

**SELL**

TP: Rs 3,300 | ▼ 20%

**ALKEM LABS**

| Pharmaceuticals

| 10 August 2023

**International sales fuel growth; margin recovery positive**

- Q1 revenue/EBITDA a beat as international business outperformed; adj. PAT growth in line with consensus at 65% QoQ
- Gross/EBITDA margin expanded 290bps/95bps QoQ led by softening of raw material and freight cost along with cost optimisation
- TP revised to Rs 3,300 (vs. Rs 3,000) on a higher 16x (vs. 15x) FY25E EV/EBITDA multiple; valuations expensive – retain SELL

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**Recovery in international business fuels growth:** Alkem’s Q1FY24 EBITDA/adj. PAT grew 10%/65% QoQ to Rs 3.9bn/Rs 2.9bn (+91%/+125% YoY). An above-expected performance in the international business coupled with margin expansion led to a 3% EBITDA beat over consensus, though PAT was in line. International business grew 18% QoQ whereas domestic revenue slipped 6%. On a YoY basis as well, domestic business remained sluggish and underperformed the market.

**Domestic business was sluggish:** Management attributed subdued growth in the domestic business (+7% YoY/-6% QoQ) to delayed monsoons in the eastern part of the country. As per IQVIA, Alkem’s Q1 sales grew 7.6% YoY as compared to Indian pharma market growth of 8.5%. Management expects India business to end the year at high-single-digit growth. Alkem highlighted the launch of an ophthalmic division during the quarter as it looks to build a presence in the segment.

**US price erosion moderating:** US business grew 18% QoQ to US\$ 85mn on account of recovery and softening pricing pressure. Price erosion reduced from double digits to high single digits in Q1 – a trend that has continued in Q2 thus far. Launches as well as existing products boosted sales, and there were no one-offs during the quarter.

**Cost pressure easing:** Gross/EBITDA margin expanded 290bps/95bps QoQ to 59.6%/13.1% (+215bps/+525bps YoY). Per management, margin expansion was aided by softening raw material prices, easing of freight cost and implementation of ongoing cost optimisation efforts. The year-ago base quarter had one of the company’s lowest EBITDA margins of 7.9%.

**Maintain SELL:** We tweak estimates to incorporate the Q1 print and raise our target FY25E EV/EBITDA multiple to 16x (a 10% discount to the stock’s 5Y average) from 15x earlier, based on recovery in the international business and an improving margin profile. Our TP thus rises from Rs 3,000 to Rs 3,300 – we maintain SELL as we find the company expensive at current valuations of 20.1x FY25E EV/EBITDA.

**Key changes**

Target	Rating
▲	◀ ▶

Ticker/Price	ALKEM IN/Rs 4,141
Market cap	US\$ 6.0bn
Free float	41%
3M ADV	US\$ 8.5mn
52wk high/low	Rs 4,243/Rs 2,855
Promoter/FPI/DII	57%/6%/16%

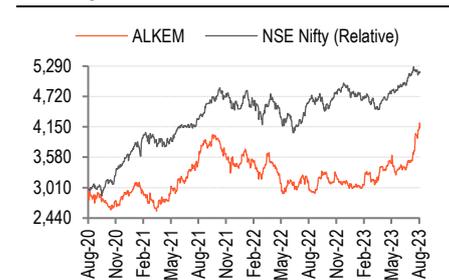
Source: NSE | Price as of 10 Aug 2023

**Key financials**

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	1,15,993	1,27,954	1,42,181
EBITDA (Rs mn)	16,095	20,482	23,626
Adj. net profit (Rs mn)	10,872	15,552	18,363
Adj. EPS (Rs)	90.9	130.1	153.6
Consensus EPS (Rs)	90.9	130.5	156.5
Adj. ROAE (%)	14.4	18.8	19.3
Adj. P/E (x)	45.5	31.8	27.0
EV/EBITDA (x)	30.6	23.8	20.1
Adj. EPS growth (%)	(34.5)	43.0	18.1

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY23	FY22	YoY (%)
<b>Net Sales</b>	<b>29,677</b>	<b>25,764</b>	<b>15.2</b>	<b>29,026</b>	<b>2.2</b>	<b>1,15,993</b>	<b>1,06,342</b>	<b>9.1</b>
<b>EBITDA</b>	<b>3,892</b>	<b>2,032</b>	<b>91.5</b>	<b>3,533</b>	<b>10.2</b>	<b>16,095</b>	<b>20,529</b>	<b>(21.6)</b>
Depreciation	724	763	(5.0)	783	-	3,104	3,040	-
<b>EBIT</b>	<b>3,168</b>	<b>1,270</b>	<b>149.5</b>	<b>2,749</b>	<b>-</b>	<b>12,990</b>	<b>17,490</b>	<b>(25.7)</b>
Interest	298	265	12.3	290	2.8	1,074	524	-
Other Income	658	514	28.1	687	(4.1)	2,161	1,627	-
<b>PBT</b>	<b>3,529</b>	<b>1,519</b>	<b>132.3</b>	<b>3,146</b>	<b>12.1</b>	<b>14,078</b>	<b>18,592</b>	<b>(24.3)</b>
Less: Taxation	650	204	-	1,440	-	2,980	1,640	81.7
Less: Minority Interest	11	38	-	(33)	-	226	347	-
<b>Recurring PAT</b>	<b>2,867</b>	<b>1,276</b>	<b>124.6</b>	<b>1,740</b>	<b>64.8</b>	<b>10,872</b>	<b>16,606</b>	<b>(34.5)</b>
Exceptional items	0	0	-	(1,030)	-	(1,030)	(150)	-
<b>Reported PAT</b>	<b>2,867</b>	<b>1,276</b>	<b>124.6</b>	<b>710</b>	<b>304.0</b>	<b>9,842</b>	<b>16,456</b>	<b>(40.2)</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	59.6	57.5	213	56.7	287	57.7	60.7	(299)
EBITDA Margin	13.1	7.9	523	12.2	94	13.9	19.3	(543)
Tax / PBT	18.4	13.5	-	45.8	-	21.2	8.8	-
NPM	9.7	5.0	471	6.0	367	9.4	15.6	(624)
EPS (Rs)	24.0	10.7	-	14.6	-	90.9	138.9	-

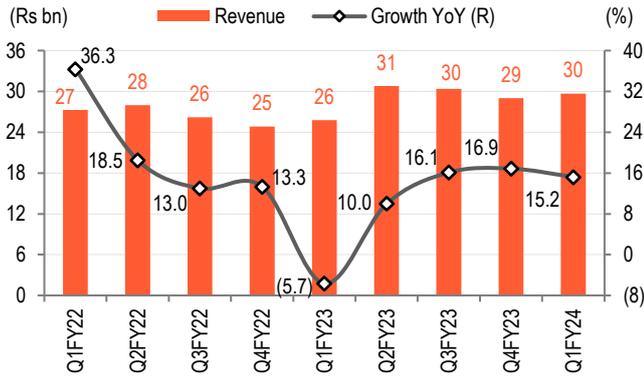
Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

(Rs mn)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY23	FY22	YoY (%)
India	19,007	17,815	6.7	20,113	(5.5)	80,011	74,045	8.1
US	6,955	5,565	25.0	5,916	17.6	25,133	23,290	7.9
RoW	3,191	2,039	56.5	2,654	20.2	9,260	7,783	19.0
<b>Net Sales</b>	<b>29,153</b>	<b>25,419</b>	<b>14.7</b>	<b>28,683</b>	<b>1.6</b>	<b>1,14,404</b>	<b>1,05,118</b>	<b>8.8</b>
Other Op. Income	524	345	52.0	343	52.8	1,589	1,224	29.8
<b>Revenue</b>	<b>29,677</b>	<b>25,764</b>	<b>15.2</b>	<b>29,026</b>	<b>2.2</b>	<b>1,15,993</b>	<b>1,06,342</b>	<b>9.1</b>
USDINR	82.2	79.0	4.0	82.2	0.0	81	75	9.0
US revenue (US\$ mn)	85	70	20.1	72	17.6	309	313	(1.0)

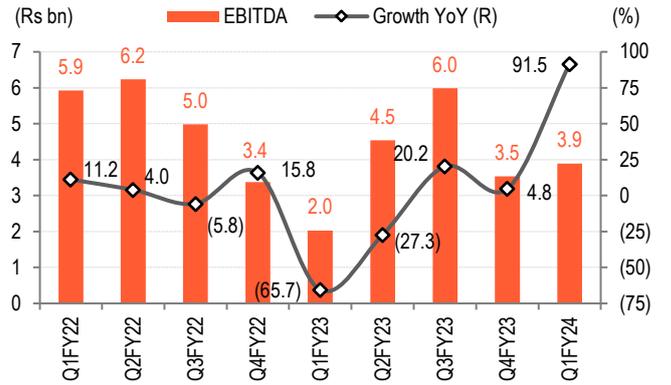
Source: Company, BOBCAPS Research

**Fig 3 – Revenue**



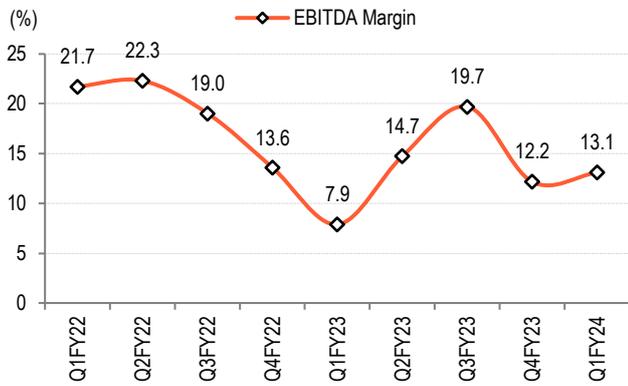
Source: Company, BOBCAPS Research

**Fig 4 – EBITDA**



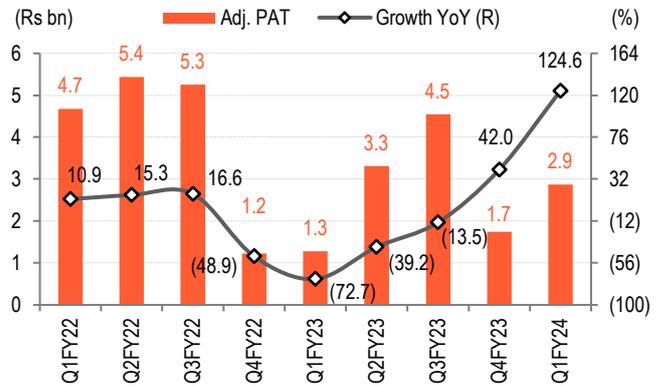
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 6 – Adj. PAT**



Source: Company, BOBCAPS Research

## Earnings call highlights

- **India:** Alkem saw below-market growth in Q1FY24 due to delayed monsoons in the eastern part of the country. However, its chronic therapies continued to grow faster than the market and the company gained a rank in the anti-diabetic and neuro/CNS therapies. It launched an ophthalmic division to build its presence in the therapy.
- **US:** US business grew 18% QoQ to US\$ 85mn on account of recovery and softening price pressure. Price erosion reduced from double digits to high single digits in Q1 – a trend that has continued in Q2 thus far. Launches as well as existing products boosted sales, and there were no one-offs during the quarter.
- **ROW:** All major markets such as Chile, the UK, Kazakhstan, and the Philippines clocked high growth during Q1.
- **Guidance:** India business is guided to grow in high single digits in FY24. Gross and EBITDA margin are guided at 59-59.5% and 16% respectively, and management expects 50-100bps of margin improvement per year.
- **R&D:** R&D expense in Q1 was Rs 1.2bn or 4.1% of revenue from operations.
- **Capex:** Alkem spent ~Rs 800mn on capex in Q1 and retained full-year FY24 guidance at Rs 3bn-3.5bn, mostly towards biosimilars.
- **ANDA:** The company filed one ANDA (abbreviated new drug application) with the USFDA and received seven approvals (including one tentative) during the quarter.
- **Enzene:** Subsidiary Enzene launched Cetuximab, the world's first biosimilar used for the treatment of head and neck cancer. With two more launches already in Q2, Enzene now has a healthy basket of six products in India. The subsidiary recorded revenue of Rs 570mn Q1 and is guided to reach Rs 2.5bn-2.6bn in FY24, of which Rs 1.5-Rs 1.7bn is likely to come from the contract development and manufacturing (CDMO) business. Management expects EBITDA breakeven in FY25.
- **CDMO:** Alkem is primarily engaging with innovator/small biopharma companies for the CDMO business.
- **Trade generics:** Trade generics contributed 17-18% of the domestic business in Q1. Alkem remains among the leading players but believes that large entrants would impact the segment in the long run.
- **Field force:** The company's current field force is 12,000-strong with no plans to increase it further. Of these, 20% are dedicated to chronic therapies. Consolidated field force productivity is at Rs 0.54mn per representative (Rs 0.59mn for acute therapies and Rs 0.39mn for chronic).
- **Depreciation:** Q1 had a lower depreciation charge on account of the St Louis plant write-off from the previous quarter.
- **Tax rate:** The effective tax rate for FY24 has been revised to 17-19% from 14-15%.
- **Healthy cash on books:** Net cash stood at Rs 24.3bn as on 30 Jun 2023.
- **Capital allocation:** Alkem has no immediate plans to increase dividend payout.

## Valuation methodology

We tweak estimates to incorporate the Q1 print and raise our target FY25E EV/EBITDA multiple to 16x (a 10% discount to the stock’s five-year average) from 15x earlier, based on recovery in the international business and an improving margin profile. Our TP thus rises from Rs 3,000 to Rs 3,300 – we maintain SELL as we find the company expensive at current valuations of 20.1x FY25E EV/EBITDA.

**Fig 7 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	128.0	142.2	131.7	145.2	(2.8)	(2.1)
EBITDA	20.5	23.6	20.5	23.5	(0.1)	0.5
EBITDA margin (%)	16.0	16.6	15.6	16.2	43bps	43bps
EPS (Rs)	130	154	133	156	(2.2)	(1.4)

Source: BOBCAPS Research

**Fig 8 – Key assumptions**

Parameter (Rs bn)	FY23A	FY24E	FY25E
Domestic	80.0	87.1	96.2
US Revenues	25.1	28.1	32.0
Non-US revenues	9.3	11.6	12.7
Other operating income	1.6	1.1	1.3

Source: Company, 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. An 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 could take Alkem’s sales ahead of estimates 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.
- **Easing margin pressure:** Prudent cost management could alleviate margin pressure, taking profitability ahead of estimates.
- **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	2.7	1,746	1,860	BUY
Alembic Pharma	ALPM IN	1.9	786	615	HOLD
Alkem Labs	ALKEM IN	6.0	4,141	3,300	SELL
Divi's Labs	DIVI IN	12.1	3,746	3,200	HOLD
Dr Reddy's Labs	DRRD IN	11.9	5,851	4,900	HOLD
Eris Lifesciences	ERIS IN	1.4	828	955	BUY
Glenmark Life Sciences	GLS IN	1.0	642	620	HOLD
Laurus Labs	LAURUS IN	2.6	399	340	HOLD
Lupin	LPC IN	6.0	1,085	800	SELL
Sun Pharma	SUNP IN	33.6	1,150	1,160	HOLD

Source: BOBCAPS Research, NSE | Price as of 10 Aug 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Total revenue</b>	<b>88,650</b>	<b>1,06,342</b>	<b>1,15,993</b>	<b>1,27,954</b>	<b>1,42,181</b>
EBITDA	19,423	20,529	16,095	20,482	23,626
Depreciation	2,746	3,040	3,104	2,949	3,176
EBIT	16,678	17,489	12,991	17,533	20,450
Net interest inc./(exp.)	(589)	(524)	(1,074)	(503)	(402)
Other inc./(exp.)	2,332	1,627	2,161	2,267	2,744
Exceptional items	0	0	0	0	0
EBT	18,421	18,592	14,078	19,297	22,792
Income taxes	2,243	1,640	2,980	3,474	4,103
Extraordinary items	0	(150)	(1,030)	0	0
Min. int./Inc. from assoc.	328	347	226	272	326
<b>Reported net profit</b>	<b>15,850</b>	<b>16,456</b>	<b>9,842</b>	<b>15,552</b>	<b>18,363</b>
Adjustments	0	(150)	(1,030)	0	0
<b>Adjusted net profit</b>	<b>15,850</b>	<b>16,606</b>	<b>10,872</b>	<b>15,552</b>	<b>18,363</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	10,694	11,734	11,650	15,636	17,375
Other current liabilities	7,343	7,739	10,178	10,146	11,274
Provisions	4,874	6,064	7,421	8,227	9,142
Debt funds	16,702	26,682	13,967	11,173	8,939
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	64,262	75,142	81,086	92,105	1,05,115
Shareholders' fund	64,501	75,381	81,325	92,344	1,05,354
<b>Total liab. and equities</b>	<b>1,04,114</b>	<b>1,27,599</b>	<b>1,24,542</b>	<b>1,37,526</b>	<b>1,52,083</b>
Cash and cash eq.	19,905	25,786	26,169	32,988	40,274
Accounts receivables	16,072	18,846	21,322	24,323	27,027
Inventories	23,124	30,055	26,075	29,535	32,819
Other current assets	10,072	16,790	14,696	14,585	16,207
Investments	3,328	3,710	6,218	6,218	6,218
Net fixed assets	27,680	29,017	26,829	27,130	27,203
CWIP	3,933	3,395	3,232	2,748	2,335
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>1,04,114</b>	<b>1,27,599</b>	<b>1,24,542</b>	<b>1,37,526</b>	<b>1,52,083</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
<b>Cash flow from operations</b>	<b>17,070</b>	<b>6,223</b>	<b>21,331</b>	<b>17,414</b>	<b>18,113</b>
Capital expenditures	(2,910)	(4,418)	1,354	(3,250)	(3,250)
Change in investments	(714)	(382)	(2,508)	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(3,624)</b>	<b>(4,800)</b>	<b>(1,154)</b>	<b>(3,250)</b>	<b>(3,250)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	75	9,980	(12,715)	(2,793)	(2,235)
Interest expenses	(589)	(524)	(1,074)	(503)	(402)
Dividends paid	(4,182)	(4,739)	(3,169)	(4,533)	(5,353)
Other financing cash flows	233	(258)	(2,836)	485	412
<b>Cash flow from financing</b>	<b>(4,464)</b>	<b>4,458</b>	<b>(19,794)</b>	<b>(7,345)</b>	<b>(7,578)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>8,982</b>	<b>5,881</b>	<b>383</b>	<b>6,819</b>	<b>7,286</b>
<b>Closing cash &amp; cash eq.</b>	<b>19,905</b>	<b>25,786</b>	<b>26,169</b>	<b>32,988</b>	<b>40,274</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	132.6	137.6	82.3	130.1	153.6
Adjusted EPS	132.6	138.9	90.9	130.1	153.6
Dividend per share	30.0	34.0	22.7	32.5	38.4
Book value per share	524.4	613.0	647.7	739.8	848.7

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	5.6	4.7	4.2	3.8	3.3
EV/EBITDA	25.6	24.1	30.6	23.8	20.1
Adjusted P/E	31.2	29.8	45.5	31.8	27.0
P/BV	7.9	6.8	6.4	5.6	4.9

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	86.0	89.3	77.2	80.6	80.6
Interest burden (PBT/EBIT)	110.5	106.3	108.4	110.1	111.5
EBIT margin (EBIT/Revenue)	18.8	16.4	11.2	13.7	14.4
Asset turnover (Rev./Avg TA)	29.3	29.0	29.4	32.2	32.6
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.2	1.1
<b>Adjusted ROAE</b>	<b>27.6</b>	<b>24.4</b>	<b>14.4</b>	<b>18.8</b>	<b>19.3</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	6.2	20.0	9.1	10.3	11.1
EBITDA	31.9	5.7	(21.6)	27.3	15.4
Adjusted EPS	40.6	4.8	(34.5)	43.0	18.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	21.9	19.3	13.9	16.0	16.6
EBIT margin	18.8	16.4	11.2	13.7	14.4
Adjusted profit margin	17.9	15.6	9.4	12.2	12.9
Adjusted ROAE	27.6	24.4	14.4	18.8	19.3
ROCE	25.1	20.9	15.4	19.9	21.3
<b>Working capital days (days)</b>					
Receivables	66	65	67	70	70
Inventory	95	103	82	85	85
Payables	44	40	37	45	45
<b>Ratios (x)</b>					
Gross asset turnover	2.4	2.5	2.9	2.9	3.0
Current ratio	3.0	3.6	3.0	3.0	3.1
Net interest coverage ratio	28.3	33.4	12.1	34.9	50.8
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>0.0</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.3)</b>

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

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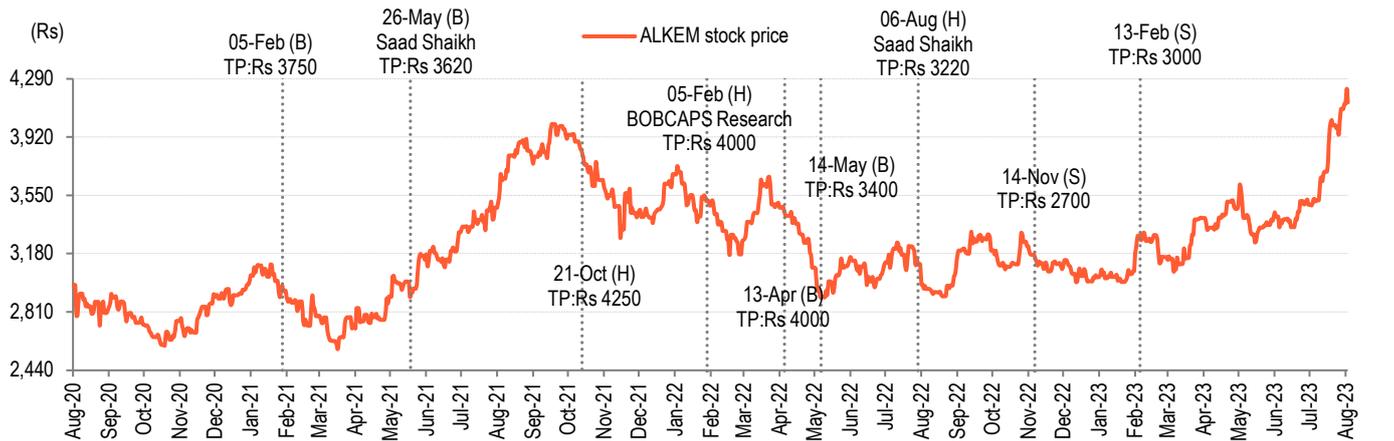
### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

- 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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