

HOLD

TP: Rs 3,220 | ▲ 3%

ALKEM LABS

| Pharmaceuticals

| 06 August 2022

Higher expenses and forex loss dent margins; cut to HOLD

- Q1 revenue declined 6% YoY (+4% QoQ) to Rs 25.7bn on a high base, and EBITDA dropped 66% on weak margins
- EBITDA margin contracted 1,400bps on account of forex loss and higher expenses toward marketing, distribution and travelling
- We cut FY23/FY24 EBITDA 9%/5% amid margin pressure, leading to a new TP of Rs 3,220 (vs. Rs 3,400) – downgrade from BUY to HOLD

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Revenue declines on high base of last year: ALKEM's Q1FY23 revenue dipped 6% YoY (+4% QoQ) to Rs 25.7bn primarily led by a 7% fall in domestic revenue on a high Covid-led base. Nevertheless, the company outperformed the Indian pharma market on secondary sales (stable YoY vs. 1.8% decline for IPM). This outperformance was mainly driven by acute therapies in the anti-infectives, respiratory and gastrointestinal segments. Pain management and gastrointestinal therapies witnessed good double-digit growth even on a high base of last year.

Elevated price erosion continues to hurt US business: US revenue for the quarter declined 8% YoY (+3% QoQ) in rupee terms and was flat QoQ in constant currency terms. The company continues to face significant pricing pressure in the US generic market. Price erosion in Q1 was 20% vs. 14% in Q4FY22. Management has guided for 8-10 product launches in the US for FY23.

Strong margin headwinds; guidance muted: Continued headwinds from US price erosion alongside soaring industrywide RM and logistics costs impacted ALKEM's gross margin, which declined 240bps YoY (-100bps QoQ). EBITDA margin contracted 14ppt YoY to 7.9% due to additional expenses of ~Rs 250mn towards marketing, travelling and distribution (17.6% ex-added expense). ALKEM also incurred a forex loss of ~Rs 500mn which further hit margins. Management has guided for an FY23 gross margin of ~59% but expressed apprehensions over achieving its earlier guided EBITDA margin of 18%.

Earnings call highlights: (1) The chronic-to-acute breakup of branded formulations was 84:16. (2) ALKEM is a leader in trade generics (TGx) in India and ranks first or second. TGx contributed 20% of revenue in Q1, and most of this business is outsourced. (3) Biosimilars will be an important growth engine for ALKEM in future.

Downgrade to HOLD: We cut our FY23/FY24 EBITDA estimates by 9%/5% in light of the muted margin guidance amid persisting cost headwinds and US price erosion. Our TP thus reduces to Rs 3,220 (vs. Rs 3,400), based on an unchanged 15x FY24E EV/EBITDA multiple – 12% discount to the 5Y average. Downgrade from BUY to HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	ALKEM IN/Rs 3,113
Market cap	US\$ 4.7bn
Free float	39%
3M ADV	US\$ 4.4mn
52wk high/low	Rs 4,070/Rs 2,828
Promoter/FPI/DII	59%/5%/14%

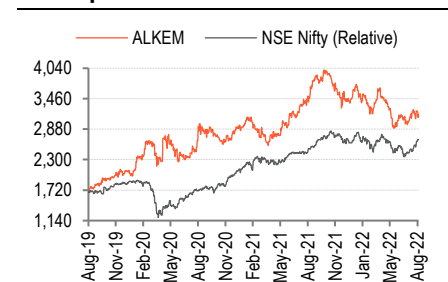
Source: NSE | Price as of 5 Aug 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	1,07,563	1,21,375	1,36,054
EBITDA (Rs mn)	21,750	19,957	25,303
Adj. net profit (Rs mn)	17,827	14,719	19,866
Adj. EPS (Rs)	149.1	123.1	166.2
Consensus EPS (Rs)	149.1	138.0	166.0
Adj. ROAE (%)	26.2	18.6	21.5
Adj. P/E (x)	20.9	25.3	18.7
EV/EBITDA (x)	17.1	18.5	14.3
Adj. EPS growth (%)	4.5	(17.4)	35.0

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q1FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	25,764	27,314	(5.7)	24,839	3.7	1,06,342	88,764	19.8
EBITDA	2,032	5,929	(65.7)	3,372	(39.7)	20,529	19,538	5.1
Depreciation	763	705	8.1	831	-	3,040	2,745	-
EBIT	1,270	5,223	(75.7)	2,541	-	17,490	16,793	4.2
Interest	265	129	106.1	170	56.2	524	589	-
Other Income	514	467	10.2	205	10%	1,627	2,217	-
PBT	1,519	5,561	(72.7)	2,576	(41.0)	18,592	18,421	0.9
Less: Taxation	204	759		1,345	-	1,640	2,243	(26.9)
Less: Minority Interest	38	121		6	-	347	328	-
Recurring PAT	1,276	4,681	(72.7)	1,225	4.2	16,606	15,850	4.8
Exceptional items	0	0		(150)	-	(150)	0	-
Reported PAT	1,276	4,681	(72.7)	1,076	18.6	16,456	15,850	3.8
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	57.5	59.9	(244)	58.5	(100)	60.7	60.6	10
EBITDA Margin	7.9	21.7	(1,382)	13.6	(569)	19.3	22.0	(271)
Tax / PBT	13.5	13.6	-	52.2	-	8.8	12.2	-
NPM	5.0	17.1	(1,218)	4.9	2	15.6	17.9	(224)
EPS (Rs)	10.7	39.2	-	10.3	-	138.9	132.6	-

Source: Company, BOBCAPS Research

Fig 2 – Regional mix

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
India	17,815	19,097	(6.7)	17,187	3.7	74,045	56,996	29.9
US	5,565	6,043	(7.9)	5,419	2.7	23,290	24,513	(5.0)
ROW	2,039	1,860	9.6	1,991	2.4	7,783	5,775	34.8
Net Sales	25,419	27,000	(5.9)	24,597	3.3	1,05,118	87,284	20.4

Source: Company, BOBCAPS Research

Valuation methodology

We cut our FY23/FY24 EBITDA estimates by 9%/5% in light of the muted margin guidance amid persisting cost headwinds and US price erosion. Our TP thus reduces to Rs 3,220 (earlier Rs 3,400), based on an unchanged 15x FY24E EV/EBITDA multiple – 12% discount to the five-year average. Downgrade from BUY to HOLD.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	121.4	136.1	121.3	136.0	0.1	0.1
EBITDA	20.0	25.3	21.9	26.6	(8.7)	(4.8)
EBITDA Margin (%)	16.4	18.6	18.0	19.6	(157bps)	(95bps)
EPS (Rs)	123.1	166.2	137.1	176.1	(10.2)	(5.6)

Source: BOBCAPS Research

Fig 4 – Key assumptions

(Rs bn)	FY22A	FY23E	FY24E
India	75.3	83.8	93.5
US	23.3	26.5	30.3
ROW	7.8	9.7	10.7

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY22-24E (%)	EV/EBITDA (x)		ROCE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Alkem Labs	ALKEM IN	HOLD	3,220	7.9	18.6	14.7	16.6	19.7	15.0
Ajanta Pharma	AJP IN	BUY	1,500	6.8	11.4	10.0	21.8	21.9	12.0
Alembic Pharma	ALPM IN	HOLD	770	14.6	9.0	7.9	12.4	16.0	11.0

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- **Uptick in domestic business:** ALKEM draws ~70% of its revenue from domestic formulations, primarily from acute therapies apart from a growing chronic business. Uptick in chronic business and outperformance in the acute segment would pose upside risks to our estimates.
- **Policy announcement on trade generics:** The government’s push towards reducing healthcare costs by promoting trade generics would help ALKEM as it is a leader in the space.
- **Above-expected US performance:** Easing pricing pressure and more launches than expected in the US market could boost performance beyond estimates.
- **Adverse currency movement:** Sharp INR depreciation against the USD represents an upside risk to our expectations.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.1	1,280	1,500	BUY
Alembic Pharma	ALPM IN	1.7	673	770	HOLD
Alkem Labs	ALKEM IN	4.7	3,113	3,220	HOLD
Aurobindo Pharma	ARBP IN	4.2	569	680	BUY
Cipla	CIPLA IN	10.5	1,034	1,100	BUY
Divi's Labs	DIVI IN	13.1	3,912	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.7	4,157	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	695	970	BUY
Glenmark Life Sciences	GLS IN	0.7	449	560	BUY
Laurus Labs	LAURUS IN	3.7	545	645	BUY
Lupin	LPC IN	3.8	668	600	SELL
Sun Pharma	SUNP IN	27.7	916	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 5 Aug 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	84,492	89,864	1,07,563	1,21,375	1,36,054
EBITDA	15,783	20,638	21,750	19,957	25,303
Depreciation	2,526	2,746	3,040	3,222	3,572
EBIT	13,257	17,892	18,710	16,735	21,731
Net interest inc./(exp.)	(650)	(589)	(524)	(1,601)	(1,601)
Other inc./(exp.)	1,043	2,332	1,627	2,065	3,550
Exceptional items	0	0	0	0	0
EBT	13,651	19,635	19,813	17,199	23,681
Income taxes	1,105	2,243	1,640	2,064	3,315
Extraordinary items	0	0	(150)	0	0
Min. int./Inc. from assoc.	222	328	347	416	500
Reported net profit	12,323	17,064	17,677	14,719	19,866
Adjustments	0	0	(150)	0	0
Adjusted net profit	12,323	17,064	17,827	14,719	19,866

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	9,541	10,694	11,734	16,438	18,426
Other current liabilities	6,010	7,343	7,739	9,600	10,761
Provisions	4,067	4,874	6,064	6,842	7,670
Debt funds	16,628	16,702	26,682	26,682	26,682
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	53,363	64,262	75,142	86,428	1,01,661
Shareholders' fund	53,602	64,501	75,381	86,667	1,01,900
Total liab. and equities	89,848	1,04,113	1,27,599	1,46,229	1,65,438
Cash and cash eq.	10,922	19,905	25,786	47,010	57,086
Accounts receivables	16,494	16,072	18,846	23,013	25,796
Inventories	18,188	23,124	30,055	26,301	29,482
Other current assets	9,180	10,072	16,790	14,400	16,141
Investments	2,614	3,328	3,710	3,710	3,710
Net fixed assets	28,821	27,679	29,017	30,795	32,223
CWIP	3,630	3,933	3,395	1,000	1,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	89,848	1,04,113	1,27,599	1,46,229	1,65,438

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	9,074	18,284	7,444	28,863	21,310
Capital expenditures	(4,500)	(4,000)	(5,000)	(5,000)	(5,000)
Change in investments	622	(714)	(382)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,878)	(4,714)	(5,382)	(5,000)	(5,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	7,603	75	9,980	0	0
Interest expenses	(650)	(589)	(524)	(1,601)	(1,601)
Dividends paid	(2,874)	(3,979)	(4,157)	(3,432)	(4,633)
Other financing cash flows	(4,968)	(94)	(1,480)	2,395	0
Cash flow from financing	(889)	(4,587)	3,819	(2,639)	(6,234)
Chg in cash & cash eq.	4,307	8,982	5,881	21,224	10,076
Closing cash & cash eq.	10,922	19,905	25,786	47,010	57,086

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	103.1	142.7	147.9	123.1	166.2
Adjusted EPS	103.1	142.7	149.1	123.1	166.2
Dividend per share	20.6	28.5	29.8	24.6	33.2
Book value per share	436.0	524.4	613.0	707.4	834.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	4.4	4.2	3.5	3.0	2.7
EV/EBITDA	23.6	18.1	17.1	18.5	14.3
Adjusted P/E	30.2	21.8	20.9	25.3	18.7
P/BV	7.1	5.9	5.1	4.4	3.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	90.3	86.9	90.0	85.6	83.9
Interest burden (PBT/EBIT)	103.0	109.7	105.9	102.8	109.0
EBIT margin (EBIT/Revenue)	15.7	19.9	17.4	13.8	16.0
Asset turnover (Rev./Avg TA)	33.0	29.7	29.3	28.2	28.1
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.4	1.3
Adjusted ROAE	24.8	29.7	26.2	18.6	21.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	14.9	6.4	19.7	12.8	12.1
EBITDA	41.7	30.8	5.4	(8.2)	26.8
Adjusted EPS	68.9	38.5	4.5	(17.4)	35.0
Profitability & Return ratios (%)					
EBITDA margin	18.7	23.0	20.2	16.4	18.6
EBIT margin	15.7	19.9	17.4	13.8	16.0
Adjusted profit margin	14.6	19.0	16.6	12.1	14.6
Adjusted ROAE	24.8	29.7	26.2	18.6	21.5
ROCE	22.4	26.7	22.2	17.5	20.9
Working capital days (days)					
Receivables	72	66	65	70	70
Inventory	80	95	103	80	80
Payables	42	44	40	50	50
Ratios (x)					
Gross asset turnover	2.4	2.3	2.5	2.5	2.5
Current ratio	2.8	3.0	3.6	3.4	3.5
Net interest coverage ratio	20.4	30.4	35.7	10.5	13.6
Adjusted debt/equity	0.1	(0.1)	0.0	(0.3)	(0.3)

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

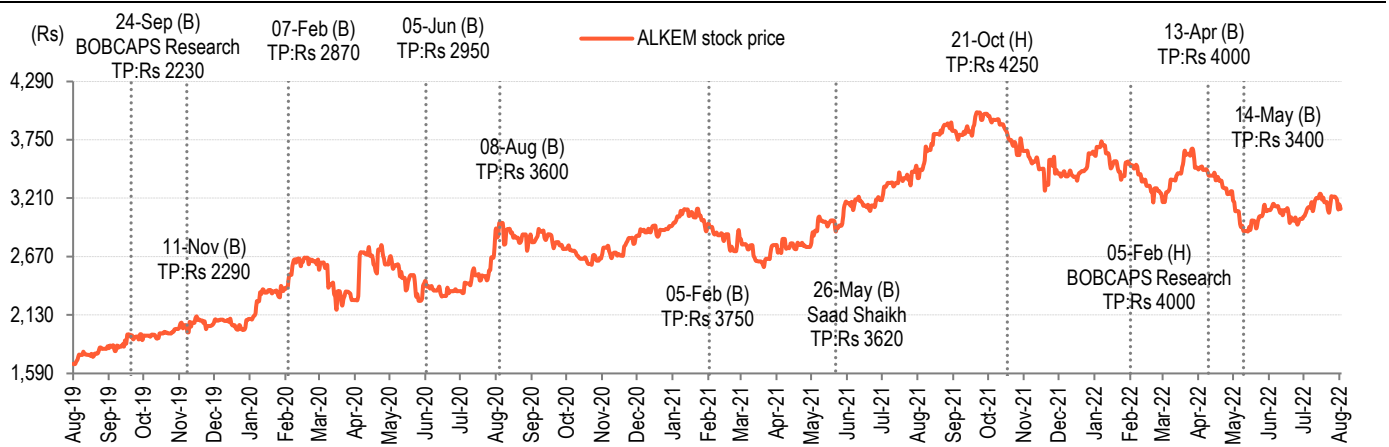
HOLD – Expected return from -6% to +15%

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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