

On recovery path

We maintain **BUY** on **ALKEM** despite a big miss on our 1QFY20 estimates. Our TP is 2,180 (22x FY21E EPS) with estimates largely unchanged owing to a sharp recovery expected in the next two quarters following a shift in the seasonally strong quarters (from 1Q earlier to 2Q now).

HIGHLIGHTS OF THE QUARTER

- Following a change in the channel filling strategy, we believe 1Q has now become the seasonally weakest quarter for Alkem's India business, while 2Q and 3Q have become the strongest quarters. This was the key reason for sub-par performance in 1QFY20. India revenues grew 12% YoY to Rs 12.2bn, leading to a 6% miss on our total revenues estimates. We expect India business to grow in double-digits over FY20/21E, in-line with the management's expectations, driven by sustained growth in both acute and chronic therapies.
- US revenue at ~US\$ 69mn was up 14% YoY, despite incremental competition in gMycophenolate during the last quarter. This was largely driven by higher market share in existing products and continued momentum in new product launches over the last six months. Our FY20 revenue estimates with 6-7% growth are much lower due to the fall we expect in gMycophenolate revenues, albeit the management is confident of achieving double-digit growth for the year.

Financial Summary (Consolidated)

Year Ending March (Rs mn)	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)	FY18	FY19	FY20E	FY21E
Net Sales	18,495	16,589	11.5	18,542	(0.3)	64,312	73,572	82,186	94,297
EBITDA	2,645	2,037	29.8	2,350	12.5	10,284	11,148	13,396	16,219
APAT	1,873	1,373	36.4	1,705	9.8	6,809	7,605	9,254	11,914
Diluted EPS (Rs)	15.7	11.5	36.4	14.3	9.8	57.0	63.6	77.4	99.6
P/E (x)						31.4	28.1	23.1	18.0
RoE (%)						14.6	14.8	16.0	18.2

Source: Company, HDFC sec Inst Research

- EBITDA at Rs 2.6bn, up 30% YoY was affected by lower India sales and higher than expected bonus component in the employee cost. The margin at 14.3% was up 202/163bps YoY/QoQ. The sequential improvement in gross margin on account of alleviated pricing pressure in raw materials was a key positive takeaway. On a favorable base, PAT grew 36% YoY in 1QFY20.
- Near-term outlook:** Expect the stock to recover with strong 2QFY20 numbers.

STANCE

With a lower than expected impact of gMycophenolate competition in the US, coupled with the highest top-line growth in India business among large-cap peers (1QFY20), we maintain our FY20/21E revenue estimates for Alkem and model a 13% CAGR over FY19-21E. The profitability, too, is likely to expand by 100-120bps YoY with lower raw material prices and improving business mix. With moderated tax expectations, we model 25% EPS CAGR over FY19-21E. Alkem remains among the fastest-growing companies in the Indian market while its performance in the US also stands out. At CMP, Alkem is available at 18x FY21E EPS. Considering its stable branded business, healthy cashflows (~Rs 8bn annual FCF over FY20/21E), and reasonable return ratios (22% RoIC in FY21E), we believe this is unjustified.

INDUSTRY	PHARMA
CMP (as on 13 Aug 2019)	Rs 1,790
Target Price	Rs 2,180
Nifty	10,926
Sensex	36,958

KEY STOCK DATA

Bloomberg	ALKEM IN
No. of Shares (mn)	120
MCap (Rs bn) / (\$ mn)	214/3,005
6m avg traded value (Rs mn)	91

STOCK PERFORMANCE (%)

52 Week high / low	Rs 2,268/1,660		
	3M	6M	12M
Absolute (%)	4.6	(0.8)	(10.5)
Relative (%)	5.9	(3.0)	(8.1)

SHAREHOLDING PATTERN (%)

	Mar-19	Jun-19
Promoters	66.02	66.03
FIs & Local MFs	5.34	6.31
FPIs	2.44	2.38
Public & Others	26.20	25.28
Pledged Shares*	-	-

Source : BSE, *% of total

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Alkem missed our revenue estimates by 6% owing to lower India sales

R&D spend was at Rs 1bn (5.6% of sales). To be maintained at 5-6% of sales going ahead

Capex for the quarter was at Rs 960mn. Expect Rs 4-4.5bn capex for the full year

Gross debt stood at Rs 10.5bn while net debt was Rs 1.2bn as of Jun-19

Tax rate is to be maintained at 13-14% for FY20E owing to fiscal benefits from investments in manufacturing facilities

Quarterly Financials Snapshot (Consolidated)

Particulars (Rs mn)	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)
Net Sales	18,495	16,589	11.5	18,542	(0.3)
Material Expenses	7,118	6,304	12.9	7,756	(8.2)
Employee Expenses	3,903	3,395	15.0	3,488	11.9
R&D Expenses	1,036	979	5.8	1,392	(25.6)
Other Operating Expenses	3,793	3,875	(2.1)	3,556	6.7
EBITDA	2,645	2,037	29.8	2,350	12.5
Depreciation	558	425		573	
EBIT	2,087	1,613	29.4	1,777	17.4
Other Income	175	268		277	
Interest Cost	161	163		66	
PBT	2,100	1,718	22.3	1,988	5.6
Tax	227	345		283	
Minority Interest	-	-		-	
APAT	1,873	1,373	36.4	1,705	9.8

Source: Company, HDFC sec Inst Research

Margin Analysis

	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)
Material Expenses % Net Sales	38.5	38.0	49	41.8	(334)
Employee Expenses % Net Sales	21.1	20.5	64	18.8	229
R&D Expenses % Net Sales	5.6	5.9	(30)	7.5	(191)
Other Operating Expenses % Net Sales	20.5	23.4	(285)	19.2	133
EBITDA Margin (%)	14.3	12.3	202	12.7	163
Tax Rate (%)	10.8	20.1	(926)	14.2	(342)
APAT Margin (%)	10.1	8.3	185	9.2	93

Source: Company, HDFC sec Inst Research

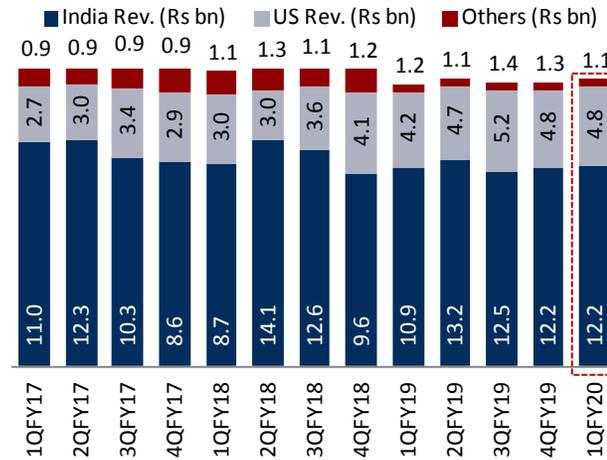
Despite incremental competition in a key product, gMycophenolate, in the US, export sales continue to account for ~33% of revenues

Gross margin expanded 334bps QoQ owing to alleviating RM prices

The management expects a 100-125bps expansion in EBITDA margin yearly over FY19-21E driven by improvement in mix and easing of RM prices

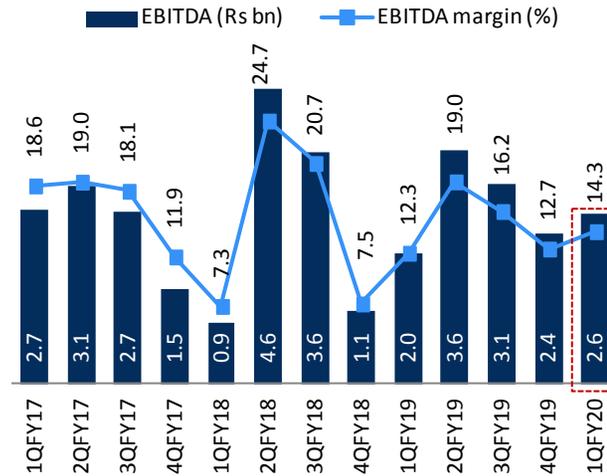
The management aims to maintain dividend payout at 20-25% of profits over the near-term

Revenue: Domestic Sales At ~66% Of Mix



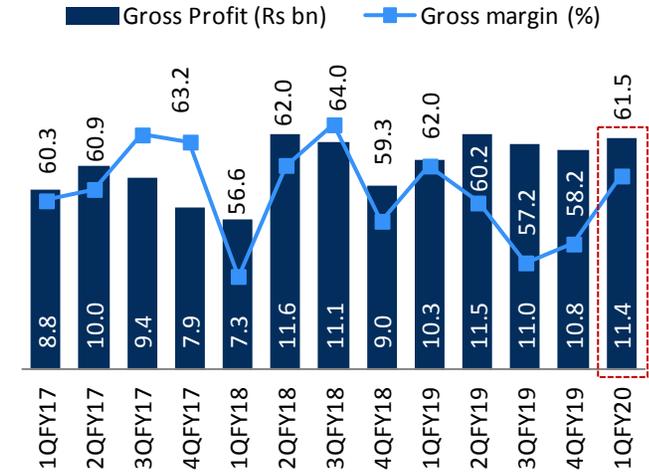
Source: Company, HDFC sec Inst Research

EBITDA Margin: Sequential Recovery To Continue



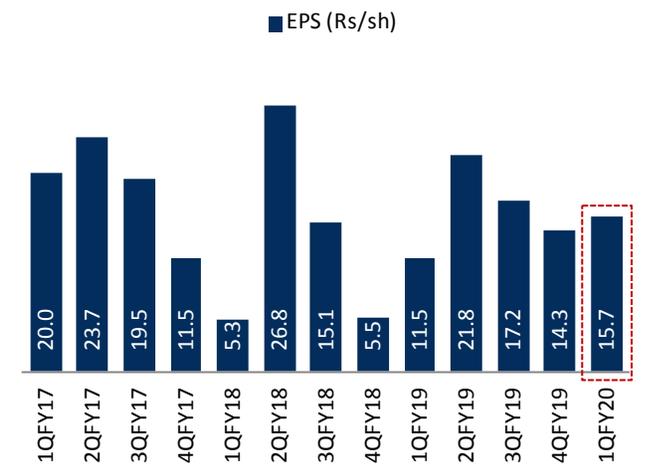
Source: Company, HDFC sec Inst Research

Gross Margin: Expanded 334bps QoQ



Source: Company, HDFC sec Inst Research

EPS: Grew 36% Aided By Lower Taxes



Source: Company, HDFC sec Inst Research

US sales grew 14% YoY, flat QoQ to Rs 4.8bn owing to new launches and market share gains, despite incremental competition in gMycophenolate

India growth of 12.1% YoY was aided by 3.5% volume growth and 5% price growth. With MR strength at ~10,000 now, the co is not planning to add to the count in FY20

While mgmt expects continued double-digit US growth in FY20E, we maintain our conservative estimates in anticipation of higher competitive intensity in gMycophenolate

The domestic biz is to grow at ~13% CAGR over FY19-21E aided by a strong MR base and continued outperformance in key therapies

Segmental Quarterly Performance

(Rs mn)	1QFY20	1QFY19	YoY (%)	4QFY19	QoQ (%)
India	12,222	10,906	12.1	12,176	0.4
US	4,817	4,237	13.7	4,822	(0.1)
RoW	1,095	1,242	(11.8)	1,275	(14.1)
Total	18,134	16,385	10.7	18,273	(0.8)

Source: HDFC sec Inst Research

Assumptions

Key segments (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
India	42,153	44,899	48,742	55,078	62,239
Growth (%)	15.6%	6.5%	8.6%	13.0%	13.0%
US	12,035	13,667	18,967	20,612	25,017
Growth (%)	21.5%	13.6%	38.8%	8.7%	21.4%
RoW	3,624	4,565	4,950	5,445	5,990
Growth (%)	3.4%	28.0%	8.4%	10.0%	10.0%
Total	57,812	63,131	72,659	81,136	93,246
Growth (%)	15.9%	9.2%	15.1%	11.7%	14.9%

Source: HDFC sec Inst Research

Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP/FV	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E
Sun Pharma	1,054	439	BUY	545	12.7	14.9	18.7	24.7	34.6	29.5	23.5	17.7	8.2	9.0	10.4	12.4
Dr Reddy's Labs	425	2,556	BUY	3,360	59.2	104.9	128.4	148.8	43.2	24.4	19.9	17.2	7.8	13.1	14.3	14.5
Divi's Labs	405	1,524	SELL	1,320	32.4	48.8	51.5	60.1	47.1	31.2	29.6	25.4	15.2	20.1	18.7	19.4
Cipla	383	476	NEU	565	18.5	19.0	19.1	25.8	25.7	25.0	25.0	18.4	11.2	10.5	9.7	11.9
Aurobindo Pharma	353	603	BUY	835	41.7	42.9	50.9	55.6	14.5	14.0	11.8	10.9	23.2	19.7	19.5	17.8
Lupin	339	748	NEU	760	38.1	16.4	23.6	34.3	19.6	45.6	31.7	21.8	12.8	5.4	7.6	10.3
Torrent Pharma	280	1,654	NEU	1,615	37.0	40.1	52.5	67.3	44.7	41.2	31.5	24.6	14.0	14.5	17.6	19.5
Cadila Healthcare	225	220	BUY	265	13.0	11.6	11.5	14.6	16.9	18.9	19.0	15.0	17.0	12.4	10.8	12.4
Alkem Laboratories	214	1,790	BUY	2,180	57.0	63.6	77.4	99.6	31.4	28.1	23.1	18.0	14.6	14.8	16.0	18.2
Abbott India	194	9,117	NR	8,990	188.8	211.9	248.6	299.6	48.3	43.0	36.7	30.4	26.1	24.3	24.1	24.5
Glenmark	117	416	BUY	565	17.5	27.4	29.6	35.4	23.8	15.2	14.0	11.7	9.4	13.3	13.1	13.9
Alembic Pharma	100	530	NEU	570	21.9	25.8	25.1	31.6	24.2	20.5	21.1	16.8	20.0	19.7	16.4	18.1
Jubilant Life Sciences	70	438	BUY	845	45.5	53.8	54.1	67.2	9.6	8.1	8.1	6.5	19.3	19.3	16.6	17.7
Strides Pharma	37	417	BUY	650	13.2	6.9	30.4	41.5	31.7	60.7	13.7	10.1	2.9	2.3	9.9	12.3
Laurus Labs	36	338	BUY	470	15.8	10.7	15.0	26.0	21.4	31.6	22.5	13.0	11.9	6.2	9.6	15.1
Dishman Carbogen Amcis	32	197	BUY	375	13.2	16.7	19.6	24.9	14.9	11.8	10.0	7.9	14.6	15.4	15.1	16.4
J B Chemicals & Pharmaceuticals	30	375	NR	485	16.6	24.1	28.9	34.7	22.6	15.5	13.0	10.8	9.9	13.3	14.7	15.6
Suven Life Sciences	30	233	NR	455	9.7	6.8	9.1	10.7	23.9	34.0	25.6	21.7	17.2	10.9	13.2	13.9
Granules India	24	93	BUY	170	5.2	9.3	11.4	13.9	17.9	10.0	8.2	6.7	12.0	16.7	17.5	18.5
Solara Active Pharma Science	11	421	NR	650	2.4	26.0	26.9	43.1	173.9	16.2	15.6	9.8	2.9	13.4	10.9	12.6
Neuland Labs	6	473	BUY	920	10.8	12.8	31.3	65.0	43.7	36.9	15.1	7.3	2.2	2.6	5.6	10.8

Source: HDFC sec Inst Research

Lower tax rate guidance led to the marginal cut to our FY20/21E EPS estimates

Change In Estimates (Consolidated)

Rs mn	Previous			New			% Chg		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Revenue	73,572	82,186	94,297	73,572	82,186	94,297	0.0	0.0	0.0
EBITDA	11,148	13,396	16,219	11,148	13,396	16,219	0.0	0.0	0.0
APAT	7,736	9,405	12,079	7,605	9,254	11,914	(1.7)	(1.6)	(1.4)

Source: HDFC sec Inst Research

Income Statement (Consolidated)

Year Ending March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Net Revenues	58,525	64,312	73,572	82,186	94,297
Growth (%)	15.9	9.9	14.4	11.7	14.7
Material Expenses	22,215	25,129	29,450	33,039	37,247
Employee Expenses	10,039	11,916	13,625	14,793	16,313
R&D Expenses	3,204	3,646	4,622	5,342	6,601
Other Operating Expenses	13,078	13,337	14,728	15,615	17,916
EBITDA	9,990	10,284	11,148	13,396	16,219
EBITDA Margin (%)	17.1	16.0	15.2	16.3	17.2
EBITDA Growth (%)	17.1	2.9	8.4	20.2	21.1
Depreciation	1,012	1,430	1,932	2,219	2,620
EBIT	8,978	8,854	9,216	11,178	13,599
Other Income (Including EO Items)	1,120	960	877	847	1,328
Interest	452	553	546	559	544
PBT	9,646	9,260	9,547	11,466	14,383
Tax (Incl Deferred)	600	2,876	1,810	2,064	2,301
Minority Interest	(126)	(75)	(131)	(148)	(168)
RPAT	8,920	6,309	7,605	9,254	11,914
EO (Loss) / Profit (Net Of Tax)	-	(500)	-	-	-
APAT	8,920	6,809	7,605	9,254	11,914
APAT Growth (%)	20.3	(23.7)	11.7	21.7	28.8
Adjusted EPS (Rs)	74.6	57.0	63.6	77.4	99.6

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year Ending March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	239	239	239	239	239
Reserves	44,437	48,399	54,154	60,995	69,804
Total Shareholders Funds	44,676	48,638	54,393	61,235	70,043
Minority Interest	1,152	1,216	1,326	1,326	1,326
Long Term Debt	2,089	1,307	2,313	2,063	1,814
Short Term Debt	4,506	8,668	7,128	7,128	7,128
Total Debt	6,595	9,976	9,441	9,191	8,942
Net Deferred Taxes	(6,958)	(6,539)	(7,073)	(7,073)	(7,073)
Other Non-current Liabilities & Provns	1,022	1,646	2,144	2,025	2,403
TOTAL SOURCES OF FUNDS	46,487	54,935	60,231	66,703	75,641
APPLICATION OF FUNDS					
Net Block	14,312	19,171	21,499	25,535	27,367
CWIP	4,149	4,502	5,319	3,064	2,613
Goodwill	3,659	3,665	3,806	3,806	3,806
Investments	-	985	957	957	957
Other Non-current Assets	4,841	1,646	1,264	1,457	1,729
Total Non-current Assets	26,960	29,968	32,844	34,819	36,472
Cash & Equivalents	9,523	9,226	8,895	14,671	20,452
Inventories	12,060	14,421	14,999	16,962	18,182
Debtors	7,136	10,805	12,484	12,384	15,501
Other Current Assets	3,039	5,679	5,784	5,784	5,784
Total Current Assets	22,235	30,905	33,267	35,130	39,467
Creditors	7,414	9,607	9,623	10,604	12,035
Other Current Liabilities & Provns	4,817	5,558	5,152	7,312	8,714
Total Current Liabilities	12,231	15,165	14,775	17,916	20,750
Net Current Assets	10,004	15,741	18,492	17,213	18,717
TOTAL APPLICATION OF FUNDS	46,487	54,935	60,231	66,703	75,641

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

Year Ending March (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Reported PBT	9,646	9,260	9,547	11,466	14,383
Non-operating & EO items	(90)	(28)	(534)	-	-
Interest expenses	(592)	(234)	(331)	(288)	(784)
Depreciation	1,012	1,430	1,932	2,219	2,620
Working Capital Change	(2,626)	(5,635)	(2,511)	551	(1,398)
Tax Paid	(2,640)	(2,032)	(1,810)	(2,064)	(2,301)
OPERATING CASH FLOW (a)	4,711	2,762	6,292	11,883	12,520
Capex	(6,344)	(6,770)	(5,077)	(4,000)	(4,001)
Free cash flow (FCF)	(1,633)	(4,009)	1,215	7,883	8,519
Investments	(417)	868	27	-	-
Non-operating Income	3,901	2,229	605	699	1,161
INVESTING CASH FLOW (b)	(2,859)	(3,674)	(4,445)	(3,301)	(2,840)
Debt Issuance/(Repaid)	121	3,574	(535)	(250)	(249)
Interest Expenses	(636)	(553)	(546)	(559)	(544)
FCFE	(2,148)	(988)	134	7,074	7,726
Share Capital Issuance	-	-	-	-	1.00
Dividend	(863)	(2,176)	(2,267)	(2,412)	(3,106)
Others	(4,289)	5,299	1,170	415	(0)
FINANCING CASH FLOW (c)	(5,668)	6,144	(2,178)	(2,806)	(3,898)
NET CASH FLOW (a+b+c)	(3,816)	5,232	(331)	5,776	5,782
EO Items, Others	-	985	957	957	957
Closing Cash & Equivalents	9,523	9,225	8,895	14,671	20,453

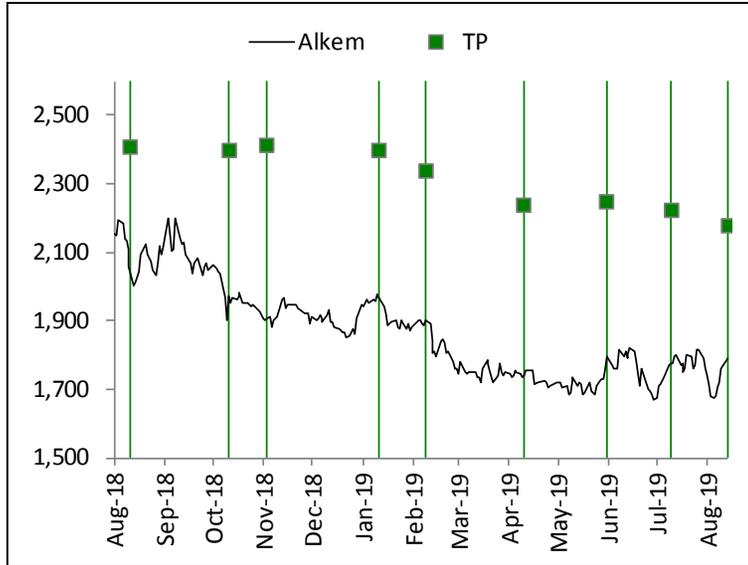
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19	FY20E	FY21E
PROFITABILITY (%)					
GPM	62.0	60.9	60.0	59.8	60.5
EBITDA Margin	17.1	16.0	15.2	16.3	17.2
APAT Margin	15.2	10.6	10.3	11.3	12.6
RoE	21.9	14.6	14.8	16.0	18.2
RoIC (or Core RoCE)	30.0	16.0	15.9	18.2	22.0
RoCE	21.6	14.2	14.0	15.3	17.4
EFFICIENCY					
Tax Rate (%)	6.2	31.1	19.0	18.0	16.0
Fixed Asset Turnover (x)	3.6	2.9	2.8	2.5	2.5
Inventory (days)	75.2	81.8	74.4	75.3	70.4
Debtors (days)	44.5	61.3	61.9	55.0	60.0
Other Current Assets (days)	19.0	32.2	28.7	25.7	22.4
Payables (days)	46.2	54.5	47.7	47.1	46.6
Other Current Liab & Provns (days)	30.0	31.5	25.6	32.5	33.7
Cash Conversion Cycle (days)	62.4	89.3	91.7	76.4	72.5
Debt/EBITDA (x)	0.7	1.0	0.8	0.7	0.6
Net D/E (x)	(0.1)	0.0	0.0	(0.1)	(0.2)
Interest Coverage (x)	19.9	16.0	16.9	20.0	25.0
PER SHARE DATA (Rs)					
EPS	74.6	57.0	63.6	77.4	99.6
Dividend	15.0	10.1	16.0	17.0	21.9
Book Value	373.7	406.8	454.9	512.1	585.8
VALUATION					
P/E (x)	24.0	31.4	28.1	23.1	18.0
P/BV (x)	4.8	4.4	3.9	3.5	3.1
EV/EBITDA (x)	21.1	20.9	19.2	15.6	12.5
EV/Revenues (x)	3.6	3.3	2.9	2.5	2.1
OCF/EV (%)	2.2	1.3	2.9	5.7	6.2
FCF/EV (%)	(0.8)	(1.9)	0.6	3.8	4.2
FCFE/Mkt Cap (%)	(1.0)	(0.5)	0.1	3.3	3.6
Dividend Yield (%)	0.8	0.6	0.9	1.0	1.2

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
11-Aug-18	2,060	BUY	2,410
10-Oct-18	1,969	BUY	2,400
5-Nov-18	1,909	BUY	2,415
10-Jan-19	1,970	BUY	2,400
9-Feb-19	1,904	BUY	2,340
9-Apr-19	1,735	BUY	2,240
31-May-19	1,760	BUY	2,250
9-Jul-19	1,773	BUY	2,225
14-Aug-19	1,790	BUY	2,180

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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