

Q2FY20 RESULT UPDATE | PHARMACEUTICALS

Alkem Laboratories

Lower taxes boost 2Q, margin sustainability remains key

Alkem reported a better than expected Q2 on the back of lower taxes. Revenues (Rs22bn, up 19% YoY) and EBITDA (Rs4.5bn, 20% margin) were in line, led by strong domestic (up 18% YoY) and US (up 12% YoY) business. Reported PAT at Rs3.8bn beat our estimates sharply owing to lower taxes (7% of PBT). Alkem has upgraded its guidance and now expects 15% growth in India on the back of extended seasonality, and it has reiterated the guidance of a 100–150bps expansion in the EBITDA margin in FY20 (vs 15.2% in FY19).

Outlook and valuation: Since the past two years, Alkem's operating performance was impacted by several factors such as (1) price control, (2) demonetisation, (3) API price hikes, and (4) investments in field force and R&D. However, with most factors now in the base, no upfront costs (lesser focus on OTC), a steady decline in API prices, and India growth in the mid-teens, we believe half of this will be recouped over the next two years. Further, recent competition in its key product (Mycophenolate) is likely to be partially offset by newer launches and market share gains in the US. Factoring in the lower tax rate guidance of 10% (vs 15% earlier), we have upgraded our earnings by 10%/7% for FY20/21E, respectively. At the CMP, the stock trades at 20x FY21 EPS of Rs97. Maintain ACCUMULATE.

ACCUMULATE

CURRENT PRICE (INR)

1,964

TARGET PRICE (INR)

2,140

UPSIDE/DOWNSIDE

▲8.9%

PREVIOUS TARGET (INR)

1,980

(CMP as on 11 Nov 2019 closing)

STOCK INFO

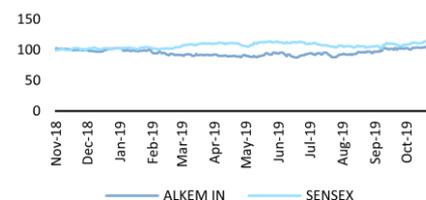
BSE	539523
NSE	ALKEM
Bloomberg	ALKEM IN
Reuters	ALKE.NS
Face Value (Rs)	2
Equity Capital (Rs mn)	239
Mkt Cap (Rs mn)	235,782
52wk High/Low	2,080 / 1,660
Avg Daily Vol (BSE+NSE)	45,606

SHAREHOLDING PATTERN (%)

Promoters	66.04
Public	33.96

(as on Sep, 2019)

PRICE PERFORMANCE



STOCK PERFORMANCE

	3m	6m	12m
Alkem Lab	11.9	13.6	3.1
SENSEX	7.4	7.7	14.8

Source: Bloomberg, IndiaNivesh Institutional Research

Financial Summary

Rs. Mn	FY17	FY18	FY19	FY20E	FY21E
Net sales	57,812	63,130	72,659	82,140	90,978
EBITDA	9,990	10,089	11,148	14,100	16,072
Adj. PAT	8,920	6,309	7,605	10,532	11,607
Adj. EPS (Rs.)	74.6	52.8	63.6	88.1	97.1
EBITDA Margin (%)	17.3	16.0	15.3	17.2	17.7
ROE	21.9	13.5	14.8	18.3	17.9
Adj. P/E (x)	26	37	31	22	20
EV/EBITDA (x)	23.5	23.4	21.1	16.5	14.3

Source: Company, IndiaNivesh Institutional Research

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Conference call takeaways

- **Seasonality favours India:** India formulations grew 18% YoY led by value growth of 23% in Q2. The growth was largely led by the anti-infective portfolio (40% of India sales) growing at 30% in Q2 on the back of seasonality. The acute portfolio, which accounts for 65% of India sales, grew by 15%, whereas the chronic portfolio grew by 24% in Q2. The company is confident of growing above the IPM growth in FY20E and has guided for 15% YoY growth, as chronic growth ramps up coupled with improving productivity. Alkem has 10,000 MRs and is not looking at any additions for the year. Attrition rate remains at par with the industry at 24%.
- **Decent growth in US despite competition in Mycophenolate:** US revenue reported strong growth of 12% YoY, 10% QoQ, aided by market share gains in existing products. Alkem expects the growth momentum to continue in the US despite competition in Mycophenolate and mid-single digit price erosion in the US. This will be driven by the existing portfolio growth and pick-up in the new launch momentum. The management reiterated that strategically, US is an important part of Alkem's business and plans to invest in complex products, implying 5–6% of sales in R&D spend in FY20E. In our view, the generic risk in Mycophenolate can be negated by the Valsartan launch and a stronger pace of approvals. Ex-US business grew 31% YoY, on a lower base with the management indicating focus in key markets to grow by gaining market share.
- **US pipeline:** The company filed 5 ANDAs and received 7 approvals in Q2 leading to 131 filings in all and 54 pending for approval. The scale-up in the US has been impressive although margins are low with low vertical integration. Profitability is expected to improve with scale (10–12 launches/year), better mix, and higher integration into API.
- **Scope for EBITDA margin expansion:** Q2FY20 margin at 20% is the best for Alkem as seen in the recent past and in line with our expectations. Though the management is striving to achieve cost efficiency, improvement in the gross margin was restricted due to the product mix. The management alluded to a one-off impact on gross margins of about 1% due to higher utilization of R&D materials in Q2. Nonetheless, the management reiterated its guidance of 61–62% gross margin led by softening API prices, improving MR productivity, and cost control measures, which will aid EBITDA margin at ~17% for FY20E. If gross margin is maintained at 60–61%, the company should be able to see ~50–100bps EBITDA margin expansion. Further, with lower capex (guided at Rs4–4.5bn for FY20E) from FY21E onwards, we expect operating leverage to play out.
- **In compliance with US regulators:** Baddi and Daman are most critical facilities, which account for ~90% of the pending ANDAs (~40–45% each). Both facilities now stand clear from USFDA the point of view.

Exhibit 1: Quarterly table – Q2FY20

Rs mn	2QFY19	2QFY20	YoY (%)	1QFY20	QoQ (%)	H1FY19	H1FY20	YoY (%)	FY19	FY20E	YoY (%)	FY21E	YoY (%)
Net Sales	18,993	22,194	16.9	18,134	22.4	35,378	40,328	14.0	72,659	82,140	13.0	90,978	11
EBITDA	3,642	4,526	24.3	2,645	71.1	5,784	7,171	24.0	11,148	14,100	26.5	16,072	14
Margin (%)	19%	20%		15%		16%	18%		15%	17%		18%	
Other Income	240.2	314.2	30.8	174.7	79.9	402.7	489	21.4	877.0	631.8	-28.0	646.7	2
Interest	164.0	177.5	8.2	161.2	10.1	326.6	339	3.7	546.3	613.3	12.3	651.6	6
Depreciation	457.7	564.0	23.2	558.3	1.0	882.2	1,122	27.2	1931.8	2255.4	16.8	2543.0	13
PBT	3,260	4,098	25.7	2,100	95.1	4,978	6,199	24.5	9,547	11,863	24.3	13,524	14
Current Tax	656	293	-55.3	227	29.1	1,001	521	-48.0	1,810	1,186	-34.5	1,758	48
Adjusted PAT	2,604	3,805	46.1	1,873	103.2	3,977	5,678	42.8	7,605	10,532	38.5	11,607	10
NPM (%)	13.7	17.1		10.3		11.2	14.1		10.5	12.8		12.8	
EPS	21.8	31.8		15.7		33.3	47.5		63.6	88.1		97.1	

Source: Company, IndiaNivesh Institutional Research

Exhibit 2: Quarterly segmental performance

Rs mn	2QFY19	2QFY20	YoY (%)	1QFY20	QoQ (%)	H1FY19	H1FY20	YoY (%)	FY19	FY20E	YoY (%)	FY21E	YoY (%)
Domestic	13,184	15,503	17.6	12,222	26.8	24,090	27,725	15.1	48,742	56,142	15.2	62,611	11.5
US	4,725	5,276	11.7	4,817	9.5	8,962	10,093	12.6	18,967	20,652	8.9	22,593	9.4
RoW	1,084	1,415	30.5	1,095	29.2	2,326	2,510	7.9	4,950	5,346	8.0	5,774	8.0
Total Sales	18,993	22,194	16.9	18,134	22.4	35,378	40,328	14.0	72,659	82,140	13.0	90,978	10.8

Source: Company, IndiaNivesh Institutional Research

Income Statement (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Net Sales	57,812	63,130	72,659	82,140	90,978
Growth (%)	15.9	9.2	15.1	13.0	10.8
Operating expenses	(48,536)	(53,923)	(62,424)	(69,117)	(76,033)
Operating profit	9,277	9,208	10,234	13,023	14,945
Other operating income	713	881	913	1,077	1,127
EBITDA	9,990	10,089	11,148	14,100	16,072
Growth (%)	17.1	1.0	10.5	26.5	14.0
Depreciation	(1,012)	(1,430)	(1,932)	(2,255)	(2,543)
Other income	1,120	1,154	877	632	647
EBIT	10,098	9,813	10,093	12,476	14,175
Finance cost	(452)	(553)	(546)	(613)	(652)
Exceptional & extraordinary	0	0	0	0	0
Profit before tax	9,646	9,260	9,547	11,863	13,524
Tax (current + deferred)	(600)	(2,876)	(1,810)	(1,186)	(1,758)
P / L form discontinuing operations	0	0	0	0	0
Profit / (Loss) for the period	9,047	6,384	7,736	10,677	11,766
P/L of Associates, Min Int, Pref Div	(126)	(75)	(131)	(144)	(159)
Reported Profit / (Loss)	8,920	6,309	7,605	10,532	11,607
Adjusted net profit	8,920	6,309	7,605	10,532	11,607
Growth (%)	20	(29)	21	38	10

Source: Company, IndiaNivesh Institutional Research

Balance Sheet (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Share capital	239	239	239	239	239
Reserves & surplus	44,437	48,399	54,154	60,656	68,233
Shareholders' funds	44,676	48,638	54,393	60,895	68,472
Minority Interests and others	1,152	1,216	1,326	1,326	1,326
Non-current liabilities	2,955	2,970	4,282	6,426	5,978
Long-term borrowings	1,816	1,307	2,135	4,135	3,135
Other non-current liabilities	1,139	1,663	2,147	2,292	2,844
Current liabilities	16,897	23,833	21,902	24,738	23,871
ST borrowings, Curr maturity	4,779	8,668	6,713	8,713	7,213
Other current liabilities	12,118	15,165	15,190	16,025	16,658
Total (Equity and Liabilities)	65,681	76,656	81,904	93,386	99,647
Non-current assets	36,509	37,504	39,921	42,257	43,859
Fixed assets (Net block)	20,963	26,646	30,234	32,479	33,936
Non-current Investments	2,594	1,965	957	957	957
Long-term loans and advances	4,272	1,145	598	676	749
Other non-current assets	8,680	7,749	8,131	8,144	8,217
Current assets	29,171	39,152	42,161	51,307	55,966
Cash & current investment	6,928	8,246	8,895	14,363	15,606
Other current assets	22,243	30,906	33,267	36,944	40,360
Total (Assets)	65,681	76,656	82,082	93,564	99,825
Total debt	6,595	9,976	8,848	12,848	10,348
Capital employed	53,563	61,492	66,714	77,361	82,989

Source: Company, IndiaNivesh Institutional Research

Cash Flow Statement (consolidated)

Period end (Rs mn)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Profit before tax	9,646	9,260	9,547	11,863	13,524
Depreciation	1,012	1,430	1,932	2,255	2,543
Change in working capital	(4,403)	(2,008)	(1,281)	(2,776)	(2,304)
Total tax paid	(2,353)	(2,382)	(2,444)	(1,186)	(1,758)
Others	451.6	553	546	613	652
Cash flow from oper. (a)	4,354	6,854	8,299	10,770	12,656
Capital expenditure	(2,132)	(7,107)	(5,400)	(4,500)	(4,000)
Change in investments	(1,310)	1,087	1,207	(342)	(393)
Others	(537)	449	238	(13)	(73)
Cash flow from inv. (b)	(3,979)	(5,571)	(3,955)	(4,855)	(4,466)
Free cash flow (a+b)	375	1,282	4,344	5,915	8,191
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	20	3,381	(1,128)	4,000	(2,500)
Dividend (incl. tax)	(1,082)	(2,329)	(2,354)	(3,074)	(3,074)
Others	(371)	1,287	(71)	(1,714)	(1,767)
Cash flow from fin. (c)	(1,433)	2,339	(3,554)	(788)	(7,341)
Net chg in cash (a+b+c)	(1,058)	3,622	790	5,127	850

Source: Company, IndiaNivesh Institutional Research

Key Ratios (consolidated)

Period end (%)	Mar 17	Mar 18	Mar 19	Mar 20E	Mar 21E
Adjusted EPS (Rs)	74.6	52.8	63.6	88.1	97.1
Growth	20.3	(29.3)	20.5	38.5	10.2
CEPS (Rs)	83.1	64.7	79.8	107.0	118.4
Book NAV/share (Rs)	373.7	406.8	455.0	509.4	572.7
Dividend/share (Rs)	6.0	15.0	15.0	20.0	20.0
Dividend payout ratio	12.1	36.9	31.0	29.2	26.5
EBITDA margin	17.3	16.0	15.3	17.2	17.7
EBIT margin	17.5	15.5	13.9	15.2	15.6
Tax rate	6.2	31.1	19.0	10.0	13.0
RoCE	20.4	17.1	15.7	17.3	17.7
Total debt/Equity (x)	0.1	0.2	0.2	0.2	0.1
Net debt/Equity (x)	(0.0)	0.0	(0.0)	(0.0)	(0.1)
Du Pont Analysis - ROE					
Net margin	15.4	10.0	10.5	12.8	12.8
Asset turnover (x)	0.9	0.9	0.9	0.9	0.9
Leverage factor (x)	1.5	1.5	1.5	1.5	1.5
Return on equity	21.9	13.5	14.8	18.3	17.9
Valuation (x)					
PER	26.3	37.2	30.9	22.3	20.2
PCE	23.6	30.3	24.6	18.4	16.6
Price/Book	5.3	4.8	4.3	3.9	3.4
Yield (%)	0.8	1.1	1.2	1.4	1.4
EV/EBITDA	23.5	23.4	21.1	16.5	14.3

Source: Company, IndiaNivesh Institutional Research

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ACCUMULATE		0 to <15%	0 to <20%	0 to <25%
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