BOBCAPS
TRUST | INNOVATION | EXCELLENCE

**BUY**
TP: Rs 660 | ⮝ 18%

**ALEMBIC PHARMA** | Pharmaceuticals | 09 December 2019

# Entering into new multi-year earnings cycle – initiate with BUY

**Alembic Pharma (ALPM) has underperformed the midcap and Sensex indices since 2015 due to subdued earnings. This cycle should reverse in the next 3-4 years with better yields on the US pipeline starting FY22 and higher earnings growth visibility of +20% through FY25, post full benefits of Rs 16bn in capex. Market concerns on high US capital allocation and weak margins could drive a large earnings surprise and stock rerating, in our view. Valuations are reasonable at 9.8x FY22E EV/EBITDA (10x sector avg.); initiate with BUY, Mar'21 TP Rs 660.**

**Vivek Kumar**
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**Market has two misconceptions on ALPM:** (1) Higher capital allocation to US generics is risky amid deteriorating margins and ROCE – here, the market is applying similar erosion dynamics across firms. (2) Back-ended growth recovery is unlikely to trigger a big earnings surprise. We believe base US margins ex-R&D are healthy at 55%+ (FY16-FY19) and investment economics are on track.

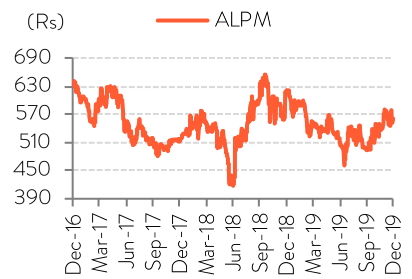
**US generics – ALPM amongst first wave in next LOE cycle (2022-26):** Our explicit analysis of the US pipeline suggests ALPM is best placed to participate in US$ 20bn worth of LOE (loss of exclusivity) in the next five years –80% are products with sizeable markets and the opportunity size gets even better after 2025. We expect US$ 300mn in US sales by FY23 (19% CAGR over FY19).

**EPS to double by FY24, good FCF record – BUY:** Muted earnings and heavy capex have weighed on the stock since 2015. In the next 6-9 months, we believe markets will start to look favourably at ALPM's US product lineup (2022-26) and with capex turning productive, we see +20% EPS growth visibility over FY21-FY25 (FY21 a reset year off a high sartan base). ROIC at 23% is higher than large/midsized generics players, and the strong growth outlook could trigger a rerating. Our TP of Rs 660 is set at 12x FY22 EV/EBITDA (21x implied P/E).

| | |
|---|---|
| Ticker/Price | ALPM IN/Rs 560 |
| Market cap | US$ 1.5bn |
| Shares o/s | 189mn |
| 3M ADV | US$ 1.5mn |
| 52wk high/low | Rs 589/Rs 530 |
| Promoter/FPI/DII | 73%/10%/6% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

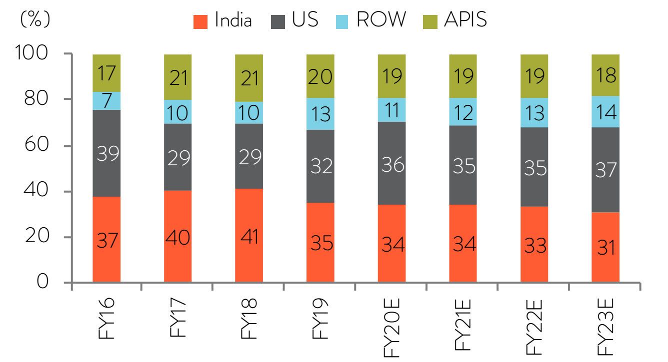
## KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 31,310 | 39,350 | 42,561 | 46,071 | 51,211 |
| EBITDA (Rs mn) | 6,711 | 8,737 | 9,422 | 9,397 | 10,914 |
| Adj. net profit (Rs mn) | 4,489 | 5,928 | 6,023 | 5,836 | 6,900 |
| Adj. EPS (Rs) | 23.4 | 31.0 | 32.0 | 31.0 | 36.6 |
| Adj. EPS growth (%) | 11.0 | 32.4 | 3.2 | (3.1) | 18.2 |
| Adj. ROAE (%) | 21.0 | 23.4 | 20.2 | 16.9 | 17.5 |
| Adj. P/E (x) | 23.9 | 18.1 | 17.5 | 18.1 | 15.3 |
| EV/EBITDA (x) | 15.4 | 12.4 | 12.0 | 11.9 | 9.8 |

Source: Company, BOBCAPS Research

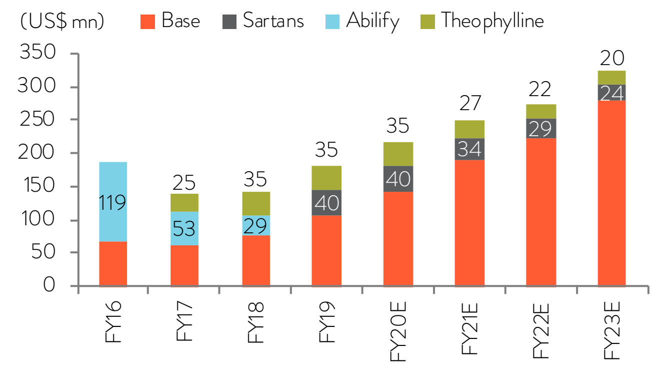
# Focus charts

### FIG 1 – BUSINESS MIX – US SHARE TO RISE



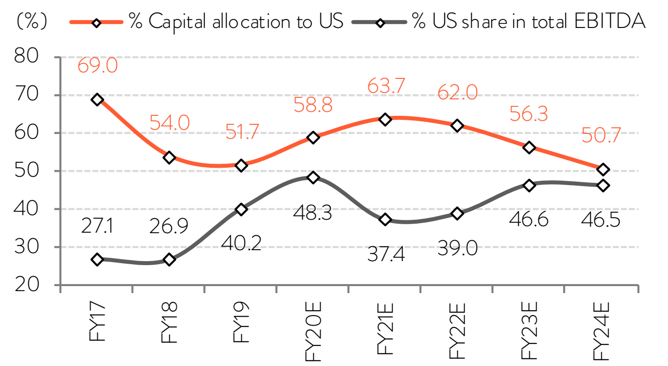

Source: Company, BOBCAPS Research

### FIG 2 – US BASE SALES: 19% CAGR OVER FY19-FY23E



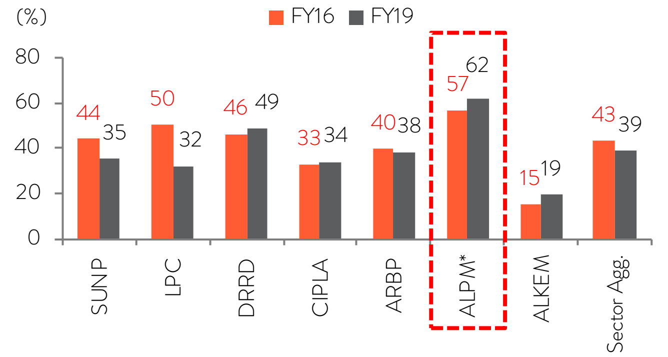

Source: Company, BOBCAPS Research

### FIG 3 – US EBITDA AND CAPITAL ALLOCATION – GAP TO NARROW MATERIALLY BY FY23E/FY24E



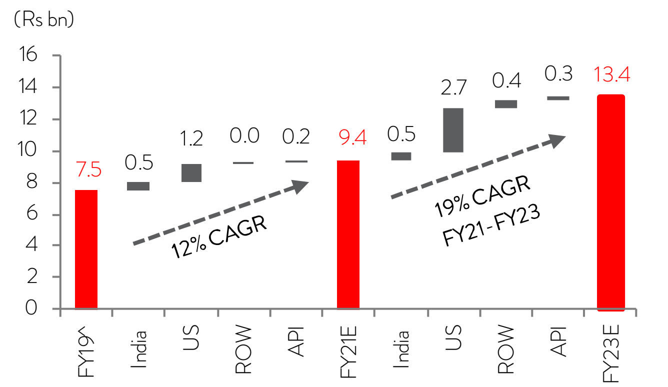

Source: Company, BOBCAPS Research

### FIG 4 – US EX-R&D EBITDA MARGIN OF +55% IS BEST VERSUS PEERS



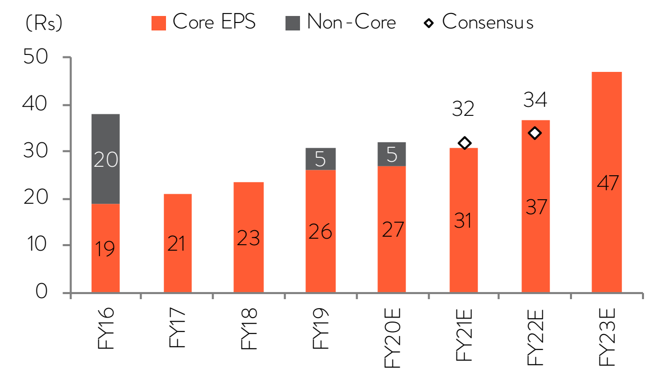

Source: Company, BOBCAPS Research | *Excludes exceptional Abilify in FY16 and Valsartan in FY19

### FIG 5 – US TO ADD ~65% OF INCREMENTAL EBITDA OVER FY19-FY23E




Source: Company, BOBCAPS Research | ^Ex of non-recurring Valsartan base

### FIG 6 – BASE EPS – EXPECT >20% GROWTH OVER FY20-FY23, WE ARE 8% ABOVE CONSENSUS FY22 EPS



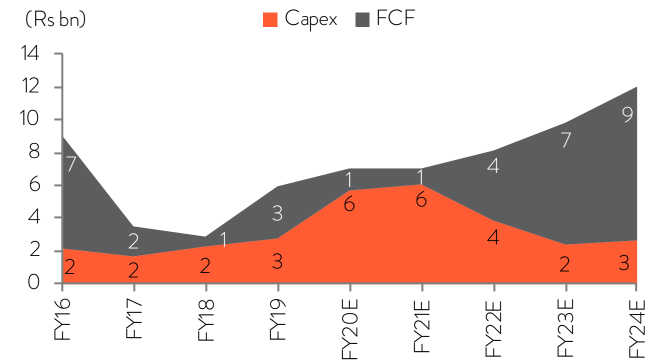

Source: Company, BOBCAPS Research, Bloomberg

### FIG 7 – US OPPORTUNITY SIZE AND KEY ASSETS OVER NEXT 5-10 YEARS

| LOE | Market size (US$ bn) | Key assets |
|---|---|---|
| Next 12M | 5.0 | Fanapt, Effient, Mevacor, Topamax and Tarceva |
| FY21-FY24 | 15.5 | Vimpat, Xarelto, Farxiga, Ibrance |
| FY25-FY27 | 10.0 | Pradaxa, Gilenya, Trintellix, Sprycel, Rexulti, Entresto, Brilinta |
| FY28-FY30 | 7.0 | Eliquis, Invokana, Tradjenta |
| >FY31 | 9.0 | Otezla, Jardiance, Imbruvica, Tagrisso |

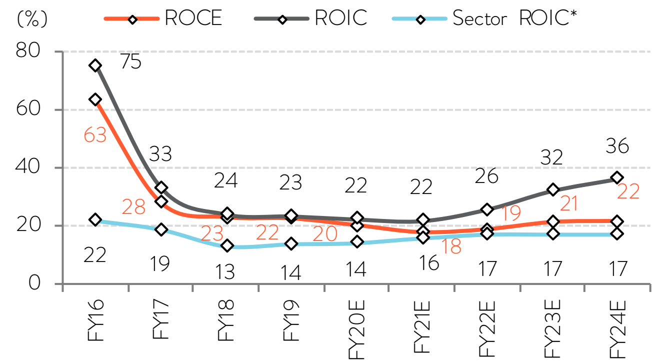
Source: Company, FDA, BOBCAPS Research

### FIG 8 – GOOD FCF TRACK RECORD DESPITE HEAVY CAPEX MOMENTUM




Source: Company, BOBCAPS Research

### FIG 9 – ALPM HAS BEST-IN-CLASS ROIC; EXPECTED TO CROSS 32% IN FY23E




Source: Company, BOBCAPS Research, Bloomberg | *Aggregate of Cipla, Sun, Lupin, Dr Reddy, Aurobindo, Alkem

### FIG 10 – EV/EBITDA – VALUATION FRAMEWORK FOR OUR COVERAGE COMPANIES

| Region (x) | ALPM | ALKEM | SUNP | LPC | DRRD | ARBP | CIPLA |
|---|---|---|---|---|---|---|---|
| US | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 7.0 | 9.0 |
| India | 15.0 | 16.0 | 15.0 | 15.0 | 15.0 | 0.0 | 14.1 |
| EM/ROW | 12.0 | 12.5 | 11.5 | 12.0 | 12.0 | 10.0 | 9.0 |
| API & Others | 8.0 | 1.0 | 8.0 | 8.0 | 8.0 | 7.0 | 8.0 |
| **EV/EBITDA (1-yr fwd)** | **11.8** | **15.4** | **10.7** | **11.6** | **11.3** | **7.2** | **12.3** |
| **P/E (implied)** | **21.3** | **20.8** | **17.5** | **23.8** | **18.7** | **10.6** | **24.3** |
| FY21E ROCE (%) | 17.7 | 19.8 | 12.8 | 10.3 | 15.2 | 13.3 | 12.5 |
| FY21E ROE (%) | 16.9 | 21.0 | 11.7 | 10.4 | 14.5 | 15.7 | 10.2 |
| FY20E-FY22E EBITDA CAGR (%) | 15.3 | 18.4 | 12.0 | 14.6 | 4.3 | 8.5 | 7.9 |

Source: Company, BOBCAPS Research

### FIG 11 – RECOMMENDATION SUMMARY FOR OUR COVERAGE UNIVERSE

| Companies | Price (as on 6-Dec-19) | Mcap (US$ mn) | Rating | Target price (Rs) | EPS (Rs) | | P/E (x) | | EV/EBITDA (x) | | RoE (%) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | FY21E | FY22E | FY21E | FY22E | FY21E | FY22E | FY21E | FY22E |
| ARBP | 446 | 3,661 | ADD | 500 | 47.0 | 47.5 | 9.5 | 9.4 | 6.8 | 6.6 | 15.7 | 13.9 |
| CIPLA | 455 | 5,150 | BUY | 570 | 21.9 | 25.0 | 20.7 | 18.2 | 10.3 | 9.3 | 10.2 | 10.6 |
| DRRD | 2,890 | 6,732 | ADD | 2,960 | 152.6 | 164.3 | 18.9 | 17.6 | 11.3 | 10.8 | 14.5 | 13.8 |
| LPC | 761 | 4,836 | ADD | 840 | 32.7 | 37.8 | 23.3 | 20.1 | 11.3 | 10.0 | 10.4 | 11.3 |
| SUNP | 429 | 14,418 | REDUCE | 430 | 23.1 | 26.1 | 18.5 | 16.4 | 11.2 | 10.2 | 11.7 | 12.1 |
| DIVI | 1,783 | 6,639 | ADD | 1,765 | 64.4 | 79.1 | 27.7 | 22.6 | 18.3 | 15.0 | 21.4 | 22.8 |
| LAURUS | 340 | 510 | BUY | 480 | 23.0 | 29.3 | 14.8 | 11.6 | 7.6 | 6.4 | 13.7 | 15.3 |
| ALKEM | 2,080 | 3,486 | BUY | 2,290 | 105.5 | 114.4 | 19.7 | 18.2 | 15.1 | 12.9 | 21.0 | 19.5 |
| ALPM | 560 | 1,480 | BUY | 660 | 31.0 | 36.6 | 18.1 | 15.3 | 11.9 | 9.8 | 16.9 | 17.5 |

Source: Company, BOBCAPS Research

# Investment summary

### Why should markets pay attention to Alembic now?

Following three years of subdued earnings and the start of a major investment cycle in 2017, the stock underwent a time correction – we believe this under-performance has largely run its course as the market now begins to discount strong earnings growth from FY22.

ALPM has invested ~Rs 16bn (partly in CWIP) over the last three years to build manufacturing capabilities for the US market in high-value portfolios such as oncology oral solids & injectables, peptides, ophthalmology and dermatology, to enhance the supply chain, and to strengthen regulatory compliance – monetisation of this capex is likely to begin from mid-FY22. We estimate that the new capacities could drive earnings growth of >20% through to 2025 over the FY21 base, with the US contributing ~65% of incremental EBITDA.

FY21 is likely to be a reset year off a high sartans base, starting when we expect operating margins to expand 80-100bps p.a. backed by an improving mix in the US. The company's US strategy focuses on (1) profit per product rather than volume market share, and (2) a capable supply chain to spot and maximise on shortage opportunities. This has helped ALPM maintain healthy operating margins for US business (at 55%+ ex-R&D) versus other US-focused Indian generics peers which were impacted from generic price contraction.

In the near-to-midterm, earnings momentum should be supported by the current set of US filings (25 ANDA p.a.) and India business margin expansion. Over the next 6-9 months, we believe the market will start to look favourably at ALPM's next US product lineup (LOE 2022-26), which includes several high-value assets like gVimpat, Xarelto, Pradaxa and Sprycel (more details in Fig 19) that could be amongst the first wave of generic launches, driving profit maximisation. In addition, moderation in capex to Rs 3bn p.a. from FY22 could drive higher FCF generation and ROIC expansion, in our view.

We initiate coverage with BUY and a Mar'21 TP of Rs 660 as we believe concerns over high US investments and weak margin dynamics are overstated. In our view, earnings could surprise on the upside, fuelling a rerating over the next 2-3 years.

### Management outlook, directionally remains upbeat

Management expects to double sales by FY24 (vs. Rs 39bn in FY19), with over 400bps of EBITDA margin expansion. This will be essentially US-led as most of the R&D investments and incremental capacity will be monetised over 2022-30. At full capacity in FY24/FY25, management expect >US$ 400mn in US sales and remains confident of regulatory compliance and supply chain efficiencies. As per ALPM, India growth will fall into place from Q1FY21 and new growth initiatives in ROW markets will aid growth in the long run.

## Downside risks

Key risks include (1) delays in commencement of new capacities for the US market, (2) early competition in niche US products (such as Theophylline) and supply restoration in generic Valsartan by competitors, and (3) worsening cGMP compliance at manufacturing sites.

### FIG 12 – VALUATION SNAPSHOT: TARGET PRICE OF RS 660/SH

| Business (Rs mn) | FY22E EBITDA | Target multiple | | Segment EV FY21E | Mix (%) | Comment |
|---|---|---|---|---|---|---|
| | | EV/EBITDA (1Y fwd) (x) | P/E (implied 1Y fwd) (x) | | | |
| India | 3,978 | 15.0 | | 59,674 | 48 | Steady demand visibility merits higher multiple |
| US | 4,252 | 9.0 | | 38,269 | 31 | Broadly aligned to US generic peers |
| ROW | 1,216 | 12.0 | | 14,591 | 12 | Discount to India due to forex risk. >70% share of ROW EBITDA is from Australia, Europe, and Canada |
| API & Others | 1,467 | 8.0 | | 11,739 | 9 | Multiple at par with sector |
| **Aggregate** | | **11.8** | **21.3** | **124,273** | | Target EV/EBITDA in line with historical average and at 5-10% premium to sector as ALPM's ROIC of >22% is the best amongst peers. Implied P/E is 15% premium to past 7Y avg. |
| Net debt | | | | 4,065 | | |
| Target Market Cap | | | | 120,208 | | |
| Per share (Rs) | | | | 638 | | |
| Book value basis (per share) | 224 | 3.1 | | 683 | | Target P/B at 25% discount to last 7Y avg. (in view of normalisation in ROCE vs. historical avg.) |
| **Target Price per share (average of EV/EBITDA & P/B)** | | | | **660** | | |
| Upside (%) | | | | 18 | | |

Source: Company, BOBCAPS Research

# Investment thesis

## US generics – Risk to ROI from high capital allocation overstated

Market participants are apprehensive about ALPM's high capital allocation to the US market over the last three years and of weak returns from new capex, triggered from the structural downtrend in US generics due to intense price pressure. Our view on ALPM's US business investments, both before 2019 and after, is a contrarian one. The company has reported ex-R&D EBITDA margin expansion of 500bps over the last three years to 62% (being among the second or third wave of generics in the market).

Further, with its R&D capability extending beyond oral solids and ALPM likely to be among the first wave of generics in the upcoming US$ 20bn LOE opportunity (2022-26), its sales growth, margins and return economics should remain strong.

### Capital allocation – aggressive capex cycle to peak out in FY21

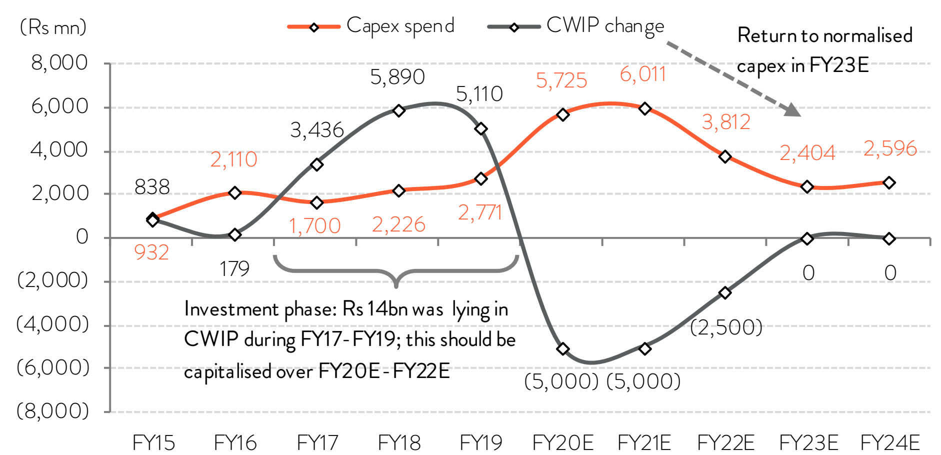
ALPM had a humble start in 2011 with plain vanilla products in the US market. Since FY17, it has significantly ramped up R&D capability together with building formulation capacity across high-growth/high-value therapies (CVS, oncology, peptides, CNS) and is further augmenting its injectables line (general + oncology). This entails Rs 16bn in investment being made over FY17-FY21 mainly toward the US market – over 3x higher than the Rs 5bn capex incurred during FY13-FY16.

The heavy capex phase should peak out in FY21 with a large part of the commercial upside starting from FY22, in our view. We expect R&D and capacity scale-up to spur growth over the longer run through to 2026. New capacity should accelerate US launches to 20+ products p.a. (vs. 8-10 seen in each of last three years).

**Bolstering formulation capabilities across high-value segments (CVS, oncology, peptides, CNS) & injectables**

**Commercial upside to kick in from FY22, in our view**

**FIG 13 – CAPEX TO PEAK OUT IN FY21**




Source: Company, BOBCAPS Research

## Expect >80% strike rate on capex implementation

Given progress of the Rs 16bn capex drive thus far, we attach a high probability of 50% capacity commissioning by FY21 and 80% by FY22 (subject to USFDA compliance). This will be critical to ALPM's growth strategy in the high-value product portfolio for the next 5-8 years. In the base case (Fig 15), these new capacities will contribute 7%/12%/18% to our FY22/FY23/FY24 sales estimates.

Operating leverage should be robust given incremental fixed cost on five manufacturing blocks post commissioning would be steady (at Rs 2.5bn-3bn p.a. as per management) and a shift toward multiple high-value products in the mix. We expect –6%/+5%/+19% EBITDA contribution from these capacities for FY22/ FY23/FY24. Productivity gains should improve the contribution further in ensuing years. Our base case assumes a conservative FY24 ATR of 1.0x vs. an average of 1.3x for FY15-FY19 after excluding Abilify & Valsartan (1.5x before exclusion).

**We see upside risk to our base case ATR of 1x for new units vs. 1.3x avg. over FY15-FY19**

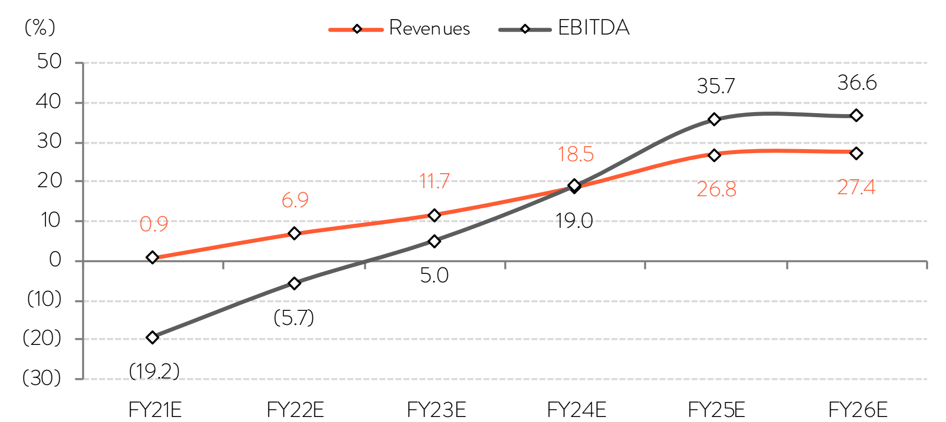
**We expect –6%/+5%/+19% EBITDA contribution from new capacities for FY22/ FY23/FY24**

### FIG 14 – CAPEX PROGRESS REPORT

| New blocks | Therapy & Form | Capex (Rs mn) | USFDA audit | Status | Commissioning |
|---|---|---|---|---|---|
| Karakhadi (Aleor Derma JV) | Dermatology | 2,070 | Approved | Issued one observation during Sep'19 inspection. EIR issued for its first inspection during Oct'18 | Q2FY20 |
| Panelav | Oncology oral solid | 3,000 | Expected in Q2FY21 | ANDA filed in H2FY19 | FY21 |
| Jarod | Oral solid | 3,000 | Expected in Q2FY21 | Expects prior approval supplement (PAS) filings by Q3FY20. Exhibit batches/stability studies in progress | Q1FY22 |
| Karakhadi | Injectable & Ophthalmic | 4,500 | Expected in Q1FY22 | ANDA filings by Q4FY20. Exhibit batches/stability studies in progress | H2FY22 |
| Panelav | Oncology injectable | 3,000 | Expected in Q1FY22 | ANDA filings by Q4FY20. Exhibit batches/stability studies in progress | H2FY22 |
| **Total** | | **15,570** | | | |

Source: Company, BOBCAPS Research

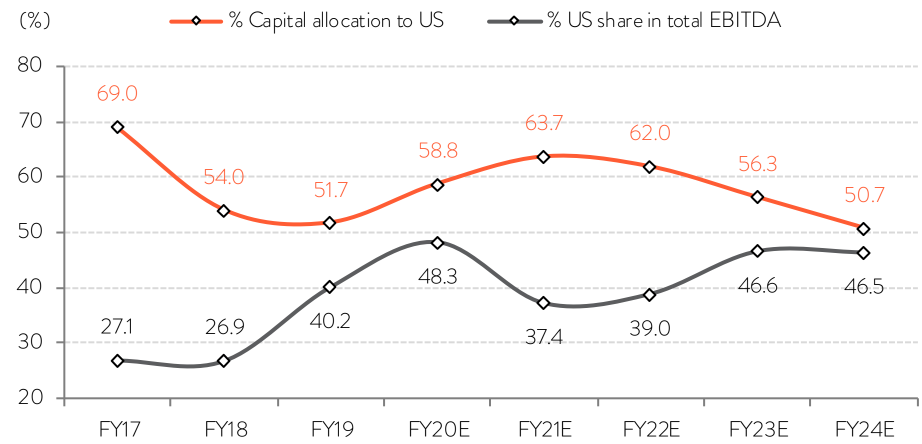
### FIG 15 – OPERATING LEVERAGE FROM CAPEX ON OUR ESTIMATES




Source: Company, BOBCAPS Research

US capital allocation-related concerns for ALPM could ease in the coming years

**FIG 16 – US EBITDA/CAPITAL ALLOCATION GAP TO NARROW BY FY23E/FY24E**




Source: Company, BOBCAPS Research

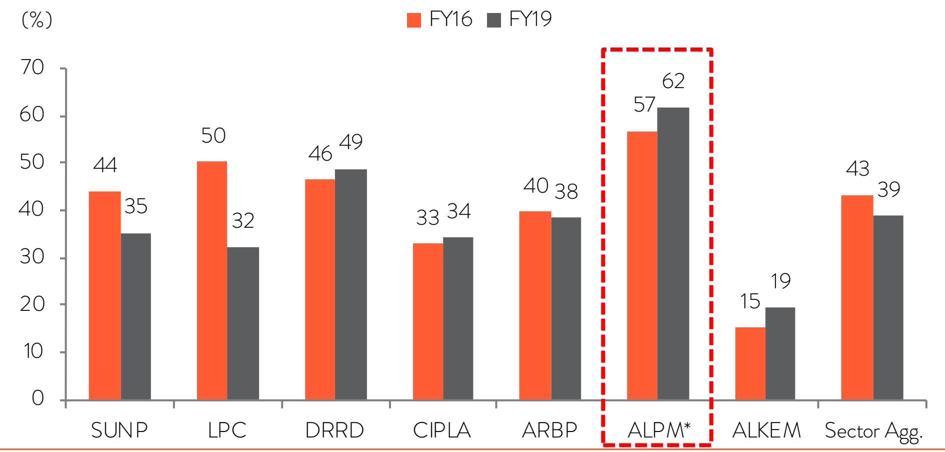
## Ex-R&D margin and ROI; unaffected by US generic pricing headwinds

Our analysis of US profitability suggests that sector EBITDA margins ex-R&D have contracted 400-500bps over the last three years owing to intense generic pricing pressure. Companies that bucked the trend from among our coverage are ALPM where margins climbed ~500bps during same period, followed by Alkem Labs and Dr Reddy's Labs (DRRD).

We believe ALPM's base business margins ex-R&D remained healthy at 55%+ (FY16-FY19) vs. 39% for industry due to its stable base portfolio, impactful launches, supply chain efficiencies and profit-focus over market share-focus. These strengths have helped the company retain a healthy return profile on the base business, at ~22%, vs. peers that have lost close to 10ppt on ROCE in the last three years.

Further, our analysis of the return economics for ALPM's US business considering the Rs 16bn capex drive and generic pipeline opportunities (see Page 10 for details) suggests (1) a healthy payback period of 5-6 years on greenfield investment assuming phased commissioning and 70% utilisation at the end of the sixth year of operation, and (2) combined 13-14% ROI on US business by FY24 and >16% ROI from FY25 onwards. This is after factoring in US$ 500mn of capital allocation towards US markets in FY25 vs. US$ 280mn in FY19.

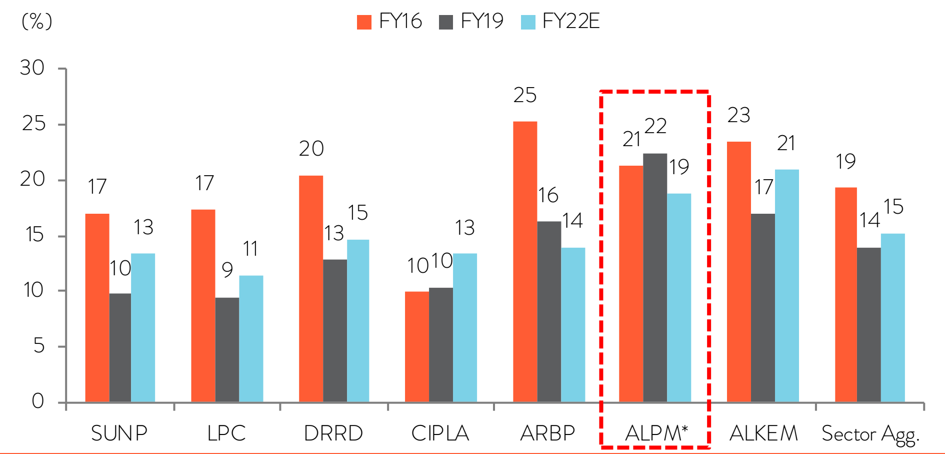
### FIG 17 – ALPM'S US MARGIN (EX-R&D) IS BEST COMPARED TO PEERS




Source: Company, BOBCAPS Research | *Excludes exceptional Abilify in FY16 and Valsartan in FY19

FY16-FY19 ROCE profile ahead of peers despite subdued India growth & intense pricing pressure in US

### FIG 18 – ROCE OF BASE BUSINESS STEADY AND SIGNIFICANTLY HIGHER THAN PEERS




Source: Company, BOBCAPS Research | *Excludes exceptional Abilify in FY16

## US generics: ALPM among first wave in next LOE cycle (2022-26)

In the last couple of years, ALPM has materially improved product development timelines for the US market by building high-value capabilities, and this should reflect in numbers from FY22. Our explicit analysis of the US pipeline suggests ALPM is best placed to participate in ~US$ 20bn worth of patent expiries in the next five years (incl. in high-value oncology, peptides and CVS), of which 80% are products with a sizeable market of >US$ 500mn on average. These include Vimpat, Xarelto, Pradaxa and Sprycel (Fig 19). The opportunity size gets even better in the following years after 2025.

ALPM's mid-term launch pipeline is decent and price erosion risk is low in the existing portfolio. We expect US sales of US$ 220mn heading into FY21 (from a US$ 140mn base business in FY19) and a sustained 19% CAGR in the base business thereafter through FY23 to US$ 300mn+, supported by 20+ launches per year. Margins ex-R&D for the base business are healthy at 55%+ (FY16-FY19) vs. 39% for industry and should improve further along with ROI.

## US pipeline – taking the bigger picture

In the next 10 years, we believe ALPM can participate in ~US$ 37bn worth of generic opportunities in the US market (US$ 20bn in the next five years). These would include roughly US$ 30bn worth of high-value brands, each with a market size of over US$ 500mn (or ~80% of the US generic opportunity), where ALPM stands a high chance of being among the first wave of approvals. Over 80% of the oral filings are backward integrated, implying healthy economics on gross margins.

Other key growth catalysts would be (1) the pipeline of 68 ANDAs pending for approval as on Sep'19 which includes 30 Para IVs/limited competition drugs, (2) expansion of manufacturing capacity, (3) further investments to boost supply chain efficiency, and (4) a wider product basket that maximises on drug shortage opportunities.

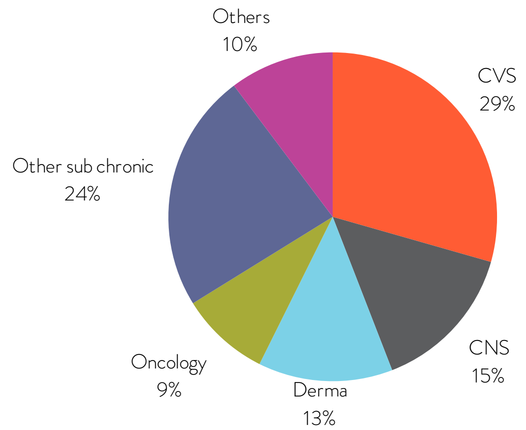
**~US$ 37bn generic opportunity over ten years (US$ 20bn in next five years)**

**FIG 19 – US OPPORTUNITY SIZE AND KEY ASSETS OVER NEXT 5-10 YEARS**

| LOE | Market size (US$ bn) | Key assets |
|---|---|---|
| Next 12M | 5.0 | Fanapt, Effient, Mevacor, Topamax and Tarceva |
| FY21-FY24 | 15.5 | Vimpat, Xarelto, Farxiga, Ibrance |
| FY25-FY27 | 10.0 | Pradaxa, Gilenya, Trintellix, Sprycel, Rexulti, Entresto, Brilinta |
| FY28-FY30 | 7.0 | Eliquis, Invokana, Tradjenta |
| >FY31 | 9.0 | Otezla, Jardiance, Imbruvica, Tagrisso |

Source: Company, BOBCAPS Research

**FIG 20 – 68 PENDING ANDAs AS OF SEP'19 – CHRONIC ACCOUNTS FOR 90%**




Source: Company, BOBCAPS Research

## US$ 5bn market opportunity in next 6-12 months

In the near term, we expect approvals for Iloperidone (Fanapt), Prasugrel (Effient), Lovastatin (Mavacor), Topiramate (Topamax) and Erlotinib - Tarceva (combined market size ~US$ 3bn). Even though these are genericised products, some of them could be lucrative opportunities with >US$ 3mn-5mn in sales per product for ALPM, in our view (vs. existing US$ 1.5mn run-rate).

**FIG 21 – POTENTIAL FROM DMF WHERE PATENT HAS EXPIRED**

| Molecule | Filing date | Therapy | Market size (US$ mn) | Generic players |
|---|---|---|---|---|
| Metoprolol Succinate USP | 29-Mar-08 | CVS | 400 | 8 |
| Pentosan Polysulfate Sodium | 20-Feb-09 | Anticoagulant | 350 | 0 |
| Warfarin Sodium Clathrate USP | 29-Mar-11 | CVS | 500 | >15 |
| Iloperidone | 06-Apr-11 | CNS | 140 | 2 |
| Bosentan | 30-Jun-11 | CVS | 60 | 8 |
| Nisoldipine | 07-Oct-11 | CVS | 30 | 1 |
| Felodipine USP | 11-Oct-11 | CVS | 100 | 11 |
| Prasugrel Hydrochloride | 21-Mar-12 | CVS | 500 | 8 |
| Topiramate | 30-Sep-13 | CNS | 1,400 | 12 |
| Lovastatin USP | 28-Mar-14 | CVS | 1,200 | 10 |
| Silodosin | 04-Sep-15 | Oncology | 200 | 10 |
| Erlotinib Hydrochloride | 30-Mar-16 | Oncology | 300 | 2 |
| Gefitinib | 19-Sep-16 | Oncology | 15 | 0 |
| Erythromycin Ethylsuccinate USP | 28-Feb-17 | Anti-biotics | 70 | 4 |

Source: Company, FDA, BOBCAPS Research

## H1 launches – ALPM was Day-1 launch in Febuxostat and Pregabalin

ALPM received six approvals and launched ten products during H1FY20 (three in the first wave including Pregabalin and Febuxostat – shared exclusivity). These could be lucrative launches with US$ 6mn-10mn in sales given that price erosion in Pregabalin (US$ 5.3bn brand sales) is still ~80% despite being an eight-player market. ALPM has 5% market share in Pregabalin, the highest after Cipla's 9%, followed by Teva and DRRD. Febuxostat (US$ 700mn brand sales) is a three-player market and ALPM has 25% market share after Mylan at 50%.

**FIG 22 – OPPORTUNITY WITHIN EXISTING US PORTFOLIO**

| Annualised sales potential (US$ mn) | Molecules | FY19 Sales | Market share (%) | | | No of in-market players | Price erosion dynamics |
|---|---|---|---|---|---|---|---|
| | | | Nov'19 | Jun'19 | FY19 | | |
| 15 | Famotidine | 7 | | | | 15 | Pricing stable |
| 10 | Irbesartan | 6 | 11 | 9 | 6 | 15 | Pricing stable |
| 15 | Lamotrigine | 10 | 6 | 7 | 5 | 15 | Pricing stable |
| 15 | Olmesartan Medoxomil | 12 | 35 | 22 | 18 | 15 | Mylan exited, Ascend losing |
| 8 | Olmesartan-Hydrochlorothiazide | 5 | 28 | 22 | 18 | 8 | Teva, Sun, Mylan losing share |
| 40 | Valsartan | 40 | 20 | 16 | 9 | 20 | Aurobindo re-filed under CB-30. Mylan share at 3.3% vs. 20% pre-Nov'18 |
| 12 | Febuxostat | 0 | 25 | | | 3 | Shared exclusivity - Sun, Mylan and Alembic launched |
| 6 | Pregabalin | 0 | 5 | | | 13 | Pricing stable |

Source: Company, Bloomberg, BOBCAPS Research I market share as on 05th Nov 2019

## Base US pipeline strong enough to reach US$ 300mn+ by FY23

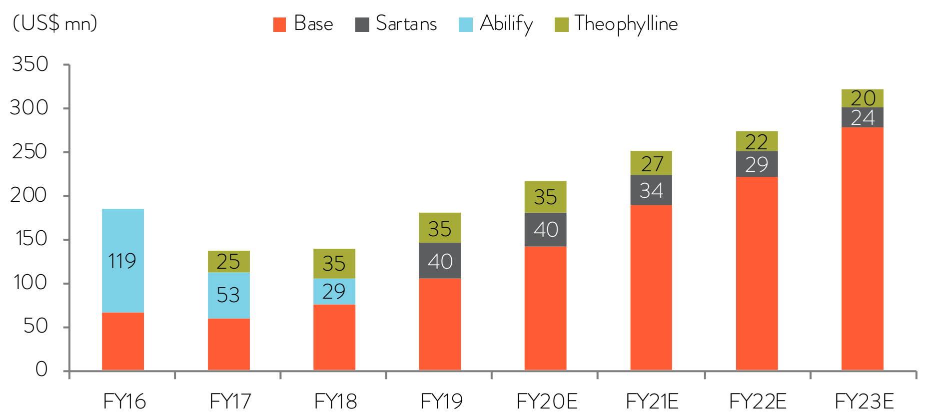
ALPM has multiple products in its pipeline as discussed above, besides which launches such as gToviaz and Vimpat could contribute US$ 6mn-10mn from FY23, aiding sustained growth in base US sales. We estimate sales of US$ 220mn in FY21 (from a US$ 140mn base in FY19 ex-Valsartan), after factoring in incremental generics for Theophylline. We expect Theophylline profit concentration to reduce from 20% of FY19 EBITDA to 8% by FY21.

In our view, the US base business can sustain a 19% CAGR over FY21-FY23 to US$ 300mn+, supported by a step up in the number of launches to 20 per year (from 8-10 launches in the last three years).

**Multiple products in pipeline should drive 19% US base growth for FY19-FY23**

**We assume profit concentration in Theophylline will reduce from 20% of FY19 EBITDA to 8% by FY21**

**FIG 23 – BASE US SALES TREND – EXPECT 19% CAGR OVER FY19-FY23**




Source: Company, BOBCAPS Research

## Theophylline – new launches to offset generic risk

**Sartan franchise opportunity could sustain for two years**

ALPM's top 5 products contribute ~50% of US business. Except for Theophylline, competition in the rest of the product basket is largely stable. The Sartan franchise could remain lucrative for the next two years, in our view, as competitors would take time to resolve raw material issues before ramp-up.

**Ex-Theophylline, competition in other products stable**

Theophylline (US$ 50mn-60mn size) is presently a three-player market with 36 listed US DMFs, three active suppliers and product patent expired before 2015. ALPM has 98% market share (vs. 70% in FY17) and the product accounts for US$ 35mn-40mn in annual sales and ~20% of FY19 EBITDA. As per management, 2-3 filers are expected to enter the market but are yet to receive approval. We believe the profit impact from additional generics would be sufficiently mitigated by ALPM's slate of 8-10 new launches. We also note that the company plans to launch over 40+ ANDAs over the next two years.

## US strategy centres around efficient monetising

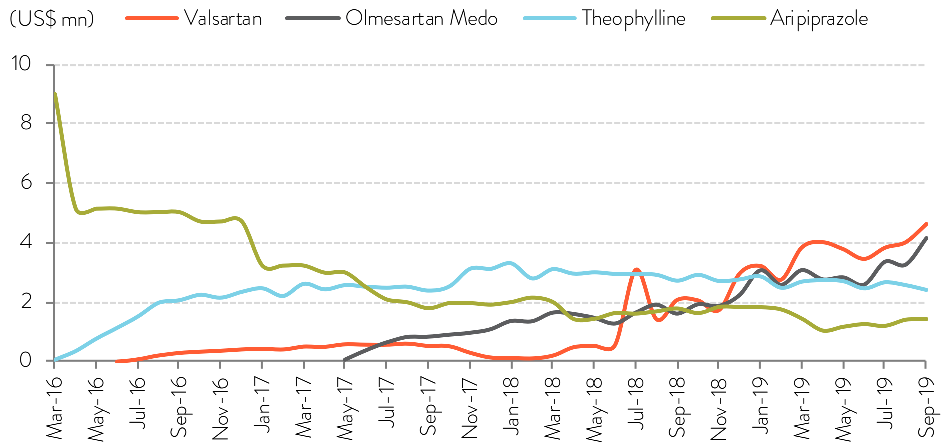
ALPM's US strategy focuses on (a) profit per product rather than chasing volume market share (as discussed earlier, ex-R&D EBITDA margins have expanded over 500bps despite intense pricing pressure in the last three years), (b) a self-funded growth approach, (c) spotting market opportunities (previously seen in products such as Abilify and Sartans), and (d) efficient supply chain management. This well-defined strategy and monetisation of the ~Rs 16bn investment to build wider R&D capabilities augurs well for growth over the next 3-4 years.

We note that over the last five years, ALPM has successfully maximised on three key short-term opportunities caused by market disruptions – Aripiprazole in FY16 (supply issues at competitors due to lack of RM integration), Theophylline in FY17 (Teva exit, RM issues), and the Sartan class in FY19 (NMDA impurity issues led by bad quality Chinese intermediates). Market share data suggests the upside from these opportunities sustained for a prolonged period (>6 months more than usual) due to the company's consistent supply, efficient sourcing and better quality control from inhouse API sourcing.

Nimble supply chain and strong quality control help tap market disruption-led opportunities

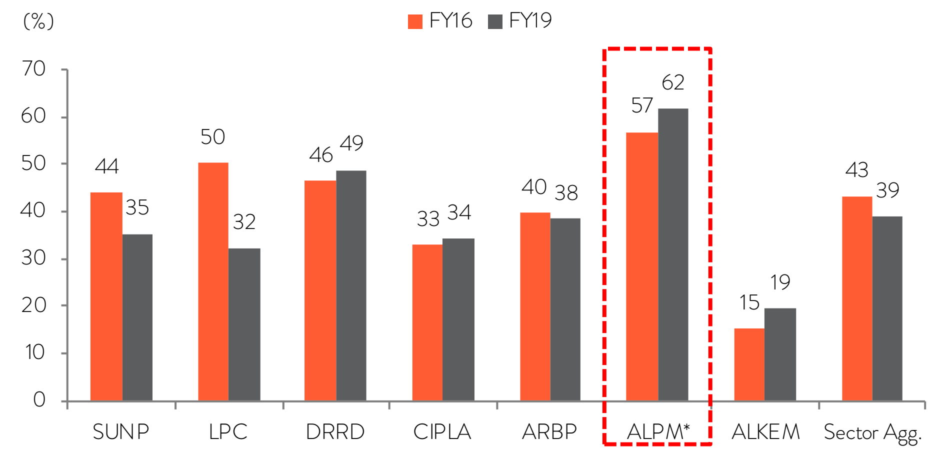
Flawless supply track record with distributor so far

**FIG 24 – DURATION OF SHORT-TERM OPPORTUNITIES LASTS LONGER THAN USUAL FOR ALPM (MONTHLY TRX $ TREND)**




Source: Company, Bloomberg, BOBCAPS Research

**FIG 25 – EBITDA MARGINS (EX-R&D) BEST IN CLASS DESPITE PRICING PRESSURE IN PAST YEARS**




Source: Company, BOBCAPS Research | *Excludes exceptional Abilify in FY16 and Valsartan in FY19

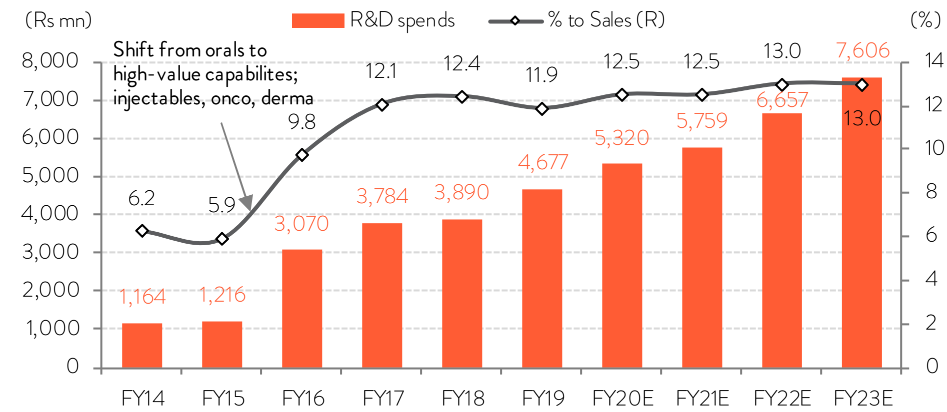
## R&D spends largely US focused

H2 should see ramp up in filings in ophthalmology, general injectables, peptides and oncology injectables

Over the past five years, ALPM has built and strengthened various platform capabilities beyond oral solids, with the US market as a major focus. The pace of US filings and R&D spends has picked up since FY15. Overall, R&D spends as a percentage of sales have doubled from 6% to 12% in FY19. At present, the company has 235+ products in the research pipeline (from 45 in FY16) and expects to scale up filings for some of the newer product categories, such as ophthalmology, general injectables, peptides and oncology injectables from H2FY20.

The long-term focus remains on building a stronger, differentiated product pipeline for the US market with equal emphasis on creating an inhouse API source. ALPM believes that while the number of ANDA filings could stay at 18-20 annually, the quality of filings/end market size should improve in coming years.

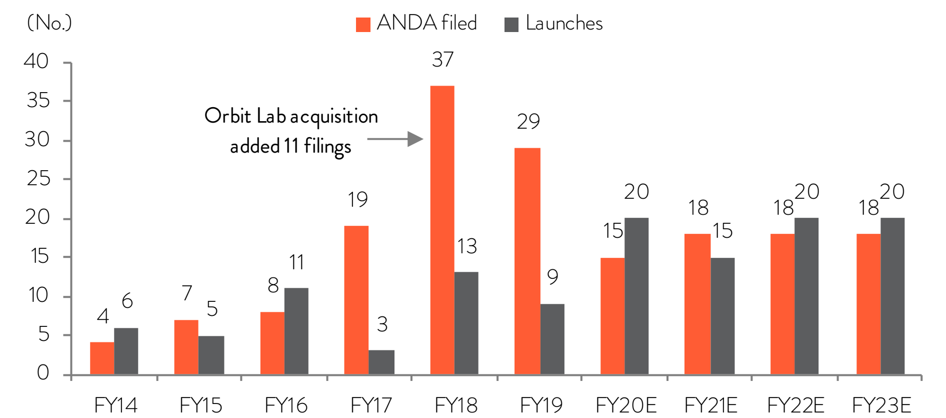
### FIG 26 – R&D SPENDS – THRUST ON BETTER PRODUCT CATEGORIES




Source: Company, BOBCAPS Research

**Expect +20 launches per year from FY20 (vs. 8-10 on average in last three years)**

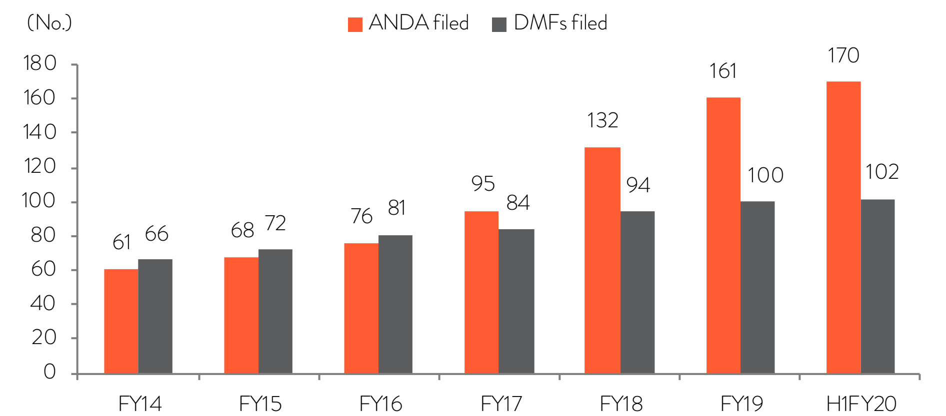
### FIG 27 – ANNUAL US FILINGS AND LAUNCHES TO STEP UP




Source: Company, BOBCAPS Research

**80% of oral products are backward integrated**

### FIG 28 – EQUAL EMPHASIS ON IN-HOUSE API DEVELOPMENT




Source: Company, BOBCAPS Research

## India – focus on brand position; growth recovery from FY21E

ALPM's India formulation business contributed 35% of FY19 revenues and is the most profitable segment for the company despite an acute-heavy portfolio – in the last five years, the business has grown in line with the market at a modest 7%. This was largely due to the impact of demonetisation, GST, NLEM expansion, and higher API prices in FY18/FY19; excluding these, growth was at 10%. The company's prescriber base has increased by ~6% p.a. over the last three years.

Management's focus in India has been on select therapies, with a bigger spotlight on maintaining brand positioning. ALPM has five brands among the top 300 pharmaceutical brands in India, and its top 10 brands contribute 75-80% of domestic revenues, growing at over 12% p.a. in the last few years. The company's strategy has been to launch a few products with an emphasis on profits.

Starting Mar'19, ALPM has taken aggressive steps to rationalise existing distributors (to derisk customer concentration) and also revised the rebate model (reducing discounts to stockists mainly in chronic areas). This affected H1FY20 growth, although we note some early traction in Q2 margins. During the Q2FY20 call, ALPM mentioned that these challenges have been dealt with and the business should recover both in terms of growth and profitability starting FY21.

### Stable Rx growth – management expects 10-11% CAGR

ALPM's prescription growth has remained largely stable at ~5% despite regulatory challenges. Building in better competitiveness, an increasing share in the chronic portfolio mix (with over 90% of launches in specialty), brand building and enhanced MR productivity, we forecast a minimum of 7-8% sales growth over the next three years (5% in acute and 12% in chronic therapies). Management has a 10-11% growth guidance for the business as it expects the growth challenges from reduced channel discounts to bottom in Q3FY20.

**Growth challenges from channel discount cuts to bottom in Q3FY20**

**FIG 29 – INDIA BUSINESS – EXPECT 7-8% CAGR OVER NEXT 3 YEARS**

| (Rs mn) | FY16 | FY17 | FY18 | FY19 | FY20E | FY21E | FY22E | CAGR (FY19-22) (%) |
|---|---|---|---|---|---|---|---|---|
| Acute | 9,090 | 9,528 | 9,664 | 10,294 | 10,475 | 11,238 | 11,860 | 4.8 |
| As % to sales | 77.3 | 76.0 | 75.9 | 74.4 | 72.9 | 71.9 | 70.5 | - |
| Chronic | 2,670 | 3,012 | 3,076 | 3,536 | 3,895 | 4,398 | 4,968 | 12.0 |
| As % to sales | 22.7 | 24.0 | 24.1 | 25.6 | 27.1 | 28.1 | 29.5 | - |
| **Total Sales** | **11,760** | **12,540** | **12,740** | **13,830** | **14,369** | **15,636** | **16,827** | **6.8** |
| Growth (%) | 11.0 | 6.6 | 1.6 | 8.6 | 3.9 | 8.8 | 7.6 | - |

Source: Company, BOBCAPS Research

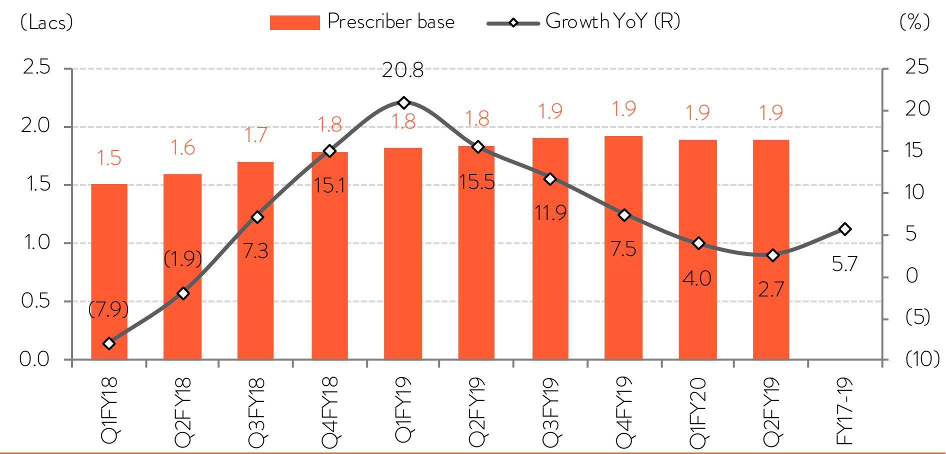
### Share of chronic therapy pie on the rise

Over the last five years, the share of chronic sales has improved to 25.6% of India business in FY19 (vs. 22% in FY15), with 90% of new launches being in the specialty category. The top 3 therapies (anti-infective, gastro, respiratory), which are low-margin businesses that dominated over 60% of domestic sales until FY15, have shrunk to 48% now. Cardiology, diabetology and gynaecology have seen good uptake and together contributed over 50% to domestic growth between FY15-19. The share of low-margin anti-infectives and gastrointestinal segment has declined from 29% and 17% respectively to 22.5% and 12.8% over FY15-FY19.

### Focus on brand building and prescriber base growth

ALPM has worked toward sustained brand building rather than launching multiple products across therapies. As a result, its top 10 brands account for 75-80% of overall India formulation revenues and have been growing at a 12% CAGR over the last three years, vs. a decline of ~6% for the rest of its portfolio. The company has five brands among the top 300 in the Indian pharmaceutical market, viz. Azithral, Tellzy, Althrocin, Wikoryl and Rekool. In addition, prescriber base growth has remained sound at 5-6% in the last three years.

**FIG 30 – AVERAGE PRESCRIBER BASE – GROWING AT 5-6% P.A.**




Source: Company, BOBCAPS Research

**FIG 31 – THERAPY-WISE REVENUE – SHARE OF LOW-MARGIN SEGMENTS COMING DOWN**

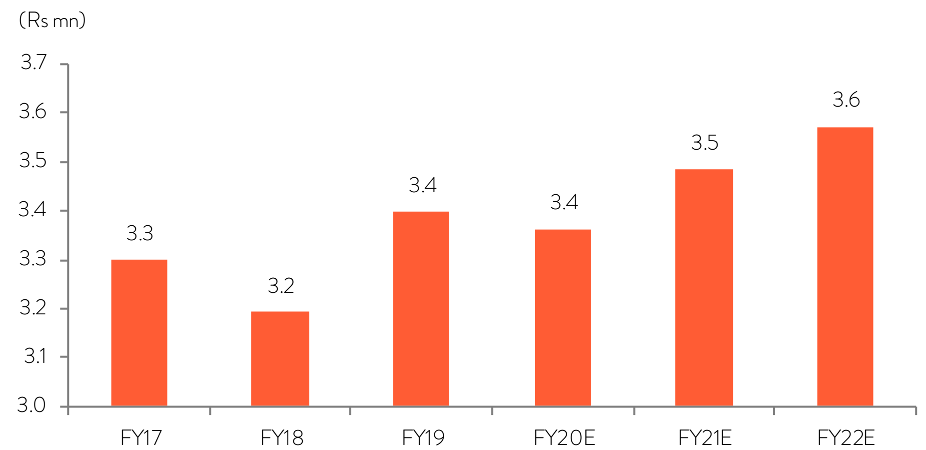
| (Segment, %) | FY16 | FY17 | FY18 | FY19 | CAGR (FY16-19) | IPM Ranking Sep'19 | Secondary trend Apr-Sep'19 growth rate | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | IPM | ALPM |
| Anti-infective | 23.8 | 22.5 | 22.8 | 22.5 | 3.6 | 4 | 16.0 | 13.0 |
| Gastrointestinal | 15.3 | 14.4 | 13.1 | 12.8 | (0.6) | 10 | 11.0 | (1.5) |
| Cough/Cold | 13.0 | 12.2 | 12.7 | 12.3 | 3.6 | 4 | 14.0 | 17.0 |
| Gynaecology | 11.2 | 13.4 | 12.7 | 12.4 | 9.3 | 5 | 13.0 | 8.3 |
| Animal health | 8.5 | 8.8 | 9.5 | 8.7 | 6.6 | - | - | - |
| Others (Urology, Ophthalmology) | 5.5 | 4.7 | 5.0 | 5.7 | 10.0 | 11 | 12.0 | 7.0 |
| **Acute mix (%)** | **77.3** | **76.0** | **75.9** | **74.4** | **-** | **-** | **-** | **-** |
| Cardiac | 14.5 | 15.2 | 15.3 | 16.3 | 9.8 | 6 | 12.0 | 6.2 |
| Anti-diabetic | 6.5 | 7.2 | 7.1 | 7.4 | 10.1 | 15 | 14.0 | 4.0 |
| Dermatology | 1.7 | 1.6 | 1.7 | 1.9 | 8.4 | 15 | 9.0 | (1.0) |
| **Chronic mix (%)** | **22.7** | **24.0** | **24.1** | **25.6** | **-** | **-** | **-** | **-** |

Source: Company, BOBCAPS Research

## Field force productivity stable

ALPM has a field force of 3,900 medical representatives (MR) across 17 marketing divisions as of FY19. Field force productivity has remained largely stable at Rs 3.4mn per rep p.a. over the last three years despite a temporary slowdown in the business (due to GST/demonetisation). We continue to expect a modest rise in productivity over the next three years with no major addition to the sales force.

**FIG 32 – MR PRODUCTIVITY – EXPECT A MODEST RISE**




Source: Company, BOBCAPS Research

## Trade generics and DPCO risk low

While regulatory action on drug pricing is difficult to predict, we believe the risk of material loss from action by the National Pharmaceutical Pricing Authority (NPPA) or generic margin capping is low. This is because 28% of the company's top 10 brands are already under price control (15% of total sales vs. 16-17% for industry). Also, some of its other key brands such as Althrocin, Wikoryl and Rekool, which accounted for 23% of FY19 sales, are in the average price bracket compared to peers in the same category.

Further, exposure to trade generic revenues as a percentage of domestic business is low at 5-6% (in line with the industry) as compared to some players (Alkem, Cipla) that have 15-18% exposure. We don't see any material business risk on this front.

**FIG 33 – TOP 10 BRANDS**

| Brand group | Molecule | Therapy | Revenues (Rs mn) | % of India formulation sales | Price control (Yes or No) |
|---|---|---|---|---|---|
| Azithral | Azithromycin | Anti-infective | 2490 | 18.0 | Y |
| Tellzy | Telmisartan combination | Cardiac | 1510 | 10.9 | Y (partly) |
| Althrocin | Erythromycin | Anti-infective | 1150 | 8.3 | N |
| Wikoryl | Phenylephrine+ Chlorpheniramine | Cough and Cold | 1040 | 7.5 | N |
| Rekool | Rabeprazole | Gastrointestinal | 980 | 7.1 | N |
| Roxid | Roxithromycin | Anti-infective | 660 | 4.8 | N |
| Ulgel | Magaldrate+ Simethicone | Gastrointestinal | 660 | 4.8 | N |
| Cetanil | Cilnidipine+Telmisartan | Cardiac | 610 | 4.4 | N |
| Gestofit-Sr | Progesterone | Gynaecology | 590 | 4.2 | N |
| Glisen | Glimepiride | Diabetic | 580 | 4.2 | N |
| **Top 10 brands** | | | | **74.2** | |

Source: Company, BOBCAPS Research

## ROW markets – expect 20% growth

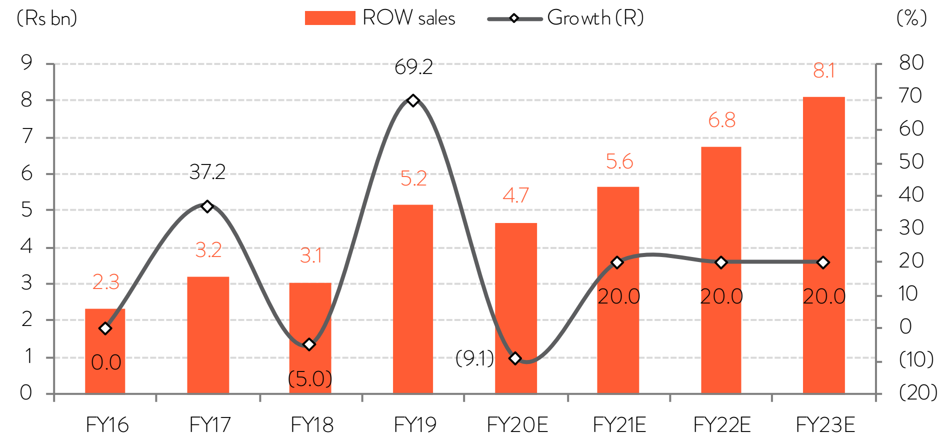
ALPM is mainly present in Europe and Australia. The ROW business has doubled in the last five years, supported by a solid FY19 where sales grew 69% over FY18 due to an improved success rate in tender applications, especially in Europe. Management continues to see long-term growth opportunities in these markets and has guided for stable 15-20% growth in coming years despite regulatory challenges and currency volatility. In the near term, ALPM does expect some base normalisation in FY20 due to manufacturing challenges for the European market (introduction of serialisation) which impacted H1.

During the Q2FY20 earnings call, management highlighted that serialisation in Europe has eaten into some of the capacities, but this is an industry-wide issue and the underlying business fundamentals remain intact. The company expects to bring ROW sales back on track from Q3 as EU compliance linked to serialisation systems for the packaging lines is largely in place. The recent May'19 JV for the Chinese market could provide additional growth optionality in the long run.

Under the new leadership, the company is also developing a strategy to penetrate other high-growth regions such as the Philippines to leverage its existing portfolio. We expect this to be a long-term driver beyond FY22.

**Management continues to see long-term growth potential in EU and Australia**

**FIG 34 – ROW MARKET SALES TO RECOVER FROM Q3FY20**




Source: Company, BOBCAPS Research

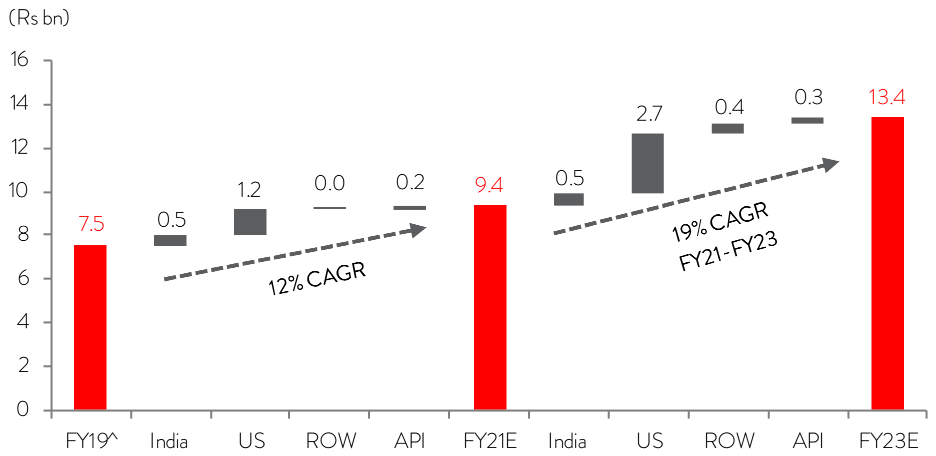
## Better mix to drive 300bps margin gains over FY19-FY23E

While ex-India business should see growth normalisation, the key catalyst for profit growth will be operating leverage in the core US business. We expect operating leverage to drive 300bps EBITDA margin expansion for ALPM in the next four years to 23%. Normalising for Valsartan sales in FY19, we estimate that the US would account for 65% of incremental EBITDA over FY19-FY23.

Commencement of new formulation capacities for the US market from FY22 plus first-wave generic approvals in multiple high-value assets in the upcoming LOE cycle (2022-26) is expected to drive over 20% EPS growth for ALPM for a relatively longer period through to FY25 over FY21 base earnings. In the near-to-midterm (FY19-FY21), core EBITDA is forecast to grow ~12% over the FY19 base ex-Valsartan, supported by the current set of US filings (we expect 20 ANDA approvals p.a.) and India/ROW business margin expansion.

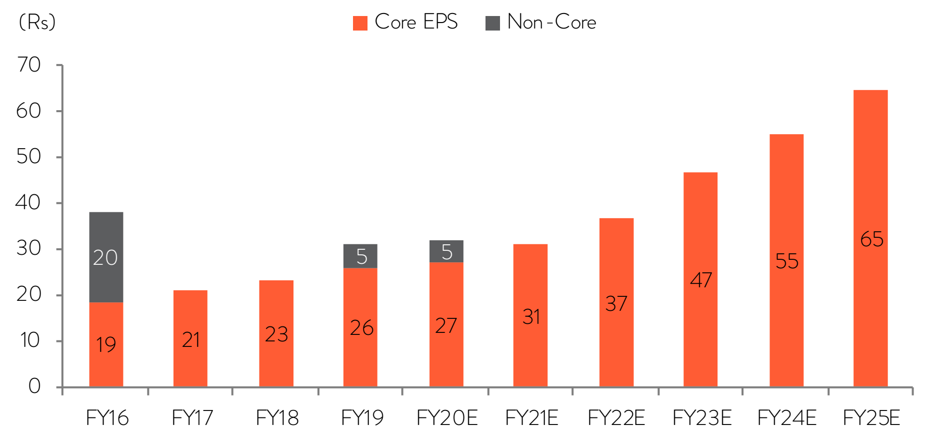
We expect 300bps margin expansion over FY19 (ex-Valsartan base) to FY23 to 23%, mainly from US leverage and India normalisation

#### FIG 35 – US TO ADD 65% OF INCREMENTAL EBITDA OVER FY19-FY23E




Source: Company, BOBCAPS Research | ^Excludes non-recurring Valsartan base

#### FIG 36 – EPS – EXPECT >20% GROWTH OVER FY21-FY25



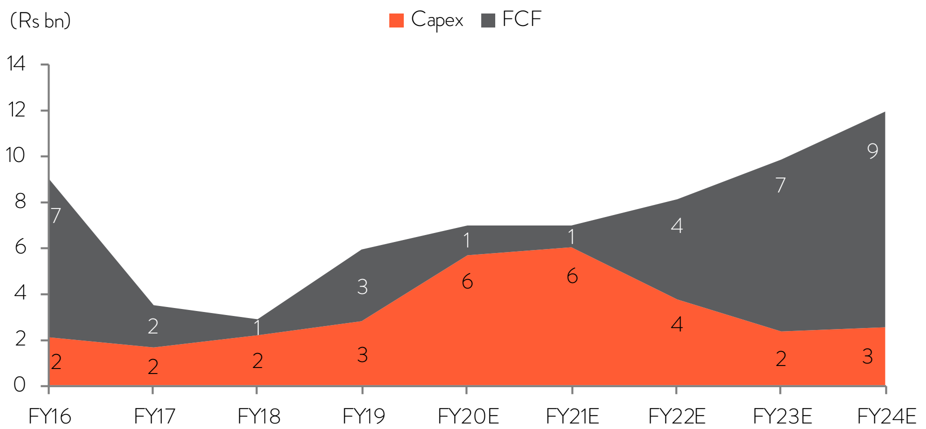

Source: Company, BOBCAPS Research

## FCF track record, cash flow + capex tailwind = ROIC boost

ALPM's net debt/equity ratio has been largely under control at 0.3x despite significant capex momentum – the Rs 16bn capital outlay has been partly incurred over the last two years mainly towards the new formulations block for the US market and will continue through to FY21. In our view, this capex will peak out in FY21 and materially reduce to Rs 2.5bn-3bn per year thereafter. Hence, we expect ROIC of 32% by FY23 (assuming it is the first full year operation of new capacity) and >40% by FY25.

**Improving profitability and limited capex to improve FCF over FY22-FY24 (Rs 18bn+) vs. FY17-FY20 (Rs 7bn)**

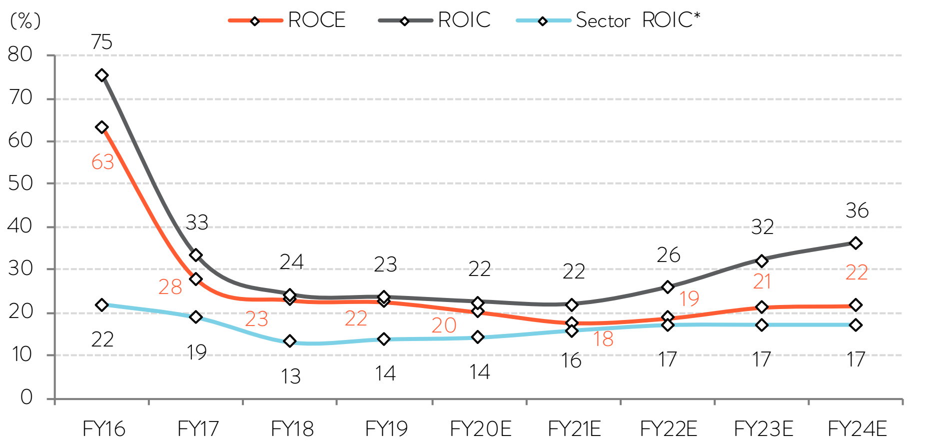
### FIG 37 – GOOD FCF TRACK RECORD DESPITE HEAVY CAPEX




Source: Company, BOBCAPS Research

**Best ROIC amongst peers**

### FIG 38 – ROIC HIGHEST AMONG PEERS; EXPECTED TO CROSS 32% BY FY23E




Source: Company, BOBCAPS Research | *Aggregate of Cipla, Sun, Lupin, Dr Reddy, Aurobindo, Alkem

# Valuation methodology

Mediocre core earnings growth and heavy capex have weighed on ALPM's share price since 2015, with the stock down 68% vs. the Sensex and 54% vs. the midcap index (up 7% vs. the healthcare index). Over the next 6-9 months, we believe markets will start discounting (a) the upcoming sizeable US generic opportunity worth US$ 20bn (2022-26) and (b) capex turning productive from FY22E. This should support over 20% EPS growth visibility for a relatively prolonged period through to FY25 over the FY21 base earnings.

ALPM's ROIC of 23% in FY19 is the best compared to large and midsize generic-focused companies which were at ~15%. Valuations are reasonable at 9.8x FY22E EV/EBITDA, compared to the existing 10x multiple for the sector. Overall, we believe the stock now offers a better risk-reward.

Using the average of EV/EBITDA (SOTP-based) and P/BV valuations, we arrive at a Mar'21 target price of Rs 660 for the stock (target EV/EBITDA multiple of 12x on Mar'22E, implied P/E of 21x). Initiate with BUY as we believe the market's concerns of high US capital allocation and weak margin dynamics are unwarranted and this could drive a large earnings surprise, fuelling a rerating in the stock over the next two years.

### Stock rerating triggers

- In the last 2-3 years, ALPM has been developing a pipeline of complex oral solids and injectables, including a few peptide-based drugs, augmenting mid- to longer-term growth visibility. In particular, its oncology filings in mid-2018 offer strong growth visibility from FY22 on (subject to regulatory clearance).
- Earnings concentration in sartans and generic risk in Theophylline can be set off by new launches and a widening portfolio, limiting the risk to forecasted earnings.
- ALPM's products stand a high chance of being among the first wave of approvals in the upcoming generics opportunity in the US. These should have higher entry barriers than its launches over the past five years. About 80% of the product opportunity has a sizeable market of >US$ 500mn on average. The opportunity size/quality gets even better in the years after 2025. A large portion of ALPM's oral filings are backward integrated, implying better gross margins and disruption-led opportunities. This suggests that our thesis of healthy earnings in the next couple of years has the potential to accelerate.
- Multi-year capex should turn productive from FY22.

- ALPM has one of the best track records on FDA cGMP inspections so far. Further, potential high-value launches in the US and growth uptick/channel restocking in India and ROW will be key catalysts ahead, in our view.

### FIG 39 – EV/EBITDA - VALUATION FRAMEWORK FOR OUR GENERIC COVERAGE COMPANIES

| Region (x) | ALPM | ALKEM | SUNP | LPC | DRRD | ARBP | CIPLA |
|---|---|---|---|---|---|---|---|
| US | 9.0 | 9.0 | 9.0 | 9.0 | 9.0 | 7.0 | 9.0 |
| India | 15.0 | 16.0 | 15.0 | 15.0 | 15.0 | 0.0 | 14.1 |
| EM/ROW | 12.0 | 12.5 | 11.5 | 12.0 | 12.0 | 10.0 | 9.0 |
| API & Others | 8.0 | 1.0 | 8.0 | 8.0 | 8.0 | 7.0 | 8.0 |
| **EV/EBITDA (1 Yr fwd)** | **11.8** | **15.4** | **10.7** | **11.6** | **11.3** | **7.2** | **12.3** |
| **P/E (implied)** | **21.3** | **20.8** | **17.5** | **23.8** | **18.7** | **10.6** | **24.3** |
| FY21 ROCE (%) | 17.7 | 19.8 | 12.8 | 10.3 | 15.2 | 13.3 | 12.5 |
| FY21 ROE (%) | 16.9 | 21.0 | 11.7 | 10.4 | 14.5 | 15.7 | 10.2 |
| FY20-FY22 EBITDA CAGR (%) | 15.3 | 18.4 | 12.0 | 14.6 | 4.3 | 8.5 | 7.9 |

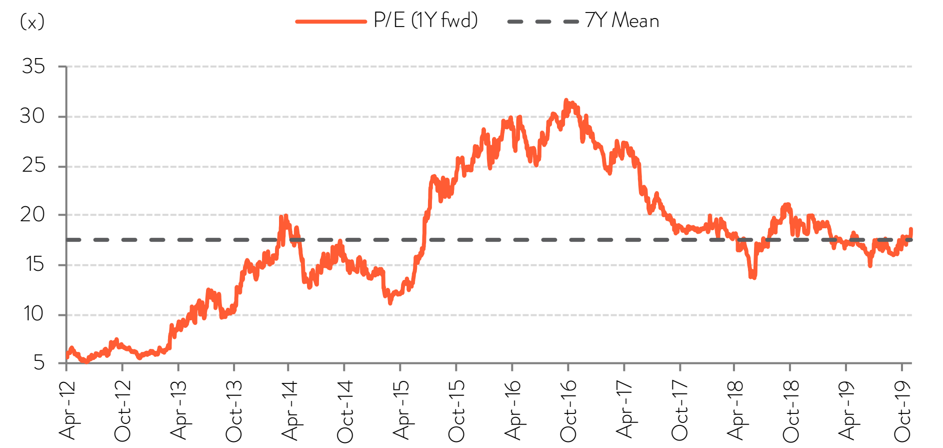
Source: Company, BOBCAPS Research

### FIG 40 – VALUATION SNAPSHOT: TARGET PRICE OF RS 660/SH

| Business (Rs mn) | FY22E EBITDA | Target multiple EV/EBITDA (1Y fwd) (x) | Target multiple P/E (implied 1Y fwd) (x) | Segment EV FY21E | Mix (%) | Comment |
|---|---|---|---|---|---|---|
| India | 3,978 | 15.0 | | 59,674 | 48 | Steady demand visibility merits higher multiple |
| US | 4,252 | 9.0 | | 38,269 | 31 | Broadly aligned to US generic peers |
| ROW | 1,216 | 12.0 | | 14,591 | 12 | Discount to India due to forex risk. >70% share of ROW EBITDA is from Australia, Europe, and Canada |
| API & Others | 1,467 | 8.0 | | 11,739 | 9 | Multiple at par with sector |
| **Aggregate** | | **11.8** | **21.3** | **124,273** | | Target EV/EBITDA in line with historical average and at 5-10% premium to sector as ALPM's ROIC of >22% is the best amongst peers. Implied P/E is 15% premium to past 7Y avg. |
| Net debt | | | | 4,065 | | |
| Target Market Cap | | | | 120,208 | | |
| Per share (Rs) | | | | 638 | | |
| Book value basis (per share) | 224 | 3.1 | | 683 | | Target P/B at 25% discount to last 7Y avg. (in view of normalisation in ROCE vs. historical avg.) |
| **Target Price per share (average of EV/EBITDA & P/B)** | | | | **660** | | |
| Upside (%) | | | | 18 | | |

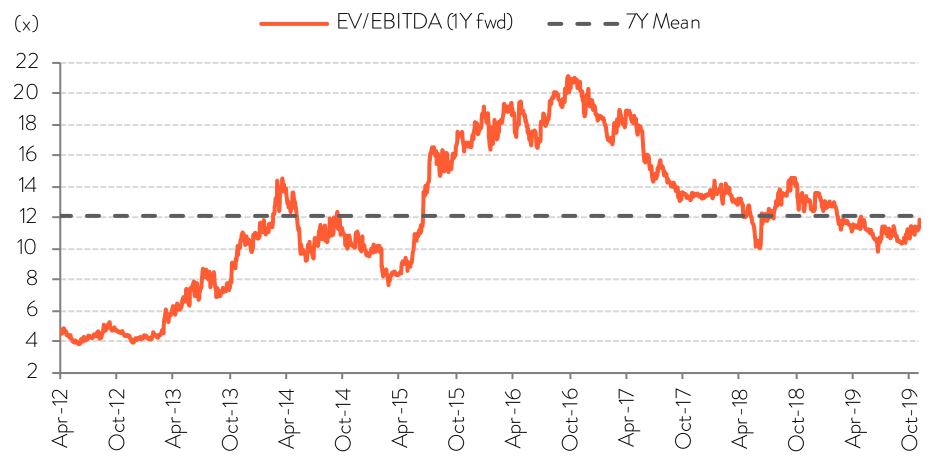
Source: Company, BOBCAPS Research

### FIG 41 – P/E MULTIPLE (ONE-YEAR FORWARD)



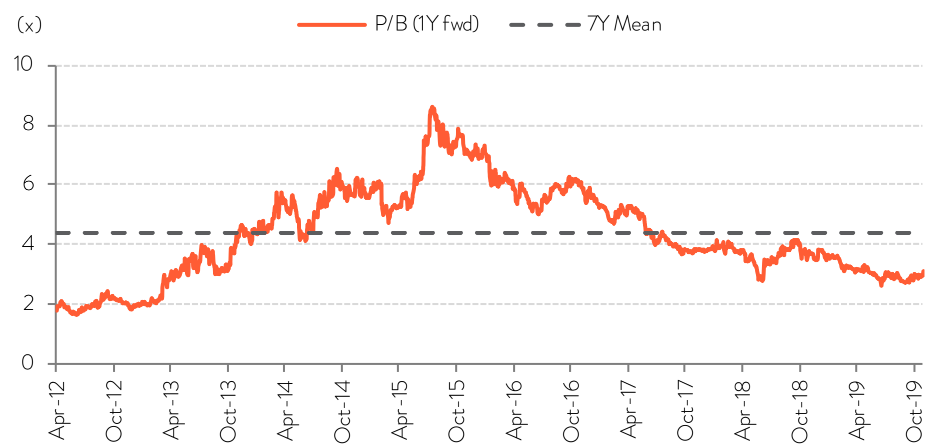

Source: Company, BOBCAPS Research

### FIG 42 – EV/EBITDA MULTIPLE (ONE-YEAR FORWARD)



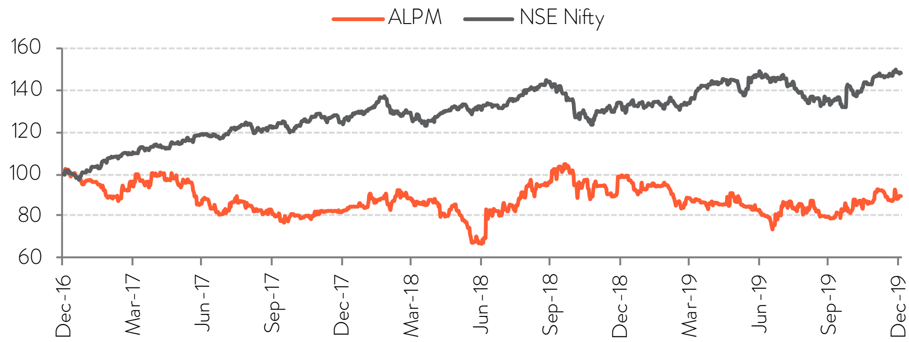

Source: Company, BOBCAPS Research

### FIG 43 – P/B MULTIPLE (ONE-YEAR FORWARD)




Source: Company, BOBCAPS Research

**FIG 44 – RELATIVE STOCK PERFORMANCE**




Source: NSE

## Key risks

- **US execution critical:** We expect the US market to contribute meaningfully to profitability in the coming years. Any delays with respect to key launches, early generic competition in Theophylline (~12% of FY21E EPS) and tardy commercialisation of the new capacities across Panelav, Karakhadi and Jarod can potentially impact profit growth.

- **US regulatory risk:** A majority of ALPM's US sales are dependent on the Panelav unit (~80% of existing sales). While the compliance track record with the FDA has been clean so far, plant concentration risk remains. We note that ALPM is working towards derisking its current manufacturing concentration to other newer units, but this is still two years away.

- **Regulatory action and slowdown in India formulations business:** Expansion of NLEM (national list of essential medicines) coverage and the FDC (fixed dose combination) ban in 2018 hit growth across the Indian pharmaceutical market. Roughly 15% of ALPM's domestic sales are under price control vs. 17% for the IPM on average. In addition, ALPM has low price leadership in top brands and chronic therapies, which should act as a cushion against substantial risk. However, regulatory action on pricing is unpredictable and hence remains a risk. Further, any slowdown in IPM growth and delays in new launches can adversely affect ALPM's earnings.

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## FINANCIALS

### Income Statement

| Y/E 31 Mar (Rs mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| **Total revenue** | **31,310** | **39,350** | **42,561** | **46,071** | **51,211** |
| EBITDA | 6,711 | 8,737 | 9,422 | 9,397 | 10,914 |
| Depreciation | 1,055 | 1,152 | 1,476 | 1,974 | 2,392 |
| EBIT | 5,656 | 7,585 | 7,947 | 7,422 | 8,522 |
| Net interest income/(expenses) | (34) | (184) | (269) | (256) | (256) |
| Other income/(expenses) | 70 | 94 | 247 | 513 | 814 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 5,692 | 7,495 | 7,925 | 7,679 | 9,080 |
| Income taxes | 1,203 | 1,567 | 1,902 | 1,843 | 2,179 |
| Extraordinary items | (278) | 0 | 0 | 0 | 0 |
| Min. int./Inc. from associates | 0 | 0 | 0 | 0 | 0 |
| **Reported net profit** | **4,211** | **5,928** | **6,023** | **5,836** | **6,900** |
| Adjustments | (278) | 0 | 0 | 0 | 0 |
| **Adjusted net profit** | **4,489** | **5,928** | **6,023** | **5,836** | **6,900** |

### Balance Sheet

| Y/E 31 Mar (Rs mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Accounts payables | 7,593 | 7,022 | 8,162 | 8,835 | 9,821 |
| Other current liabilities | 1,427 | 1,221 | 2,128 | 2,304 | 2,561 |
| Provisions | 751 | 843 | 912 | 987 | 1,097 |
| Debt funds | 7,077 | 11,284 | 10,258 | 10,258 | 10,258 |
| Other liabilities | 0 | 0 | 0 | 0 | 0 |
| Equity capital | 377 | 377 | 377 | 377 | 377 |
| Reserves & surplus | 22,177 | 27,021 | 31,913 | 36,429 | 41,821 |
| Shareholders' fund | 22,554 | 27,398 | 32,290 | 36,806 | 42,198 |
| **Total liabilities and equities** | **39,402** | **47,768** | **53,750** | **59,190** | **65,936** |
| Cash and cash eq. | 898 | 2,055 | 6,193 | 10,899 | 16,239 |
| Accounts receivables | 5,263 | 4,888 | 6,996 | 7,573 | 8,418 |
| Inventories | 7,339 | 9,672 | 9,328 | 10,098 | 11,224 |
| Other current assets | 5,005 | 3,426 | 4,256 | 4,607 | 5,121 |
| Investments | 416 | 483 | 483 | 483 | 483 |
| Net fixed assets | 9,270 | 10,984 | 15,233 | 19,270 | 20,690 |
| CWIP | 10,550 | 15,660 | 10,660 | 5,660 | 3,160 |
| Intangible assets | 661 | 600 | 600 | 600 | 600 |
| Deferred tax assets, net | 0 | 0 | 0 | 0 | 0 |
| Other assets | 0 | 0 | 0 | 0 | 0 |
| **Total assets** | **39,402** | **47,768** | **53,750** | **59,190** | **65,936** |

Source: Company, BOBCAPS Research

### Cash Flows

| Y/E 31 Mar (Rs mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Net income + Depreciation | 5,185 | 6,986 | 7,498 | 7,810 | 9,292 |
| Interest expenses | 34 | 184 | 269 | 256 | 256 |
| Non-cash adjustments | 0 | 0 | 0 | 0 | 0 |
| Changes in working capital | (2,308) | (1,064) | (479) | (773) | (1,133) |
| Other operating cash flows | 0 | 0 | 0 | 0 | 0 |
| **Cash flow from operations** | **2,911** | **6,106** | **7,289** | **7,293** | **8,416** |
| Capital expenditures | (2,226) | (2,771) | (5,725) | (6,011) | (3,812) |
| Change in investments | 82 | (67) | 0 | 0 | 0 |
| Other investing cash flows | 0 | 0 | 0 | 0 | 0 |
| **Cash flow from investing** | **(2,144)** | **(2,838)** | **(5,725)** | **(6,011)** | **(3,812)** |
| Equities issued/Others | 0 | 0 | 0 | 0 | 0 |
| Debt raised/repaid | 6,192 | 4,207 | (1,026) | 0 | 0 |
| Interest expenses | (34) | (184) | (269) | (256) | (256) |
| Dividends paid | (907) | (907) | (1,131) | (1,320) | (1,508) |
| Other financing cash flows | (6,715) | (5,227) | 5,000 | 5,000 | 2,500 |
| **Cash flow from financing** | **(1,464)** | **(2,112)** | **2,574** | **3,424** | **736** |
| **Changes in cash and cash eq.** | **(697)** | **1,157** | **4,138** | **4,706** | **5,340** |
| **Closing cash and cash eq.** | **898** | **2,055** | **6,193** | **10,899** | **16,239** |

### Per Share

| Y/E 31 Mar (Rs) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Reported EPS | 21.9 | 31.0 | 32.0 | 31.0 | 36.6 |
| Adjusted EPS | 23.4 | 31.0 | 32.0 | 31.0 | 36.6 |
| Dividend per share | 4.0 | 5.5 | 6.0 | 7.0 | 8.0 |
| Book value per share | 119.6 | 145.3 | 171.3 | 195.3 | 223.9 |

### Valuations Ratios

| Y/E 31 Mar (x) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| EV/Sales | 3.3 | 2.8 | 2.7 | 2.4 | 2.1 |
| EV/EBITDA | 15.4 | 12.4 | 12.0 | 11.9 | 9.8 |
| Adjusted P/E | 23.9 | 18.1 | 17.5 | 18.1 | 15.3 |
| P/BV | 4.7 | 3.9 | 3.3 | 2.9 | 2.5 |

### DuPont Analysis

| Y/E 31 Mar (%) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Tax burden (Net profit/PBT) | 78.9 | 79.1 | 76.0 | 76.0 | 76.0 |
| Interest burden (PBT/EBIT) | 100.6 | 98.8 | 99.7 | 103.5 | 106.5 |
| EBIT margin (EBIT/Revenue) | 18.1 | 19.3 | 18.7 | 16.1 | 16.6 |
| Asset turnover (Revenue/Avg TA) | 31.4 | 28.8 | 26.2 | 25.7 | 25.7 |
| Leverage (Avg TA/Avg Equity) | 1.2 | 1.4 | 1.4 | 1.3 | 1.3 |
| Adjusted ROAE | 21.0 | 23.4 | 20.2 | 16.9 | 17.5 |

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

### Ratio Analysis

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| **YoY growth (%)** | | | | | |
| Revenue | (0.1) | 25.7 | 8.2 | 8.2 | 11.2 |
| EBITDA | 10.1 | 30.2 | 7.8 | (0.3) | 16.1 |
| Adjusted EPS | 11.0 | 32.4 | 3.2 | (3.1) | 18.2 |
| **Profitability & Return ratios (%)** | | | | | |
| EBITDA margin | 21.4 | 22.2 | 22.1 | 20.4 | 21.3 |
| EBIT margin | 18.1 | 19.3 | 18.7 | 16.1 | 16.6 |
| Adjusted profit margin | 14.3 | 15.1 | 14.2 | 12.7 | 13.5 |
| Adjusted ROAE | 21.0 | 23.4 | 20.2 | 16.9 | 17.5 |
| ROCE | 22.9 | 22.5 | 20.2 | 17.7 | 18.8 |
| **Working capital days (days)** | | | | | |
| Receivables | 61 | 45 | 60 | 60 | 60 |
| Inventory | 86 | 90 | 80 | 80 | 80 |
| Payables | 89 | 65 | 70 | 70 | 70 |
| **Ratios (x)** | | | | | |
| Gross asset turnover | 2.7 | 2.7 | 2.1 | 1.8 | 1.7 |
| Current ratio | 1.9 | 2.2 | 2.4 | 2.7 | 3.0 |
| Net interest coverage ratio | 166.4 | 41.2 | 29.5 | 28.9 | 33.2 |
| Adjusted debt/equity | 0.3 | 0.3 | 0.1 | 0.0 | (0.1) |

Source: Company, BOBCAPS Research

# Disclaimer

**Recommendations and Absolute returns (%) over 12 months**

**BUY –** Expected return >+15%

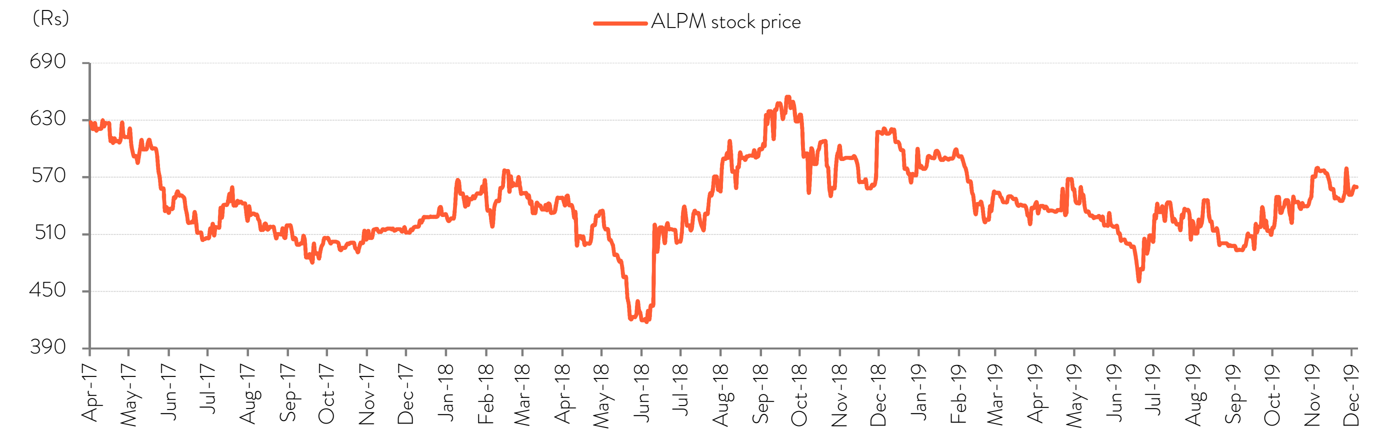
**ADD –** Expected return from >+5% to +15%

**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: ALEMBIC PHARMA (ALPM IN)**




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

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