

**BUY**

TP: Rs 2,950 | ▲ 23%

**ALKEM LABS**

Pharmaceuticals

05 June 2020

## Buoyant earnings outlook to fuel rerating

Alkem Labs reported in-line Q4 EBITDA; margins were a tad miss at 14.8% as the negative gross margin was offset by lower staff cost. India sales were weak, rising 3% YoY; US sales grew 3% QoQ to US\$ 84mn. Q1 could be soft but Alkem is confident of expanding EBITDA margins in FY21. Management highlighted robust double-digit growth in the trade generics business and expects US operating leverage to support healthy FY21. We raise FY21/FY22 EPS 1-8%. Retain BUY with a revised TP of Rs 2,950 (vs. Rs 2,870).

Vivek Kumar

research@bobcaps.in

**Margin miss, India sales a tad lower while US stable:** Q4 India sales growth of 3% YoY could be an aberration due to deferment of Rs 1.3bn in sales to Q1FY21. US growth was mainly led by the base portfolio and had limited stocking benefit. Gross margin contracted both YoY and QoQ to 56% (vs. 61% for 9M) due to an adverse business mix (higher trade generics + international sales) and competition for Mycophenolate. The EBITDA margin miss was contained by lower staff cost (-17% QoQ) due to rationalisation of incentives.

Ticker/Price	ALKEM IN/Rs 2,395
Market cap	US\$ 3.8bn
Shares o/s	120mn
3M ADV	US\$ 5.2mn
52wk high/low	Rs 2,879/Rs 1,660
Promoter/FPI/DII	66%/2%/5%

Source: NSE

**FY21 outlook cautiously optimistic:** Alkem expects India growth to be <10% as slower Rx growth due to Covid-19 can be offset by the double-digit uptick in trade generics. Optimistic about a pick-up in parenteral antibiotics as surgeries are likely to surge from Jul'20. US commentary is stable with guidance for good growth over FY20 – we expect US\$ 440mn in sales by FY22 (17% CAGR). Despite Covid, Alkem retains its 60% gross margin outlook and expects EBITDA margin expansion over FY20, led by cost control and US operating leverage.

## STOCK PERFORMANCE



Source: NSE

**Earnings call highlights:** (1) Targeting 10 launches and 12-15 filings in the US in FY21. (2) Parenteral antibiotics contribute 40% of Alkem's anti-infective sales. (3) Q4 included a one-off accelerated depreciation charge of Rs 180mn. (4) FY21 capex to be Rs 3.5bn; tax rate 12-15%.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	64,218	73,558	82,983	94,912	105,981
EBITDA (Rs mn)	10,284	11,135	14,730	17,802	20,511
Adj. net profit (Rs mn)	6,309	7,298	11,270	13,458	15,520
Adj. EPS (Rs)	52.8	61.0	94.3	112.6	129.8
Adj. EPS growth (%)	(29.3)	15.7	54.4	19.4	15.3
Adj. ROAE (%)	15.8	16.3	22.7	23.5	22.7
Adj. P/E (x)	45.4	39.2	25.4	21.3	18.4
EV/EBITDA (x)	27.6	25.8	19.5	16.2	13.9

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

Important disclosures, including any required research certifications, are provided at the end of this report.



**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var. (%)	FY20P	FY19	YoY (%)
<b>Net Sales</b>	<b>20,490</b>	<b>18,542</b>	<b>10.5</b>	<b>21,818</b>	<b>(6.1)</b>	<b>19,985</b>	<b>2.5</b>	<b>83,443</b>	<b>73,676</b>	<b>13.3</b>
<b>EBITDA</b>	<b>3,030</b>	<b>2,351</b>	<b>28.9</b>	<b>4,533</b>	<b>(33.2)</b>	<b>3,074</b>	<b>(1.4)</b>	<b>14,735</b>	<b>11,253</b>	<b>30.9</b>
Depreciation	810	573	-	594	-	580	-	2,526	1,932	-
EBIT	2,220	1,778	24.9	3,939	(43.6)	2,494	-	12,209	9,321	31.0
Interest	141	66	-	170	-	120	-	650	546	-
Other Income	275	277	-	279	-	277	-	1,043	773	-
<b>PBT</b>	<b>2,354</b>	<b>1,989</b>	<b>18.4</b>	<b>4,048</b>	<b>(41.8)</b>	<b>2,651</b>	<b>-</b>	<b>12,603</b>	<b>9,547</b>	<b>32.0</b>
Less: Taxation	438	283	-	147	-	530	-	1,105	1,810	-
Less: Minority Interest	28	31	-	80	-	0	-	222	131	-
<b>Recurring PAT</b>	<b>1,889</b>	<b>1,675</b>	<b>12.8</b>	<b>3,822</b>	<b>(50.6)</b>	<b>2,121</b>	<b>(10.9)</b>	<b>11,276</b>	<b>7,607</b>	<b>48.2</b>
Exceptional items	0	0	-	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>1,889</b>	<b>1,675</b>	<b>12.8</b>	<b>3,822</b>	<b>(50.6)</b>	<b>2,121</b>	<b>(10.9)</b>	<b>11,276</b>	<b>7,607</b>	<b>48.2</b>
<b>Key Ratios (%)</b>										
Gross Margin	56.3	58.2	-	61.8	-	60.5	-	59.9	58.9	-
EBITDA Margin	14.8	12.7	-	20.8	-	15.4	-	17.7	15.3	-
Tax / PBT	18.6	14.2	-	3.6	-	20.0	-	8.8	19.0	-
NPM	9.2	9.0	-	17.5	-	10.6	-	13.5	10.3	-
<b>EPS (Rs)</b>	<b>15.8</b>	<b>14.0</b>	<b>-</b>	<b>32.0</b>	<b>-</b>	<b>17.7</b>	<b>-</b>	<b>94.3</b>	<b>63.6</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT SALES**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Q4FY20E	Var. (%)	FY20P	FY19	YoY (%)
<b>Formulations</b>										
India	12,576	12,176	3.3	14,239	(11.7)	12,945	(2.8)	54,540	48,741	11.9
US	6,068	4,822	25.8	5,837	4.0	5,600	8.4	22,092	18,966	16.5
RoW	1,455	1,275	14.1	1,416	2.8	1,441	1.0	5,287	4,951	6.8
<b>Net Sales</b>	<b>20,099</b>	<b>18,273</b>	<b>10.0</b>	<b>21,492</b>	<b>(6.5)</b>	<b>19,985</b>	<b>0.6</b>	<b>81,919</b>	<b>72,658</b>	<b>12.7</b>

Source: Company, BOBCAPS Research

### Valuation methodology

Alkem has delivered a strong beat on EBITDA margins in FY20 (up >250bps YoY). We continue to believe that the company’s profitability base has moved up and should sustain given a focus on raising the high-margin acute mix, increasing MR efficiency and driving operating leverage in the US from new launches. This coupled with ROIC of >30% from FY21E (vs. ~23% over FY18-FY20) and strong FCF should support expansion in one-year forward EV/EBITDA multiples closer to the three-year mean of 19x from ~14x currently.

We raise our FY21-FY22 EPS estimates by 1-8% led by (1) a USDINR forex reset to Rs 74 resulting in higher US sales, and (2) improved profitability for both India and US businesses in FY22. We expect 18% EBITDA growth over the next two years. Retain BUY as we raise our Mar’21 target price to Rs 2,950 (from Rs 2,870), based on a target EV/EBITDA multiple of 17x (implied P/E of 23x). Our revised FY21/FY22 EPS estimates stand at Rs 113/Rs 130.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	New			Old			Change (%)		
	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E	FY20P	FY21E	FY22E
Sales	82,983	94,912	105,981	82,607	92,525	103,306	0.5	2.6	2.6
EBITDA	14,730	17,802	20,511	14,255	16,779	19,480	3.3	6.1	5.3
EBITDA margin (%)	17.8	18.8	19.4	17.3	18.1	18.9	49bps	62bps	50bps
EPS (Rs)	94	113	130	94	112	120	0.3	0.5	7.8

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 26% 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. Further, any slowdown in IPM growth and delay in new launches can 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 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	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>64,218</b>	<b>73,558</b>	<b>82,983</b>	<b>94,912</b>	<b>105,981</b>
EBITDA	10,284	11,135	14,730	17,802	20,511
Depreciation	1,430	1,932	2,526	2,557	2,872
EBIT	8,854	9,203	12,204	15,245	17,639
Net interest income/(expenses)	(553)	(546)	(650)	(998)	(998)
Other income/(expenses)	960	582	1,043	1,350	1,995
Exceptional items	0	0	0	0	0
EBT	9,260	9,239	12,598	15,596	18,636
Income taxes	2,876	1,810	1,105	1,872	2,795
Extraordinary items	0	307	0	0	0
Min. int./Inc. from associates	75	131	222	267	320
<b>Reported net profit</b>	<b>6,309</b>	<b>7,605</b>	<b>11,270</b>	<b>13,458</b>	<b>15,520</b>
Adjustments	0	307	0	0	0
<b>Adjusted net profit</b>	<b>6,309</b>	<b>7,298</b>	<b>11,270</b>	<b>13,458</b>	<b>15,520</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	9,607	9,622	9,541	12,840	14,338
Other current liabilities	4,487	4,435	6,010	7,499	8,373
Provisions	2,742	3,275	4,067	4,652	5,195
Debt funds	9,950	9,025	16,628	16,628	16,628
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	43,075	48,407	53,363	63,683	75,584
Shareholders' fund	43,314	48,646	53,602	63,922	75,823
<b>Total liabilities and equities</b>	<b>70,100</b>	<b>75,003</b>	<b>89,848</b>	<b>105,541</b>	<b>120,356</b>
Cash and cash eq.	5,768	6,615	10,922	22,408	29,351
Accounts receivables	10,805	12,484	16,494	17,976	20,073
Inventories	14,422	14,998	18,188	20,031	22,367
Other current assets	8,016	7,669	9,180	11,248	12,560
Investments	4,443	3,236	2,614	2,614	2,614
Net fixed assets	22,836	25,072	28,821	30,264	32,392
CWIP	3,810	4,930	3,630	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
<b>Total assets</b>	<b>70,099</b>	<b>75,004</b>	<b>89,848</b>	<b>105,541</b>	<b>120,356</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	7,740	9,537	13,796	16,015	18,392
Interest expenses	553	546	650	998	998
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,500)	(1,411)	(6,425)	(21)	(2,830)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>6,793</b>	<b>8,671</b>	<b>8,021</b>	<b>16,992</b>	<b>16,560</b>
Capital expenditures	(6,266)	(3,991)	(4,500)	(4,000)	(5,000)
Change in investments	1,087	1,207	622	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(5,179)</b>	<b>(2,784)</b>	<b>(3,878)</b>	<b>(4,000)</b>	<b>(5,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,411	(925)	7,603	0	0
Interest expenses	(553)	(546)	(650)	(998)	(998)
Dividends paid	(2,180)	(1,702)	(2,628)	(3,138)	(3,619)
Other financing cash flows	(516)	(1,868)	(4,161)	2,630	0
<b>Cash flow from financing</b>	<b>162</b>	<b>(5,040)</b>	<b>164</b>	<b>(1,506)</b>	<b>(4,617)</b>
<b>Changes in cash and cash eq.</b>	<b>1,776</b>	<b>847</b>	<b>4,308</b>	<b>11,486</b>	<b>6,943</b>
<b>Closing cash and cash eq.</b>	<b>5,768</b>	<b>6,614</b>	<b>10,922</b>	<b>22,408</b>	<b>29,351</b>

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	52.8	63.6	94.3	112.6	129.8
Adjusted EPS	52.8	61.0	94.3	112.6	129.8
Dividend per share	13.0	12.2	18.9	22.5	26.0
Book value per share	352.1	395.8	436.0	522.3	621.8

### Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	4.4	3.9	3.5	3.0	2.7
EV/EBITDA	27.6	25.8	19.5	16.2	13.9
Adjusted P/E	45.4	39.2	25.4	21.3	18.4
P/BV	6.8	6.0	5.5	4.6	3.9

### DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	68.1	79.0	89.5	86.3	83.3
Interest burden (PBT/EBIT)	104.6	100.4	103.2	102.3	105.7
EBIT margin (EBIT/Revenue)	13.8	12.5	14.7	16.1	16.6
Asset turnover (Revenue/Avg TA)	32.5	33.2	32.4	31.5	30.6
Leverage (Avg TA/Avg Equity)	1.2	1.2	1.3	1.3	1.3
Adjusted ROAE	15.8	16.3	22.7	23.5	22.7

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	12.9	14.5	12.8	14.4	11.7
EBITDA	2.9	8.3	32.3	20.9	15.2
Adjusted EPS	(29.3)	15.7	54.4	19.4	15.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.0	15.1	17.8	18.8	19.4
EBIT margin	13.8	12.5	14.7	16.1	16.6
Adjusted profit margin	9.8	9.9	13.6	14.2	14.6
Adjusted ROAE	15.8	16.3	22.7	23.5	22.7
ROCE	19.9	17.6	20.7	22.0	22.7
<b>Working capital days (days)</b>					
Receivables	62	63	73	70	70
Inventory	83	75	81	78	78
Payables	55	48	42	50	50
<b>Ratios (x)</b>					
Gross asset turnover	2.5	2.4	2.4	2.5	2.4
Current ratio	2.3	2.4	2.8	2.9	3.0
Net interest coverage ratio	16.0	16.9	18.8	15.3	17.7
Adjusted debt/equity	0.0	0.0	0.1	(0.1)	(0.2)

Source: Company, BOBCAPS Research

## Disclaimer

### 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

### Rating distribution

As of 31 May 2020, out of 92 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 55 have BUY ratings, 20 have ADD ratings, 9 are rated REDUCE, 7 are rated SELL and 1 is UNDER REVIEW. None of these companies have been investment banking clients in the last 12 months.

### Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

### General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

### **Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014**

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.