

Exports leads Q4, growth outlook remains intact

- Alkem reported an in-line operational performance despite a sharp miss in the gross margins while higher other income led to 8% miss in the PAT.
- Revenues (Rs 20bn, up 10% YoY) came in line with estimates as exports led the growth (India grew 3% YoY), gross margins at 56.3% (down 540bps QoQ and 180bps YoY) was impacted due to product mix (higher contribution from trade generics and competition in Mycophenolate in the US) coupled with higher API prices from China.
- Despite poor gross margins, lower fixed costs and employee expenses (15% cost is variable) led to EBITDA margins at 14.8% (up 210bps YoY). PAT at Rs 1.9bn beat our estimates by 8% led by higher other income.

Outlook and Valuation

While Q1 is expected to be soft, management's guidance of ~20% IPM growth outperformance and continuous operational improvement exudes confidence in the underlying business. While seasonality led growth could be challenging, we believe FY21 will be driven by trade generics (Alkem has the 2nd largest trade generics business in India, growing in healthy double digits) and normalized 2H. This along with operating leverage in the US (of the 87 approved products only 50% has been commercialized) is likely to lead to EBITDA margin improvement of 110bps over FY20-22E. However, the aspirational target of 20% EBITDA margins could still take a couple of years. Moderating capex, compliant facilities and improving profitability in the US is expected to boost FCF/EBITDA conversion rate at ~70% by FY22E. We have built in 10% top-line/bottom-line CAGR over FY20-22E. At CMP, the stock trades at 24x/21x FY21/22E EPS. Accumulate with a price target of Rs 2,515 (22x FY22E).

Q4FY20 Result (Rs Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	20,490	18,542	10.5	21,818	(6.1)
Total Expense	17,460	16,192	7.8	17,286	1.0
EBITDA	3,030	2,350	28.9	4,533	(33.1)
Depreciation	631	573	10.1	595	6.0
EBIT	2,400	1,777	35.0	3,938	(39.1)
Other Income	275	277	(0.7)	279	(1.4)
Interest	142	66	114.7	170	(17.0)
EBT	2,713	1,988	36.5	4,046	(32.9)
Tax	398	283	40.7	500	(20.2)
RPAT	2,275	1,705	33.5	3,900	(41.7)
APAT	2,275	1,705	33.5	3,900	(41.7)
			(bps)		(bps)
Gross Margin (%)	56.3	58.2	(182)	61.8	(541)
EBITDA Margin (%)	14.8	12.7	211	20.8	(599)
NPM (%)	11.1	9.2	191	17.9	(677)
Tax Rate (%)	14.7	14.2	45	12.3	234
EBIT Margin (%)	11.7	9.6	213	18.0	(634)

CMP	Rs 2,395
Target / Upside	Rs 2,515 / 5%
BSE Sensex	34,359
NSE Nifty	10,142

Scrip Details

Equity / FV	Rs 239mn / Rs 2
Market Cap	Rs 286bn
	USD 4bn
52-week High/Low	Rs 2,879/Rs 1,660
Avg. Volume (no)	157,240
NSE Symbol	ALKEM
Bloomberg Code	ALKEM IN

Shareholding Pattern Mar'20(%)

Promoters	65.9
MF/Banks/FIs	8.7
FIIIs	3.6
Public / Others	21.8

Valuation (x)

	FY20A	FY21E	FY22E
P/E	25.4	23.9	21.0
EV/EBITDA	19.7	17.0	14.5
ROE (%)	19.4	18.1	18.1
RoACE (%)	18.0	16.6	17.2

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	83,444	90,676	99,835
EBITDA	14,734	16,536	18,856
PAT	11,271	11,960	13,662
EPS (Rs.)	94.3	100.0	114.3

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Exhibit 1: Revenue mix

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Domestic	12,576	12,176	3.3	14,239	(11.7)	54,540	48,742	11.9
US	6,068	4,822	25.8	5,837	4.0	21,997	18,967	16.0
RoW	1,455	1,275	14.1	1,416	2.8	5,382	4,950	8.7
Total Sales	20,099	18,273	10.0	21,492	(6.5)	81,919	72,659	12.7

Source: Company, DART

Concall takeaways

- **Guidance:** Management guided of 60% gross margins in FY21E, despite a soft 1H based on improving product mix (expect hospital based parenteral portfolio to ramp up faster) along with improving US growth profile. This coupled with MR productivity and cost control measures shall aid EBITDA margin expansion, **aspirational target being 20% EBITDA margin in the next 2 years**. Further, with moderating capex (guided at Rs 3.5bn for FY21E), we expect operating leverage to play out.
- **COVID hits India:** India formulations grew 3% YoY in 4Q impacted by supply disruptions, spill over of Rs 1-1.5bn in sales to be seen in Q1. The company is confident of growing above IPM growth in FY21E led by pick-up in parenteral portfolio (anti-bacterial related to surgery, 40% of India sales) and a strong trade generics business. With PCPA at Rs 4.8 Lakh Company endeavours to improve productivity in FY21E. 26% of India sales comes from products under NLEM.
- **US-launch momentum continues:** US revenue reported strong growth of 26% YoY, driven by new product launches and market share gains in existing portfolio. Management highlighted that it has achieved break-even in the US and aims for an ROCE of 15% over the next 4-5 years from this geography. R&D spend guided at 5-6% for FY21E. Alkem's existing products revenue at US\$7-8mn per product is higher compared to Indian peers. While competition impact is in base for Mycophenolate (Q4 saw a major hit), Alkem's strong pipeline at 55 filings pending for approval and only 50% products commercialized from 87 approved, provides ample scope for mid-teens growth. Company guided for 12-15 filings and 10 launches in the US for FY21E.
- **US Pipeline:** Company filed 18 ANDAs and received 23 approvals in FY20 leading to cumulative 144 filings and 55 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.

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	73,572	83,444	90,676	99,835
Total Expense	62,424	68,710	74,141	80,979
COGS	29,450	33,449	35,767	38,608
Employees Cost	13,625	15,055	16,797	18,993
Other expenses	19,350	20,205	21,577	23,378
EBIDTA	11,148	14,734	16,536	18,856
Depreciation	1,932	2,528	2,877	3,176
EBIT	9,216	12,206	13,659	15,680
Interest	546	651	692	737
Other Income	877	1,042	902	887
Exc. / E.O. items	0	0	0	0
EBT	9,547	12,598	13,869	15,831
Tax	1,810	1,105	1,664	1,900
RPAT	7,605	11,271	11,960	13,662
Minority Interest	131	222	245	269
Profit/Loss share of associates	0	0	0	0
APAT	7,605	11,271	11,960	13,662

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	239	239	239	239
Minority Interest	1,326	1,483	1,483	1,483
Reserves & Surplus	54,154	61,368	70,122	80,435
Net Worth	54,393	61,607	70,361	80,674
Total Debt	9,026	16,628	14,670	12,670
Net Deferred Tax Liability	(4,057)	(5,580)	(5,377)	(5,163)
Total Capital Employed	60,689	74,137	81,137	89,664

Applications of Funds

Net Block	26,660	28,985	29,608	29,433
CWIP	3,574	3,725	3,725	3,725
Investments	1,619	1,445	1,494	1,552
Current Assets, Loans & Advances	42,760	55,533	61,591	69,794
Inventories	14,999	18,188	18,637	19,616
Receivables	12,484	16,494	15,924	16,730
Cash and Bank Balances	6,616	10,922	17,356	24,044
Loans and Advances	1,971	2,784	2,585	2,578
Other Current Assets	4,411	5,447	5,390	5,127
Less: Current Liabilities & Provisions	13,924	15,551	15,281	14,840
Payables	9,623	9,541	9,401	9,173
Other Current Liabilities	4,302	6,011	5,880	5,667
<i>sub total</i>				
Net Current Assets	28,835	39,982	46,311	54,954
Total Assets	60,689	74,137	81,137	89,664

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	60.0	59.9	60.6	61.3
EBIDTA Margin	15.2	17.7	18.2	18.9
EBIT Margin	12.5	14.6	15.1	15.7
Tax rate	19.0	8.8	12.0	12.0
Net Profit Margin	10.3	13.5	13.2	13.7
(B) As Percentage of Net Sales (%)				
COGS	40.0	40.1	39.4	38.7
Employee	18.5	18.0	18.5	19.0
Other	26.3	24.2	23.8	23.4
(C) Measure of Financial Status				
Gross Debt / Equity	0.2	0.3	0.2	0.2
Interest Coverage	16.9	18.8	19.7	21.3
Inventory days	74	80	75	72
Debtors days	62	72	64	61
Average Cost of Debt	6.1	5.1	4.4	5.4
Payable days	48	42	38	34
Working Capital days	143	175	186	201
FA T/O	2.8	2.9	3.1	3.4
(D) Measures of Investment				
AEPS (Rs)	63.6	94.3	100.0	114.3
CEPS (Rs)	79.8	115.4	124.1	140.8
DPS (Rs)	27.7	25.6	26.8	28.0
Dividend Payout (%)	43.5	27.2	26.8	24.5
BVPS (Rs)	455.0	515.3	588.6	674.8
RoANW (%)	14.8	19.4	18.1	18.1
RoACE (%)	14.3	18.0	16.6	17.2
RoAIC (%)	17.9	20.8	21.5	24.2
(E) Valuation Ratios				
CMP (Rs)	2395	2395	2395	2395
P/E	37.6	25.4	23.9	21.0
Mcap (Rs Mn)	286,268	286,268	286,268	286,268
MCap/ Sales	3.9	3.4	3.2	2.9
EV	286,399	290,275	281,883	273,195
EV/Sales	3.9	3.5	3.1	2.7
EV/EBITDA	25.7	19.7	17.0	14.5
P/BV	5.3	4.6	4.1	3.5
Dividend Yield (%)	1.2	1.1	1.1	1.2
(F) Growth Rate (%)				
Revenue	14.9	13.4	8.7	10.1
EBITDA	10.5	32.2	12.2	14.0
EBIT	6.4	32.4	11.9	14.8
PBT	3.1	32.0	10.1	14.1
APAT	20.5	48.2	6.1	14.2
EPS	20.5	48.2	6.1	14.2

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	8,299	5,763	16,083	16,101
CFI	(3,955)	(4,098)	(3,549)	(3,059)
CFF	(3,496)	2,641	(6,100)	(6,355)
FCFF	4,344	1,665	12,534	13,043
Opening Cash	5,768	6,616	10,922	17,356
Closing Cash	6,616	10,922	17,356	24,044

E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

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