

BUY

TP: Rs 2,290 | ▲ 16%

ALKEM LABS

Pharmaceuticals

11 November 2019

Good Q2, tax cut drives EPS upgrade; retain BUY

Alkem reported an 11% EBITDA beat in Q2 driven by a sales beat and better cost control. India grew 17.6% YoY; US sales grew 10% QoQ to US\$ 76mn. Gross margin (excl. one-time cost) improved YoY. Prescription growth trend is healthy so far, and Alkem retains its mid-teen sales growth guidance for FY20. Trade generic business was flat at 15% of sales. H2 should benefit from more US launches and softer RM cost. We raise FY20/FY21 EPS by ~13% due to lower tax guidance of 10% and the India beat. Retain BUY; TP revised to Rs 2,290 (vs. Rs 2,230).

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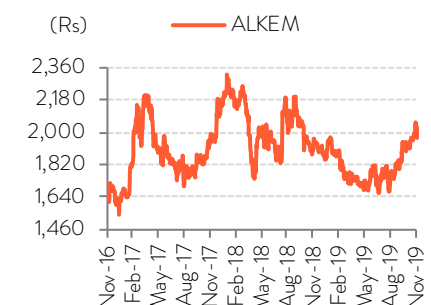
India business upbeat, one-time cost hits gross margins: Q2 India sales growth was better than estimates at 17.6% YoY (acute up 15%, chronic 24%), with normalised generics business (15% of sales). Alkem sees no change on the 1.5% industry volume growth pattern so far and its prescription growth trend is healthy. Gross margin fell 146bps QoQ due to a higher anti-infective mix plus one-off cost related to material used for R&D activities (1ppt impact) which should be recouped. Alkem maintained its mid-teen growth guidance for FY20.

Ticker/Price	ALKEM IN/Rs 1,972
Market cap	US\$ 3.3bn
Shares o/s	120mn
3M ADV	US\$ 1.2mn
52wk high/low	Rs 2,079/Rs 1,660
Promoter/FPI/DII	66%/2%/5%

Source: NSE

11% EBITDA beat, US sales steady: US sales at US\$ 76mn rose 10% QoQ led by a stable base and limited contribution from sartans. H2 should be launch-heavy and hence we expect the quarterly run-rate to improve, with scale-up in existing products (gVesicare, Ampyra). H1 US sales totalled US\$ 144mn and is tracking well with our full-year FY20 estimate of US\$ 311mn. Cost control was visible in Q2 as well, with SG&A increasing 11% YoY vs. 17% growth in sales.

STOCK PERFORMANCE



Source: NSE

Other key highlights: (1) Only 20-30% of targeted cost saving realised; rest to reflect in next two years. (2) Field force steady at ~10,000 with ~24% attrition. (3) Increase in net debt over Mar-Sep'19 due to higher working capital; will ease in coming quarters. (4) FY20 tax guided at 10% (15% earlier).

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	64,218	73,558	82,096	91,948	102,662
EBITDA (Rs mn)	10,284	11,135	13,324	15,958	18,696
Adj. net profit (Rs mn)	6,309	7,298	10,263	12,608	13,682
Adj. EPS (Rs)	52.8	61.0	85.9	105.5	114.4
Adj. EPS growth (%)	(29.3)	15.7	40.6	22.8	8.5
Adj. ROAE (%)	15.8	16.3	20.0	21.0	19.5
Adj. P/E (x)	37.4	32.3	23.0	18.7	17.2
EV/EBITDA (x)	22.9	21.3	17.7	14.3	11.9

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Q2FY20E	Var. (%)
Net Sales	22,640	19,189	18.0	18,495	22.4	21,368	6.0
EBITDA	4,526	3,642	24.3	2,646	71.1	4,083	10.8
Depreciation	564	458	-	558	-	580	-
EBIT	3,962	3,184	24.4	2,088	89.8	3,503	-
Interest	178	164	-	161	-	120	-
Other Income	314	240	-	175	-	240	-
PBT	4,099	3,260	25.7	2,102	95.0	3,623	-
Less: Taxation	293	656	-	227	-	725	-
Less: Minority Interest	97	60	-	18	-	0	-
Recurring PAT	3,709	2,545	45.7	1,857	99.7	2,899	27.9
Exceptional items	0	0	-	0	-	0	-
Reported PAT	3,709	2,545	45.7	1,857	99.7	2,899	27.9
Key Ratios (%)							
Gross Margin	60.1	60.2	-	61.5	-	60.0	-
EBITDA Margin	20.0	19.0	-	14.3	-	19.1	-
Tax / PBT	7.2	20.1	-	10.8	-	20.0	-
NPM	16.4	13.3	-	10.0	-	13.6	-
EPS (Rs)	31.0	21.3	-	15.5	-	24.2	-

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT SALES

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Q2FY20E	Var. (%)
Formulations							
India	15,503	13,184	17.6	12,222	26.8	15,033	3.1
US	5,370	4,725	13.7	4,817	11.5	5,110	5.1
RoW	1,321	1,084	21.9	1,095	20.6	1,225	7.8
Net Sales	22,194	18,993	16.9	18,134	22.4	21,368	3.9

Source: Company, BOBCAPS Research

Valuation methodology

Factoring in lower tax guidance for FY20/FY21, we revise our EPS estimates up 13-14%; however, our core EBITDA upgrade is in the region of 2% for these years partially led by the good India sales beat. We now expect over 25% EPS growth over the next two years. Our revised FY20/FY21 EPS estimates stand at Rs 86/Rs 105. Alkem is currently trading at 19x FY21E P/E and 14x EV/EBITDA, which is ~30% below the three-year mean.

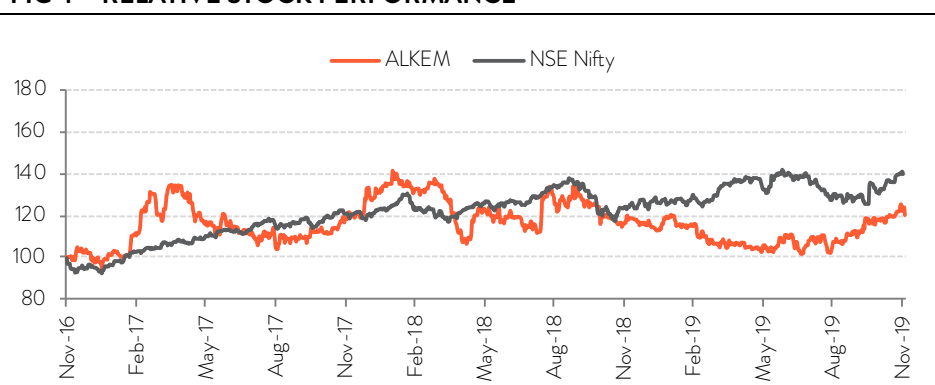
We continue to like Alkem based on (1) recovery in India formulation business margins led by the high-margin acute portfolio and emerging chronic sales, (2) strong operating leverage in the US from new launches (expect 4x margin jump from current low single digits) together with an improving pipeline, (3) easing of US facility concentration risk, (4) reversal of the negative earnings growth trend over the next two years, and (5) capex moderation driving >29% ROIC in two years. We revise our Sep'20 SOTP-based target price from Rs 2,230 to Rs 2,290 (15x EV/EBITDA, implied P/E of 21x). Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs bn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Sales	82.1	91.9	102.7	82.1	91.9	102.7	0.0	0.0	0.0
EBITDA	13.3	16.0	18.7	13.1	15.7	18.4	2.1	1.7	1.6
EBITDA margin (%)	16.2	17.4	18.2	15.9	17.1	17.9	33bps	29bps	29bps
EPS (Rs)	86	105	114	75	93	111	14.5	13.2	2.8

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Regulatory action and slowdown in India formulation business:** Expansion of NLEM coverage and the FDC ban in 2018 affected industry growth. The NLEM order has hit most large brands in the acute segment, taking the share of Alkem's price-controlled portfolio to 30% of its domestic formulation business vs. 17% for IPM.

While Alkem's current portfolio under NLEM is meaningfully higher than the market, any further regulatory action in the acute segment is unlikely to have much bearing on financials. Also, Alkem has a minor presence in the chronic segment with smaller brands and negligible price leadership. Disruption in the trade generics business due to regulatory action could also be a key risk to the stock since this accounts for 15% of overall domestic sales. Also, any slowdown in IPM growth and delay in new launches can adversely affect earnings.

- **Poor US execution:** We expect the US market to contribute meaningfully to profitability in the coming years – up from 3% of FY19 EBITDA to 8% in FY21 (or 30% of incremental EBITDA). Any delay in key launches, surprise new competition in niche products, regulatory action on manufacturing facilities (Daman, Baddi, St. Louis), and above-expected price erosion in the top 5 products could be potential threats to earnings.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	64,218	73,558	82,096	91,948	102,662
EBITDA	10,284	11,135	13,324	15,958	18,696
Depreciation	1,430	1,932	2,034	2,301	2,585
EBIT	8,854	9,203	11,290	13,657	16,111
Net interest income/(expenses)	(553)	(546)	(572)	(602)	(602)
Other income/(expenses)	960	582	990	1,486	1,876
Exceptional items	0	0	0	0	0
EBT	9,260	9,239	11,709	14,541	17,386
Income taxes	2,876	1,810	1,288	1,745	3,477
Extraordinary items	0	307	0	0	0
Min. int./Inc. from associates	75	131	157	189	226
Reported net profit	6,309	7,605	10,263	12,608	13,682
Adjustments	0	307	0	0	0
Adjusted net profit	6,309	7,298	10,263	12,608	13,682

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	9,607	9,622	11,106	12,439	13,889
Other current liabilities	4,487	4,435	6,486	7,264	8,111
Provisions	2,742	3,275	3,655	4,094	4,571
Debt funds	9,950	9,025	10,025	10,025	10,025
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	43,075	48,407	56,277	65,945	76,436
Shareholders' fund	43,314	48,646	56,516	66,184	76,675
Total liabilities and equities	70,100	75,003	87,789	100,006	113,270
Cash and cash eq.	5,768	6,615	15,187	20,806	26,327
Accounts receivables	10,805	12,484	14,438	16,171	18,055
Inventories	14,422	14,998	16,659	18,659	20,833
Other current assets	8,016	7,669	9,729	10,897	12,166
Investments	4,443	3,236	3,236	3,236	3,236
Net fixed assets	22,836	25,072	27,538	29,237	31,652
CWIP	3,810	4,930	1,000	1,000	1,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	70,099	75,004	87,789	100,006	113,270

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	7,740	9,537	12,297	14,909	16,267
Interest expenses	553	546	572	602	602
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,500)	(1,411)	(1,761)	(2,350)	(2,555)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	6,793	8,671	11,108	13,161	14,313
Capital expenditures	(6,266)	(3,991)	(4,500)	(4,000)	(5,000)
Change in investments	1,087	1,207	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(5,179)	(2,784)	(4,500)	(4,000)	(5,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,411	(925)	1,000	0	0
Interest expenses	(553)	(546)	(572)	(602)	(602)
Dividends paid	(2,180)	(1,702)	(2,393)	(2,940)	(3,191)
Other financing cash flows	(516)	(1,868)	3,930	0	0
Cash flow from financing	162	(5,040)	1,965	(3,542)	(3,792)
Changes in cash and cash eq.	1,776	847	8,573	5,619	5,521
Closing cash and cash eq.	5,768	6,614	15,188	20,806	26,327

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	52.8	63.6	85.9	105.5	114.4
Adjusted EPS	52.8	61.0	85.9	105.5	114.4
Dividend per share	13.0	12.2	17.2	21.1	22.9
Book value per share	352.1	395.8	461.6	542.5	630.3

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	3.7	3.2	2.9	2.5	2.2
EV/EBITDA	22.9	21.3	17.7	14.3	11.9
Adjusted P/E	37.4	32.3	23.0	18.7	17.2
P/BV	5.6	5.0	4.3	3.6	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	68.1	79.0	87.7	86.7	78.7
Interest burden (PBT/EBIT)	104.6	100.4	103.7	106.5	107.9
EBIT margin (EBIT/Revenue)	13.8	12.5	13.8	14.9	15.7
Asset turnover (Revenue/Avg TA)	32.5	33.2	33.0	32.2	31.5
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.2	1.2	1.2
Adjusted ROAE	15.8	16.3	20.0	21.0	19.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	12.9	14.5	11.6	12.0	11.7
EBITDA	2.9	8.3	19.7	19.8	17.2
Adjusted EPS	(29.3)	15.7	40.6	22.8	8.5
Profitability & Return ratios (%)					
EBITDA margin	16.0	15.1	16.2	17.4	18.2
EBIT margin	13.8	12.5	13.8	14.9	15.7
Adjusted profit margin	9.8	9.9	12.5	13.7	13.3
Adjusted ROAE	15.8	16.3	20.0	21.0	19.5
ROCE	19.9	17.6	19.8	21.2	22.1
Working capital days (days)					
Receivables	62	63	65	65	65
Inventory	83	75	75	75	75
Payables	55	48	50	50	50
Ratios (x)					
Gross asset turnover	2.5	2.4	2.4	2.4	2.4
Current ratio	2.3	2.4	2.6	2.8	2.9
Net interest coverage ratio	16.0	16.9	19.8	22.7	26.8
Adjusted debt/equity	0.0	0.0	(0.1)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: ALKEM LABS (ALKEM IN)



B – Buy, A – Add, R – Reduce, S – Sell

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