

**BUY**

TP: Rs 3,620 | ▲ 25%

**ALKEM LABS**

Pharmaceuticals

26 May 2021

## Poor US sales and inventory provision affect Q4

Alkem Labs reported a below-expected Q4FY21 with +7%/-4% YoY sales/EBITDA growth. Gross margin was a miss, contracting 470bps QoQ to 57% (due to a Rs 800mn inventory provision), though adj. EBITDA margin was up 215bps YoY. India sales grew strongly at 17% YoY but US sales declined. Alkem is optimistic on US business (double-digit FY22 launches) and expects India sales growth in the mid-teens with >200bps of margin gains over FY20. We cut FY22/FY23 EPS by 8% each and retain BUY with a new Mar'22 TP of Rs 3,620 (vs. Rs 3,750).

Saad Shaikh

researchreport@bobcaps.in

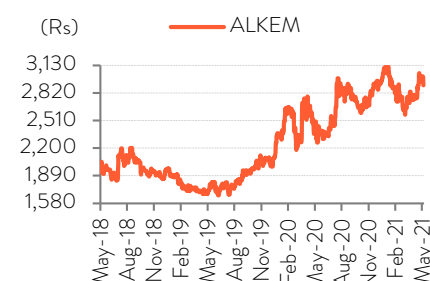
**India trade generics and VMN growth robust:** Double digit growth in the trade generics business (~20% of domestic sales) in Q4, recovery in acute business and continued improvement in prescription (Rx) sales led domestic sales growth of 17% YoY. The VMN/ antidiabetic/gastrointestinal portfolios grew 36%/27%/17% YoY and larger brands continued to do well. US sales declined 11% QoQ to US\$ 75mn due to higher price erosion and the Covid impact. We expect a US/India sales CAGR of 10%/13% over FY21-FY23.

Ticker/Price	ALKEM IN/Rs 2,905
Market cap	US\$ 4.8bn
Shares o/s	120mn
3M ADV	US\$ 8.9mn
52wk high/low	Rs 3,152/Rs 2,222
Promoter/FPI/DII	60%/4%/13%

Source: NSE

**Gross margin hit by inventory write-off:** Gross margin contraction of 470bps QoQ (+63bps YoY) caused EBITDA margin to drop 955bps QoQ (-150bps YoY) to 13.3%. Other factors like front-loading of costs as well as higher employee and selling expenses from staff additions and reversal of pandemic-led savings further weakened operating margins. Alkem expects its gross margin to decline 100bps in FY22 but intends to maintain EBITDA margin via cost control.

## STOCK PERFORMANCE



Source: NSE

**Earnings call highlights:** (1) Launched 12 products in the US out of 19 final approvals. (2) No change in dividend policy or M&A activity on the cards. (3) Tax rate to be 13-14% going forward. (4) Net cash levels at >Rs 5bn. (5) MR strength at 12,000 with 600 added to the acute division. (6) Launched first biosimilar (peptide) in India and planning more rollouts over the next few years.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	73,558	82,983	88,650	99,976	1,11,114
EBITDA (Rs mn)	11,135	14,730	19,424	20,234	23,067
Adj. net profit (Rs mn)	7,298	11,270	15,850	15,313	17,815
Adj. EPS (Rs)	61.0	94.3	132.6	128.1	149.0
Adj. EPS growth (%)	15.7	54.4	40.6	(3.4)	16.3
Adj. ROAE (%)	16.3	22.7	27.6	22.3	21.9
Adj. P/E (x)	47.6	30.8	21.9	22.7	19.5
EV/EBITDA (x)	31.3	23.6	18.0	17.1	14.5

Source: Company, BOBCAPS Research | P – Provisional

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)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	Cons.	Var. (%)	FY21	FY20	YoY (%)
<b>Net Sales</b>	<b>21,922</b>	<b>20,490</b>	<b>7.0</b>	<b>23,181</b>	<b>(5.4)</b>	<b>22,218</b>	<b>(1.3)</b>	<b>88,764</b>	<b>83,443</b>	<b>6.4</b>
<b>EBITDA</b>	<b>2,911</b>	<b>3,030</b>	<b>(3.9)</b>	<b>5,291</b>	<b>(45.0)</b>	<b>3,961</b>	<b>(26.5)</b>	<b>19,538</b>	<b>14,735</b>	<b>32.6</b>
Depreciation	685	810	-	690	-	-	-	2,745	2,526	-
<b>EBIT</b>	<b>2,226</b>	<b>2,220</b>	<b>0.3</b>	<b>4,601</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>16,793</b>	<b>12,209</b>	<b>37.5</b>
Interest	107	141	-	131	-	-	-	589	650	-
Other Income	463	275	-	964	-	-	-	2,217	1,043	-
<b>PBT</b>	<b>2,582</b>	<b>2,354</b>	<b>9.7</b>	<b>5,434</b>	<b>(52.5)</b>	<b>-</b>	<b>-</b>	<b>18,421</b>	<b>12,603</b>	<b>46.2</b>
Less: Taxation	89	438	-	796	-	-	-	2,243	1,105	-
Less: Minority Interest	92	28	-	129	-	-	-	328	222	-
<b>Recurring PAT</b>	<b>2,400</b>	<b>1,889</b>	<b>27.1</b>	<b>4,510</b>	<b>(46.8)</b>	<b>2,853</b>	<b>(15.9)</b>	<b>15,850</b>	<b>11,276</b>	<b>40.6</b>
Exceptional items	0	0	-	0	-	-	-	0	0	-
<b>Reported PAT</b>	<b>2,400</b>	<b>1,889</b>	<b>27.1</b>	<b>4,510</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>15,850</b>	<b>11,276</b>	<b>40.6</b>
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>					<b>(bps)</b>
Gross Margin	57.0	56.3	63	61.7	472	-	-	60.6	59.9	67
EBITDA Margin	13.3	14.8	(151)	22.8	(955)	-	-	22.0	17.7	435
Tax / PBT	3.5	18.6	-	14.6	-	-	-	12.2	8.8	-
NPM	10.9	9.2	173	19.5	(851)	-	-	17.9	13.5	434
<b>EPS (Rs)</b>	<b>20.1</b>	<b>15.8</b>	<b>-</b>	<b>37.7</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>132.6</b>	<b>94.3</b>	<b>-</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT SALES**

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
<b>Formulations</b>								
India	14,732	12,576	17.1	15,140	(2.7)	56,996	54,540	4.5
US	5,435	6,068	(10.4)	6,156	(11.7)	24,513	22,092	11.0
RoW	1,472	1,455	1.2	1,582	(7.0)	5,775	5,287	9.2
<b>Net Sales</b>	<b>21,639</b>	<b>20,099</b>	<b>7.7</b>	<b>22,878</b>	<b>(5.4)</b>	<b>87,284</b>	<b>81,919</b>	<b>6.5</b>
INR/US\$	73	72	1.3	74	(0.8)	74	71	3.8
US sales in \$ terms	75	84	(11.5)	84	(11.0)	332	311	6.9

Source: Company, BOBCAPS Research

### Valuation methodology

Alkem has delivered a strong EBITDA margin beat in FY21 marked by >400bps YoY expansion. 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 20bn 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 cut FY22/FY23 EPS estimates by 8% each to factor in a weaker gross margin outlook following the Q4FY21 results. Our Mar’22 target price thus reduces to Rs 3,620 (vs. Rs. 3,750). We continue to value the stock at a target EV/EBITDA multiple of 19x (implied P/E of 24x). Maintain BUY.

**FIG 3 – REVISED ESTIMATES**

(Rs bn)	New		Old		Change (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Sales	100	111	102	114	(1.9)	(2.1)
EBITDA	20	23	22	25	(6.4)	(6.9)
EBITDA margin (%)	20.2	20.8	21.2	21.8	(97bps)	(106bps)
EPS (Rs)	128	149	139	161	(8.1)	(7.6)

Source: BOBCAPS Research

**FIG 4 – 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 the Indian pharma market (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. 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	FY21P	FY22E	FY23E
<b>Total revenue</b>	<b>73,558</b>	<b>82,983</b>	<b>88,650</b>	<b>99,976</b>	<b>1,11,114</b>
EBITDA	11,135	14,730	19,424	20,234	23,067
Depreciation	1,932	2,526	2,746	2,872	3,222
EBIT	9,203	12,204	16,678	17,362	19,845
Net interest income/(expenses)	(546)	(650)	(589)	(1,002)	(1,002)
Other income/(expenses)	582	1,043	2,332	2,117	2,928
Exceptional items	0	0	0	0	0
EBT	9,239	12,598	18,421	18,477	21,770
Income taxes	1,810	1,105	2,243	2,772	3,483
Extraordinary items	307	0	0	0	0
Min. int./Inc. from associates	131	222	328	393	472
<b>Reported net profit</b>	<b>7,605</b>	<b>11,270</b>	<b>15,850</b>	<b>15,313</b>	<b>17,815</b>
Adjustments	307	0	0	0	0
<b>Adjusted net profit</b>	<b>7,298</b>	<b>11,270</b>	<b>15,850</b>	<b>15,313</b>	<b>17,815</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	9,622	9,541	10,694	13,484	14,986
Other current liabilities	4,435	6,010	7,343	7,875	8,752
Provisions	3,275	4,067	4,874	5,496	6,109
Debt funds	9,025	16,628	16,702	16,702	16,702
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	48,407	53,363	64,262	76,004	89,665
Shareholders' fund	48,646	53,602	64,501	76,243	89,904
<b>Total liabilities and equities</b>	<b>75,003</b>	<b>89,848</b>	<b>1,04,113</b>	<b>1,19,800</b>	<b>1,36,453</b>
Cash and cash eq.	6,615	10,922	19,905	33,940	43,052
Accounts receivables	12,484	16,494	16,072	18,878	20,981
Inventories	14,998	18,188	23,124	21,035	23,379
Other current assets	7,669	9,180	10,072	11,812	13,128
Investments	3,236	2,614	3,328	3,328	3,328
Net fixed assets	25,072	28,821	27,679	29,807	31,585
CWIP	4,930	3,630	3,933	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>1,04,113</b>	<b>1,19,800</b>	<b>1,36,453</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	9,537	13,796	18,596	18,185	21,037
Interest expenses	546	650	589	1,002	1,002
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,411)	(6,425)	(2,115)	1,488	(2,771)
Other operating cash flows	0	0	0	0	0
<b>Cash flow from operations</b>	<b>8,671</b>	<b>8,021</b>	<b>17,070</b>	<b>20,675</b>	<b>19,269</b>
Capital expenditures	(3,991)	(4,500)	(4,000)	(5,000)	(5,000)
Change in investments	1,207	622	(714)	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>(4,714)</b>	<b>(5,000)</b>	<b>(5,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(925)	7,602	75	0	0
Interest expenses	(546)	(650)	(589)	(1,002)	(1,002)
Dividends paid	(1,702)	(2,628)	(3,696)	(3,571)	(4,155)
Other financing cash flows	(1,868)	(4,161)	837	2,933	0
<b>Cash flow from financing</b>	<b>(5,040)</b>	<b>164</b>	<b>(3,374)</b>	<b>(1,640)</b>	<b>(5,157)</b>
<b>Changes in cash and cash eq.</b>	<b>847</b>	<b>4,308</b>	<b>8,982</b>	<b>14,035</b>	<b>9,112</b>
<b>Closing cash and cash eq.</b>	<b>6,614</b>	<b>10,923</b>	<b>19,905</b>	<b>33,940</b>	<b>43,052</b>

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	63.6	94.3	132.6	128.1	149.0
Adjusted EPS	61.0	94.3	132.6	128.1	149.0
Dividend per share	12.2	18.9	26.5	25.6	29.8
Book value per share	395.8	436.0	524.4	622.6	736.9

### Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	4.7	4.2	3.9	3.5	3.0
EV/EBITDA	31.3	23.6	18.0	17.1	14.5
Adjusted P/E	47.6	30.8	21.9	22.7	19.5
P/BV	7.3	6.7	5.5	4.7	3.9

### DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	79.0	89.5	86.0	82.9	81.8
Interest burden (PBT/EBIT)	100.4	103.2	110.5	106.4	109.7
EBIT margin (EBIT/Revenue)	12.5	14.7	18.8	17.4	17.9
Asset turnover (Revenue/Avg TA)	33.2	32.4	29.3	28.7	27.8
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.3	1.3	1.2
Adjusted ROAE	16.3	22.7	27.6	22.3	21.9

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	14.5	12.8	6.8	12.8	11.1
EBITDA	8.3	32.3	31.9	4.2	14.0
Adjusted EPS	15.7	54.4	40.6	(3.4)	16.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.1	17.8	21.9	20.2	20.8
EBIT margin	12.5	14.7	18.8	17.4	17.9
Adjusted profit margin	9.9	13.6	17.9	15.3	16.0
Adjusted ROAE	16.3	22.7	27.6	22.3	21.9
ROCE	17.6	20.7	25.1	22.4	22.8
<b>Working capital days (days)</b>					
Receivables	63	73	67	70	70
Inventory	75	81	97	78	78
Payables	48	42	45	50	50
<b>Ratios (x)</b>					
Gross asset turnover	2.4	2.4	2.3	2.3	2.3
Current ratio	2.4	2.8	3.0	3.2	3.4
Net interest coverage ratio	16.9	18.8	28.3	17.3	19.8
Adjusted debt/equity	0.0	0.1	(0.1)	(0.3)	(0.3)

Source: Company, BOBCAPS Research

## Disclaimer

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

**BUY** – Expected return >+15%

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

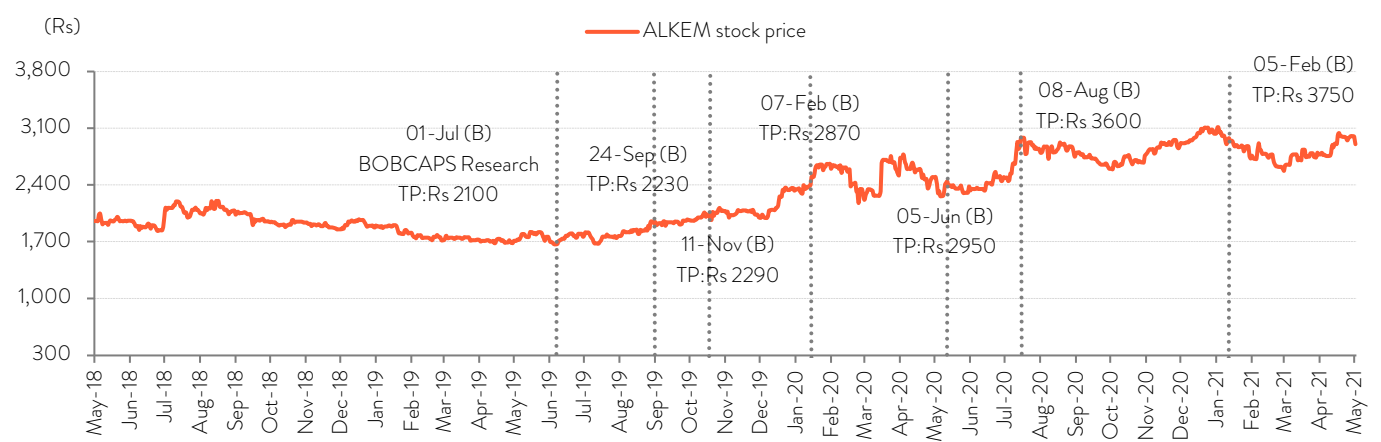
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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, A – Add, R – Reduce, S – Sell

### Rating distribution

As of 30 April 2021, out of 90 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 43 have BUY ratings, 16 have ADD ratings, 5 are rated REDUCE and 26 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.