

### In-line 2Q, upping the ante with biosimilars

Alkem reported an in-line 2Q driven by exports and speedy recovery in India. Despite an acute heavy portfolio, India formulations were flattish YoY, up 35% QoQ exhibiting a sharp recovery aided by double digit growth in trade generics. US (\$84mn) was strong with 12% CC growth backed by new launches and market share gains. As marketing and promotional activities resume slowly in India (~70%), EBITDA margins came 120bps lower sequentially at 25.4%. However, with promotional activities resuming normalcy we expect 2H to report margins of 15-16%, slightly better than historical average as digital marketing gains traction. Management commentary remained upbeat on the growth trajectory in the US as profitability improves with an aspirational RoCE target of 15%. On the biosimilar front, company plans to launch 2 peptides and 1 Mab in 4Q, moving up the value chain. Besides, the established brands in India continue to do well ably supported by Gx and chronic segment.

Alkem has built a decent platform for growth in the US with its diversified manufacturing base (6 FDA approved facilities including 2 in the US), pipeline of ~90 ANDAs (only 50% commercialized) and front-end presence. US business targets 12-15 filings and ~10 launches p.a. With sales force expansion spend in base and enhanced digital marketing tools, we expect steady EBITDA margin at ~20% over FY21-23E vs 17% earlier. No major capex, compliant facilities and improving profitability in the US is expected to boost FCF/EBITDA conversion rate at ~70% by FY23E. We introduce FY23 numbers and pencil in 11% revenue CAGR and 14% PAT CAGR over FY21-23E. At CMP, the stock trades at 21.6x/18.7x FY22/23E earnings. We upgrade to BUY with a price target of Rs3,290 (22x FY23E).

### Q2FY21 Result (Rs Mn)

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Revenue	23,628	22,640	4.4	20,035	17.9
Total Expense	17,623	18,114	(2.7)	14,703	19.9
EBITDA	6,005	4,526	32.7	5,332	12.6
Depreciation	702	564	24.5	668	5.1
EBIT	5,303	3,962	33.8	4,664	13.7
Other Income	355	314	13.1	435	(18.3)
Interest	180	178	1.6	171	5.5
EBT	5,478	4,098	33.7	4,928	11.2
Tax	662	293	125.8	696	(4.8)
RPAT	4,815	3,805	26.6	4,232	13.8
APAT	4,815	3,805	26.6	4,232	13.8
			(bps)		(bps)
Gross Margin (%)	60.5	60.1	42	63.4	(290)
EBITDA Margin (%)	25.4	20.0	542	26.6	(120)
NPM (%)	20.4	16.8	357	21.1	(74)
Tax Rate (%)	12.1	7.2	493	14.1	(202)
EBIT Margin (%)	22.4	17.5	494	23.3	(84)

CMP	Rs 2,753
Target / Upside	Rs 3,290 / 20%
NIFTY	12,264

### Scrip Details

Equity / FV	Rs 239mn / Rs 2
Market Cap	Rs 329bn
	USD 4bn
52-week High/Low	Rs 3,090/ 1,881
Avg. Volume (no)	2,08,689
Bloom Code	ALKEM IN
<b>Price Performance</b>	<b>1M</b> <b>3M</b> <b>12M</b>
Absolute (%)	1 (8) 37
Rel to NIFTY (%)	1 (8) 44

### Shareholding Pattern

	Mar'20	Jun'20	Sep'20
Promoters	65.9	62.4	62.4
MF/Banks/FIs	8.9	8.7	7.7
FIIIs	3.6	3.5	3.9
Public / Others	21.6	25.4	26.0

### Valuation (x)

	FY21E	FY22E	FY23E
P/E	24.0	22.4	19.4
EV/EBITDA	17.4	15.7	13.3
ROE (%)	20.7	19.2	19.3
RoACE (%)	19.3	19.0	19.5

### Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	92,387	1,01,906	1,12,553
EBITDA	18,791	20,358	23,223
PAT	13,727	14,688	16,929
EPS (Rs.)	114.8	122.9	141.6

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## Exhibit 1: Revenue mix

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	1HFY21	1HFY20	YoY (%)	FY20	FY19	YoY (%)
Domestic	15,574	15,503	0.5	11,550	34.8	27,124	27,725	(2.2)	56,062	49,642	12.9
US	6,258	5,276	18.6	6,664	(6.1)	12,922	10,093	28.0	21,999	18,979	15.9
RoW	1,532	1,415	8.3	1,189	28.8	2,721	2,510	8.4	5,382	4,950	8.7
<b>Total Sales</b>	<b>23,364</b>	<b>22,194</b>	<b>5.3</b>	<b>19,403</b>	<b>20.4</b>	<b>42,767</b>	<b>40,328</b>	<b>6.0</b>	<b>83,443</b>	<b>73,571</b>	<b>13.4</b>

Source: Company, DART

## Concall Takeaways

- **Guidance:** Management guided of 60%+ gross margins and EBITDA margin expansion (2H is expected to be lower as promotional activities pick up) 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. Enhanced usage of digital marketing and planned travel shall keep costs lower atleast for the next 3-4 quarters. 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 Rs3.5bn for FY21E), improving working capital cycle, we expect operating leverage to play out further. R&D – 6% of sales, Tax rate – 14-15% for FY21 and FY22E.
- **India:** India formulations is on a recovery mode and grew 35% QoQ (flattish YoY). 20% growth in trade generics (Gx) aided growth. Gx now contributes 27% of sales vs 20% in FY20.
  - The company is confident of growing double digit in 2HFY21E, above IPM, led by pick-up in parenteral portfolio (anti-bacterial related to surgery, 40% of India sales) and a strong trade generics business.
  - On field activities have seen pick up in 2Q and early signs of normalization in Oct'20. With sales force expansion in base and PCPA at Rs4.8 Lakh Company endeavours to improve productivity in FY21E.
  - Chronic portfolio growth was average in 1H. However, its cardio-diabetes portfolio is witnessing an improved traction, growing at double digits.
  - E-pharmacies in the long run might pose risk to the Rx methodology thereby impacting acute businesses, however, there is no such possibility in the foreseeable future.
  - Under its digital initiatives, Company started, “Konnnect to Clinic” a telemedicine app. Currently it has 20,000 doctors on this platform. Alkem aims to bring 10-15% of the total doctor universe (1 mn). Over the next few years, this could be a substantial feature replacing feet on the street.
- **US:** US revenue reported healthy growth of 19% YoY (12% in CC), driven by new product launches and market share gains in existing portfolio. US business profitability has improved in the past 15 months driven by newer launches (bio-equivalence led difficult oral solids and controlled substances). Alkem's existing products revenue at US\$7-8mn per product is higher compared to Indian peers. It's strong pipeline at 56 filings pending for approval and only 50% products commercialized from 91 approved, provides ample scope for mid-teens growth. Company guided for ~15 filings and 10 launches in the US for FY21E.
- **US Pipeline:** Company filed 5 ANDAs and received 6 approvals in 1H leading to cumulative 147 filings and 56 pending for approval. The scale-up in the US has been impressive with higher margins in 1H indicating better filings. Profitability is expected to improve with scale (10-12 launches/year) and better mix.

- **Biosimilars:** Alkem plans to launch 2 peptides and 1 MAb in 4Q. It currently incurs an operational expense of Rs800mn annually. While US launch will be a long gestation period, company will first start by in-licensed products in US and EU. Biosimilar launches will first start in India and RoW where company plans to opt for a mix model of own plus out-licensing. It is also mulling options of CDMO for biosimilars.
- **Working Capital improves:** Alkem's CFO/EBITDA had been sub-par and volatile in past 3-4 years averaging at ~45% given the high working capital cycle. With company becoming net cash positive and tighter control on working capital, we expect this to improve and sustain higher at ~75-80%.

### Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>83,444</b>	<b>92,387</b>	<b>1,01,906</b>	<b>1,12,553</b>
<b>Total Expense</b>	<b>68,710</b>	<b>73,596</b>	<b>81,548</b>	<b>89,330</b>
COGS	33,449	36,743	39,827	43,323
Employees Cost	15,055	17,069	19,333	21,354
Other expenses	20,205	19,784	22,389	24,653
<b>EBIDTA</b>	<b>14,734</b>	<b>18,791</b>	<b>20,358</b>	<b>23,223</b>
Depreciation	2,528	2,801	3,036	3,231
<b>EBIT</b>	<b>12,206</b>	<b>15,990</b>	<b>17,322</b>	<b>19,993</b>
Interest	651	688	728	772
Other Income	1,042	944	1,003	1,043
Exc. / E.O. items	0	0	0	0
<b>EBT</b>	<b>12,598</b>	<b>16,246</b>	<b>17,597</b>	<b>20,264</b>
Tax	1,105	2,274	2,640	3,040
RPAT	11,271	13,727	14,688	16,929
Minority Interest	222	245	269	296
<b>Profit/Loss share of associates</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>APAT</b>	<b>11,271</b>	<b>13,727</b>	<b>14,688</b>	<b>16,929</b>

### Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Sources of Funds</b>				
Equity Capital	239	239	239	239
Minority Interest	1,483	1,483	1,483	1,483
Reserves & Surplus	61,368	70,930	81,310	93,930
<b>Net Worth</b>	<b>61,607</b>	<b>71,169</b>	<b>81,549</b>	<b>94,169</b>
Total Debt	16,628	14,661	12,898	11,398
Net Deferred Tax Liability	(5,580)	(9,161)	(9,136)	(9,111)
<b>Total Capital Employed</b>	<b>74,137</b>	<b>78,153</b>	<b>86,793</b>	<b>97,939</b>

### Applications of Funds

Net Block	28,984	29,683	29,648	28,917
CWIP	3,725	3,725	3,725	3,725
Investments	1,445	1,506	1,567	1,636
<b>Current Assets, Loans &amp; Advances</b>	<b>55,533</b>	<b>59,265</b>	<b>67,143</b>	<b>80,687</b>
Inventories	18,188	18,921	20,032	21,974
Receivables	16,494	16,277	17,127	18,918
Cash and Bank Balances	10,922	14,216	20,397	29,384
Loans and Advances	2,784	2,643	2,639	2,915
Other Current Assets	5,447	5,509	5,249	5,797
<b>Less: Current Liabilities &amp; Provisions</b>	<b>15,551</b>	<b>16,027</b>	<b>15,290</b>	<b>17,026</b>
Payables	9,541	10,017	9,489	10,619
Other Current Liabilities	6,010	6,010	5,801	6,408
<i>sub total</i>				
Net Current Assets	39,982	43,238	51,853	63,661
<b>Total Assets</b>	<b>74,137</b>	<b>78,153</b>	<b>86,793</b>	<b>97,939</b>

E – Estimates

### Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
<b>(A) Margins (%)</b>				
Gross Profit Margin	59.9	60.2	60.9	61.5
EBIDTA Margin	17.7	20.3	20.0	20.6
EBIT Margin	14.6	17.3	17.0	17.8
Tax rate	8.8	14.0	15.0	15.0
Net Profit Margin	13.5	14.9	14.4	15.0
<b>(B) As Percentage of Net Sales (%)</b>				
COGS	40.1	39.8	39.1	38.5
Employee	18.0	18.5	19.0	19.0
Other	24.2	21.4	22.0	21.9
<b>(C) Measure of Financial Status</b>				
Gross Debt / Equity	0.3	0.2	0.2	0.1
Interest Coverage	18.8	23.2	23.8	25.9
Inventory days	80	75	72	71
Debtors days	72	64	61	61
Average Cost of Debt	5.1	4.4	5.3	6.4
Payable days	42	40	34	34
Working Capital days	175	171	186	206
FA T/O	2.9	3.1	3.4	3.9
<b>(D) Measures of Investment</b>				
AEPS (Rs)	94.3	114.8	122.9	141.6
CEPS (Rs)	115.4	138.3	148.3	168.6
DPS (Rs)	36.2	34.8	36.0	36.0
Dividend Payout (%)	38.4	30.3	29.3	25.5
BVPS (Rs)	515.3	595.3	682.1	787.7
RoANW (%)	19.4	20.7	19.2	19.3
RoACE (%)	18.0	19.3	19.0	19.5
RoAIC (%)	20.8	25.2	26.6	29.6
<b>(E) Valuation Ratios</b>				
CMP (Rs)	2753	2753	2753	2753
P/E	29.2	24.0	22.4	19.4
Mcap (Rs Mn)	3,29,091	3,29,091	3,29,091	3,29,091
MCap/ Sales	3.9	3.6	3.2	2.9
EV	3,33,098	3,27,837	3,19,893	3,09,406
EV/Sales	4.0	3.5	3.1	2.7
EV/EBITDA	22.6	17.4	15.7	13.3
P/BV	5.3	4.6	4.0	3.5
Dividend Yield (%)	1.3	1.3	1.3	1.3
<b>(F) Growth Rate (%)</b>				
Revenue	13.4	10.7	10.3	10.4
EBITDA	32.2	27.5	8.3	14.1
EBIT	32.4	31.0	8.3	15.4
PBT	32.0	29.0	8.3	15.2
APAT	48.2	21.8	7.0	15.3
EPS	48.2	21.8	7.0	15.3

### Cash Flow

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	5,763	13,919	16,311	18,432
CFI	(4,098)	(3,561)	(3,061)	(2,568)
CFF	2,641	(7,063)	(7,069)	(6,876)
FCFF	1,665	10,357	13,250	15,863
Opening Cash	6,616	10,922	14,216	20,397
Closing Cash	10,922	14,216	20,397	29,384

E – Estimates

### DART RATING MATRIX

Total Return Expectation (12 Months)

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

### Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jun-20	Accumulate	2,515	2,395
Jun-20	Accumulate	2,515	2,399
Jun-20	Accumulate	2,515	2,384
Aug-20	Accumulate	2,920	2,982

\*Price as on recommendation date

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