

SELL

TP: Rs 4,800 | ▼ 10%

ALKEM LABS

| Pharmaceuticals

| 10 February 2024

Good quarter; cut to SELL on stretched valuations

- Revenue grew 9% YoY in Q3 backed by strong India and ROW growth that offset lower US business
- EBITDA margin expanded 160bps YoY on a better mix, favourable input prices and reduced intensity of US price erosion
- Downgrade to SELL given 25% rally in 3M; TP raised to Rs 4,800 (vs. Rs 3,850) on higher 18x EV/EBITDA multiple (vs. 16x)

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Strong India growth makes up for US decline: Alkem reported a strong Q3FY24 with 9% YoY revenue growth to Rs 33.2bn. India business grew 12% YoY and ROW markets 47%, compensating for a 10% fall in US revenue. Though price erosion has reduced, US business contracted due to a weaker flu season than last year.

India rebounds after two quarters, ROW growth sustainable: After two quarters of mid-single-digit growth, domestic business rebounded 12% YoY in Q3, driven by the gastrointestinal, anti-diabetic and vitamin & mineral portfolios. Alkem’s anti-diabetic segment continued to grow ahead of the market (by close to 3x). Trade generics fared well too. The 47% uptick in ROW stemmed from a strong international showing, especially in LATAM and Europe, and a low base. Growth was also supported by the launch of limited-competition products in key markets. Management highlighted that Q3 had no one-time sales and current levels of business should sustain.

Better mix and favourable costs boost margins: A decline in low-margin US business and high growth in the India and ROW markets that offer better margins, along with moderating raw material prices, helped Alkem to improve gross/EBITDA margins by 180bps/160bps YoY to 60.8%/21.3% in Q3 (60.6%/18.9% in 9MFY24). Management expects to end FY24 at a lower 17% operating margin considering a seasonally weak fourth quarter and anticipated higher US sales in the product mix.

Earnings call highlights: (1) Cash generation stood at Rs 6bn in Q3. (2) Biosimilar business is guided to break even in FY24. (3) The tax rate is guided to remain low till FY26 due to a tax holiday at the Sikkim facility. (4) Management expects an annual capex run-rate of Rs 3bn-3.5bn at most.

Downgrade to SELL on stretched valuations: We retain FY24-FY26 estimates but raise our target FY26E EV/EBITDA multiple from 16x to 18x – in line with stock’s 5Y average – to reflect the rebound in India business. On rolling over to FY26E valuations, our TP rises to Rs 4,800 (vs. Rs 3,850). The stock has rallied 25% over the past three months and current valuations look expensive at 22.9x/19.5x FY25E/FY26E EV/EBITDA. We thus downgrade our rating from HOLD to SELL.

Key changes

Target	Rating
▲	▼

Ticker/Price	ALKEM IN/Rs 5,328
Market cap	US\$ 7.8bn
Free float	41%
3M ADV	US\$ 15.8mn
52wk high/low	Rs 5,420/Rs 3,042
Promoter/FPI/DII	57%/6%/16%

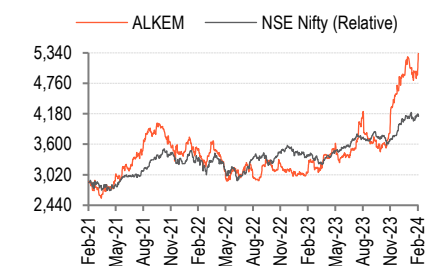
Source: NSE | Price as of 9 Feb 2024

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	17,786	21,426
Adj. EPS (Rs)	90.9	148.8	179.2
Consensus EPS (Rs)	90.9	141.4	163.1
Adj. ROAE (%)	14.4	21.4	22.2
Adj. P/E (x)	58.6	35.8	29.7
EV/EBITDA (x)	39.4	28.1	22.9
Adj. EPS growth (%)	(34.5)	63.6	20.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Net Sales	33,239	30,409	9.3	34,402	(3.4)	97,318	86,967	11.9
EBITDA	7,076	5,991	18.1	7,467	(5.2)	18,435	12,562	46.8
Depreciation	696	784	(11.3)	739	-	2,159	2,321	-
EBIT	6,380	5,206	22.6	6,728	-	16,276	10,241	58.9
Interest	255	271	(5.9)	303	(16.0)	856	784	-
Other Income	936	453	106.6	632	48.2	2,227	1,474	-
PBT	7,062	5,389	31.0	7,057	0.1	17,648	10,931	61.4
Less: Taxation	506	789	-	332	-	1,488	1,540	-
Less: Minority Interest	93	53	-	(56)	-	48	259	-
Recurring PAT	6,463	4,547	42.1	6,782	(4.7)	16,112	9,132	76.4
Exceptional items	(513)	0	-	(577)	-	(1,090)	0	-
Reported PAT	5,950	4,547	30.8	6,205	(4.1)	15,022	9,132	64.5
Key Ratios (%)								
Gross Margin	60.8	58.9	182bps	61.4	(67bps)	60.6	58.0	263bps
EBITDA Margin	21.3	19.7	159bps	21.7	(42bps)	18.9	14.4	450bps
Tax / PBT	7.2	14.6	-	4.7	-	8.4	14.1	-
NPM	19.4	15.0	449bps	19.7	(27bps)	16.6	10.5	-
EPS (Rs)	54.1	38.0	-	56.7	-	134.8	76.4	-

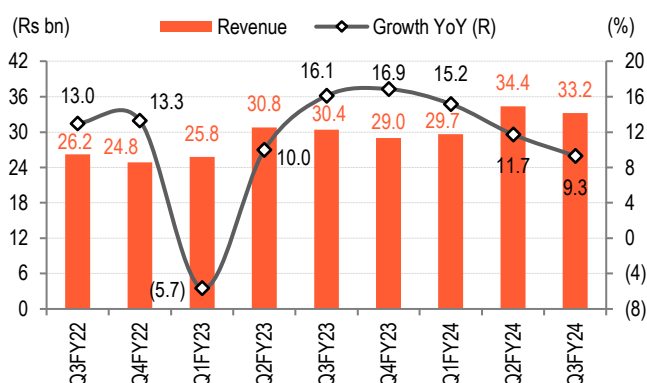
Source: Company, BOBCAPS Research

Fig 2 – Revenue mix

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
India	22,328	19,922	12.1	23,278	(4.1)	64,613	59,898	7.9
US	6,838	7,612	(10.2)	7,675	(10.9)	21,468	19,217	11.7
RoW	3,402	2,316	46.9	2,866	18.7	9,459	6,606	43.2
Net Sales	32,568	29,850	9.1	33,819	(3.7)	95,540	85,721	11.5
Other Op. Income	671	559	20.0	583	15.1	1,778	1,246	42.7
Revenue	33,239	30,409	9.3	34,402	(3.4)	97,318	86,967	11.9
USDINR	83.3	82.4	1.1	83.0	0.3	83	81	2.4
US revenue (US\$ mn)	82	92	(11.1)	92	(11.2)	259	238	9.1

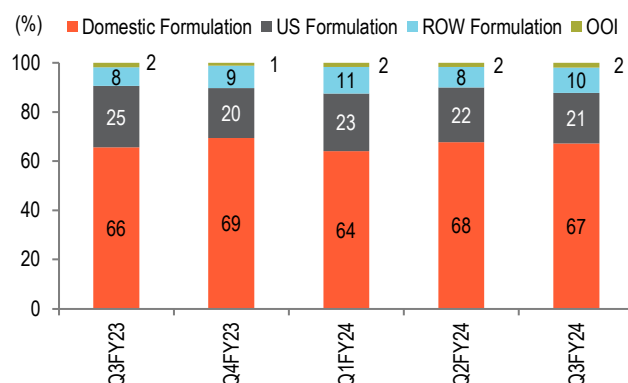
Source: Company, BOBCAPS Research

Fig 3 – Total revenue



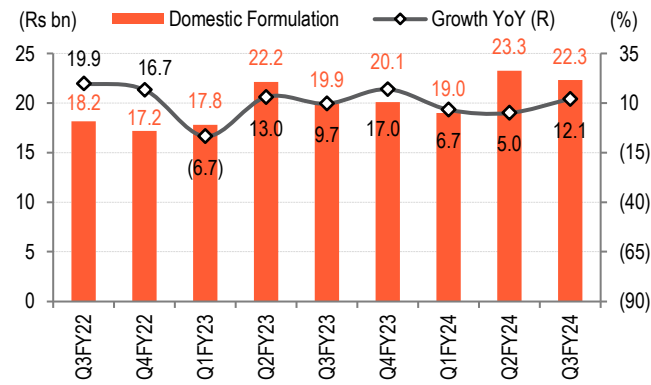
Source: Company, BOBCAPS Research

Fig 4 – Revenue mix



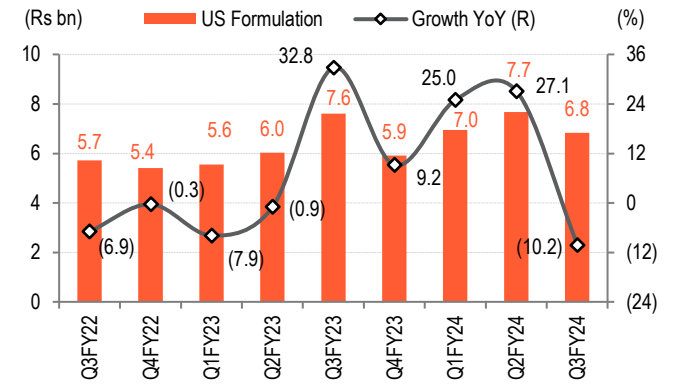
Source: Company, BOBCAPS Research

Fig 5 – Domestic formulation revenue



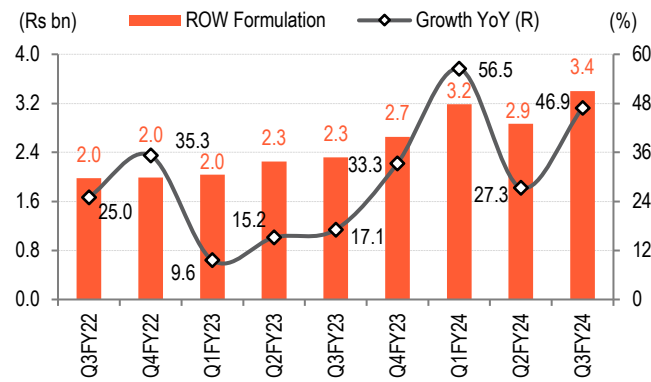
Source: Company, BOBCAPS Research

Fig 6 – US formulation revenue



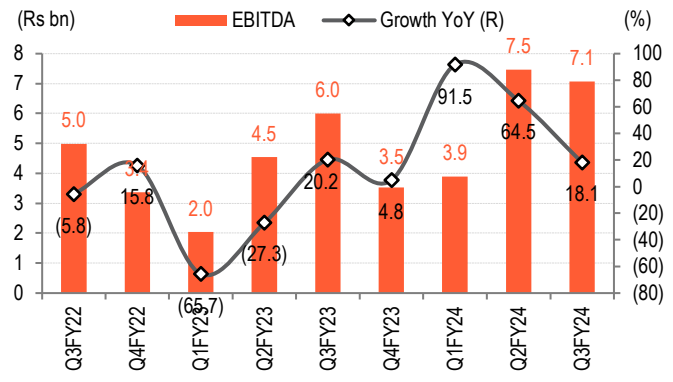
Source: Company, BOBCAPS Research

Fig 7 – ROW formulation revenue



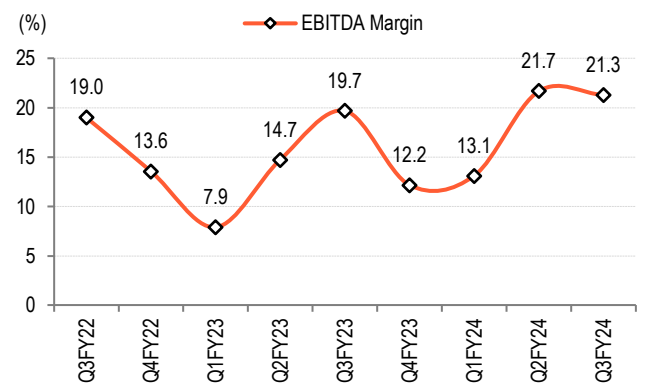
Source: Company, BOBCAPS Research

Fig 8 – EBITDA



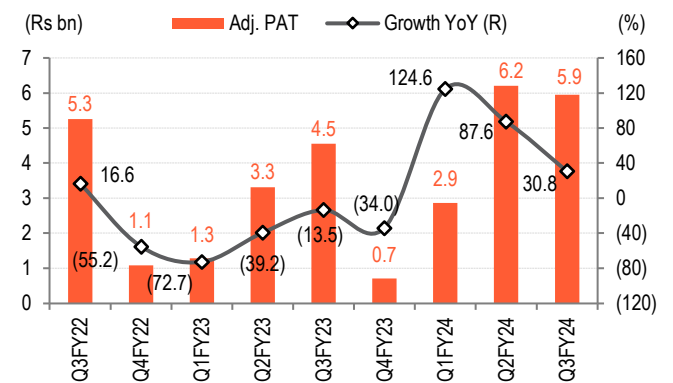
Source: Company, BOBCAPS Research

Fig 9 – EBITDA margin



Source: Company, BOBCAPS Research

Fig 10 – Adj. PAT



Source: Company, BOBCAPS Research

Valuation methodology

We believe lower price erosion in the US, softer raw material costs and recent cost optimisation initiatives would help Alkem sustain EBITDA margins above 17%, with further gradual improvement as the share of chronic business rises in the domestic portfolio. The company continues to invest in its biosimilar franchise and has successfully launched seven products in the domestic market, with the business guided to break even this fiscal year. It is also setting up a facility in the US over the next 2-3 years to cater to the contract manufacturing business focusing on biosimilars.

We retain FY24-FY26 estimates but raise our target FY26E EV/EBITDA multiple from 16x to 18x – in line with stock’s five-year average – to reflect the rebound in India business. On rolling over to FY26E valuations, our TP rises to Rs 4,800 (vs. Rs 3,850). However, the stock has rallied 25% over the past three months and current valuations look expensive at 22.9x/19.5x FY25E/FY26E EV/EBITDA. We thus downgrade our rating from HOLD to SELL.

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	131.8	145.8	159.4	(0.0)	(0.0)	(0.0)
EBITDA	22.4	26.9	31.1	22.4	26.9	31.1	0.0	0.0	0.0
EBITDA margin (%)	17.0	18.5	19.5	17.0	18.5	19.5	0bps	0bps	0bps
EPS (Rs)	149	179	208	147	182	210	1.4	(1.4)	(1.0)

Source: BOBCAPS Research

Fig 12 – Key assumptions

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

Source: Company, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- positive surprises on margins stemming from lower US price erosion and softening raw material prices,
- faster growth in chronic sales that can drive margins higher, and
- pickup in the anti-infective therapy segment for the industry as well as the company, as this is a large component of Alkem’s domestic business.

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)	(1,131)	(905)	(724)
Other inc./(exp.)	1,627	2,161	2,591	2,729	3,397
Exceptional items	0	0	0	0	0
EBT	18,592	14,078	20,876	25,591	30,417
Income taxes	1,640	2,980	2,818	3,839	5,171
Extraordinary items	(150)	(1,030)	(1,090)	0	0
Min. int./Inc. from assoc.	347	226	272	326	391
Reported net profit	16,456	9,842	16,696	21,426	24,855
Adjustments	(150)	(1,030)	(1,090)	0	0
Adjusted net profit	16,606	10,872	17,786	21,426	24,855

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	92,598	107,778	125,388
Shareholders' fund	75,381	81,325	92,837	108,017	125,627
Total liab. and equities	127,599	124,542	138,726	155,368	174,773
Cash and cash eq.	25,786	26,169	32,766	42,308	55,006
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	138,726	155,368	174,773

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	6,223	21,331	18,471	21,765	25,355
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)	(1,131)	(905)	(724)
Dividends paid	(4,739)	(3,169)	(5,185)	(6,246)	(7,245)
Other financing cash flows	(258)	(2,836)	485	412	350
Cash flow from financing	4,458	(19,794)	(8,624)	(8,973)	(9,407)
Chg in cash & cash eq.	5,881	383	6,597	9,542	12,698
Closing cash & cash eq.	25,786	26,169	32,766	42,308	55,006

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	137.6	82.3	139.7	179.2	207.9
Adjusted EPS	138.9	90.9	148.8	179.2	207.9
Dividend per share	34.0	22.7	37.2	44.8	52.0
Book value per share	613.0	647.7	744.0	870.9	1,018.2

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	6.0	5.5	4.8	4.2	3.8
EV/EBITDA	31.0	39.4	28.1	22.9	19.5
Adjusted P/E	38.4	58.6	35.8	29.7	25.6
P/BV	8.7	8.2	7.2	6.1	5.2

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	107.5	107.7	109.6
EBIT margin (EBIT/Revenue)	16.4	11.2	14.7	16.3	17.4
Asset turnover (Rev./Avg TA)	29.0	29.4	33.1	33.0	31.9
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.2	1.1	1.1
Adjusted ROAE	24.4	14.4	21.4	22.2	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)	63.6	20.5	16.0
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	13.5	14.7	15.6
Adjusted ROAE	24.4	14.4	21.4	22.2	22.0
ROCE	20.9	15.4	22.1	24.0	24.9
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	17.2	26.3	38.3
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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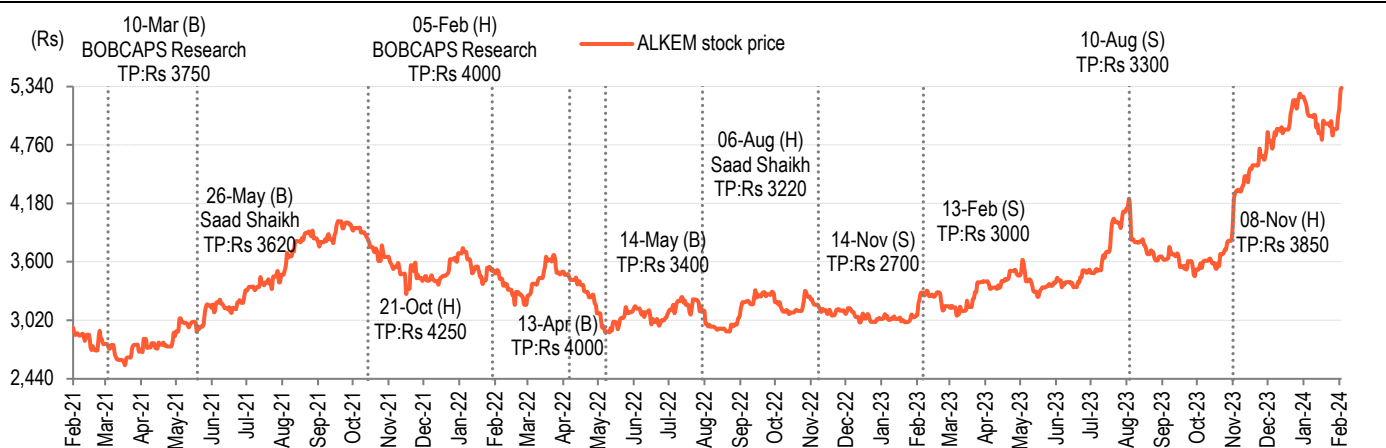
HOLD – Expected return from -6% to +15%

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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