

SELL

TP: Rs 3,000 | ▼ 9%

ALKEM LABS

| Pharmaceuticals

| 13 February 2023

Quarter buoyed by seasonal tailwinds

- Q3 revenue grew 16% YoY to Rs 30bn led by double-digit growth across markets; flu season drove US sales of US\$ 92mn
- Gross margin contracted but EBITDA margin stable at 19.7% as cost control mitigated raw material and US price erosion pressures
- On rollover, we revise our TP to Rs 3,000 (vs. Rs 2,700), based on 15x EV/EBITDA; maintain SELL

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US flu season leads growth: Alkem reported 16% YoY revenue growth to Rs 30.4bn in Q3FY23 driven primarily by strong growth in US business, supported by healthy sales in India (+10%) and ROW (+17%) markets. US sales rose 24% QoQ to US\$ 92mn owing to the flu season, which is expected to fade away in Q4. Though the company continues to see double-digit price erosion in the US, the pace of erosion has slowed with new launches (eight in 9MFY23) helping to mitigate the price impact some extent. Growth in ROW was led by Chile and Kazakhstan.

Outperformed India pharma market in key therapies: Alkem witnessed double-digit growth in India business at 10% YoY supported by outperformance in anti-infectives, VMN, pain management and gastrointestinal therapies in the acute space, and anti-diabetic and neurology/CNS therapies in the chronic segment. Trade generics, which form ~20% of the domestic business, reported mid-single-digit growth. Management expects India business to grow in single digits in FY23.

High input cost and US price erosion continues to dampen margins: Gross margin contracted 300bps YoY to 58.9% due to continued elevated raw material costs and US price erosion. Though input prices have moderated, they are yet to return to pre-Covid levels. Savings in operating cost (R&D, other expenses) headed off steeper gross margin contraction and helped sustain the EBITDA margin at 19.7% (+65bps YoY). Sequentially, lower US price erosion and the flu season aided gross margin gains of 140bps. This along with cost saving measures drove Alkem's EBITDA margin up 500bps QoQ. The company expects margins to improve 2-2.5ppt in FY24.

Maintain SELL: Relentless price erosion in the US market and elevated input cost, along with higher marketing spends, continue to take a toll on margins though Q3 did see some positive impacts from cost optimisation measures. We expect US business to be sluggish as investments are recalibrated amid challenges to growth. On rollover to FY25 valuations, we revise our TP Rs 3,000 (vs. Rs 2,700), based on an unchanged 15x EV/EBITDA – a discount of 15% to the stock's 5Y average. Given 9% downside potential from the current stock price, we maintain SELL.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	ALKEM IN/Rs 3,293
Market cap	US\$ 4.8bn
Free float	39%
3M ADV	US\$ 3.3mn
52wk high/low	Rs 3,725/Rs 2,828
Promoter/FPI/DII	59%/5%/14%

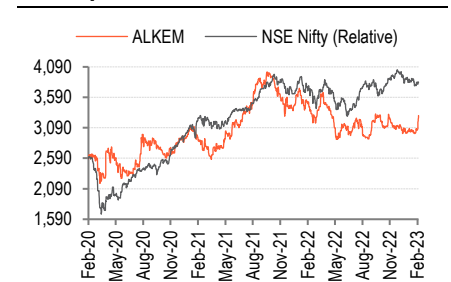
Source: NSE | Price as of 10 Feb 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,06,342	1,16,707	1,32,180
EBITDA (Rs mn)	20,529	17,679	21,184
Adj. net profit (Rs mn)	16,606	12,997	16,124
Adj. EPS (Rs)	138.9	108.7	134.9
Consensus EPS (Rs)	138.9	102.7	137.7
Adj. ROAE (%)	24.4	16.7	18.3
Adj. P/E (x)	23.7	30.3	24.4
EV/EBITDA (x)	19.2	22.1	18.3
Adj. EPS growth (%)	4.8	(21.7)	24.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
Net Sales	30,409	26,190	16.1	30,794	(1.2)	86,967	81,503	6.7
EBITDA	5,991	4,985	20.2	4,539	32.0	12,562	17,157	(26.8)
Depreciation	784	775	1.3	774	-	2,321	2,208	-
EBIT	5,206	4,210	23.7	3,765	-	10,241	14,949	(31.5)
Interest	271	106	155.9	249	8.9	784	354	-
Other Income	453	535	(15.3)	507	(10.5)	1,474	1,421	-
PBT	5,389	4,639	16.2	4,023	33.9	10,931	16,016	(31.7)
Less: Taxation	789	(694)	-	546	-	1,540	295	-
Less: Minority Interest	53	77	-	169	-	259	341	-
Recurring PAT	4,547	5,257	(13.5)	3,308	37.4	9,132	15,380	(40.6)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	4,547	5,257	(13.5)	3,308	37.4	9,132	15,380	(40.6)
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	58.9	61.9	(302)	57.6	137	58.0	61.4	(335)
EBITDA Margin	19.7	19.0	67	14.7	496	14.4	21.1	(661)
Tax / PBT	14.6	(15.0)	-	13.6	-	14.1	1.8	-
NPM	15.0	20.1	(512)	10.7	421	10.5	18.9	-
EPS (Rs)	38.0	44.0	-	27.7	-	76.4	128.7	-

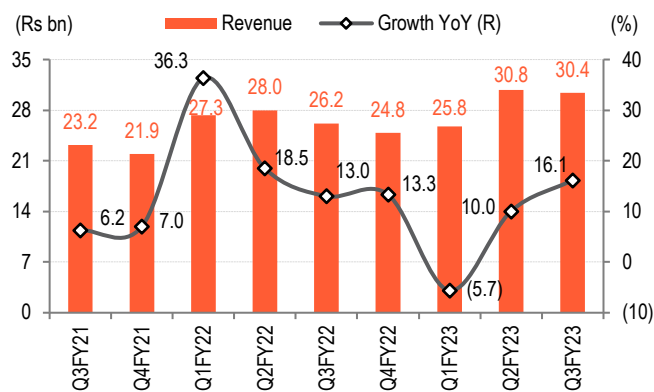
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
India	19,922	18,156	9.7	22,161	(10.1)	59,898	56,858	5.3
US	7,612	5,731	32.8	6,040	26.0	19,217	17,871	7.5
ROW	2,316	1,978	17.1	2,251	2.9	6,606	5,792	14.1
Net Sales	29,850	25,865	15.4	30,452	(2.0)	85,721	80,521	6.5
Other Op. Income	559	325	72.1	342	63.6	1,246	982	26.8
Revenue	30,409	26,190	16.1	30,794	(1.2)	86,967	81,503	6.7
USDINR	82.4	75.0	9.9	81.3	1.4	81	74	8.9
US revenue (US\$ mn)	92	76	20.8	74	24.3	238	241	(1.3)

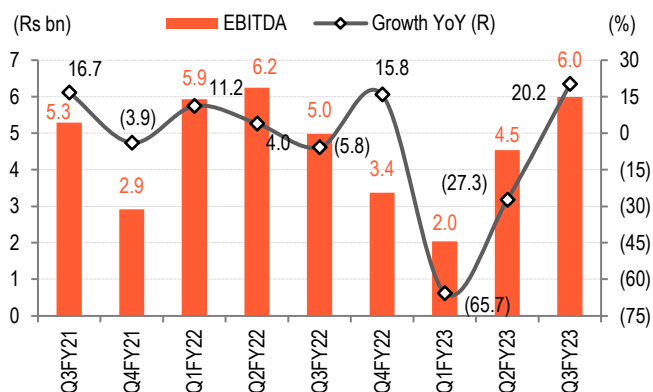
Source: Company, BOBCAPS Research

Fig 3 – Revenue



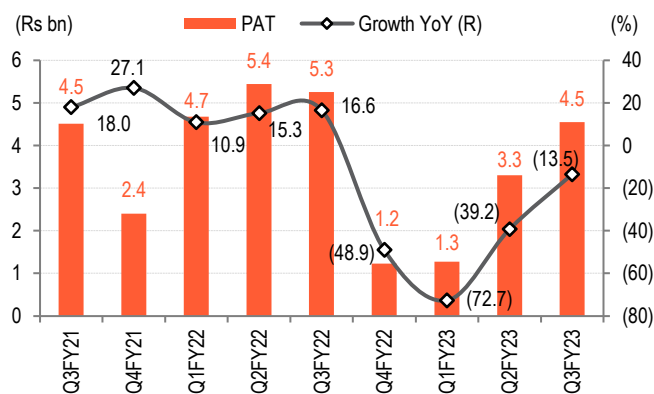
Source: Company, BOBCAPS Research

Fig 4 – EBITDA



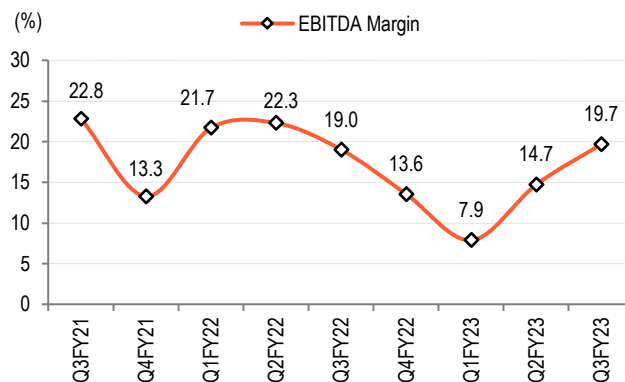
Source: Company, BOBCAPS Research

Fig 5 – PAT



Source: Company, BOBCAPS Research

Fig 6 – EBITDA margin



Source: Company, BOBCAPS Research

Earnings call highlights

- India:** Volume and price-led growth have picked up after a muted Q1FY23. Anti-diabetic and neurology/CNS (central nervous system) therapies led the way, growing in excess of 30% YoY during the quarter. Outperformance in acute therapies was led by the anti-infective, VMN (vitamins/minerals/nutrients), gastrointestinal and pain management segments, whereas chronic therapy sales were driven by anti-diabetes, neurology/CNS and dermatology during the quarter. Some sales have spilled over to Q4FY23, per management.
- US:** Price erosion in the US market was in low single digits. Q3 sales were supported by a strong flu season which is expected to wane in Q4. Alkem launched eight products in the US in 9MFY23.
- Rest of World (ROW):** Growth in other international markets was led by Chile and Kazakhstan in Q3FY23.

- **Guidance:** Management expects to achieve a gross margin of 58-58.5% and EBITDA margin of 15-15.5% in FY23. For FY24, cost optimisation measures are guided to expand EBITDA margin by 2-2.5ppt YoY.
- **ANDAs:** The company filed two ANDAs (abbreviated new drug applications) with the USFDA and received three approvals (including one tentative approval) during Q3. For 9MFY23, it filed eight ANDAs and received eleven approvals (including four tentative). As on Dec'22, the company has filed a total of 169 ANDAs and 2 new drug applications (NDA) with the USFDA. Of these, it has received approval for 129 ANDAs (including 14 tentative) and 2 NDAs.
- **Biosimilars:** Alkem raised Rs 1.6bn and partnered with Eight Roads Ventures and F-Prime Capital for its subsidiary Enzene Bio-sciences. The company launched Adalimumab in the domestic market, taking its tally in the segment to four commercial launches. It also received approval for Cetuximab, its fifth biosimilar for the Indian market. Biosimilar sales in 9MFY23, including Enzene, totalled Rs 950mn.
- **Cash balance:** Alkem has strong net cash of Rs 19bn as of Dec'22.

Valuation methodology

Relentless price erosion in the US market and elevated input cost, along with higher marketing spends, continue to take a toll on margins though Q3FY23 did see some positive impacts from cost optimisation measures. We expect US business to be sluggish as investments are recalibrated amid challenges to growth. On rollover to FY25 valuations, we revise our TP Rs 3,000 (vs. Rs 2,700), based on an unchanged 15x EV/EBITDA – a discount of 15% to the stock’s five-year average. Given 9% downside potential from the current stock price, we maintain SELL.

Fig 7 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	116.7	132.2	145.7	118.3	132.8	NA	(1.4)	(0.5)	-
EBITDA	17.7	21.2	24.2	17.5	20.8	NA	1.1	1.7	-
EBITDA margin (%)	15.1	16.0	16.6	14.8	15.7	NA	37bps	35bps	-
EPS (Rs)	108.7	135	160	108.6	132	NA	0.1	2.2	-

Source: BOBCAPS Research

Fig 8 – Key assumptions

Revenue (Rs bn)	FY22	FY23E	FY24E	FY25E
Domestic	74.0	81.1	90.5	101.2
US	23.3	25.4	30.3	32.0
ROW	7.8	9.0	9.8	10.8
OOI	1.2	1.3	1.5	1.7

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 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.
- **Above-expected margins:** Prudent cost management could alleviate margin pressure, taking profitability ahead of 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	1.9	1,208	1,470	HOLD
Alembic Pharma	ALPM IN	1.2	525	615	HOLD
Alkem Labs	ALKEM IN	4.8	3,293	3,000	SELL
Aurobindo Pharma	ARBP IN	3.3	469	635	BUY
Cipla	CIPLA IN	10.1	1,033	1,250	BUY
Divi's Labs	DIVI IN	9.0	2,811	3,200	HOLD
Dr Reddy's Labs	DRRD IN	9.1	4,500	4,700	HOLD
Eris Lifesciences	ERIS IN	1.1	643	810	BUY
Glenmark Life Sciences	GLS IN	0.6	379	585	BUY
Laurus Labs	LAURUS IN	2.2	340	540	HOLD
Lupin	LPC IN	4.1	737	700	HOLD
Sun Pharma	SUNP IN	29.2	1,007	1,100	HOLD

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	88,650	1,06,342	1,16,707	1,32,180	1,45,695
EBITDA	19,423	20,529	17,679	21,184	24,242
Depreciation	2,746	3,040	3,187	3,467	3,747
EBIT	16,678	17,489	14,492	17,717	20,495
Net interest inc./(exp.)	(589)	(524)	(961)	(768)	(615)
Other inc./(exp.)	2,332	1,627	2,065	2,381	3,070
Exceptional items	0	0	0	0	0
EBT	18,421	18,592	15,597	19,330	22,951
Income taxes	2,243	1,640	2,184	2,706	3,213
Extraordinary items	0	(150)	0	0	0
Min. int./Inc. from assoc.	328	347	416	500	600
Reported net profit	15,850	16,456	12,997	16,124	19,138
Adjustments	0	(150)	0	0	0
Adjusted net profit	15,850	16,606	12,997	16,124	19,138

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	10,694	11,734	14,223	16,109	17,756
Other current liabilities	7,343	7,739	9,229	10,453	11,522
Provisions	4,874	6,064	6,655	7,537	8,307
Debt funds	16,702	26,682	21,346	17,076	13,661
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	64,262	75,142	84,350	95,774	1,09,333
Shareholders' fund	64,501	75,381	84,589	96,013	1,09,572
Total liab. and equities	1,04,113	1,27,599	1,36,042	1,47,188	1,60,819
Cash and cash eq.	19,905	25,786	30,309	40,149	46,685
Accounts receivables	16,072	18,846	22,125	25,059	27,621
Inventories	23,124	30,055	31,607	30,428	33,539
Other current assets	10,072	16,790	15,575	15,026	16,563
Investments	3,328	3,710	3,710	3,710	3,710
Net fixed assets	27,679	29,017	29,830	30,363	30,616
CWIP	3,933	3,395	2,886	2,453	2,085
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	1,04,113	1,27,599	1,36,042	1,47,188	1,60,819

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	17,070	6,223	18,099	23,145	19,777
Capital expenditures	(4,000)	(5,000)	(4,000)	(4,000)	(4,000)
Change in investments	(714)	(382)	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(4,714)	(5,382)	(4,000)	(4,000)	(4,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	75	9,980	(5,336)	(4,269)	(3,415)
Interest expenses	(589)	(524)	(961)	(768)	(615)
Dividends paid	(4,182)	(4,739)	(3,789)	(4,700)	(5,579)
Other financing cash flows	1,323	324	509	433	368
Cash flow from financing	(3,373)	5,040	(9,576)	(9,305)	(9,241)
Chg in cash & cash eq.	8,982	5,881	4,523	9,841	6,536
Closing cash & cash eq.	19,905	25,786	30,309	40,149	46,685

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	132.6	137.6	108.7	134.9	160.1
Adjusted EPS	132.6	138.9	108.7	134.9	160.1
Dividend per share	30.0	34.0	27.2	33.7	40.0
Book value per share	524.4	613.0	690.0	785.6	899.0

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	4.5	3.7	3.3	2.9	2.6
EV/EBITDA	20.4	19.2	22.1	18.3	15.5
Adjusted P/E	24.8	23.7	30.3	24.4	20.6
P/BV	6.3	5.4	4.8	4.2	3.7

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	86.0	89.3	83.3	83.4	83.4
Interest burden (PBT/EBIT)	110.5	106.3	107.6	109.1	112.0
EBIT margin (EBIT/Revenue)	18.8	16.4	12.4	13.4	14.1
Asset turnover (Rev./Avg TA)	29.3	29.0	28.1	30.2	30.8
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.2	1.2
Adjusted ROAE	27.6	24.4	16.7	18.3	19.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	6.2	20.0	9.7	13.3	10.2
EBITDA	31.9	5.7	(13.9)	19.8	14.4
Adjusted EPS	40.6	4.8	(21.7)	24.1	18.7
Profitability & Return ratios (%)					
EBITDA margin	21.9	19.3	15.1	16.0	16.6
EBIT margin	18.8	16.4	12.4	13.4	14.1
Adjusted profit margin	17.9	15.6	11.1	12.2	13.1
Adjusted ROAE	27.6	24.4	16.7	18.3	19.0
ROCE	25.1	20.9	15.9	18.4	19.9
Working capital days (days)					
Receivables	66	65	70	70	70
Inventory	95	103	100	85	85
Payables	44	40	45	45	45
Ratios (x)					
Gross asset turnover	2.3	2.4	2.5	2.6	2.6
Current ratio	3.0	3.6	3.3	3.2	3.3
Net interest coverage ratio	28.3	33.4	15.1	23.1	33.3
Adjusted debt/equity	(0.1)	0.0	(0.1)	(0.3)	(0.3)

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%

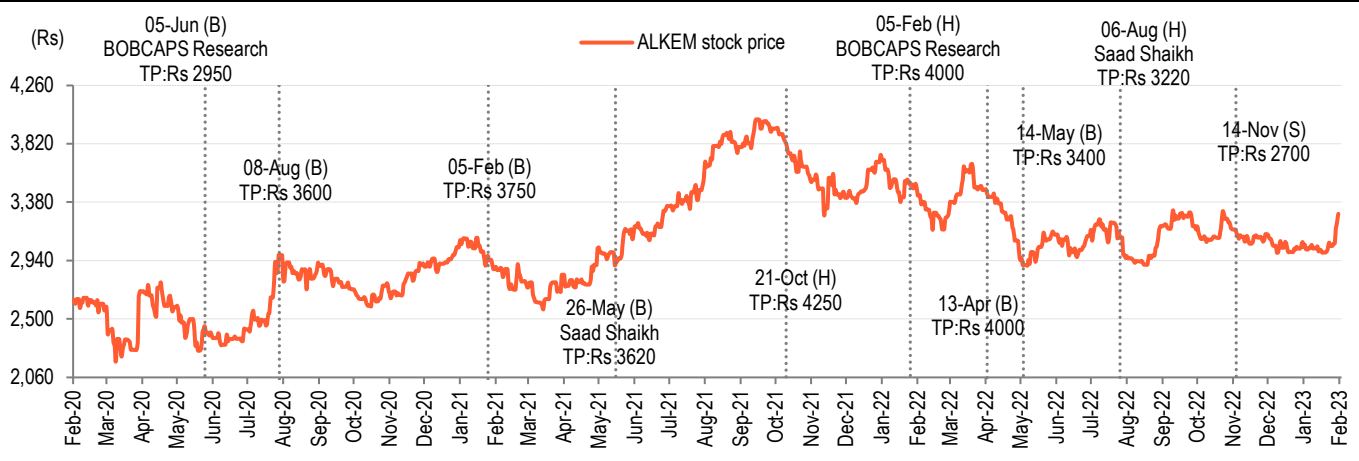
HOLD – Expected return from -6% to +15%

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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