

Equity Research

August 9, 2020

BSE Sensex: 38041

ICICI Securities Limited is the author and distributor of this report

Q1FY21 result review and earnings revision

Pharmaceuticals

Target price Rs3,500

Earnings revision

(%)	FY21E	FY22E
Sales	1.1	0.9
EPS	21.9	11.3

Target price revision

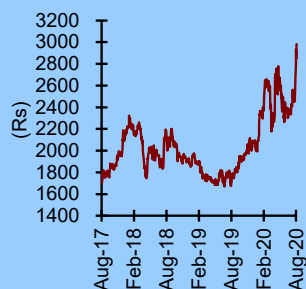
Rs3,500 from Rs2,902

Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	66.0	65.9	62.4
Institutional investors	14.5	15.3	15.5
MFs and others	9.1	8.6	7.9
FIs/Banks/Ins.	2.4	2.7	3.7
FIs	3.0	4.0	3.9
Others	19.5	18.8	22.1

Source: BSE India

Price chart



Research Analysts:

Sriraam Rathi

Sriraam.rathi@icicisecurities.com
+91 22 6637 7574

Vinay Bafna

vinay.bafna@icicisecurities.com
+91 22 6637 7339

INDIA



Alkem Laboratories

BUY

Maintained

Rs2,980

Strong performance and outlook

Alkem Laboratories (Alkem) reported Q1FY21 performance significantly above our estimates on profitability front with beat of 2/85/112% on revenue/EBITDA/PAT front. Revenue growth was healthy at 8.3% YoY to Rs20.0bn (I-Sec: Rs19.6bn) driven by 38.3% increase in US sales. India business contributed ~58% to the revenues and we believe it would be the key value driver for Alkem, though India sales were down 5.5% in Q1FY21 impacted by lockdown. EBITDA margin improved 1,230bps YoY to 26.6% largely driven by impressive cost control with 930bps decline in S,G&A expenses. We remain positive on the long-term outlook given sustainable growth in the domestic market and continued scale-up in US generic business, though near term outlook remains uncertain considering its large acute portfolio. Reiterate BUY.

- **Steady revenue growth despite drop in India sales:** Domestic revenues reported a decline of 5.5% YoY mainly due to nationwide lockdown. There was a spillover of sales from Q4FY20, adjusting for the same the decline would be ~15%. The decline in secondary sales (IQVIA) was 11.8% in Q1FY21 vs industry decline of 4.9%, due to higher acute concentration which was the worst affected during lockdown. US revenues grew 5.1% QoQ to US\$89mn (+29.1% YoY). New launches and market share gain in key products aided the higher than estimated performance. Successful USFDA audits at company's key facilities in past twelve months would ensure filing and launch of new products that would help maintain the growth momentum in US.
- **EBITDA margin surprised positively:** EBITDA margin improved 1,230bps to 26.6% on back of improved gross margin and lower S,G&A expenses. Gross margin improved 190bps led by better product mix and favorable currency. We believe improvement in gross margin and EBITDA margin is partially sustainable. Overall, we expect EBITDA margin improvement of 330bps over FY20-FY22E to be driven by increasing contribution from chronic segments in India, improving MR productivity and controlled costs.
- **Outlook:** We expect Alkem to register 10.6% revenue and 19.5% PAT CAGRs over FY20-FY22E with margin expansion of 330bps to 21.0%. Strong earnings growth along with reduced capex requirement would help in high free cashflow generation of ~Rs25bn over FY21E-FY22E. It would also drive the return ratios, RoE and RoCE higher to 20.8% and 18.1% respectively by FY22E.
- **Valuations and risks:** We raise earnings estimates by 11-22% for FY21E-FY22E to factor in higher US sales, better gross margin profile and lower S,G&A expenses. We raise target P/E to 26x from 24x considering strong India business and improving margin profile leading to better return ratios. We maintain **BUY** with a revised target of Rs3,500/share based on 26x FY22E EPS (earlier Rs2,902/share). Key downside risks: regulatory hurdles and delay in product approvals in the US.

Market Cap	Rs357bn/US\$4.8bn
Reuters/Bloomberg	ALKE.BO/ALKEM IN
Shares Outstanding (mn)	119.6
52-week Range (Rs)	2982/1706
Free Float (%)	34.0
FII (%)	4.0
Daily Volume (USD/'000)	6,085
Absolute Return 3m (%)	16.6
Absolute Return 12m (%)	77.1
Sensex Return 3m (%)	21.7
Sensex Return 12m (%)	4.9

Year to Mar	FY19	FY20	FY21E	FY22E
Revenue (Rs mn)	73,572	83,444	92,378	102,158
Net Income (Rs mn)	7,706	10,957	14,657	16,092
EPS (Rs)	63.6	94.3	122.6	134.6
% Chg YoY	9.4	48.2	30.0	9.8
P/E (x)	46.8	31.6	24.3	22.1
CEPS (Rs)	79.3	115.4	145.4	158.3
EV/E (x)	31.9	24.5	17.7	16.1
Dividend Yield (%)	0.5	0.8	1.0	1.1
RoCE (%)	12.7	15.9	18.0	18.1
RoE (%)	14.8	19.4	22.0	20.8

Please refer to important disclosures at the end of this report

Q1FY21 result and earnings call highlights

Net sales grew 8.3% YoY in Q1FY21 to Rs20.0bn led by growth in export markets.

- **Domestic formulation sales** declined 5.5% YoY and 8.2% QoQ to Rs11.6bn. The sales were impacted due to the nationwide lockdown. Lower patient footfall in OPDs and private clinics affecting new prescriptions caused a decline. This was more pronounced in the acute therapies. Restrictions have eased with gradual improvement of footfalls at OPDs. Anti-infectives and gastro-intestinal fared better than the industry during the quarter. Company expects Q2FY21 to perform better than Q1FY21.

Company's anti-infectives and derma portfolio declined sharply by 22.1% and 35.7% respectively dragging the company's overall growth. Other acute therapies like gastro-intestinal and pain/analgesics also declined. VMN was the only exception with a growth of 3.9% during the quarter. Growth across emerging therapies for Alkem remains strong. Anti-diabetic segment grew 11.7% and cardiac grew 13.9%. Company is the second largest trade generics player in India and is witnessing strong double digit growth in the segment even in the current environment.

Domestic formulations contributed 57.6% to total revenues. Company has a field force of ~11,000. Company doesn't intend to add anymore MRs in FY21. Company utilised digital marketing during the current quarter.

- **US formulation sales** grew 9.8% QoQ and 29.1% YoY to US\$89mn. The growth was driven by new launches and market share gain in existing products. US contributed 33.3% of total revenues. Company launched five products, filed four ANDAs and received two approvals (incl. one tentative approval) during Q1FY21 taking cumulative approvals to 90 including 13 tentative approvals. In total, the company has filed 148 ANDAs including two NDA. Company expects to file 12-15 ANDAs and launch ~10-12 products in FY21.
- **Exports to other international markets** grew 8.6% YoY to Rs1.2bn, contributing 5.9% of total revenues during the quarter. Chile and Kazakhstan registered healthy growth during the quarter.
- **Gross margin** improved 190bps YoY and 710bps QoQ to 63.4% in Q1FY21 compared to 61.5% in Q1FY20 with improving business and product mix. Controlled other expenses aided **EBITDA margin** expansion of 1230bps YoY (+1180bps QoQ) to 26.6%.
- **Adjusted PAT** grew 127.5% YoY to Rs4.2bn with strong operational.
- **Capex** is expected to be Rs3.5bn for FY21.
- R&D expenses for the company stood at 5.9% for the quarter. Alkem expects R&D expenses to be ~5-6% of sales for FY21 with a large part geared to the international market.
- **Effective tax rate** for the company would be ~12-14% for FY21E.

Table 1: Q1FY21 result review

(Rs mn, year ending March 31)

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Net Sales	20,035	18,495	8.3	20,490	(2.2)
EBITDA	5,332	2,645	101.6	3,030	75.9
Other income	435	175	149.0	275	58.4
PBIDT	5,767	2,820	104.5	3,305	74.5
Depreciation	668	558	19.7	631	6.0
Interest	171	161	6.1	142	20.8
PBT	4,928	2,100	134.6	2,353	109.4
Tax	696	227	206.0	438	59.0
Minority Interest	12	18	(35.2)	28	(57.4)
Adjusted PAT	4,220	1,855	127.5	2,034	107.5
Extra ordinary income/ (exp.)	-	-		(180)	
Reported PAT	4,220	1,855	127.5	1,888	123.6
EBITDA margins (%)	26.6	14.3	1230bps	14.8	1180bps

Source: Company data, I-Sec research

Table 2: Revenue mix

(Rs mn, year ending March 31)

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Domestic	11,550	12,222	(5.5)	12,576	(8.2)
Exports	7,853	5,912	32.8	7,523	4.4
US	6,664	4,817	38.3	6,068	9.8
Others	1,189	1,095	8.6	1,455	(18.3)
Other Op Income	632	361	75.0	391	61.7
Total	20,035	18,495	8.3	20,490	(2.2)

Source: Company data, I-Sec research

Revising sales and earnings estimates

For FY20-FY22E, we forecast net sales and earnings to increase at CAGRs of 10.6% and 19.5% respectively. We raise earnings estimates by 11-22% for FY21E-FY22E to factor in higher US sales, better gross margin profile and lower S,G&A expenses.

Table 3: Earnings revision

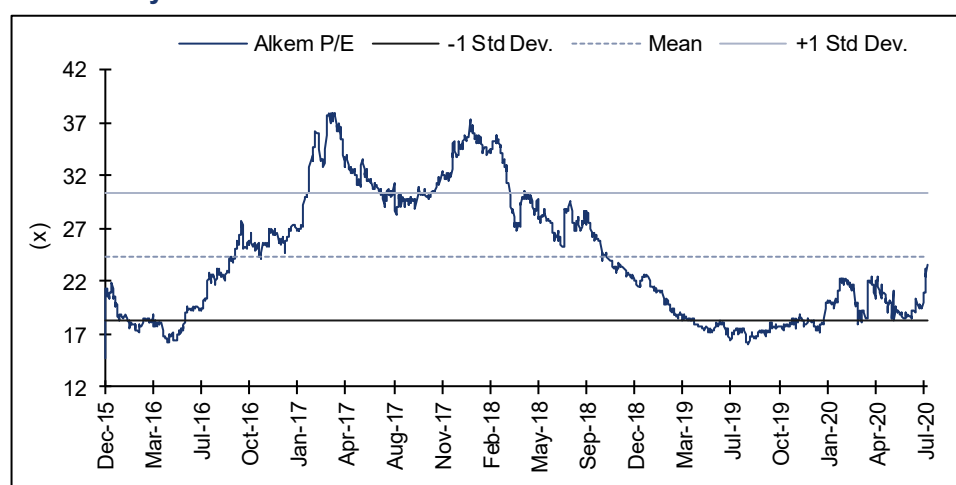
	FY21E	FY22E
Total sales (Rs mn)		
Sales – new	92,378	102,158
Sales – old	91,366	101,251
Change (%)	1.1	0.9
EPS (Rs)		
EPS – new	122.6	134.6
EPS – old	100.6	120.9
Change (%)	21.9	11.3

Source: I-Sec research

Valuations

We expect Alkem to witness an earnings CAGR of 19.5% over FY20-FY22E driven by revenue CAGR of 10.6% and EBITDA margin expansion to 21.0% in FY22E from 17.7% in FY20. Return ratios (RoE and RoCE) would improve with margin expansion led by strong growth in India. The stock currently trades at valuations of 24.3x FY21E and 22.1x FY22E earnings and EV/EBITDA multiple of 17.7x FY21E and 16.1x FY22E. We remain positive on the long-term outlook considering the company's strong brand presence in the domestic market with sustainable growth and scale-up of US generic business (58 pending ANDAs). We raise target P/E to 26x from 24x considering strong India business and improving margin profile leading to better return ratios and maintain **BUY** with a revised target price of Rs3,500/share based on 26x FY22E earnings (earlier Rs2,902/share based on 24x FY22E).

Chart 1: 1-year forward P/E



Source: Company data, I-Sec research

Summary financials (consolidated)

Table 4: Profit & Loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Domestic	48,742	54,540	58,416	65,377
Exports	23,917	27,379	32,354	35,056
Total Gross Sales	72,659	81,920	90,770	100,433
Excise	-	-	-	-
Other Operating Income	913	1,524	1,608	1,725
Total Net Revenue	73,572	83,444	92,378	102,158
YoY Growth%	14.9	13.4	10.7	10.6
Total Op. Exp.	62,379	68,710	72,368	80,688
EBITDA	11,193	14,734	20,009	21,470
Margins %	15.2	17.7	21.7	21.0
YoY Growth%	8.1	31.6	35.8	7.3
Depreciation	1,877	2,528	2,728	2,838
EBIT	9,316	12,206	17,282	18,632
Other Income	877	1,042	1,146	1,261
Interest	546	651	715	471
EO Items	-	-	-	-
PBT	9,647	12,598	17,714	19,422
Tax	1,810	1,419	2,834	3,107
Tax Rate (%)	18.8	11.3	16.0	16.0
Minority Interest	131	222	222	222
Reported PAT	7,706	10,957	14,657	16,092
Adj. PAT	7,706	10,957	14,657	16,092
Net Margins (%)	10.5	13.1	15.9	15.8

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Paid-up Capital	239	239	239	239
Reserves & Surplus	54,154	61,368	71,610	82,854
Total Equity	54,393	61,607	71,849	83,093
Minority Interest	1,326	1,483	1,705	1,928
Total Debt	9,441	17,009	12,049	7,094
Deferred Liabilities	(7,073)	(9,326)	(9,326)	(9,326)
Capital Employed	58,087	70,773	76,278	82,789
Current Liabilities	16,919	19,335	20,762	22,918
Total Liabilities	75,006	90,108	97,040	105,707
Net Fixed Assets	30,234	32,710	33,482	34,644
Investments	957	915	1,013	1,120
Inventory	14,999	18,188	19,157	21,359
Debtors	12,484	16,494	18,260	20,193
Other Current Assets	7,437	9,180	10,144	11,198
Cash and Equivalents	8,895	12,621	14,985	17,193
Total Cur. Assets	44,772	57,398	63,557	71,063
Total Assets	75,006	90,108	97,040	105,707

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
PBT (Adj. for Extraordinary)	9,547	12,598	17,714	19,422
Depreciation	1,877	2,528	2,728	2,838
Net Chg in WC	(2,041)	(5,429)	(2,307)	(3,074)
Taxes	(2,511)	(2,834)	(2,834)	(3,107)
Others	379	(1,662)	36	40
CFO	7,250	5,200	15,336	16,118
Capex	(5,269)	(3,476)	(3,500)	(4,000)
Net Investments made	1,662	(4,454)	(98)	(107)
Others	443	517	-	-
CFI	(3,164)	(7,414)	(3,598)	(4,107)
Change in Share capital	-	-	-	-
Change in Debts	(1,057)	5,838	(4,959)	(4,955)
Div. & Div Tax	(2,186)	(4,396)	(4,415)	(4,847)
Others	5	5,077	-	-
CFF	(3,238)	6,519	(9,374)	(9,802)
Total Cash Generated	848	4,306	2,364	2,208
Cash Opening Balance	5,768	6,616	10,922	13,286
Cash Closing Balance	6,616	10,922	13,286	15,494

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Adj EPS	63.6	94.3	122.6	134.6
YoY Growth%	9.4	48.2	30.0	9.8
Cash EPS	79.3	115.4	145.4	158.3
EBITDA - Core (%)	15.2	17.7	21.7	21.0
NPM (%)	10.5	13.1	15.9	15.8
Net Debt to Equity (x)	0.0	0.1	(0.0)	(0.1)
P/E (x)	46.8	31.6	24.3	22.1
EV/EBITDA Core (x)	31.9	24.5	17.7	16.1
P/BV (x)	6.4	5.6	4.8	4.2
EV/Sales (x)	4.8	4.3	3.8	3.4
RoCE (%)	12.7	15.9	18.0	18.1
RoE (%)	14.8	19.4	22.0	20.8
RoIC (%)	13.2	16.1	18.3	18.8
Book Value (Rs)	455	515	601	695
DPS (Rs)	16.0	23.6	30.7	33.7
Dividend Payout (%)	25.2	25.0	25.0	25.0
Div Yield (%)	0.5	0.8	1.0	1.1
Asset Turnover Ratio	1.0	1.0	1.0	1.0
Avg Collection days	58	63	69	69
Avg Inventory days	73	73	74	72

Source: Company data, I-Sec research

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

*New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return*

ANALYST CERTIFICATION

I/We, **Sriiram Rathi, CA; Vinay Bafna, MBA;** authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. ICICI Securities Limited is a SEBI registered Research Analyst with SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icicidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.