

Alembic Pharma

BUY

CMP Rs863

Target Rs1,100

Upside 27.5%

Focus on underlying business – Upgrade to BUY

Alembic Pharma brings solid visibility to topline growth in the medium term as Rs20bn of capex is monetized from next fiscal. In the current disruptive environment, we reckon stocks with high certainty of earnings would command a disproportionate investor interest and wide premium to sector averages. We believe Alembic Pharma fits the bill as it forays in to onco and general injectables and improves the revenue mix in 3 years. Expect US business to clock 20% cagr ex-Sartans over next 4 years to touch ~US\$450mn in FY24E. Domestic business should rebound and our recovery case is premised on strong close to Q4 FY20 as well as positive management commentary. We assume moderation in gross margin though EBIDTA should pick up pace as US business delivers a topline surge especially after FY22. We raise our target to Rs1,100 and upgrade to conviction BUY as we raise PE multiple to 25x FY22E; While factors like robust execution record, a clean history in terms of FDA compliance and improving FCF profile are positive but known factors, we raise multiple primarily as reckon market would continue to reward companies with visibility on topline and earnings. Key risks include any sustained deceleration in US business and less than market growth in domestic business.

Strong earnings prognosis beyond FY22; upgrade to conviction BUY

We remain bullish on US growth as large capacities build over past 2 years would alter the revenue mix starting from FY22 and peak out after 3 years. Moreover, the US business would also migrate towards a better mix as injectables and derma start contribution vs currently an oral solids portfolio. sterile injectables. Although over next 2 years earnings could face a challenge from higher opex hitting P&L and as sartans ebb away, we believe strong prognosis beyond FY22 gives tremendous support to earnings. Upgrade to BUY with revised PT of Rs1,100 based on 25x FY22E; key risk includes sharp slowdown in US (much lower than 20% cagr assumed) and below market growth in domestic business.

One of the largest spenders on R&D

Alembic Pharma is the one of the largest spenders on R&D in the past two years, measured as a % of total sales and even on an absolute basis, given the size of the company. Indeed, Alembic is significantly punching above its weight with FY20 absolute R&D budget at Rs6bn which is about a third of those of the like of Sun and Lupin whose US sales are ~4-7x that of Alembic. Amongst companies who have a similar US scale, Alembic's closest R&D comparable is Torrent and Alkem though the latter two companies have a nearly 85-90% higher revenue base.

Exhibit 1: Financial summary

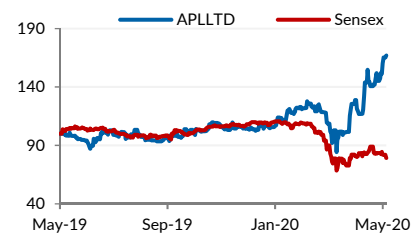
Y/e 31 Mar (Rs m)	FY18	FY19	FY20	FY21E	FY22E
Revenues	31,310	39,347	46,060	49,911	54,528
yoy growth (%)	(0.1)	25.7	17.1	8.4	9.3
Operating profit	6,433	8,736	12,233	12,708	14,182
OPM (%)	20.5	22.2	26.6	25.5	26.0
Reported PAT	4,148	5,844	8,294	8,113	8,314
yoy growth (%)	2.8	40.9	41.9	(2.2)	2.5
EPS (Rs)	22.0	31.0	44.0	43.0	44.1
P/E (x)	40.5	28.7	20.2	20.7	20.2
Price/Book (x)	7.6	6.2	5.2	4.3	3.7
EV/EBITDA (x)	26.8	19.6	14.5	13.8	12.0
Debt/Equity (x)	0.2	0.2	0.3	0.5	0.1
RoE (%)	20.5	24.0	28.4	23.1	19.9
RoCE (%)	19.8	23.5	25.2	18.9	21.9

Source: Company, YES Sec – Research

Stock data (as May 19, 2019)

Sensex:	30,196
52 Week h/l (Rs)	900 /433
Market cap (Rs/USD mn)	162,623/2,189
Outstanding Shares	189
6m Avg t/o (Rs mn):	228
Div yield (%):	0.8
Bloomberg code:	ALPM IN
NSE code:	APLLTD

Stock performance



	1M	3M	1Y
Absolute return	42.8%	39.2%	71.8%

Shareholding pattern (As of Mar '20 end)

Promoter	73.0%
FII+DII	15.2%
Others	11.9%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	ADD
Target Price	1,100	790

Δ in earnings estimates

	FY21e	FY22e
EPS (New)	43.0	44.1
EPS (Old)	42.3	43.8
% change	1.7%	0.7%

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Exhibit 2: Alembic is amongst the largest R&D spenders

R&D	Rs mn	% of sales	US revenues* (US\$ mn)
Alembic	6,000	13.0	282
Alkem	4,900	6.0	300
Ajanta	1,800	8.0	51
Strides	1,020	4.7	225
Natco	1,980	9.3	118
Torrent	6,000	7.5	227
Sun	17,000	5.2	1,580
Lupin	17,350	10.0	840
Dr Reddys'	16,100	9.6	930
Aurobindo	9,750	4.5	1,500
Glenmark	11,800	11.1	465

Source: Companies, YES Sec - Research, *estimated FY20 US revenues

Exhibit 3: Snapshot of upcoming capacities

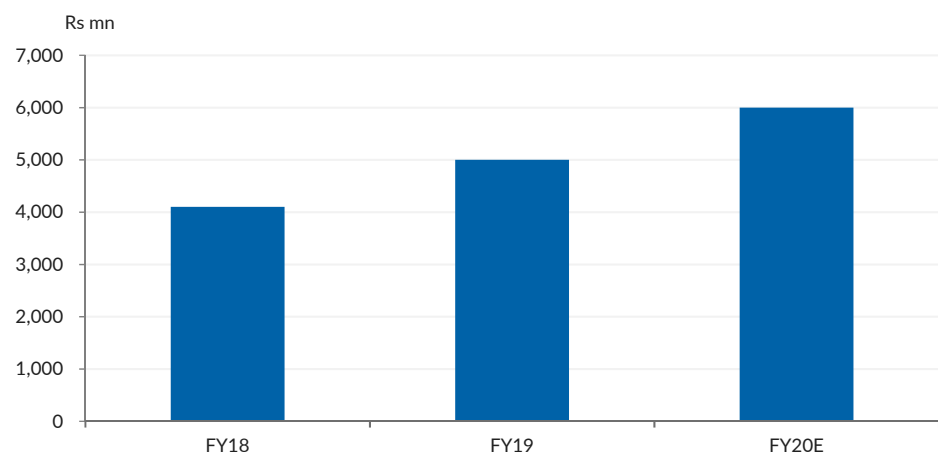
Location	Dosage form	ANDA filing timeline
Jarod - F4	General oral solids	H1 FY21#
Panelav - F1	Oncology oral solids	Jun' 19*
	Oncology injectables	H2 FY21#
	General oral solids	Mar' 20 *
Karkhadi - F3	General injectables	Jan' 20#
	Ophthalmic	
Dermatology JV	Ointment, Shampoo, Tube	Jan' FY20*

Source: Companies, YES Sec - Research

*Last FDA inspection

Filing/expected filing

Exhibit 4: Absolute R&D spends



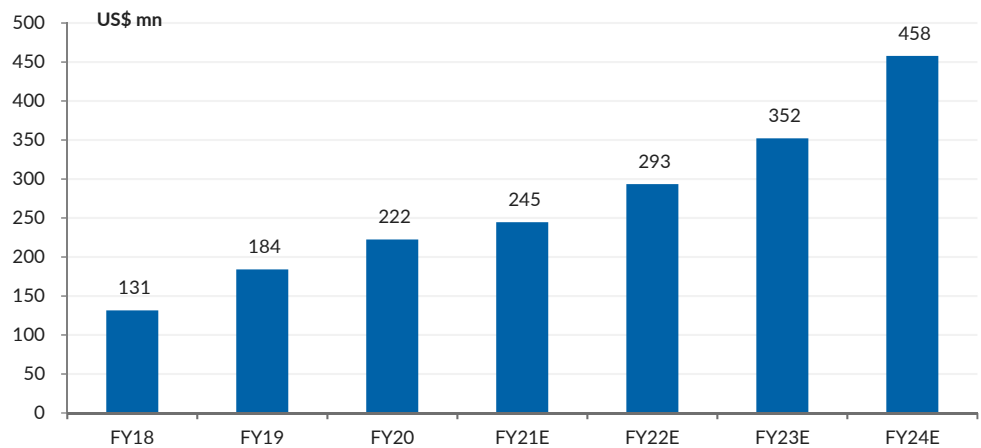
Source: Company, YES Sec - Research

Alembic Pharma

US business can undergo significant scale up as capacities come on stream

Alembic ended FY20 with US business of ~US\$280mn of which we reckon about US\$50-60mn would have accrued from sartans. However, ex-sartans the business can undergo a significant scale up as capacities come on stream in CY20 and filings gain approval from FY22. We highlight that management had shared aspiration of US\$500mn in US sales in next 3-4 years in one of their earnings call. We build in US\$450mn sales in FY24E which implies an asset turn of ~0.5x on incremental US revenues between FY20 and FY24. Alembic management has also been nimble in latching on to sartans opportunities FY20 which has led to sharp jump in quarterly US run rate to ~US\$70mn from US\$50mn 6 months ago. We built in some normalization of US sales as sartans opportunity presumably recede over next two years which would partly offset some of the 12-15 launches on annualized basis. Company has started exhibit batches for both the injectables units and should see the first filing for general injectable in CY20 followed by first filing for onco injectables in H1 FY21. Company would slowly start with regular filings subsequently followed by more complex ones. In terms of competitive scenario, we flag the risk emanating from domestic players like Lupin and Strides who also nurture injectable ambitions. Lupin is expected to file ~10 products annually and Strides is known for its capabilities in building an injectable business.

Exhibit 5: Ex-sartans US revenue base to touch US\$450mn in FY24E

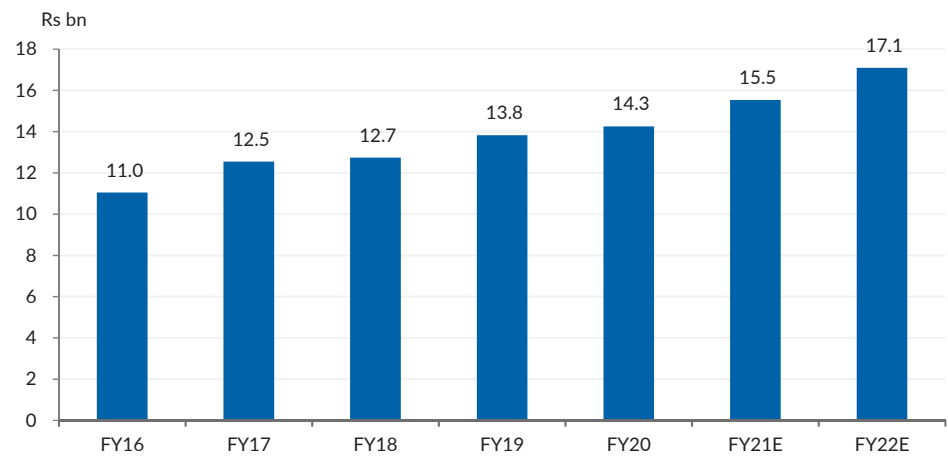


Source: Company, YES Sec – Research

Domestic business virtually flat in FY20; expect return to growth in FY21

Alembic management revealed a clampdown on discounts given to chemists had an impact on 9m FY20 growth which had an impact on FY20 despite a 13% rise in sales in Q4. This compared to 9-13% yoy growth expected for most of the larger peers in FY20. Company indicated COVID has had a neutral impact so far and it expects domestic growth rate to be sustainable at least over the next 3-4 quarters. Specialty grew by 10% while acute business led by Azithromycin posted 24% rise in sales; despite a weak FY20, company has gained market share in key brands. A flat growth indicates company has been foregoing volume growth even as it nets 4-5% price increase in the domestic portfolio. Although management indicated they have been gaining new Rx, a cut in discounting offered to the channel has led to volume underperformance. Management indicated that clampdown is not across the board and it is specific to certain products and stockists. Since company is gaining prescriptions in the absence of volume discounts, underlying business can return to stronger growth once the base effect is digested in the sales.

Exhibit 6: Build in a rebound in domestic sales over FY20-22E

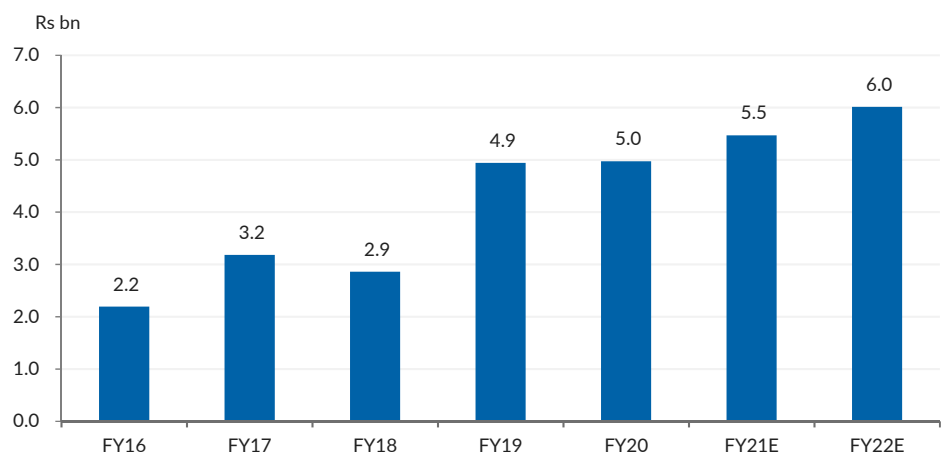


Source: Company, YES Sec - Research

Serialization issue dampened ROW in FY20

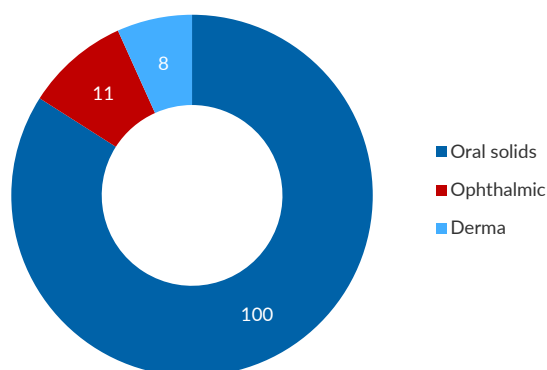
Alembic ROW business has been weak due to serialization issue in Europe which required changes to manufacturing lines to enable traceability. There had been a delay from a vendor and capacity has been blocked due to implementation of the new process. This led to flat revenues yoy in FY20. However, company reiterated there is no change in the demand and though serialization issue at most other pharma players are behind, it appears Alembic was impacted for a longer period of time; management expected ROW markets sales to recover in H2 FY20; although H2 FY20 growth at 26% yoy was slower than previous year's 40%, we bake in recovery at 10% cagr over next two years. API business, as is seen with most other pharma companies, has been on a strong footing as prices have stayed elevated due to disruption in supplies from China. While visibility on API remains robust, we would err on the side of caution and forecast 5% growth in API sales over FY20-22E.

Exhibit 7: Trend in ROW sales - serialization issue impacted Europe sales in FY20



Source: Company, YES Sec - Research

Exhibit 8: Oral solids account for bulk of US filings



Source: Company, YES Sec – Research

Exhibit 9: Domestic therapy market share

	Q4 FY20				Q4 FY19			
	Therapy growth % (ORG)	Market share % (ORG)	Alembic growth % (ORG)	Alembic growth % (PRIM)	Therapy growth % (ORG)	Market share % (ORG)	Alembic growth % (ORG)	Alembic growth % (PRIM)
Cardiology	15	2.0	11	18	11	2.1	16	10
Anti-diabetic	13	1.5	4	12	13	1.6	16	10
Gynecology	8	2.2	9	33	11	2.2	15	(6)
Gastrology	8	1.0	12	9	8	1.0	21	14
Dermatology	7	1.3	(9)	(8)	6	1.5	11	11
Orthopaedic	6	15	(3)	15	4	1.6	11	(10)
Ophthalmology	6	0.3	(19)	(13)	9	0.4	23	16
Nephro / Uro	6	2.5	1(6)	11	11	2.9	32	(3)
Anti-infective	23	4.9	22	22	0	5.0	8	(1)
Cold & Cough	10	3.2	15	28	3	3.0	4	(6)
Overall	10	1.5	7	18	8	1.6	13	0

Source: Company, YES Sec – Research

Exhibit 10: Medium term valuation forecast

Y/e 31 Mar (Rs mn)	FY19	FY20E	FY21E	FY22E	FY23E	FY24E
Revenues	39,347	46,060	49,911	54,528	60,454	71,155
yoy growth (%)	25.7	17.1	8.4	9.3	10.9	17.7
OPM (%)	22.2	26.6	25.5	26.0	24.9	28.6
Reported PAT	5,844	8,294	8,113	8,314	8,947	13,029
yoy growth (%)	40.9	41.9	(2.2)	2.5	7.6	45.6
EPS (Rs)	31.0	44.0	43.0	44.1	47.5	69.1
P/E (x)	27.8	19.6	20.1	19.6	18.2	12.5
P/BV (x)	6.0	5.1	4.2	3.6	3.1	2.5
EV/EBITDA (x)	19.0	14.1	13.4	11.6	10.2	7.0
Debt/Equity (x)	0.2	0.3	0.5	0.1	0.1	0.1
ROE (%)	24.0	28.4	23.1	19.9	18.3	22.3
ROCE (%)	23.5	25.2	18.9	21.9	20.2	24.1

Source: Company, YES Sec – Research

FINANCIALS

Exhibit 11: Balance sheet

Y/e 31 Mar (Rs m)	FY18	FY19	FY20	FY21E	FY22E
Equity capital	377	377	377	377	377
Reserves	21,824	26,811	31,820	38,389	45,159
Net worth	22,201	27,188	32,197	38,766	45,536
Debt	5,408	5,513	10,348	18,000	5,500
Def.tax lia	354	188	(168)	(168)	(168)
Total liabilities	27,963	32,889	42,377	56,599	50,868
Fixed assets	20,037	27,097	33,980	34,448	33,971
Investments	1,128	1,103	1,287	1,103	1,103
Net working capital	6,799	4,689	7,110	21,047	15,794
Inventories	7,339	9,673	11,875	12,868	14,059
Sundry debtors	5,263	4,889	8,648	8,888	9,710
Cash	895	2,064	1,115	9,773	3,080
Other current assets	4,745	2,960	2,987	3,494	3,817
Sundry creditors	(7,593)	(6,443)	(6,259)	(6,782)	(7,410)
Other current liabilities	(3,851)	(8,453)	(11,257)	(7,194)	(7,462)
Misc.exp	-	-	-	-	-
Total assets	27,963	32,889	42,377	56,599	50,868

Source: Company, YES Sec - Research

Exhibit 12: Income statement

Y/e 31 Mar (Rs m)	FY18	FY19	FY20	FY21E	FY22E
Revenue	31,310	39,347	46,060	49,911	54,528
Operating profit	6,433	8,736	12,233	12,708	14,182
Depreciation	(1,055)	(1,152)	(1,573)	(2,063)	(3,077)
Interest expense	(34)	(184)	(272)	(496)	(705)
Other income	90	94	49	94	94
Profit before tax	5,434	7,493	10,437	10,243	10,493
Taxes	(1,204)	(1,568)	(1,992)	(2,049)	(2,099)
Adj. profit	4,231	5,926	8,446	8,194	8,395
Exceptional items	(83)	(82)	285	(81)	(81)
Net profit	4,148	5,844	8,730	8,113	8,314

Source: Company, YES Sec - Research

Exhibit 13: Cash flow statement

Y/e 31 Mar (Rs m)	FY18	FY19	FY20	FY21E	FY22E
Profit before tax	5,434	7,493	10,437	10,243	10,493
Depreciation	1,055	1,152	1,573	2,063	3,077
Def.tax lia	(15)	(167)	(355)	-	-
Tax paid	(1,204)	(1,568)	(1,992)	(2,049)	(2,099)
Working capital Δ	(702)	3,279	(3,370)	(5,280)	(1,440)
Other operating items	(83)	(82)	285	(81)	(81)
Operating cashflow	4,485	10,108	6,578	4,897	9,951
Capital expenditure	(9,135)	(8,212)	(8,457)	(2,531)	(2,600)
Free cash flow	(4,649)	1,896	(1,878)	2,366	7,351
Equity raised	(87)	356	(1,516)	(0)	(0)
Investments	83	24	(184)	184	-
Debt financing/disposal	4,835	106	4,835	7,652	(12,500)
Dividends	(882)	(1,213)	(2,206)	(1,544)	(1,544)
Net Δ in cash	(700)	1,169	(949)	8,657	(6,693)

Source: Company, YES Sec - Research

Exhibit 14: DuPont analysis

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Tax burden (x)	0.78	0.79	0.81	0.80	0.80
Interest burden (x)	0.99	0.98	0.97	0.95	0.94
EBIT margin (x)	0.17	0.20	0.23	0.22	0.21
Asset turnover (x)	0.94	0.90	0.86	0.77	0.80
Financial leverage (x)	1.61	1.77	1.81	1.84	1.62
RoE (%)	20.5	24.0	28.4	23.1	19.9

Source: Company, YES Sec - Research

Exhibit 15: Ratio analysis

Y/e 31 Mar	FY18	FY19	FY20	FY21E	FY22E
Growth matrix (%)					
Revenue growth	(0.1)	25.7	17.1	8.4	9.3
Op profit growth	4.5	35.8	40.0	3.9	11.6
EBIT growth	2.2	40.4	39.5	0.3	4.3
Net profit growth	2.8	40.9	49.4	(7.1)	2.5
Profitability ratios (%)					
OPM	20.5	22.2	26.6	25.5	26.0
EBIT margin	17.5	19.5	23.3	21.5	20.5
Net profit margin	13.5	15.1	18.3	16.4	15.4
RoCE	19.8	23.5	25.2	18.9	21.9
RoNW	20.5	24.0	28.4	23.1	19.9
RoA	12.8	13.6	15.7	12.6	12.3
Per share ratios					
EPS	22.0	31.0	46.3	43.0	44.1
Dividend per share	4.0	5.5	10.0	7.0	7.0
Cash EPS	28.0	37.5	53.1	54.4	60.9
Book value per share	117.8	144.2	170.8	205.6	241.6
Valuation ratios (x)					
P/E	40.5	28.7	20.2	20.7	20.2
P/BV	7.6	6.2	5.2	4.3	3.7
M Cap/Sales	5.4	4.3	3.6	3.4	3.1
EV/EBIDTA	26.8	19.6	14.5	13.8	12.0
Payout (%)					
Tax payout	22.2	20.9	19.1	20.0	20.0
Dividend payout	21.3	20.8	25.3	19.0	18.6
Liquidity ratios					
Debtor days	61	45	69	65	65
Inventory days	86	90	94	94	94
Creditor days	89	60	50	50	50
Leverage ratios					
Interest coverage	160.8	41.7	39.4	21.6	15.9
Net debt / equity	0.2	0.1	0.3	0.2	0.1
Net debt / op. profit	0.7	0.4	0.8	0.6	0.2

Source: Company, YES Sec – Research

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