

HOLD

TP: Rs 3,850 | ▼ 4%

ALKEM LABS

| Pharmaceuticals

| 08 November 2023

Sizeable margin gains; tax guided to reduce – raise to HOLD

- Q2 EBITDA/PAT outstripped consensus by 44%/54% on higher margins, strong US growth and low taxes
- Margin guidance remains cautious at ~59%/16.5% on gross/EBITDA level for FY24; tax rate guided to stay low at 12-15%
- Our TP rises to Rs 3,850 (vs Rs 3,300) as we hike FY24-FY25 EBITDA estimates by 9%/14%; upgrade from SELL to HOLD

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Strong US growth aids revenue, margin gains lift PAT: ALKEM reported healthy revenue growth of 12% YoY to Rs 34.4bn in Q2FY24 led by the US business which grew 24% YoY (+9% QoQ) to US\$ 92mn. Management highlighted that the US had no one-off sales (barring some seasonality benefit) and it was a better product mix, easing raw material costs and moderating price erosion that lent a fillip to the quarter. Cost-saving measures saw gross/EBITDA margins swell 390bps/700bps YoY to 61.4%/21.7%. Margin gains and a lower tax rate propelled PAT up 88% YoY to Rs 6.2bn.

India business grows despite slowdown in acute therapies: ALKEM's revenue was further supported by 5% YoY growth in India business despite an industry-wide slowdown in acute therapies on account of a delayed and sporadic monsoon. ALKEM slightly underperformed the market in anti-infectives, pain and dermatology but outperformed in antidiabetics, gastrointestinal, vitamins, minerals & nutrients (VMN), neurology and cardiac therapies. Trade generics formed ~20% of revenue and grew 6-7% YoY. Chronic therapies fared well, especially antidiabetic (+23% YoY), cardiac (+9.6%) and neurology (+9.1%).

Margin guidance conservative despite strong H1: Alkem closed H1FY24 with gross/EBITDA margins of 60.6%/17.7%. Even so, considering a better product mix than usual in Q2 and “supernormal” operating margins, management conservatively retains its FY24 margin guidance of 59-59.5%/16.5%, also allowing for historically weaker profit trends in the fourth quarter. Ongoing cost-saving measures aided Q2 margins by way of low R&D & employee cost and reduced overheads as a percentage of revenue, apart from operating leverage upon recovery in the international business. On the tax front, management expects a low 12-15% tax rate for FY24 vs. 18% earlier.

Upgrade to HOLD: We raise our FY24/FY25 EBITDA estimates by 9%/14% and hike our operating margin assumptions by 100-200bps to incorporate recovery in the US and international business and an improving margin profile. This takes our TP to Rs 3,850 (from Rs 3,300), based on an unchanged FY25E EV/EBITDA multiple of 16x, a 10% discount to the stock's 5Y average. As the stock now offers slight upside potential, we upgrade from SELL to HOLD.

Key changes

	Target	Rating
	▲	▲

Ticker/Price	ALKEM IN/Rs 4,027
Market cap	US\$ 5.9bn
Free float	41%
3M ADV	US\$ 7.6mn
52wk high/low	Rs 4,243/Rs 2,940
Promoter/FPI/DII	57%/6%/16%

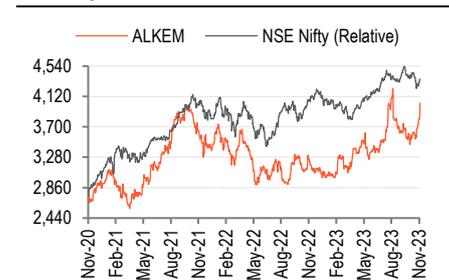
Source: NSE | Price as of 7 Nov 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	115,993	131,776	145,807
EBITDA (Rs mn)	16,095	22,365	26,943
Adj. net profit (Rs mn)	10,872	18,112	21,727
Adj. EPS (Rs)	90.9	151.5	181.7
Consensus EPS (Rs)	90.9	127.3	155.7
Adj. ROAE (%)	14.4	21.7	22.3
Adj. P/E (x)	44.3	26.6	22.2
EV/EBITDA (x)	29.7	21.2	17.1
Adj. EPS growth (%)	(34.5)	66.6	20.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Net Sales	34,402	30,794	11.7	29,677	15.9	64,079	56,558	13.3
EBITDA	7,467	4,539	64.5	3,892	91.9	11,359	6,572	72.9
Depreciation	739	774	(4.5)	724	-	1,463	1,537	-
EBIT	6,728	3,765	78.7	3,168	-	9,896	5,035	97
Interest	303	249	22.0	298	1.8	601	514	-
Other Income	632	507	24.7	658	(4.0)	1,290	1,021	-
PBT	7,057	4,023	75.4	3,529	100.0	10,586	5,542	91.0
Less: Taxation	332	546	-	650	-	982	751	-
Less: Minority Interest	(56)	169	-	11	-	(46)	207	-
Recurring PAT	6,782	3,308	105.0	2,867	136.5	9,649	4,585	110.5
Exceptional items	(577)	0	-	0	-	(577)	0	-
Reported PAT	6,205	3,308	87.6	2,867	116.4	9,073	4,585	97.9
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	61.4	57.6	387	59.6	181	60.6	57.5	306
EBITDA Margin	21.7	14.7	697	13.1	859	17.7	11.6	611
Tax / PBT	4.7	13.6		18.4	-	9.3	13.5	-
NPM	19.7	10.7	897	9.7	1005	15.1	8.1	-
EPS (Rs)	56.7	27.7	-	24.0	-	80.7	38.4	-

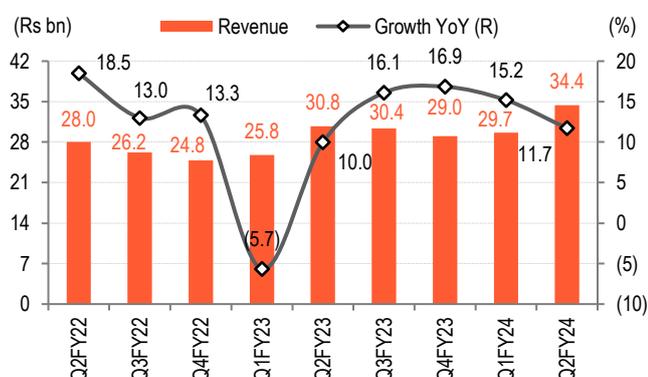
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
India	23,278	22,161	5.0	19,007	22.5	42,285	39,976	5.8
US	7,675	6,040	27.1	6,955	10.4	14,630	11,605	26.1
RoW	2,866	2,251	27.3	3,191	(10.2)	6,057	4,290	41.2
Net Sales	33,819	30,452	11.1	29,153	16.0	62,972	55,871	12.7
Other Op. Income	583	342	70.5	524	11.2	1,107	687	61.2
Revenue	34,402	30,794	11.7	29,677	15.9	64,079	56,558	13.3
USDINR	83.0	81.3	2.1	82.2	1.0	82.6	80.2	3.1
US revenue (US\$ mn)	92	74	24.4	85	9.2	177	145	22.3

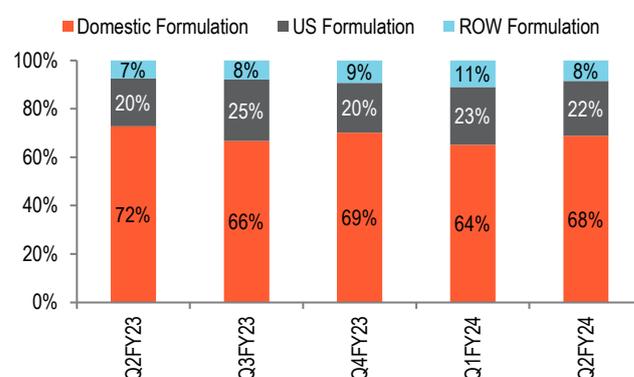
Source: Company, BOBCAPS Research

Fig 3 – Total revenue



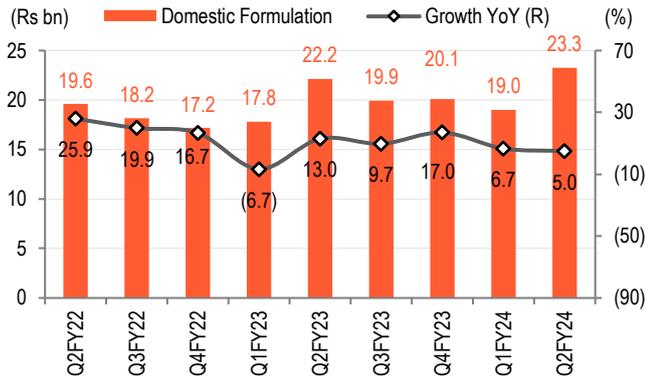
Source: Company, BOBCAPS Research

Fig 4 – Revenue mix



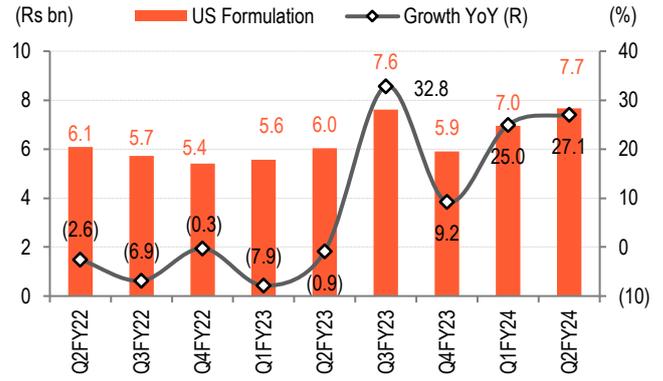
Source: Company, BOBCAPS Research

Fig 5 – Domestic formulation revenue



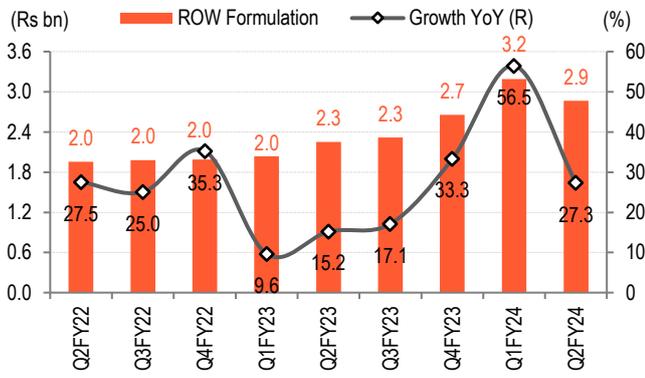
Source: Company, BOBCAPS Research

Fig 6 – US formulation revenue



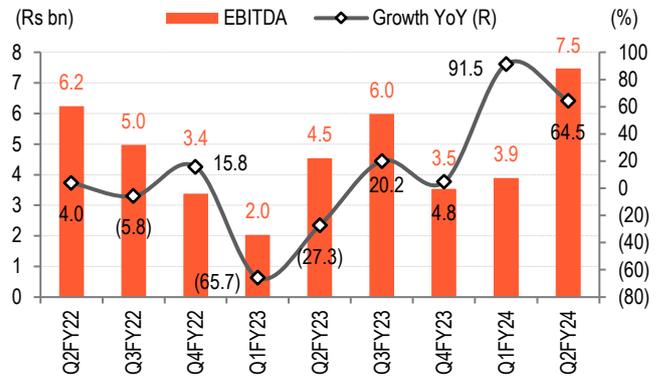
Source: Company, BOBCAPS Research

Fig 7 – ROW formulation revenue



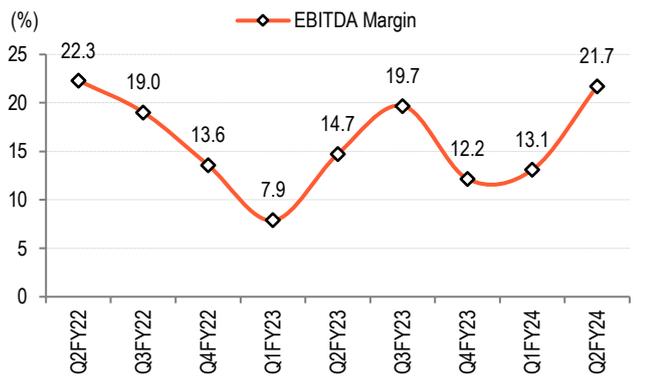
Source: Company, BOBCAPS Research

Fig 8 – EBITDA



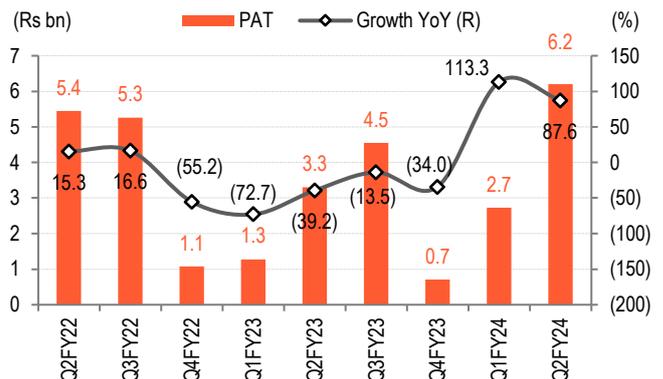
Source: Company, BOBCAPS Research

Fig 9 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 10 – PAT



Source: Company, BOBCAPS Research

Earnings call highlights

- **US formulations:** A low base, some seasonality benefit and reduced price erosion (of 5-6%) aided US revenue growth of 9% QoQ to US\$ 92mn in Q2FY24. Alkem highlighted that there were no one-off sales in Q2 and guided for single-digit dollar revenue growth in FY24. Management further indicated that it has cut back R&D on small molecule compounds and raised spending on more complex products. The company is targeting 8-9 filings for FY24 with a focus on products that have low price erosion.
- **India formulations:** Alkem's domestic revenue grew 5% YoY despite an industry-wide slowdown in acute therapies on account of a delayed and sporadic monsoon. Management expects to clock high-single-digit growth on an annualised basis in FY24.
 - **Chronic therapies:** Chronic therapies performed well, especially antidiabetic, cardiac and neurology. This remains a focus area for the company in terms of organic as well inorganic growth.
 - **Trade generics:** Revenue contribution from trade generics stood at ~20% with 6-7% YoY growth in Q2.
 - **Field force:** Alkem has completed its field force expansion (~12,000 personnel) and is now focusing on double-digit growth in productivity and achieving operating leverage.
- **Enzene Biosciences:** Enzene saw several new launches during the quarter. The subsidiary contributed revenue of Rs 800mn in Q2 and is guided to break even next year.
- **Biosimilars:** Alkem's biosimilars portfolio is performing well in the domestic market, with Enzene's latest addition of Ranibizumab taking the product suite to seven.
- **Exceptional item:** Alkem booked an exceptional expense of Rs 577mn in Q2 on account of impairment of fixed assets.
- **Tax rate:** Net profit growth for the quarter was aided by a lower tax rate of 4.7% (vs. 18.4%/13.6% in Q1FY24/Q2FY23). Management has guided for an effective tax rate of 12-15% for FY24 from 18% earlier, with FY25 likely to attract a similar rate.
- **M&A:** Management is increasingly evaluating M&A opportunities with a focus on the chronic and consumer segments.

Valuation methodology

We raise our FY24/FY25 EBITDA estimates by 9%/14% and hike our operating margin assumptions by 100-200bps to incorporate recovery in the US and international business and an improving margin profile. This takes our TP to Rs 3,850 (from Rs 3,300), based on an unchanged FY25E EV/EBITDA multiple of 16x, which is a 10% discount to the stock's five-year average. As the stock now offers slight upside potential, we upgrade our rating from SELL to HOLD.

Fig 11 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	131.8	145.8	159.4	128.0	142.2	NA	3.0	2.6	NA
EBITDA	22.4	26.9	31.1	20.5	23.6	NA	9.2	14.0	NA
EBITDA margin (%)	17.0	18.5	19.5	16.0	16.6	NA	96bps	186bps	NA
EPS (Rs)	152	182	210	130	154	NA	16.5	18.3	NA

Source: BOBCAPS Research

Fig 12 – Key assumptions

Revenue (Rs bn)	FY23	FY24E	FY25E	FY26E
Domestic	80.0	88.1	97.3	107.5
US	25.1	28.9	32.2	33.9
ROW	9.3	12.5	13.7	15.1
Other Operating Income	1.6	2.3	2.6	2.8

Source: Company, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- faster-than-expected uptick in domestic business, especially on the acute side, and
- positive surprise on margins with continued softening of raw material cost, a better mix and cost-saving measures.

Key downside risks are:

- continued slowdown in the acute segment of the Indian pharma market where Alkem draws a large portion of revenue,
- change in product mix towards low-margin regions or products, and
- above-guided tax rate.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.8	1,827	2,070	BUY
Alembic Pharma	ALPM IN	1.8	740	615	HOLD
Alkem Labs	ALKEM IN	5.9	4,027	3,850	HOLD
Aurobindo Pharma	ARBP IN	6.4	903	880	HOLD
Cipla	CIPLA IN	11.9	1,216	1,360	BUY
Divi's Labs	DIVI IN	11.2	3,481	2,800	SELL
Dr Reddy's Labs	DRRD IN	11.0	5,404	5,500	HOLD
Eris Lifesciences	ERIS IN	1.4	869	955	BUY
Glenmark Life Sciences	GLS IN	0.9	621	620	HOLD
Laurus Labs	LAURUS IN	2.4	370	340	HOLD
Lupin	LPC IN	6.6	1,190	800	SELL
Sun Pharma	SUNP IN	34.2	1,171	1,200	HOLD

Source: BOBCAPS Research, NSE | Price as of 7 Nov 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	106,342	115,993	131,776	145,807	159,409
EBITDA	20,529	16,095	22,365	26,943	31,148
Depreciation	3,040	3,104	2,949	3,176	3,404
EBIT	17,489	12,991	19,416	23,767	27,744
Net interest inc./(exp.)	(524)	(1,074)	(754)	(603)	(483)
Other inc./(exp.)	1,627	2,161	2,591	2,781	3,464
Exceptional items	0	0	0	0	0
EBT	18,592	14,078	21,253	25,945	30,725
Income taxes	1,640	2,980	2,869	3,892	5,223
Extraordinary items	(150)	(1,030)	(577)	0	0
Min. int./Inc. from assoc.	347	226	272	326	391
Reported net profit	16,456	9,842	17,536	21,727	25,111
Adjustments	(150)	(1,030)	(577)	0	0
Adjusted net profit	16,606	10,872	18,112	21,727	25,111

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	11,734	11,650	15,961	17,660	19,308
Other current liabilities	7,739	10,178	10,357	11,460	12,529
Provisions	6,064	7,421	8,398	9,292	10,159
Debt funds	26,682	13,967	11,173	8,939	7,151
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	75,142	81,086	93,342	108,735	126,526
Shareholders' fund	75,381	81,325	93,581	108,974	126,765
Total liab. and equities	127,599	124,542	139,470	156,325	175,912
Cash and cash eq.	25,786	26,169	33,510	43,265	56,144
Accounts receivables	18,846	21,322	24,828	27,472	30,034
Inventories	30,055	26,075	30,148	33,358	36,470
Other current assets	16,790	14,696	14,888	16,473	18,010
Investments	3,710	6,218	6,218	6,218	6,218
Net fixed assets	29,017	26,829	27,130	27,203	27,049
CWIP	3,395	3,232	2,748	2,335	1,985
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	127,599	124,542	139,470	156,325	175,912

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	6,223	21,331	18,934	21,764	25,369
Capital expenditures	(4,418)	1,354	(3,250)	(3,250)	(3,250)
Change in investments	(382)	(2,508)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(4,800)	(1,154)	(3,250)	(3,250)	(3,250)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	9,980	(12,715)	(2,793)	(2,235)	(1,788)
Interest expenses	(524)	(1,074)	(754)	(603)	(483)
Dividends paid	(4,739)	(3,169)	(5,280)	(6,333)	(7,320)
Other financing cash flows	(258)	(2,836)	485	412	350
Cash flow from financing	4,458	(19,794)	(8,342)	(8,759)	(9,240)
Chg in cash & cash eq.	5,881	383	7,341	9,755	12,879
Closing cash & cash eq.	25,786	26,169	33,510	43,265	56,144

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	137.6	82.3	146.7	181.7	210.0
Adjusted EPS	138.9	90.9	151.5	181.7	210.0
Dividend per share	34.0	22.7	37.9	45.4	52.5
Book value per share	613.0	647.7	750.2	878.9	1,027.8

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	4.5	4.1	3.6	3.2	2.8
EV/EBITDA	23.4	29.7	21.2	17.1	14.4
Adjusted P/E	29.0	44.3	26.6	22.2	19.2
P/BV	6.6	6.2	5.4	4.6	3.9

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	89.3	77.2	85.2	83.7	81.7
Interest burden (PBT/EBIT)	106.3	108.4	109.5	109.2	110.7
EBIT margin (EBIT/Revenue)	16.4	11.2	14.7	16.3	17.4
Asset turnover (Rev./Avg TA)	29.0	29.4	32.9	32.7	31.7
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.2	1.1	1.1
Adjusted ROAE	24.4	14.4	21.7	22.3	22.0

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	20.0	9.1	13.6	10.6	9.3
EBITDA	5.7	(21.6)	39.0	20.5	15.6
Adjusted EPS	4.8	(34.5)	66.6	20.0	15.6
Profitability & Return ratios (%)					
EBITDA margin	19.3	13.9	17.0	18.5	19.5
EBIT margin	16.4	11.2	14.7	16.3	17.4
Adjusted profit margin	15.6	9.4	13.7	14.9	15.8
Adjusted ROAE	24.4	14.4	21.7	22.3	22.0
ROCE	20.9	15.4	22.0	23.8	24.8
Working capital days (days)					
Receivables	65	67	70	70	70
Inventory	103	82	85	85	85
Payables	40	37	45	45	45
Ratios (x)					
Gross asset turnover	2.5	2.9	3.0	3.1	3.2
Current ratio	3.6	3.0	3.0	3.1	3.3
Net interest coverage ratio	33.4	12.1	25.7	39.4	57.5
Adjusted debt/equity	0.0	(0.2)	(0.3)	(0.4)	(0.4)

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%

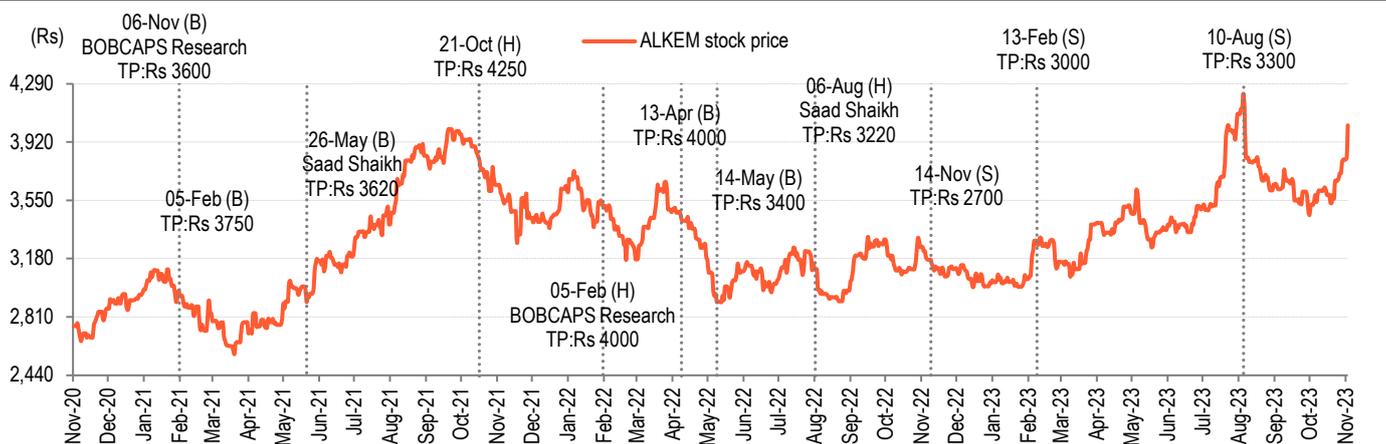
HOLD – Expected return from -6% to +15%

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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