

**BUY**  
 TP: Rs 7,225 | ▲ 30%

**ALKEM LABS**

Pharmaceuticals

14 November 2024

**In-line Q2, margins expected to sustain due to cost efficiencies**

- Q2 reported in-line numbers, where sales/EBITDA were 4% below our estimates. However, PAT was 1% above our estimate
- EBITDA margin was maintained at 22%, despite 6% domestic growth and 22% decline in US sales, driven by cost efficiencies
- We maintain BUY on ALKEM and value the stock at a P/E of 29x on Sep’26 to yield a TP of Rs 7,225 due to higher EBITDA margin trajectory

**Foram Parekh**

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**Slowdown in acute therapies takes a toll on domestic business:** ALKEM reported muted revenue growth in Q2 of -0.7% YoY (12% QoQ) to Rs 34.1bn, missing our estimate by 3.7%. This was due to the continued slowdown in the injectables segment of Anti-Infective therapy and no price hike in the NLEM portfolio vs double-digit growth last year. However, cost efficiency measures and higher other income (inclusion of forex gains) resulted in 11% YoY growth in PAT to Rs 6.9bn.

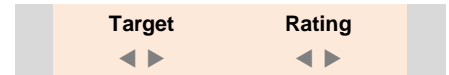
**US business to witness recovery in H2:** The US business declined 22% YoY to Rs 5.9bn due to supply chain issues in the past resulting in volume degrowth and mid-single digit price erosion pressure and the lack of new product launches. However, with supply chain issues normalising, we expect a recovery in volume growth and, hence, H2 to be better than H1.

**High-margin ROW segment growth to sustain:** ROW sales grew by 12% YoY to Rs 3.2bn driven by higher traction in Latin America, Australia and Europe. Growth in this market is expected to sustain, driven by price hikes and new product launches. ROW is a high-margin segment and going forward we expect the contribution of the ROW market to increase from the current ~10% of sales and the low-margin US region’s contribution to come down.

**FY25 margins to increase to 20%:** ALKEM’s gross margin in Q2 increased to 64.7% driven by cost efficiencies and growth from high-margin businesses like India and ROW, followed by operating cost efficiencies from EBITDA margin increasing 34bps YoY to 22%. Going forward, management expects at least ~100bps increase in margin driven by (1) recovery in domestic growth, (2) continuous growth in ROW market, and (3) cost efficiencies.

**We maintain BUY and TP at Rs 7,225:** We expect ALKEM’s EBITDA margin to rise to 20% in FY25 from 18% in FY24, driven by cost efficiencies and healthy product mix. Hence, we value the stock at a P/E of 29x on Sep’26E, ~29% premium to its five-year mean, which yields a TP of Rs 7,225.

**Key changes**



Ticker/Price	ALKEM IN/Rs 5,571
Market cap	US\$ 7.9bn
Free float	41%
3M ADV	US\$ 15.5mn
52wk high/low	Rs 6,440/Rs 4,289
Promoter/FPI/DII	57%/6%/16%

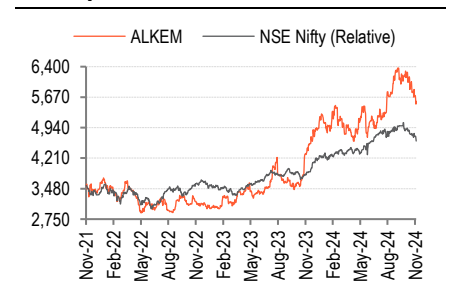
Source: NSE | Price as of 13 Nov 2024

**Key financials**

Y/E 31 Mar	FY24A	FY25E	FY26E
Total revenue (Rs mn)	126,677	141,518	154,873
EBITDA (Rs mn)	22,456	28,942	32,533
Adj. net profit (Rs mn)	19,174	22,181	25,169
Adj. EPS (Rs)	160.4	185.5	210.5
Consensus EPS (Rs)	160.4	181.0	210.0
Adj. ROAE (%)	23.2	23.1	22.4
Adj. P/E (x)	34.7	30.0	26.5
EV/EBITDA (x)	29.3	22.7	20.3
Adj. EPS growth (%)	76.4	15.7	13.5

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



## Earnings call highlights

### Financial performance

- ALKEM registered quarterly net profit before tax of over Rs 7.8bn for the first time.
- The international business declined by 2% YoY due to 22% decline in US sales (25% of sales).
- The company generated about Rs 12.0bn in cash in H1FY25, resulting in opportunities in M&A activity.
- During the quarter, gross margin increased by 330bps YoY to 64.7% and EBITDA margin by 34bps to 22%.

### Outlook for FY25

- ALKEM expects domestic sales growth to be in line with Indian Pharma Market's (IPM) growth of 8-9%.
- US to witness healthy H2FY25 over H1FY25.
- ROW market growth momentum to continue.
- Expect 100bps YoY increase in EBITDA margin FY25.

### India segment

- ALKEM's India acute business was affected by Anti-Infective which grew by 2.2% vs IPM's growth of 6.7% and Pain Management segment which grew by 5.4% vs 7.7%. However, the Gastro segment grew by 11.2% vs IPM growth of 10.6% and Vitamins by 12.7% vs IPM's 8.1%, and Gynaec by 6.3% vs IPM's 3.3%.
- The Anti-Infective segment's decline was due to lower volume growth and no price hike in the National List of Essential Medicines (NLEM) as against the 12% price hike in 2QFY24.
- According to IQVIA (SSA) data, ALKEM registered positive volume growth of 1.1% in a challenging market that witnessed 0% volume growth in Q2FY25.
- For the first time in history, an ALKEM brand, PAN, became the second-ranked brand in the IPM, growing at 12.8% compared to market growth of 7.3% (as per MAT Sep'24, SSA).

### The US

- The US segment declined by 22% YoY in Q2FY25 due to mid-single-digit price erosion in the US and degrowth in volumes due to supply chain issues.
- The US region is witnessing increasing profitability due to cost efficiencies and better product mix.
- EBITDA margin in the US is lower than the company level EBITDA margin.

**The ROW**

- Positive momentum in non-US international markets is expected to continue with higher traction from the Latin America region, Australia and European region.
- Contributions from this segment are expected to increase to reduce the dependence on US sales.

**Enzene Biosciences**

- The biosimilar business is showing significant traction with a portfolio of seven products. The company aims to sustain this performance momentum into the next financial year.
- The CDMO biologic plant where ALKEM would be doing more of pre-clinical to clinical kind of production is expected to commercialise from 4QFY25 or 1QFY26.

**Trade generics and market competition**

- ALKEM's trade generics contributes 20% of total domestic sales and is witnessing good improvement in overall margins due to better product mix and better pricing.
- Despite competitive pressures, the company is optimistic about the growth and margin improvement in its trade generic business.

**Cost efficiency and investments**

- ALKEM continues to focus on cost efficiency measures, with improvements reflected in gross margins.
- Potential for further EBITDA improvement at the business unit level, though corporate-level EBITDA might stabilize due to planned investments for future growth.

**Capex**

- ALKEM expects capex for FY25 to be around Rs 6.0bn to Rs 7.0bn, of which Rs 4.0bn will go towards the new Enzene facility in the US.

**Fig 1 – Quarterly financial highlights**

(Rs mn)	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
Net Sales	34,147	34,402	(0.7)	30,318	12.6
Total Expenses	26,618	26,934		24,231	
(%) of net sales	78	78		80	
Raw material consumed	12,047	13,271	(9.2)	10,759	12.0
(%) of net sales	35.3	38.6		35	
Staff cost	6,105	5,554	9.9	6,023	1.4
(%) of net sales	17.9	16.1		19.9	
R&D cost	1,465	1,158	26.5	1,257	16.5
(%) of net sales	4.3	3.4		4.1	
Manufacturing & Other Expenses	7,002	6,952	0.7	6,193	13.1
(%) of net sales	20.5	20.2		20.4	
EBITDA	7,528	7,467	0.8	6,087	23.7
Depreciation	789	739	6.8	805	
EBIT	6,739	6,728	0.2	5,282	
Interest	281	303	(7.2)	291	(3.3)
Other Income	1,345	632	112.8	1,203	11.8
PBT	7,803	7,057	10.6	6,194	26.0
Less: Taxation	783	332		691	
Less: Minority Interest	133	(56)		51	
Recurring PAT	6,886	6,782	1.5	5,452	26.3
Exceptional items	0	(577)		0	
Reported PAT	6,886	6,205	11.0	5,452	26.3
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>
Gross Margin	64.7	61.4	330	64.5	21
EBITDA Margin	22.0	21.7	34	20.1	197
Tax / PBT	10.0	4.7		11.2	
NPM	20.2	19.7	45	18.0	218
EPS (Rs)	57.6	56.7		45.6	

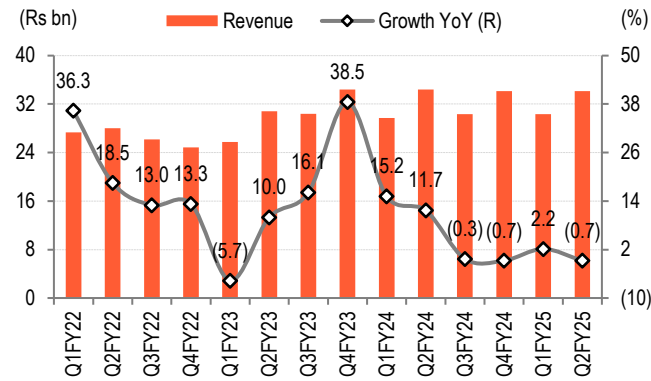
Source: Company, BOBCAPS Research

**Fig 2 – Segmental revenue breakdown**

(Rs mn)	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)
<b>Formulations</b>					
India	25,140	23,278	8.0	20,223	24.3
US	7,080	7,675	(7.7)	6,416	10.4
RoW	3,009	2,866	5.0	3,261	(7.7)
Net Sales	35,230	33,819	4.2	29,900	17.8
Other Op. Income	(1,083)	583	(285.9)	418	(359.0)
Revenue	34,147	34,402	(0.7)	30,318	12.6

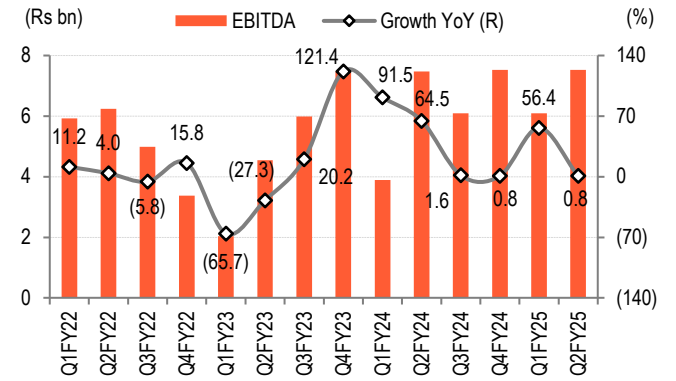
Source: Company, BOBCAPS Research

**Fig 3 – Sales growth declined due to lower Anti-Infective (AI) sales in domestic region**



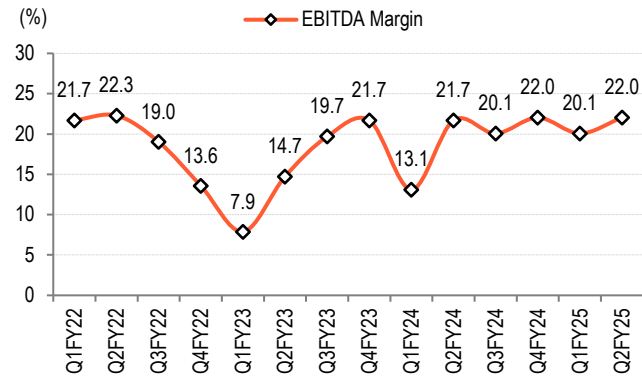
Source: Company, BOBCAPS Research

**Fig 4 – EBITDA growth lower due to higher R&D cost**



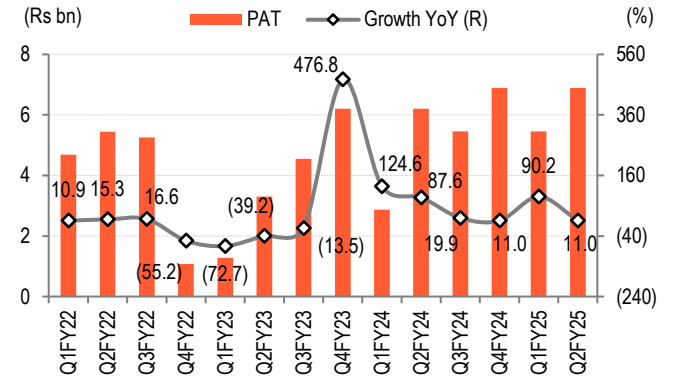
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA margin increased due to cost efficiencies**



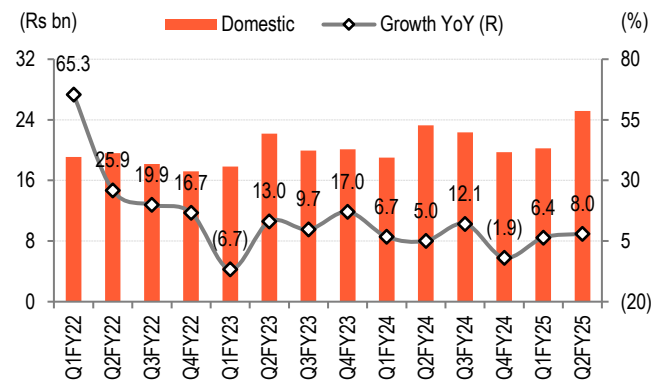
Source: Company, BOBCAPS Research

**Fig 6 – PAT growth maintained due to higher other income**



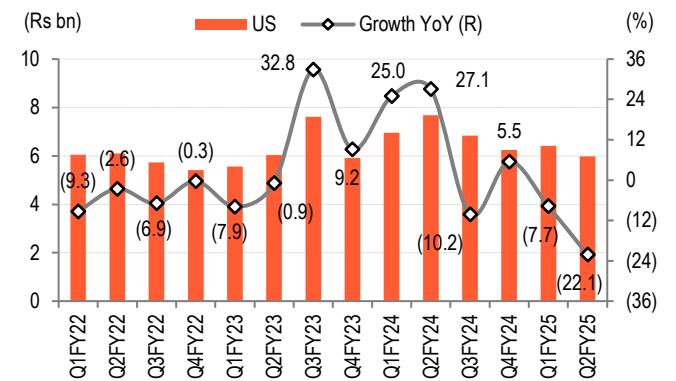
Source: Company, BOBCAPS Research

**Fig 7 – Domestic sales growth driven by Acute therapies ex AI**



Source: Company, BOBCAPS Research

**Fig 8 – US sales growth declined due to lower volume growth**



Source: Company, BOBCAPS Research

## Valuation methodology

ALKEM'S earnings was impacted by lower US sales and domestic sales affected by acute therapy. However, it is focusing on increasing operating margins to above 20% by increasing (1) productivity to Rs 800k per month from Rs 500k, (2) being among the top 1-3 players in launching Chronic products, (3) focusing on profitability in the trade generics business, (4) filing ANDAs in low competition, large-size markets for molecules in the US region, (5) focusing on branded generics in the ROW market, and (6) aggressively growing in the biologics/biosimilars spaces through Enzene. ALKEM has invested in newer initiatives like setting up a CDMO plant in the US region and investing in med tech ventures through the asset-light model which would be commercialised from FY27. We believe the commissioning of these products could potentially raise EBITDA margin to more than 25%, which we have not factored into our estimates. However, we expect earnings to grow at 20% CAGR for FY25E-27E ex CDMO and med tech initiatives.

We maintain our BUY rating and value the stock at a P/E of 29x on Sep'26E, ~29% premium to its five-year mean, yielding a TP of Rs 7,225. We believe ALKEM warrants this premium valuation given its focus on expanding its (1) biologics/biosimilars sales, (2) improving profitability in the US region, (3) increasing focus on the high-margin ROW market, and (4) scope of M&A activity with healthy cash balance of ~Rs 20bn as at Sep'24.

**Fig 9 – Key assumptions**

(Rs mn)	FY24	FY25E	FY26E	FY27E
Sales	126,677	141,518	154,873	170,019
EBITDA	22,456	28,942	32,533	38,374
PAT	19,174	22,181	25,169	30,110
EPS (Rs)	160.4	185.5	210.5	251.9
EBITDA Margin (%)	17.7	20.5	21.0	22.6
PAT Margin (%)	15.1	15.7	16.3	17.7

Source: Company, BOBCAPS Research

## Key risks

Key downside risks to our estimates:

- Slowdown in the Anti-Infective therapy segment for the industry as well as the company, as this is a large component of ALKEM's domestic business.
- Negative surprises on margins stemming from higher US price erosion and rising raw material prices.
- Slower growth in chronic sales that can drive margins higher.

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
<b>Total revenue</b>	<b>115,993</b>	<b>126,677</b>	<b>141,518</b>	<b>154,873</b>	<b>170,019</b>
EBITDA	16,095	22,456	28,942	32,533	38,374
Depreciation	3,104	2,993	3,290	3,658	3,938
EBIT	12,991	19,463	25,651	28,875	34,436
Net interest inc./(exp.)	(1,074)	(1,124)	(1,085)	(670)	(290)
Other inc./(exp.)	2,161	3,108	1,444	1,325	1,181
Exceptional items	0	0	0	0	0
EBT	14,078	21,447	26,011	29,529	35,327
Income taxes	2,980	2,117	3,641	4,134	4,946
Extraordinary items	(1,030)	(1,215)	0	0	0
Min. int./Inc. from assoc.	226	157	188	226	271
<b>Reported net profit</b>	<b>9,842</b>	<b>17,959</b>	<b>22,181</b>	<b>25,169</b>	<b>30,110</b>
Adjustments	(1,030)	(1,215)	0	0	0
<b>Adjusted net profit</b>	<b>10,872</b>	<b>19,174</b>	<b>22,181</b>	<b>25,169</b>	<b>30,110</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Accounts payables	11,650	17,481	17,128	15,412	16,005
Other current liabilities	10,178	12,672	15,282	16,725	15,022
Provisions	7,421	4,267	4,767	5,217	5,727
Debt funds	13,967	14,184	9,929	4,964	1,489
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	81,086	91,757	107,472	125,304	146,637
Shareholders' fund	81,325	91,996	107,711	125,543	146,876
<b>Total liab. and equities</b>	<b>124,542</b>	<b>140,601</b>	<b>154,818</b>	<b>167,862</b>	<b>185,120</b>
Cash and cash eq.	26,169	15,794	14,085	12,037	14,409
Accounts receivables	21,322	22,528	24,741	26,659	28,809
Inventories	26,075	26,612	28,547	35,407	41,156
Other current assets	14,696	40,516	49,320	55,495	62,592
Investments	6,218	4,838	4,838	4,838	4,838
Net fixed assets	26,829	28,728	31,938	32,280	32,342
CWIP	3,232	1,586	1,348	1,146	974
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>124,542</b>	<b>140,601</b>	<b>154,818</b>	<b>167,862</b>	<b>185,120</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
<b>Cash flow from operations</b>	<b>21,331</b>	<b>(315)</b>	<b>16,360</b>	<b>14,721</b>	<b>18,743</b>
Capital expenditures	1,354	(3,250)	(6,500)	(4,000)	(4,000)
Change in investments	(2,508)	1,380	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(1,154)</b>	<b>(1,870)</b>	<b>(6,500)</b>	<b>(4,000)</b>	<b>(4,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(12,715)	217	(4,255)	(4,964)	(3,475)
Interest expenses	(1,074)	(1,124)	(1,085)	(670)	(290)
Dividends paid	(3,169)	(5,589)	(6,466)	(7,337)	(8,777)
Other financing cash flows	(2,836)	(1,694)	238	202	172
<b>Cash flow from financing</b>	<b>(19,794)</b>	<b>(8,190)</b>	<b>(11,568)</b>	<b>(12,769)</b>	<b>(12,371)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>383</b>	<b>(10,375)</b>	<b>(1,708)</b>	<b>(2,049)</b>	<b>2,372</b>
<b>Closing cash &amp; cash eq.</b>	<b>26,169</b>	<b>15,794</b>	<b>14,085</b>	<b>12,037</b>	<b>14,409</b>

### Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
Reported EPS	82.3	150.2	185.5	210.5	251.9
Adjusted EPS	90.9	160.4	185.5	210.5	251.9
Dividend per share	22.7	40.1	46.4	52.6	63.0
Book value per share	647.7	735.9	867.3	1,016.5	1,194.9

### Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
EV/Sales	5.7	5.2	4.6	4.3	3.9
EV/EBITDA	41.2	29.3	22.7	20.3	17.2
Adjusted P/E	61.3	34.7	30.0	26.5	22.1
P/BV	8.6	7.6	6.4	5.5	4.7

### DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Tax burden (Net profit/PBT)	77.2	89.4	85.3	85.2	85.2
Interest burden (PBT/EBIT)	108.4	110.2	101.4	102.3	102.6
EBIT margin (EBIT/Revenue)	11.2	15.4	18.1	18.6	20.3
Asset turnover (Rev./Avg TA)	29.4	31.4	31.6	31.2	30.5
Leverage (Avg TA/Avg Equity)	1.3	1.2	1.2	1.1	1.1
<b>Adjusted ROAE</b>	<b>14.4</b>	<b>23.2</b>	<b>23.1</b>	<b>22.4</b>	<b>22.8</b>

### Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
<b>YoY growth (%)</b>					
Revenue	9.1	9.2	11.7	9.4	9.8
EBITDA	(21.6)	39.5	28.9	12.4	18.0
Adjusted EPS	(34.5)	76.4	15.7	13.5	19.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	13.9	17.7	20.5	21.0	22.6
EBIT margin	11.2	15.4	18.1	18.6	20.3
Adjusted profit margin	9.4	15.1	15.7	16.3	17.7
Adjusted ROAE	14.4	23.2	23.1	22.4	22.8
ROCE	15.4	22.4	24.2	24.3	25.5
<b>Working capital days (days)</b>					
Receivables	67	66	65	64	63
Inventory	82	78	75	85	90
Payables	37	51	45	37	35
<b>Ratios (x)</b>					
Gross asset turnover	2.9	2.9	2.8	2.9	2.9
Current ratio	3.0	3.1	3.1	3.5	4.0
Net interest coverage ratio	12.1	17.3	23.6	43.1	118.6
<b>Adjusted debt/equity</b>	<b>(0.2)</b>	<b>0.0</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.1)</b>

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

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**BUY** – Expected return >+15%

**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): ALKEM LABS (ALKEM IN)



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

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