3
FIIs	1.9	2.0	2.3
Public / Others	34.4	34.6	33.8

Valuation (x)

	FY24E	FY25E	FY26E
P/E	23.0	17.8	14.3
EV/EBITDA	14.6	11.8	9.7
ROE (%)	17.2	19.4	20.7
RoACE (%)	12.7	14.4	16.1

Estimates (Rs bn)

	FY24E	FY25E	FY26E
Revenue	29.0	32.7	36.7
EBITDA	3.9	4.7	5.7
PAT	2.2	2.8	3.5
EPS (Rs.)	23.7	30.6	38.1

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Exhibit 1: Quarterly revenue mix

Particulars (Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ%	H1FY24	H1FY23	YoY (%)
API	5,089	5,433	(6.3)	5,245	(3.0)	10,336	10,233	1.0
Formulations	866	825	4.9	899	(3.7)	1,765	1,675	5.4
Specialty chemicals, Intermediates & Others	460	619	(25.7)	467	(1.5)	925	1,187	(22.1)
Total	6,415	6,877	(6.7)	6,611	(3.0)	13,026	13,095	(0.5)

Source: Company, DART

Exhibit 2: Actual vs DART estimates

Particulars (Rs mn)	Q2FY24	Q2FY24E	Variance (%)	Comments
Revenue	6,415	7,012	(8.5)	Negative rate variance led to miss on sales
EBITDA	765	936	(18.3)	Lower sales led to miss on EBITDA margin
EBITDA margin (%)	11.9	13.4	(143bps)	
PAT	396	547	(27.6)	
EPS (Rs)	4.3	5.9	(27.6)	

Source: Company, DART

Exhibit 3: Change in estimates

Particulars (Rs mn)	FY24E			FY25E		
	Old	New	Chg. (%)	Old	New	Chg. (%)
Revenue	30,710	28,977	(5.6)	34,452	32,684	(5.1)
EBITDA	4,299	3,854	(10.4)	5,340	4,739	(11.3)
EBITDA Margin (%)	14.0	13.3	(70bps)	15.5	14.5	(100bps)
PAT	2,549	2,198	(13.8)	3,301	2,833	(14.2)
EPS (Rs)	27.5	23.7	(13.8)	35.7	30.6	(14.2)

Source: Company, DART

We downgrade our EPS estimates by 13.8%/14.2% for FY24E/FY25E, assuming lower-than-expected sales & EBITDA margin.

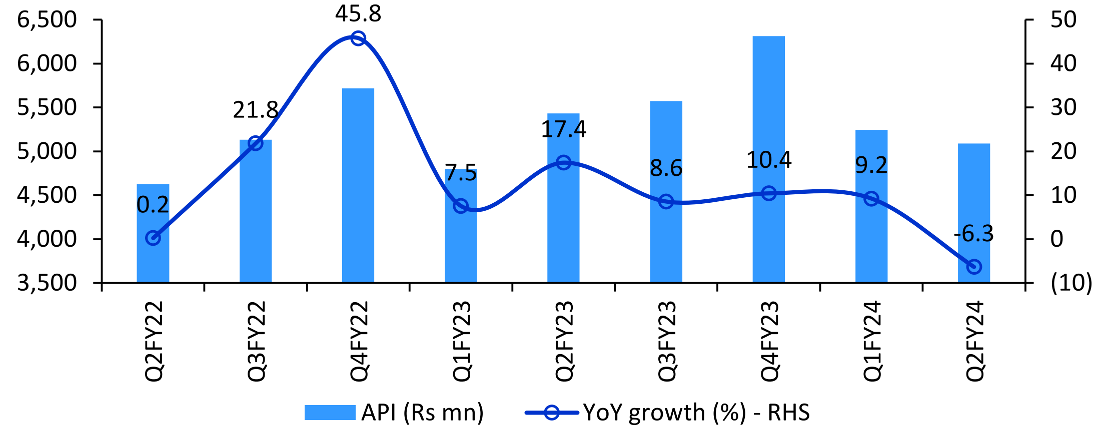
Exhibit 4: Annual revenue assumption table

Particulars (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
API	19,942	22,231	23,565	26,393	29,560
% of sales	80.1	81.9	81.3	80.8	80.6
% YoY	17.0	11.5	6.0	12.0	12.0
Formulation	2,837	2,739	3,013	3,314	3,646
% of sales	11.4	10.1	10.4	10.1	9.9
% YoY	(0.4)	(3.5)	10.0	10.0	10.0
Specialty Chemicals, Intermediates & Others	2,108	2,190	2,399	2,977	3,471
% of sales	8.5	8.1	8.3	9.1	9.5
% YoY	27.5	3.9	9.5	24.1	16.6
Total	**24,887**	**27,160**	**28,977**	**32,684**	**36,676**

Source: Company, DART

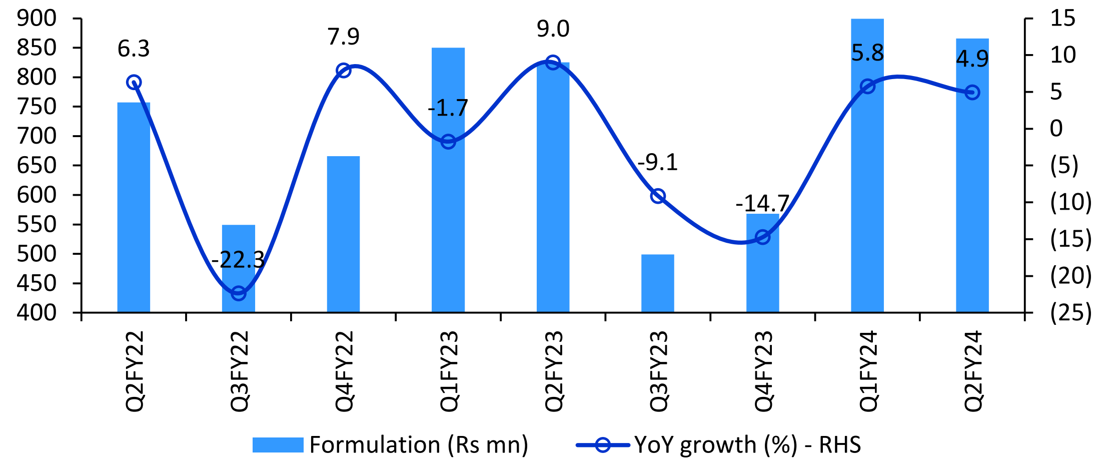
Story in charts

Exhibit 5: Lower realisation led to lower growth in API sales



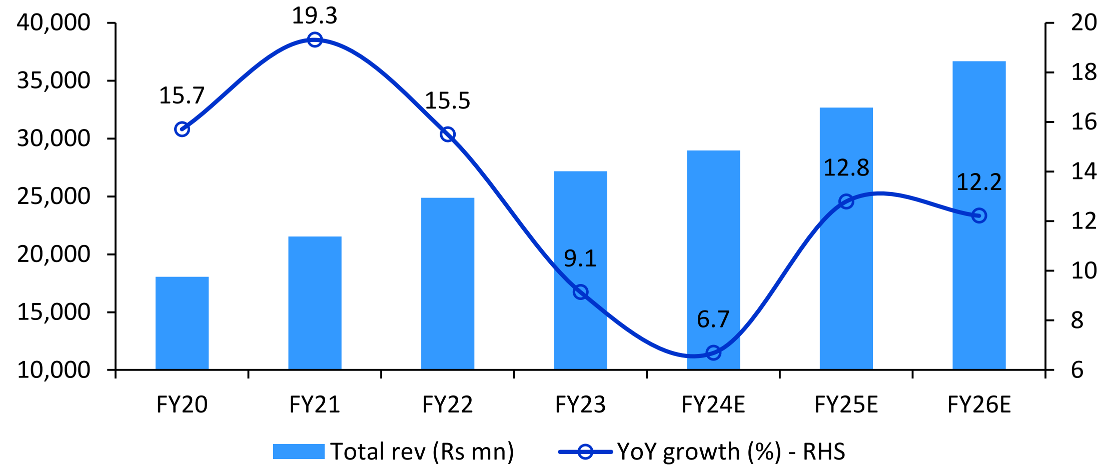
Source: Company, DART

Exhibit 6: New orders drives formulation segment growth



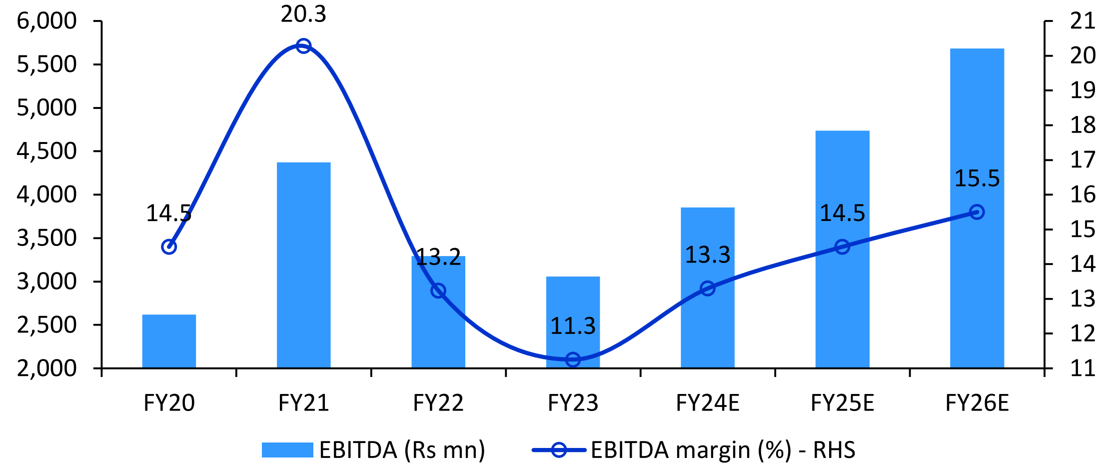
Source: Company, DART

Exhibit 7: Revenue growth to recover due to ramp up in capacity utilization



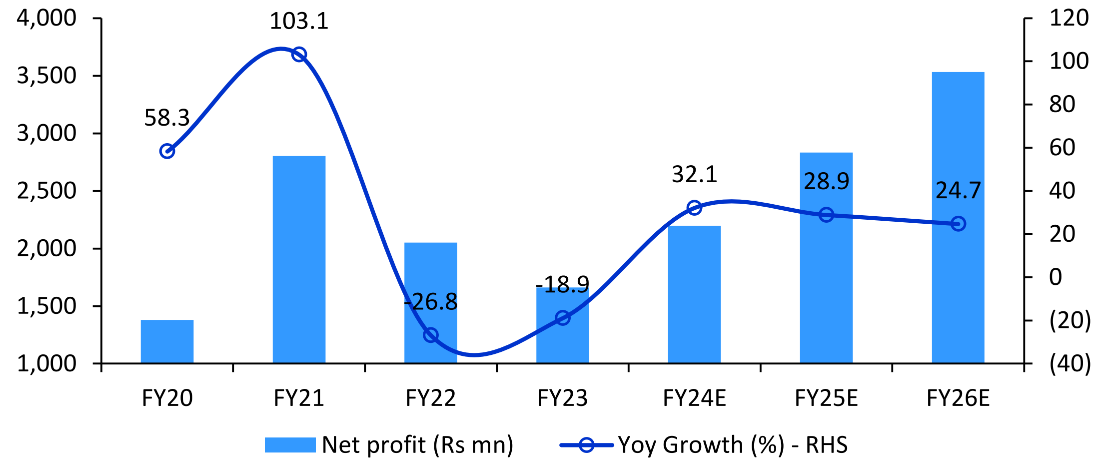
Source: Company, DART

Exhibit 8: EBITDA margin to expand with inflationary pressures on cost cooling off



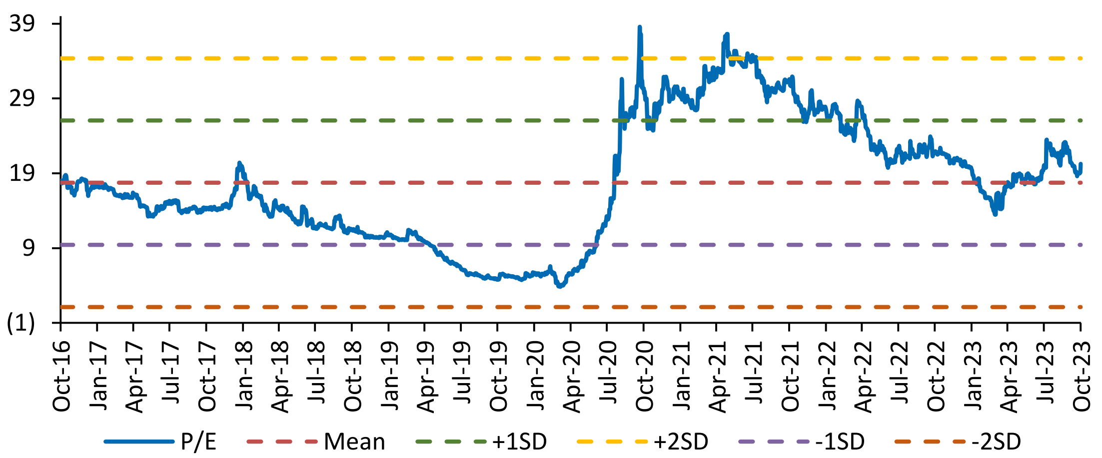
Source: Company, DART

Exhibit 9: Expect 29% earnings CAGR over FY23-26E



Source: Company, DART

Exhibit 10: One year forward P/E band



Source: Company, DART

Earnings call KTA's

Guidance

- The management reduced its EBITDA margin guidance for FY24 from 14.5% to 13%.
- Capex guidance for FY24 maintained at Rs2.5-3.0bn.

API & Specialty Chemicals

- Within the API business, the antibiotic therapeutic category contributed 47%, anti-diabetic- 16%, anti-protozoal- 17%, anti-inflammatory- 10%, antifungal- 8% and the rest contributed 2% to total API sales for Q2FY24.
- The standalone business contributed ~87% to the consolidated revenue for the quarter.
- API volumes grew considerably at ~10% in Q2FY24, led by secular growth across acute as well as chronic therapies.
- 67% of the standalone revenues (API + Specialty Chemicals) came from the domestic market and 33% from the exports market.
- Domestic revenue grew approximately by ~1.0% while exports declined by ~21.0% YoY for Q2FY24.
- Globally, specialty chemical industry demand visibility has been weak and absence of couple of campaign-based products in H1FY24 has impacted this segment. Moreover, there is some spill-over of execution of campaign based specialty products into next quarter.
- High cost inventory were not utilized completely in H1FY24 as there was further price cut in end products in Sep'23.
- The company sources 50% of total raw-materials within India and 40% are imported from China and 10% from other countries.
- The company sees huge potential and demand for Methyl amine products (backward integration for Metformin) and has two products under development. Total capacity allocated to methyl amine is 60MTPA. Out of which, only 30-35% capacity will be utilized in FY25 as it takes time to settle the process.
- Salicylic acid project is expected to start by Dec'23 end.
- API prices have fallen in the past two consecutive quarter. Raw material prices have stabilized from Feb'23, but few of antibiotic & anti-diabetic raw material prices have declined further. For the months of Jul'23 & Aug'23 prices were stable for most of the products while in Sep'23 prices have reduced further.
- Volume growth in API business was partly driven by market gain & partly by rise in demand.
- Volume growth is roughly +5% QoQ but rate declined by 7.5% in Q2FY24.
- API prices declined by 7-7.5% MoM and declined by 16% YoY in the month of Sep'23.
- In month of Sep'23 rate variance declined by 4% for few top products and expects around 3-3.5% decline in rate variance in Q3FY24.
- Backward integration in specialty chemical segment has a positive impact on improving the operating margin by 20%.
- Exports demand has been sluggish for some of the geographies for APIs in the H1FY24 on account of USD shortages, increased interest rates and cautious spending by customers.

Formulation

- Exports continued to remain a key focus area for the formulation segment contributing 49% of total formulation sales.

Pipeline projects

- The company expects Gujarat Sayakha project (Greenfield specialty chemical), Tarapur Capex on Dermatology and Specialty chemical to get completed by mid H2FY24 which shall lead to improvement in margins once commissioned and ramp up in capacity utilization.
- Capex for both combined Sayakha & Tarapur plant is around Rs2.5-3.0bn (Split 50:50).
- Sayakha project was expected to be completed by Q3FY24, but was slightly delayed to Jan'24 due to delay in instrument delivery and is expected to be commercialized by Feb'24. Products in Sayakha are different line of products which are completely new products.
- In Tarapur (brownfield) both facilities are dedicated for chlorosulfonation and its derivatives.
- Post approval of E-22 facility, couple of DMF products will be launched which are in pipeline. The demand for Ciprofloxacin is huge and as the company has received EU GMP certificate, it expects Europe sales to pick up much faster than the US.
- Price differential of two DMF in pipeline which are Narcotic products costs 25% more in Europe and 35-40% more in the US vs India.
- Ciprofloxacin prices in ROW market is US$23-25 and in Europe/US it is around $US35-40.
- Capacity utilization on the existing facility is 74-75% (up by 1% QoQ). Peak utilization is achievable at 90% and in some products around 95% can be achieved.

Others

- The company witnessed a marginal increase in opex due to one-time buyback costs, labour rates revision and other expenses.
- Capex for H1FY24 stood at ~Rs1.09bn and is expected to be in the range of Rs2.5-3.0bn for FY24.
- Capex in FY25 will not be more than Rs1.5bn and dedicated mainly towards adding production line for metformin and one greenfield project mainly adding lines for group of products correlated to salicylic acid.
- Net debt for Q2FY24 is Rs5.9bn.
- Net debt/Equity ratio for Q2FY24 is 0.49x

Financial Performance

Profit and Loss Account

(Rs Mn)	FY23A	FY24E	FY25E	FY26E
Revenue	**27,161**	**28,977**	**32,684**	**36,676**
Total Expense	**24,104**	**25,123**	**27,944**	**30,991**
COGS	18,885	19,356	21,767	24,426
Employees Cost	920	1,130	1,177	1,320
Other expenses	4,299	4,636	5,001	5,245
EBIDTA	**3,056**	**3,854**	**4,739**	**5,685**
Depreciation	503	604	664	704
EBIT	**2,553**	**3,250**	**4,076**	**4,981**
Interest	333	348	328	303
Other Income	22	27	29	31
Exc. / E.O. items	0	0	0	0
EBT	**2,242**	**2,930**	**3,777**	**4,709**
Tax	578	732	944	1,177
RPAT	1,663	2,198	2,833	3,532
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**1,663**	**2,198**	**2,833**	**3,532**

Balance Sheet

(Rs Mn)	FY23A	FY24E	FY25E	FY26E
Sources of Funds				
Equity Capital	926	926	926	926
Minority Interest	2	2	2	2
Reserves & Surplus	10,998	12,647	14,771	17,420
Net Worth	**11,924**	**13,573**	**15,697**	**18,346**
Total Debt	6,065	6,515	6,115	5,615
Net Deferred Tax Liability	954	958	961	964
Total Capital Employed	**18,946**	**21,048**	**22,776**	**24,927**
Applications of Funds				
Net Block	**6,762**	**9,099**	**9,895**	**10,895**
CWIP	2,104	2,104	2,104	2,104
Investments	425	444	485	522
Current Assets, Loans & Advances	**14,923**	**15,081**	**16,672**	**18,503**
Inventories	5,163	5,557	6,268	7,034
Receivables	8,648	7,939	8,507	9,546
Cash and Bank Balances	90	552	755	769
Loans and Advances	0	0	0	0
Other Current Assets	1,023	1,033	1,142	1,154
Less: Current Liabilities & Provisions	**5,268**	**5,678**	**6,380**	**7,096**
Payables	4,803	5,124	5,820	6,531
Other Current Liabilities	465	554	559	565
sub total				
Net Current Assets	9,656	9,403	10,292	11,406
Total Assets	**18,946**	**21,048**	**22,776**	**24,927**

E – Estimates

Important Ratios

Particulars	FY23A	FY24E	FY25E	FY26E
(A) Margins (%)				
Gross Profit Margin	30.5	33.2	33.4	33.4
EBIDTA Margin	11.3	13.3	14.5	15.5
EBIT Margin	9.4	11.2	12.5	13.6
Tax rate	25.8	25.0	25.0	25.0
Net Profit Margin	6.1	7.6	8.7	9.6
(B) As Percentage of Net Sales (%)				
COGS	69.5	66.8	66.6	66.6
Employee	3.4	3.9	3.6	3.6
Other	15.8	16.0	15.3	14.3
(C) Measure of Financial Status				
Gross Debt / Equity	0.5	0.5	0.4	0.3
Interest Coverage	7.7	9.3	12.4	16.5
Inventory days	69	70	70	70
Debtors days	116	100	95	95
Average Cost of Debt	5.8	5.5	5.2	5.2
Payable days	65	65	65	65
Working Capital days	130	118	115	114
FA T/O	4.0	3.2	3.3	3.4
(D) Measures of Investment				
AEPS (Rs)	18.0	23.7	30.6	38.1
CEPS (Rs)	23.4	30.3	37.8	45.7
DPS (Rs)	1.0	5.9	7.6	9.5
Dividend Payout (%)	5.6	25.0	25.0	25.0
BVPS (Rs)	128.8	146.6	169.5	198.1
RoANW (%)	14.9	17.2	19.4	20.7
RoACE (%)	11.2	12.7	14.4	16.1
RoAIC (%)	14.4	16.5	19.2	21.6
(E) Valuation Ratios				
CMP (Rs)	545	545	545	545
P/E	30.3	23.0	17.8	14.3
Mcap (Rs Mn)	50,467	50,467	50,467	50,467
MCap/ Sales	1.9	1.7	1.5	1.4
EV	56,443	56,430	55,827	55,313
EV/Sales	2.1	1.9	1.7	1.5
EV/EBITDA	18.5	14.6	11.8	9.7
P/BV	4.2	3.7	3.2	2.8
Dividend Yield (%)	0.2	1.1	1.4	1.7
(F) Growth Rate (%)				
Revenue	9.1	6.7	12.8	12.2
EBITDA	(7.2)	26.1	23.0	20.0
EBIT	(8.6)	27.3	25.4	22.2
PBT	(17.0)	30.7	28.9	24.7
APAT	(18.9)	32.1	28.9	24.7
EPS	(18.9)	32.1	28.9	24.7

E – Estimates

Cash Flow

Particulars	FY23A	FY24E	FY25E	FY26E
Profit before tax	**2,220**	**2,902**	**3,748**	**4,679**
Depreciation & w.o.	503	604	664	704
Net Interest Exp	333	348	328	303
Direct taxes paid	(589)	(732)	(944)	(1,177)
Change in Working Capital	(1,150)	719	(684)	(1,097)
Non Cash	0	0	0	0
(A) CF from Operating Activities	**1,317**	**3,841**	**3,111**	**3,410**
Capex {(Inc.)/ Dec. in Fixed Assets n WIP}	(1,702)	(2,940)	(1,460)	(1,704)
Free Cash Flow	**(385)**	**901**	**1,651**	**1,707**
(Inc)./ Dec. in Investments	0	0	0	0
Other	22	27	29	31
(B) CF from Investing Activities	**(1,680)**	**(2,913)**	**(1,431)**	**(1,673)**
Issue of Equity/ Preference	0	0	0	0
Inc./(Dec.) in Debt	660	450	(400)	(500)
Interest exp net	(333)	(348)	(328)	(303)
Dividend Paid (Incl. Tax)	(93)	(549)	(708)	(883)
Other	(5)	(19)	(41)	(37)
(C) CF from Financing	**229**	**(466)**	**(1,477)**	**(1,723)**
Net Change in Cash	(134)	462	203	15
Opening Cash balances	**223**	**90**	**552**	**755**
Closing Cash balances	**90**	**552**	**755**	**769**

E – Estimates

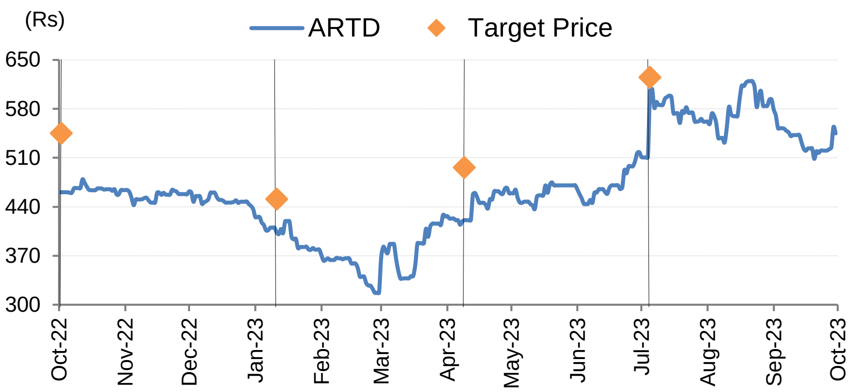
Notes

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Oct-22	Accumulate	545	461
Jan-23	Accumulate	451	404
Apr-23	Accumulate	496	421
Jul-23	Accumulate	625	606

**Price as on recommendation date*

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