

**BUY**

TP: Rs 3,750 | ▲ 27%

**ALKEM LABS**

Pharmaceuticals

05 February 2021

## Q3 in line; strong free cash to support rerating

Alkem Labs' Q3FY21 was in line, with sales/EBITDA growth at 6%/17% YoY. Gross margin was healthy at 61.7% and EBITDA margin beat estimates at 22.8% despite a surge in SGA spend (+27% QoQ, -5% YoY). India growth recovered to 6% YoY (trade generics up >20% YoY), but US sales were muted QoQ. Alkem is cautiously optimistic of achieving 4-5% India sales growth in FY21 led by acute business recovery and is confident of >150bps EBITDA margin gains over three years. Retain BUY with a new Mar'22 TP of Rs 3,750 on rollover (vs. Rs 3,600).

Vivek Kumar | Saad Shaikh

research@bobcaps.in

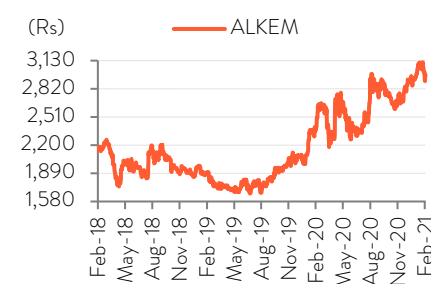
**India trade generics remain robust; US to rebound in Q4:** Growth in the trade generics business held strong (>20%) and prescription (Rx) sales rebounded QoQ. Generics share has moderated to ~23% (from 27% in H1) with Rx pickup; this is expected to normalise to 20% levels by FY22. India sales grew 6% YoY as acute business recovered and larger brands continued to do well. US sales were muted QoQ at US\$ 84mn and should revive in Q4 on new launches (seven approvals in Q3). Management retains its 15-20% US growth guidance for FY21-FY23. We expect a US/India sales CAGR of 17%/8% for this period.

Ticker/Price	ALKEM IN/Rs 2,944
Market cap	US\$ 4.8bn
Shares o/s	120mn
3M ADV	US\$ 4.6mn
52wk high/low	Rs 3,152/Rs 1,881
Promoter/FPI/DII	62%/4%/11%

Source: NSE

**EBITDA margin healthy; gross margin surprises positively:** Q3 gross margin sustained at a robust 61.7% (+120bps QoQ) despite recovery in acute portfolio growth, implying underlying US margins have improved. Chronic business remains slow. Alkem expects to sustain ~62% gross margins in coming quarters. SGA spends have largely normalised in Q3 (+27% QoQ) but are still down 5% YoY – management reiterated that some part of savings is structural and should support FY22 EBITDA margins (guided at 20-21% vs. an exceptional 23% print in FY21).

## STOCK PERFORMANCE



Source: NSE

**Earnings call highlights:** (1) Sustainable market share gains in larger brands during Covid. (2) India business can see small sized M&A in FY22. (3) Other income includes onetime brand monetisation. (4) Cash levels: Rs 8bn.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	73,558	82,983	91,288	101,943	113,526
EBITDA (Rs mn)	11,135	14,730	20,767	21,621	24,768
Adj. net profit (Rs mn)	7,298	11,270	15,960	16,662	19,276
Adj. EPS (Rs)	61.0	94.3	133.5	139.4	161.2
Adj. EPS growth (%)	15.7	54.4	41.6	4.4	15.7
Adj. ROAE (%)	16.3	22.7	27.4	23.6	22.8
Adj. P/E (x)	48.2	31.2	22.1	21.1	18.3
EV/EBITDA (x)	31.7	24.0	17.0	16.1	13.6

Source: Company, BOBCAPS Research

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

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



**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Q3FY21E	Var. (%)	9MFY21	9MFY20	YoY (%)
<b>Net Sales</b>	<b>23,181</b>	<b>21,818</b>	<b>6.2</b>	<b>23,628</b>	<b>(1.9)</b>	<b>23,486</b>	<b>(1.3)</b>	<b>66,843</b>	<b>62,953</b>	<b>6.2</b>
<b>EBITDA</b>	<b>5,291</b>	<b>4,533</b>	<b>16.7</b>	<b>6,005</b>	<b>(11.9)</b>	<b>5,281</b>	<b>0.2</b>	<b>16,627</b>	<b>11,705</b>	<b>42.0</b>
Depreciation	690	594	-	702	-	624	-	2,060	1,716	-
EBIT	4,601	3,939	16.8	5,303	(13.2)	4,658	-	14,567	9,989	45.8
Interest	131	170	-	180	-	180	-	482	509	-
Other Income	964	279	-	355	-	355	-	1,754	768	-
<b>PBT</b>	<b>5,434</b>	<b>4,048</b>	<b>34.2</b>	<b>5,478</b>	<b>(0.8)</b>	<b>4,833</b>	<b>-</b>	<b>15,839</b>	<b>10,249</b>	<b>54.5</b>
Less: Taxation	796	147	-	662	-	677	-	2,154	667	-
Less: Minority Interest	129	80	-	95	-	95	-	235	195	-
<b>Recurring PAT</b>	<b>4,510</b>	<b>3,822</b>	<b>18.0</b>	<b>4,721</b>	<b>(4.5)</b>	<b>4,062</b>	<b>11.0</b>	<b>13,450</b>	<b>9,387</b>	<b>43.3</b>
Exceptional items	0	0	-	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>4,510</b>	<b>3,822</b>	<b>18.0</b>	<b>4,721</b>	<b>(4.5)</b>	<b>4,062</b>	<b>11.0</b>	<b>13,450</b>	<b>9,387</b>	<b>43.3</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>			<b>(bps)</b>				
Gross Margin	61.7	61.8	(5)	60.5	123	61.0	-	61.8	61.1	-
EBITDA Margin	22.8	20.8	205	25.4	(259)	22.5	-	24.9	18.6	-
Tax / PBT	14.6	3.6	-	12.1	-	14.0	-	13.6	6.5	-
NPM	19.5	17.5	-	20.0	-	17.3	-	20.1	14.9	-
<b>EPS (Rs)</b>	<b>37.7</b>	<b>32.0</b>	<b>-</b>	<b>39.5</b>	<b>-</b>	<b>34.0</b>	<b>-</b>	<b>112.5</b>	<b>78.5</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT SALES**

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	Q3FY21E	Var. (%)	9MFY21	9MFY20	YoY (%)
<b>Formulations</b>										
India	15,140	14,239	6.3	15,574	(2.8)	15,420	(1.8)	42,264	41,964	0.7
US	6,156	5,837	5.5	6,258	(1.6)	6,438	(4.4)	19,078	16,024	19.1
RoW	1,582	1,416	11.7	1,532	3.3	1,628	(2.8)	4,303	3,832	12.3
<b>Net Sales</b>	<b>22,878</b>	<b>21,492</b>	<b>6.4</b>	<b>23,364</b>	<b>(2.1)</b>	<b>23,486</b>	<b>(2.6)</b>	<b>65,645</b>	<b>61,820</b>	<b>6.2</b>
INR/US\$	74	71	3	74	0.0	74	-	74	71	5
US sales in \$ terms	84	82	2	85	(1.6)	88	-	258	227	14

Source: Company, BOBCAPS Research

### Valuation methodology

Alkem delivered a strong beat on EBITDA margins in FY20 (up >250bps YoY). We continue to believe that the company’s profit base has moved up sustainably given its focus on raising the high-margin acute mix, increasing marketing efficiency and driving operating leverage in the US from new launches. This coupled with expectations of sustained ROIC of >35% (vs. ~23% over FY18-FY20) and strong FCF of Rs 40bn over the next three years (vs. Rs 10bn in the last five years) should support expansion in one-year forward EV/EBITDA multiples closer to the three-year mean of 19x from ~15x currently.

We expect 21% EBITDA growth over the next two years and maintain our FY22-FY23 EPS estimates. On rolling valuations forward, we arrive at a revised Mar’22 target price of Rs 3,750 (vs. Rs 3,600), based on an unchanged target EV/EBITDA multiple of 19x (implied P/E of 24x). Retain BUY.

**FIG 3 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- **Regulatory action and slowdown in India formulation business:** Expansion of NLEM coverage and the FDC ban in 2018 affected industry growth. The NLEM order has hit most large brands in the acute segment, taking the share of Alkem's price-controlled portfolio to 26% of its domestic formulation business vs. 17% for IPM. While Alkem's current portfolio under NLEM is meaningfully higher than the market, any further regulatory action in the acute segment is unlikely to have much bearing on financials. Also, Alkem has a minor presence in the chronic segment with smaller brands and negligible price leadership.

Disruption in the trade generics business due to regulatory action could also be a key risk to the stock since this accounts for 15% of overall domestic sales. Further, any slowdown in IPM growth and delay in new launches can affect earnings.

- **Poor US execution:** We expect the US market to contribute meaningfully to profitability in the coming years – up from 3% of FY19 EBITDA to 8% in FY21 (or 30% of incremental EBITDA). Any delay in key launches, surprise competition in niche products, regulatory action on manufacturing facilities (Daman, Baddi, St. Louis), and above-expected price erosion in the top 5 products could be potential threats to earnings.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>73,558</b>	<b>82,983</b>	<b>91,288</b>	<b>101,943</b>	<b>113,526</b>
EBITDA	11,135	14,730	20,767	21,621	24,768
Depreciation	1,932	2,526	2,557	2,872	3,222
EBIT	9,203	12,204	18,210	18,749	21,546
Net interest income/(expenses)	(546)	(650)	(998)	(998)	(998)
Other income/(expenses)	582	1,043	1,656	2,228	2,857
Exceptional items	0	0	0	0	0
EBT	9,239	12,598	18,868	19,979	23,405
Income taxes	1,810	1,105	2,642	2,997	3,745
Extraordinary items	307	0	0	0	0
Min. int./Inc. from associates	131	222	267	320	384
<b>Reported net profit</b>	<b>7,605</b>	<b>11,270</b>	<b>15,960</b>	<b>16,662</b>	<b>19,276</b>
Adjustments	307	0	0	0	0
<b>Adjusted net profit</b>	<b>7,298</b>	<b>11,270</b>	<b>15,960</b>	<b>16,662</b>	<b>19,276</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	9,622	9,541	12,350	13,791	15,358
Other current liabilities	4,435	6,010	7,212	8,054	8,969
Provisions	3,275	4,067	4,474	4,997	5,564
Debt funds	9,025	16,628	16,628	16,628	16,628
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	48,407	53,363	65,601	78,378	93,158
Shareholders' fund	48,646	53,602	65,840	78,617	93,397
<b>Total liabilities and equities</b>	<b>75,003</b>	<b>89,848</b>	<b>106,505</b>	<b>122,086</b>	<b>139,917</b>
Cash and cash eq.	6,615	10,922	25,252	33,177	43,218
Accounts receivables	12,484	16,494	17,290	19,308	21,502
Inventories	14,998	18,188	19,266	21,515	23,959
Other current assets	7,669	9,180	10,819	12,081	13,454
Investments	3,236	2,614	2,614	2,614	2,614
Net fixed assets	25,072	28,821	30,264	32,392	34,170
CWIP	4,930	3,630	1,000	1,000	1,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>75,004</b>	<b>89,848</b>	<b>106,505</b>	<b>122,086</b>	<b>139,917</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	9,537	13,796	18,517	19,534	22,498
Interest expenses	546	650	998	998	998
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,411)	(6,425)	906	(2,724)	(2,961)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>8,671</b>	<b>8,021</b>	<b>20,420</b>	<b>17,808</b>	<b>20,534</b>
Capital expenditures	(3,991)	(4,500)	(4,000)	(5,000)	(5,000)
Change in investments	1,207	622	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(2,784)</b>	<b>(3,878)</b>	<b>(4,000)</b>	<b>(5,000)</b>	<b>(5,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(925)	7,603	0	0	0
Interest expenses	(546)	(650)	(998)	(998)	(998)
Dividends paid	(1,702)	(2,628)	(3,722)	(3,886)	(4,495)
Other financing cash flows	(1,868)	(4,161)	2,630	0	0
<b>Cash flow from financing</b>	<b>(5,040)</b>	<b>164</b>	<b>(2,090)</b>	<b>(4,883)</b>	<b>(5,493)</b>
<b>Changes in cash and cash eq.</b>	<b>847</b>	<b>4,308</b>	<b>14,330</b>	<b>7,924</b>	<b>10,042</b>
<b>Closing cash and cash eq.</b>	<b>6,614</b>	<b>10,922</b>	<b>25,252</b>	<b>33,177</b>	<b>43,218</b>

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	63.6	94.3	133.5	139.4	161.2
Adjusted EPS	61.0	94.3	133.5	139.4	161.2
Dividend per share	12.2	18.9	26.7	27.9	32.2
Book value per share	395.8	436.0	538.3	645.2	768.8

### Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.8	4.3	3.9	3.4	3.0
EV/EBITDA	31.7	24.0	17.0	16.1	13.6
Adjusted P/E	48.2	31.2	22.1	21.1	18.3
P/BV	7.4	6.8	5.5	4.6	3.8

### DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	79.0	89.5	84.6	83.4	82.4
Interest burden (PBT/EBIT)	100.4	103.2	103.6	106.6	108.6
EBIT margin (EBIT/Revenue)	12.5	14.7	19.9	18.4	19.0
Asset turnover (Revenue/Avg TA)	33.2	32.4	29.9	28.7	27.7
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.3	1.3	1.2
Adjusted ROAE	16.3	22.7	27.4	23.6	22.8

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	14.5	12.8	10.0	11.7	11.4
EBITDA	8.3	32.3	41.0	4.1	14.6
Adjusted EPS	15.7	54.4	41.6	4.4	15.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.1	17.8	22.7	21.2	21.8
EBIT margin	12.5	14.7	19.9	18.4	19.0
Adjusted profit margin	9.9	13.6	17.5	16.3	17.0
Adjusted ROAE	16.3	22.7	27.4	23.6	22.8
ROCE	17.6	20.7	26.0	23.6	23.8
<b>Working capital days (days)</b>					
Receivables	63	73	70	70	70
Inventory	75	81	78	78	78
Payables	48	42	50	50	50
<b>Ratios (x)</b>					
Gross asset turnover	2.4	2.4	2.4	2.3	2.3
Current ratio	2.4	2.8	3.0	3.2	3.4
Net interest coverage ratio	16.9	18.8	18.3	18.8	21.6
Adjusted debt/equity	0.0	0.1	(0.2)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

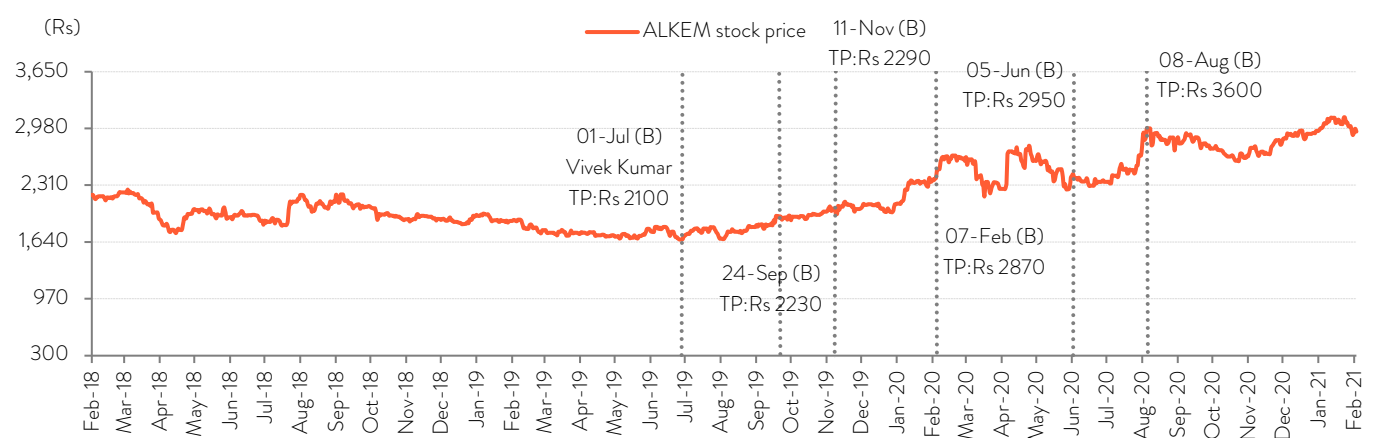
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): ALKEM LABS (ALKEM IN)



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

### Rating distribution

As of 31 January 2021, out of 88 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 41 have BUY ratings, 13 have ADD ratings, 6 are rated REDUCE and 28 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

### Analyst certification

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

### General disclaimers

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

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

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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