

BUY

TP: Rs 3,400 | ▲ 17%

ALKEM LABS

| Pharmaceuticals

| 14 May 2022

Q4 revenue in line; margin guidance weak

- Q4 revenue of Rs 24.8bn broadly in line with our estimate; PAT reduced 55% to Rs 1.1bn on account of prior years' tax
- FY23 gross margin guided to contract 150-170bps amid RM inflation and US price erosion; some signs of easing in the latter
- We cut FY23-FY24 EBITDA 3-9% and pare our EV/EBITDA multiple to 15x (vs. 17x) for a new TP of Rs 3,400 (vs. Rs 4,000); retain BUY

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Domestic and ROW markets lead growth in Q4: Alkem's Q4FY22 revenue growth (13% YoY, -5% QoQ) was led by India (+17% YoY) and ROW markets (+35%) while the US remained flat. Domestic (~70% contribution) growth primarily came from acute therapies such as anti-infectives, VMN, gastrointestinal and pain management therapies, further aided by Covid-19 tailwinds. Trade generics contributed 32% in Q4 and branded formulations 68%. The chronic-to-acute breakup of branded formulations was 80:20. Management expects field force addition, the respiratory foray and improving productivity to drive 10-12% growth for the domestic business in FY23.

Elevated price erosion hurt US business: US revenue for the quarter declined ~6% QoQ to US\$ 72mn due to significant pricing pressure in the generic market. Management indicated that pricing pressure is easing and expects 10-12% growth in FY23 based on new launches and stabilising prices. Currently, 50% of the company's 160 ANDAs are yet to be commercialised while it also expects to achieve full potential in 15 of its launched products, which would drive core business in FY23.

FY23 gross margin guided to contract 150-170bps; tax rate to be 13-14%: As seen across the industry, soaring raw material and logistics costs impacted Alkem's gross/EBITDA margin by 350bps/550bps QoQ, resulting in a lower EBITDA margin of 13.6% in Q4 vs. 19.0%/13.3% in Q3FY22/Q4FY21. Management expects a contraction of 150-170bps at the gross margin level in FY23.

Maintain BUY; reduce TP to Rs 3,400: We cut our FY23-FY24 EBITDA estimates by 3-9% and trim our FY24E EV/EBITDA multiple to 15x (earlier 17x) in light of the reduced margin guidance amid persisting cost headwinds and US price erosion. Our TP thus reduces to Rs 3,400 (earlier Rs 4,000). The stock has corrected ~15% in the last one month and is attractively valued at 12x FY24E EV/EBITDA – we thus retain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	ALKEM IN/Rs 2,906
Market cap	US\$ 4.5bn
Free float	39%
3M ADV	US\$ 4.2mn
52wk high/low	Rs 4,070/Rs 2,832
Promoter/FPI/DII	59%/5%/14%

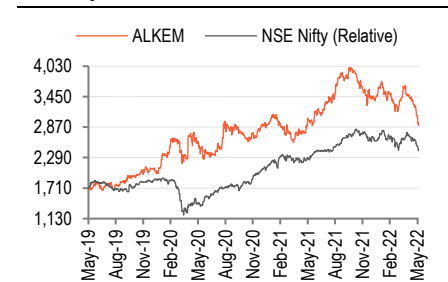
Source: NSE | Price as of 13 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	1,06,342	1,21,297	1,35,977
EBITDA (Rs mn)	20,529	21,851	26,585
Adj. net profit (Rs mn)	16,606	16,385	21,051
Adj. EPS (Rs)	138.9	137.1	176.1
Consensus EPS (Rs)	138.9	158.5	179.0
Adj. ROAE (%)	24.4	20.6	22.4
Adj. P/E (x)	20.9	21.2	16.5
EV/EBITDA (x)	16.9	15.8	12.6
Adj. EPS growth (%)	4.8	(1.3)	28.5

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
Net Sales	24,839	21,922	13.3	26,190	(5.2)	1,06,342	88,764	19.8
EBITDA	3,372	2,911	15.8	4,985	(32.3)	20,529	19,538	5.1
Depreciation	831	685	21.4	775	-	3,040	2,745	-
EBIT	2,541	2,226	14.2	4,210	-	17,490	16,793	4.2
Interest	170	107	58.5	106	-	524	589	-
Other Income	205	463	(55.7)	535	(56)	1,627	2,217	-
PBT	2,576	2,582	(0.2)	4,639	(44.5)	18,592	18,421	0.9
Less: Taxation	1,345	89	-	(694)	-	1,640	2,243	(26.9)
Less: Minority Interest	6	92	-	77	-	347	328	-
Recurring PAT	1,225	2,400	(48.9)	5,257	(76.7)	16,606	15,850	4.8
Exceptional items	(150)	0	-	0	-	(150)	0	-
Reported PAT	1,076	2,400	(55.2)	5,257	(79.5)	16,456	15,850	3.8
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	58.5	57.0	149	61.9	(347)	60.7	60.6	10
EBITDA Margin	13.6	13.3	30	19.0	(546)	19.3	22.0	(271)
Tax / PBT	52.2	3.5	-	(15.0)	-	8.8	12.2	-
NPM	4.9	10.9	(601)	20.1	(1514)	15.6	17.9	(224)
EPS (Rs)	10.3	20.1	-	44.0	-	138.9	132.6	-

Source: Company, BOBCAPS Research

Fig 2 – Regional mix

(Rs mn)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY22	FY21	YoY (%)
India	17,187	14,732	16.7	18,156	(5.3)	74,045	56,996	29.9
US	5,419	5,435	(0.3)	5,731	(5.4)	23,290	24,513	(5.0)
ROW	1,991	1,472	35.3	1,978	0.7	7,783	5,775	34.8
Net Sales	24,597	21,639	13.7	25,865	(4.9)	1,05,118	87,284	20.4
USDINR	75	73	3.2	75	0.4	75	74	1.1
US revenue (US\$ mn)	72	75	(3.4)	76	(5.8)	313	332	(6.0)

Source: Company, BOBCAPS Research

Earnings call takeaways

- **India formulations:** After achieving 17% YoY growth in Q4FY22 and 30% in FY22, Alkem has guided for a 10-12% rise in India formulation revenue in FY23 aided by a 10-11% uptick in acute therapies and over 20% growth in chronic therapies. Trade generics contributed 32% of India sales in Q4 and branded formulations 68%, of which acute therapies comprised 80% and chronic therapies 20%. The pain management, anti-infective and gastrointestinal portfolios were major contributors of growth in FY22. Management expects healthy growth from its foray into pulmonary therapeutic areas.
- **Breakup of India growth:** The 13% increase in India formulation revenue during 4QFY22 contributed by price rise (7% contribution), drug launches (3%) and volume growth (3%). Management expects similar trend in FY23E, with price rise in branded formulations to remain a major contributor.
- **US generics:** Alkem continues to witness pricing pressure due to competitive intensity in its core portfolio. It witnessed price erosion of 11-12% in FY22 and expects high-single-digit erosion in FY23. Despite these headwinds, management has guided for 10-12% growth in US generics in FY23. Alkem has filed 160 ANDAs, of which 50% are not yet commercialised. In addition, ramp-up in 15 launched products would drive core business. The US business contributed 25% of revenue, achieved profit at the EBITDA level and breakeven at the PBT level.
- **Margin headwinds:** Alkem has guided for a 150-170bps impact on gross and EBITDA margins in FY23 vs. FY22 due to inflationary pressure in raw materials, freight and manpower costs. Management, however, observed a softening of raw material prices in Q1FY23. While the EBITDA margin stood at 19.3% in FY22, Alkem has guided for 18% levels in FY23.
- **R&D expense:** R&D expense was at 7% of sales in FY22 and is guided at 5.5-6% for FY23. With no major allocation for biosimilar drugs, US generics account for 90% of the R&D expense.
- **Headcount additions:** With the addition of 1,000-1,200 MRs every year, the company inducted 500 MRs in FY22 which it believes will help drive India formulations growth at 13% YoY in FY23. MR productivity is currently at Rs 600,000 p.a. for acute therapy drugs and Rs 300,000-350,000 for chronic therapy drugs.
- **Tax rate:** While the tax rate stood at 9% in FY22, management has guided for a gradually higher rate of 11-14% from FY23 onwards.
- **Exceptional items:** The company had an exceptional charge of Rs 150mn on account of fair value of investment and income tax of earlier years, besides Rs 910mn due to disallowance of marketing expenses in light of the recent legal pronouncement.

Valuation methodology

We cut our FY23/FY24 EBITDA estimates by 9%/3% and trim our FY24E EV/EBITDA multiple to 15x (earlier 17x) in light of the reduced margin guidance amid persisting headwinds from raw material costs, logistics costs and US price erosion. Our TP thus reduces to Rs 3,400 (earlier Rs 4,000). The stock has corrected ~15% in the last one month and is attractively valued at 12x FY24E EV/EBITDA – we thus retain BUY.

Fig 3 – Revised estimates

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	121.3	136.0	120.0	133.4	1.1	1.9
EBITDA	21.9	26.6	24.1	27.3	(9.2)	(2.6)
EBITDA Margin (%)	18.0	19.6	20.0	20.5	(204bps)	(90bps)
EPS (Rs)	137.1	176.1	158.8	179.4	(13.7)	(1.9)

Source: BOBCAPS Research

Fig 4 – Key assumptions

(Rs bn)	FY22A	FY23E	FY24E
India	74.0	83.7	93.4
US	23.3	26.5	30.3
ROW	7.8	9.7	10.7

Source: Company, BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EBITDA CAGR FY21-24E (%)	EV/EBITDA (x)		ROE (%)		Target EV/EBITDA (x)
					FY23E	FY24E	FY23E	FY24E	
Alkem Labs	ALKEM IN	BUY	3,400	11.0	15.9	13.0	20.6	22.4	15.0
Ajanta Pharma	AJP IN	BUY	2,050	4.1	13.8	12.5	20.1	19.2	15.0
Alembic Pharma	ALPM IN	HOLD	770	3.2	9.9	8.7	11.5	15.0	11.0

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- **Regulatory action and slowdown in India formulation business:** Alkem's current portfolio under NLEM is meaningfully higher than the market. That said, 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:** Disruptive regulatory action in trade generics could be a key risk to the stock since this accounts for ~15-20% of overall domestic sales. Further, any slowdown in Indian pharma market growth and delay in new launches can affect earnings.
- **Poor US execution:** 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 Alkem's top 5 products for the US market could be potential threats to earnings.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	1.9	1,713	2,050	BUY
Alembic Pharma	ALPM IN	1.9	742	770	HOLD
Alkem Labs	ALKEM IN	4.5	2,906	3,400	BUY
Aurobindo Pharma	ARBP IN	4.3	563	850	BUY
Cipla	CIPLA IN	9.7	935	1,100	BUY
Divi's Labs	DIVI IN	14.7	4,281	5,250	BUY
Dr Reddy's Labs	DRRD IN	8.4	3,924	4,700	HOLD
Eris Lifesciences	ERIS IN	1.2	672	970	BUY
Laurus Labs	LAURUS IN	3.7	538	645	HOLD
Lupin	LPC IN	4.1	696	800	HOLD
Sun Pharma	SUNP IN	27.3	883	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 13 May 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Total revenue	82,983	88,650	1,06,342	1,21,297	1,35,977
EBITDA	14,275	19,424	20,529	21,851	26,585
Depreciation	2,526	2,746	3,040	3,222	3,572
EBIT	11,749	16,678	17,490	18,629	23,013
Net interest inc./(exp.)	(650)	(589)	(524)	(1,601)	(1,601)
Other inc./(exp.)	1,043	2,332	1,627	2,065	3,647
Exceptional items	0	0	0	0	0
EBT	12,142	18,421	18,592	19,092	25,059
Income taxes	1,105	2,243	1,640	2,291	3,508
Extraordinary items	0	0	(150)	0	0
Min. int./Inc. from assoc.	222	328	347	416	500
Reported net profit	10,815	15,850	16,456	16,385	21,051
Adjustments	0	0	(150)	0	0
Adjusted net profit	10,815	15,850	16,606	16,385	21,051

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Accounts payables	9,541	10,694	11,734	16,425	18,413
Other current liabilities	6,010	7,343	7,739	9,592	10,753
Provisions	4,067	4,874	6,064	6,916	7,753
Debt funds	16,628	16,702	26,682	26,682	26,682
Other liabilities	0	0	0	0	0
Equity capital	239	239	239	239	239
Reserves & surplus	53,363	64,262	75,142	87,706	1,03,848
Shareholders' fund	53,602	64,501	75,381	87,945	1,04,087
Total liab. and equities	89,848	1,04,113	1,27,599	1,47,560	1,67,688
Cash and cash eq.	10,922	19,905	25,786	48,391	59,386
Accounts receivables	16,494	16,072	18,846	22,995	25,778
Inventories	18,188	23,124	30,055	26,280	29,461
Other current assets	9,180	10,072	16,790	14,389	16,130
Investments	2,614	3,328	3,710	3,710	3,710
Net fixed assets	28,821	27,679	29,017	30,795	32,223
CWIP	3,630	3,933	3,395	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
Total assets	89,848	1,04,113	1,27,599	1,47,560	1,67,688

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22P	FY23E	FY24E
Cash flow from operations	7,566	17,070	6,223	30,632	22,505
Capital expenditures	(4,500)	(4,000)	(5,000)	(5,000)	(5,000)
Change in investments	622	(714)	(382)	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(3,878)	(4,714)	(5,382)	(5,000)	(5,000)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	7,602	75	9,980	0	0
Interest expenses	(650)	(589)	(524)	(1,601)	(1,601)
Dividends paid	(2,522)	(3,696)	(3,872)	(3,821)	(4,909)
Other financing cash flows	(3,811)	837	(543)	2,395	0
Cash flow from financing	620	(3,374)	5,040	(3,027)	(6,510)
Chg in cash & cash eq.	4,308	8,982	5,881	22,605	10,995
Closing cash & cash eq.	10,923	19,905	25,786	48,391	59,386

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22P	FY23E	FY24E
Reported EPS	90.5	132.6	137.7	137.1	176.1
Adjusted EPS	90.5	132.6	138.9	137.1	176.1
Dividend per share	18.1	26.5	27.8	27.4	35.2
Book value per share	436.0	524.4	613.0	718.1	853.1

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22P	FY23E	FY24E
EV/Sales	4.2	3.9	3.3	2.8	2.5
EV/EBITDA	24.4	18.0	16.9	15.8	12.6
Adjusted P/E	32.1	21.9	20.9	21.2	16.5
P/BV	6.7	5.5	4.7	4.0	3.4

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22P	FY23E	FY24E
Tax burden (Net profit/PBT)	89.1	86.0	89.3	85.8	84.0
Interest burden (PBT/EBIT)	103.4	110.5	106.3	102.5	108.9
EBIT margin (EBIT/Revenue)	14.2	18.8	16.4	15.4	16.9
Asset turnover (Rev./Avg TA)	32.4	29.3	29.0	28.0	27.7
Leverage (Avg TA/Avg Equity)	1.3	1.3	1.3	1.4	1.3
Adjusted ROAE	21.8	27.6	24.4	20.6	22.4

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22P	FY23E	FY24E
YoY growth (%)					
Revenue	12.8	6.8	20.0	14.1	12.1
EBITDA	28.2	36.1	5.7	6.4	21.7
Adjusted EPS	48.2	46.6	4.8	(1.3)	28.5
Profitability & Return ratios (%)					
EBITDA margin	17.2	21.9	19.3	18.0	19.6
EBIT margin	14.2	18.8	16.4	15.4	16.9
Adjusted profit margin	13.0	17.9	15.6	13.5	15.5
Adjusted ROAE	21.8	27.6	24.4	20.6	22.4
ROCE	20.0	25.1	20.9	19.1	21.7
Working capital days (days)					
Receivables	73	67	65	70	70
Inventory	81	97	104	80	80
Payables	42	45	41	50	50
Ratios (x)					
Gross asset turnover	2.4	2.3	2.4	2.5	2.5
Current ratio	2.8	3.0	3.6	3.4	3.5
Net interest coverage ratio	18.1	28.3	33.4	11.6	14.4
Adjusted debt/equity	0.1	(0.1)	0.0	(0.3)	(0.3)

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

Disclaimer

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

BUY – Expected return >+15%

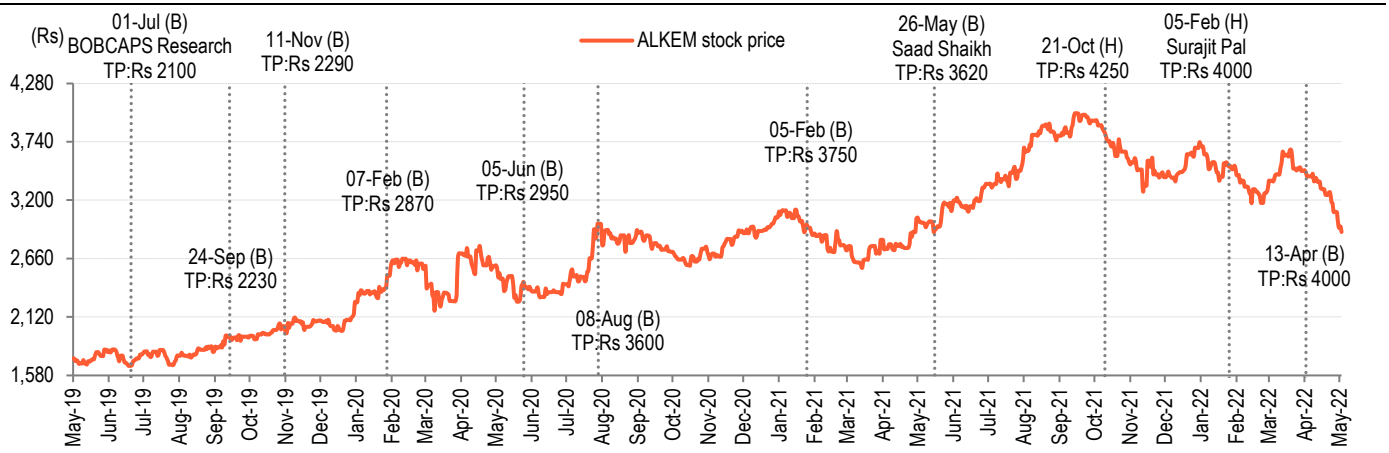
HOLD – Expected return from -6% to +15%

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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