

## Alkem Laboratories

### Performance Highlights

Y/E March (₹ cr)	3QFY17	3QFY16	% chg (yoy)	9MFY17	9MFY16	% chg (yoy)
<b>Net Sales</b>	<b>1,482</b>	<b>1,288</b>	<b>15.1</b>	<b>4,601</b>	<b>3,877</b>	<b>18.7</b>
EBITDA	268	236	13.7	850	697	21.8
EBITDA Margin (%)	18.1	18.3	-21 bp	18.5	18.0	48 bp
<b>Adj. PAT</b>	<b>233</b>	<b>187</b>	<b>24.9</b>	<b>755</b>	<b>655</b>	<b>15.3</b>

Source: Company, Angel Research

**Domestic business remains strong, US business shows strong growth:** Alkem reported revenue grew of 15% yoy in 3QFY17. Domestic revenue grew by 16.8% yoy to ₹1,030cr while exports grew by 18.7% to ₹432cr. US revenue grew by 30% yoy to ₹339cr. Other exports de-grew by 9.8% yoy as company continues to focus on select few international markets. Domestic business contributed 70.4% of the total revenue. Exports mix changed substantially with US contribution in total revenue going up from 18.7% in 2QFY17 to 23.2% in 3QFY17.

Gross margins improved by ~300bps on yoy basis and 270bps on qoq basis. Staff costs increased due to increased incentives but are likely to come down going ahead. As % of net sales, staff cost was at 19.2% in the quarter vs. 16.8% in 2QFY17 and 18.0% in 3QFY16. EBITDA came at ₹268cr vs. ₹236cr in 3QFY16 showing a yoy growth of 13.7%. 3QFY17 margin at 18.1% shows contraction of ~21bps on yoy basis. Net profit grew by 25% yoy from ₹187cr in 3QFY16 to ₹233cr in 3QFY17.

**Outlook and valuation:** The stock at the CMP of ₹1,837 is available at P/E of 17.5x of FY19E EPS of ₹105. The stock price in CY2017 has appreciated by 13% leaving less room for further upside at this juncture. We expect company to report CAGR of 17.4% and 22.4% in top line and bottom line respectively in next two years. Its ANDA pipeline has not seen strong traction this year so far, despite which Alkem maintains guidance of high single digit ANDA launches going ahead. This justifies the ~29-30% growth in the US business over next two years.

**We rate Alkem Accumulate with PT of 1,996 based on 19.5x of FY19E EPS.**

#### Key financials (Standalone)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E	FY2019E
<b>Net Sales</b>	<b>27,351</b>	<b>28,160</b>	<b>28,083</b>	<b>30,096</b>	<b>33,071</b>
% chg	8.9	3.0	(0.3)	7.2	9.9
<b>Net Profit</b>	<b>2,541</b>	<b>3,132</b>	<b>3,432</b>	<b>3,734</b>	<b>4,072</b>
% chg	13.1	31.3	9.6	8.8	9.0
OPM (%)	12.8	15.5	16.7	17.0	17.0
<b>EPS (₹)</b>	<b>119.5</b>	<b>156.9</b>	<b>171.8</b>	<b>187.0</b>	<b>203.9</b>
P/E (x)	27.0	20.6	18.8	17.3	15.8
P/BV (x)	9.8	8.1	6.6	5.5	4.7
RoE (%)	35.3	33.9	30.1	27.9	25.8
RoCE (%)	42.3	44.9	38.8	35.8	33.3
EV/Sales (x)	2.2	2.1	2.1	1.9	1.7
EV/EBITDA (x)	18.5	15.0	13.8	12.2	10.9

Source: Company, Angel Research; Note: CMP as of February 13, 2017

## ACCUMULATE

CMP	₹1,837
Target Price	₹1,996

Investment Period	12 Months
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#### Stock Info

Sector	Pharma
Market Cap (₹ cr)	21,969
Net Debt (₹ cr)	80
Beta	0.3
52 Week High / Low	1,886/1,175
Avg. Daily Volume	15,878
Face Value (₹)	2
BSE Sensex	28,352
Nifty	8,805
Reuters Code	ALKE.BO
Bloomberg Code	ALKEM IN

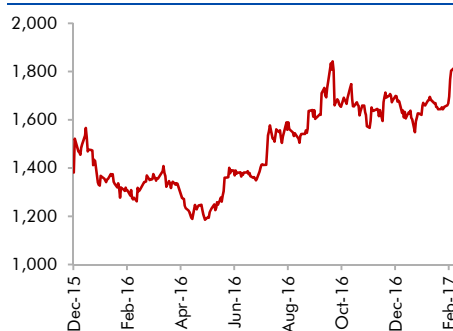
#### Shareholding Pattern (%)

Promoters	66.9
MF / Banks / Indian Fls	3.3
FII / NRIs / OCBs	3.7
Indian Public / Others	26.1

Abs. (%)	3m	1yr	3yr
Sensex	5.8	23.4	NA
Alkem	12.3	39.4	40.4

NA due to listing in December 2015

#### 3-year price chart



Source: Company, Angel Research

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**Exhibit 1: Quarterly financial performance**

Y/E March (₹ cr)	3QFY17	3QFY16	% chg (yoy)	2QFY17	% chg (qoq)	9MFY17	9MFY16	% chg (yoy)
<b>Net sales</b>	<b>1,482</b>	<b>1,288</b>	<b>15.1</b>	<b>1,638</b>	<b>(9.5)</b>	<b>4,601</b>	<b>3,877</b>	<b>18.7</b>
Consumption of RM	540	509	6.1	641	(15.7)	1,761	1,533	14.8
(% of Sales)	36.5	39.6		39.1		38.3	39.5	
Staff costs	284	232	22.4	276	3.0	814	700	16.3
(% of Sales)	19.2	18.0		16.8		17.7	18.1	
Other expenses	389	310	25.3	410	(5.2)	1,176	946	24.3
(% of Sales)	26.3	24.1		25.1		25.6	24.4	
<b>Total Expenditure</b>	<b>1,214</b>	<b>1,052</b>	<b>15.4</b>	<b>1,328</b>	<b>(8.6)</b>	<b>3,751</b>	<b>3,180</b>	<b>18.0</b>
<b>Operating Profit</b>	<b>268</b>	<b>236</b>	<b>13.7</b>	<b>310</b>	<b>(13.6)</b>	<b>850</b>	<b>697</b>	<b>21.8</b>
OPM	18.1	18.3		19.0		57.3	54.2	
Depreciation	26	23	16.5	25	3.5	75	69	8.2
Other income	25	18	39.9	34	(25.1)	87	136	(35.8)
Finance cost	12	18	(36.5)	12	(2.6)	34	61	(44.9)
<b>PBT (excl. Extr. Items)</b>	<b>255</b>	<b>213</b>	<b>20.0</b>	<b>307</b>	<b>(16.8)</b>	<b>829</b>	<b>703</b>	<b>17.8</b>
<b>Extr. Income/(Expense)</b>	<b>0</b>	<b>0</b>		<b>0</b>		<b>0</b>	<b>0</b>	
PBT (incl. Extr. Items)	255	213	20.0	307	(16.8)	829	703	17.8
(% of Sales)	17.2	16.5		18.7		18.0	18.1	
Tax	19	23	(15.0)	19	2.3	61	37	62.4
(% of PBT)	0.1	0.1		0.1		0.1	0.1	
<b>Reported PAT</b>	<b>236</b>	<b>190</b>	<b>24.2</b>	<b>288</b>	<b>(18.0)</b>	<b>768</b>	<b>666</b>	<b>15.3</b>
Minority int. and Asso. Company	3	3	(14.9)	5	(46.2)	13	11	17.7
<b>Adj PAT</b>	<b>233</b>	<b>187</b>	<b>24.9</b>	<b>283</b>	<b>(17.5)</b>	<b>755</b>	<b>655</b>	<b>15.3</b>
Adj. PATM	15.7	14.5		17.3		16.4	16.9	
<b>Equity capital (cr)</b>	<b>24</b>	<b>24</b>		<b>24</b>		<b>24</b>	<b>24</b>	
<b>Adjusted EPS (₹)</b>	<b>20</b>	<b>16</b>	<b>24.9</b>	<b>24</b>	<b>(17.5)</b>	<b>63</b>	<b>55</b>	<b>15.3</b>

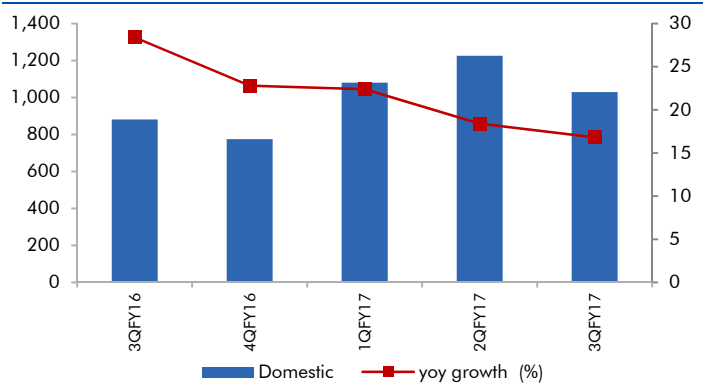
Source: Company, Angel Research

- Alkem's revenue grew by 15% yoy. The domestic revenue grew by 16.8% yoy to ₹1,030cr while exports grew by 18.7% yoy to ₹432cr.
- Domestic business' yoy growth at 16.8% during the quarter continues to outperform the industry growth of 5.7% in 3QFY17.
- US revenue was at ₹339cr vs. ₹260cr in 3QFY16, this shows a yoy growth of 30%. Exports to other international markets de-grew by 9.8% yoy as Alkem continues to focus on select few markets.
- During the quarter, company maintained its market share in the Anti-infective, GI and pain management segments. Company was able to grow faster than the industry in chronic segment, especially Neuro/CNS, Derma, Cardiac and Anti-diabetic. We believe that the company has gained market share in these segments owing to faster growth.
- Domestic business contributed 70.4% of the total revenue while exports contributed 29.6%.
- The company has seen substantial increase in the exports mix with US contribution going up from 18.7% in 2QFY17 to 23.2% in 3QFY17. On yoy

basis, this contribution has grown by 227bps, in line with the company's strategy to grow its US business.

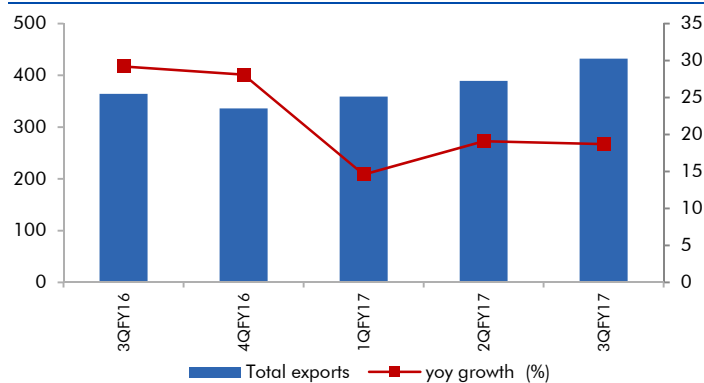
- Total R&D investments during the quarter were at ₹85cr (5.7% of net sales) vs. ₹43.8cr (3.4% of net sales) in 3QFY16.
- Gross margins improved to ~300bps on yoy basis and 270bps on qoq basis.
- Staff costs increased due to increased incentives. As % of net sales, staff cost was at 19.2% vs. 16.8% in 2QFY17 and 18.0% in 3QFY16.
- EBITDA came at ₹268cr vs. ₹236cr in 3QFY16 showing a yoy growth of 13.7%.
- EBITDA margins at 18.1% in the quarter declined by ~21bps on yoy basis and by ~86bps on qoq basis.
- Net profit grew by 25% yoy from ₹187cr in 3QFY16 to ₹233cr in 3QFY17.

**Exhibit 2: Domestic business growth at 16.8%**



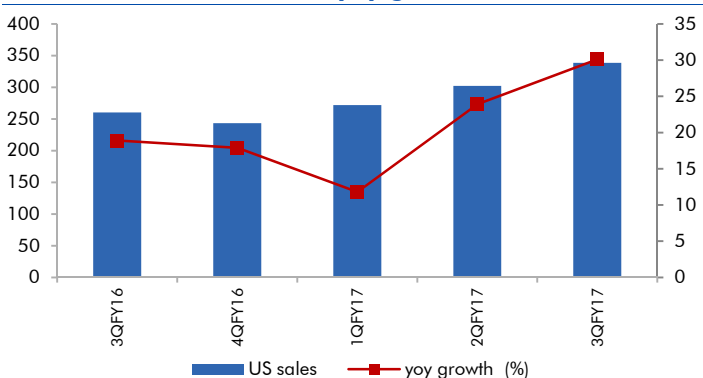
Source: Company, Angel Research

**Exhibit 3: Export continues to grow**



Source: Company, Angel Research

**Exhibit 4: US records 30% yoy growth**



Source: Company, Angel Research

**Exhibit 5: ANDA pipeline**

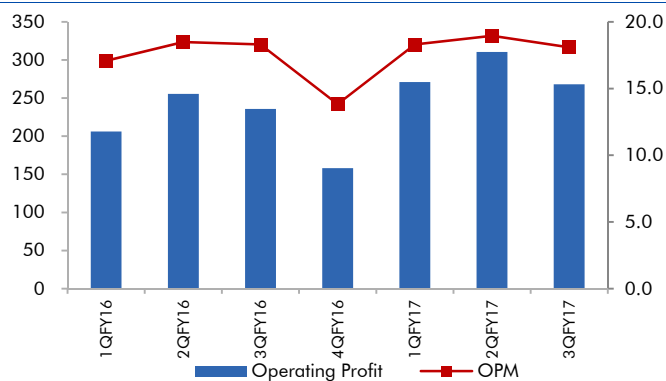


Source: Company, Angel Research

## Conference call – Key highlights

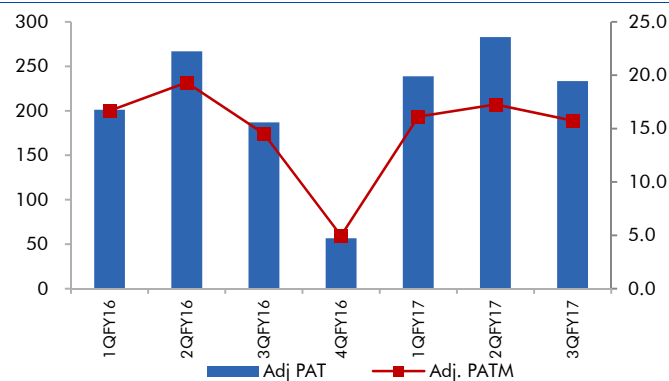
- R&D expenses guidance of 5-6% of net sales maintained.
- FY17E capex likely to be ₹550-600cr.
- The tax rate will go up by FY19E.
- Company maintains the guidance to launch high single digit ANDAs per year going ahead.

**Exhibit 6: Margins decline due to higher staff costs**



Source: Company, Angel Research

**Exhibit 7: PAT grows 25% yoy**



Source: Company, Angel Research

## Investment arguments

- **Strong domestic business**– Alkem is the 5<sup>th</sup> largest pharma company in India in terms of domestic revenues. Its acute segment contributes 88% of domestic revenue while chronic business contributes 12%. In the acute business, company is ranked #1 in anti-infective segment and #3 each in pain and Gastro intestinal segments. Alkem is currently a small player in the chronic segment but it is expanding this business rapidly.
- **Domestic business to continue its outperformance vs. industry:** Alkem is expected to continue its outperformance vs. industry due to strong growth in its acute and chronic segments. Both segments are expected to grow at CAGR of 16% and 30% respectively in next 3 years due to higher sales of major brands and market share gains. We expect domestic sales to grow at 15.8% CAGR to ₹5,620cr in FY19E, vs. domestic industry growth of ~14% in next 3 years.
- **US revenue to double with increased ANDA monetization:** Alkem's ANDA pipeline increased 2.5x from 31 ANDAs in FY12 to 76 ANDAs in H1FY17. ANDA approvals also grew by 2.8x during the same period. In next three years company expects increased ANDA launches on the back of approval to 2/3<sup>rd</sup> of its pipeline. This will to double its US revenue from ₹991cr in FY16 to ₹1,919cr in FY19E.

**Improving operating performance:** Alkem's operating performance is expected to improve with better sales mix (increasing exports) and market share gains in chronic segment. The company has already seen margin improvement and with rising profitability of US business, we estimate 70-100bps margin expansion.

## Outlook and valuation

The stock at the CMP of ₹1,837 is available at P/E of 17.5x of FY19E EPS of ₹105. The stock price in CY2017 has appreciated by 13% leaving less room for further upside at this juncture. We expect company to report CAGR of 17.4% and 22.4% in top line and bottom line respectively in next two years. Its ANDA pipeline has not seen strong traction this year so far, despite which Alkem maintains guidance of high single digit ANDA launches going ahead. This justifies the ~29-30% growth in the US business over next two years. **We rate Alkem Accumulate with PT of 1,996 based on 19.5x of FY19E EPS.**

## Company background

Alkem Laboratories is a Mumbai based pharma company engaged in manufacturing and marketing of generic drugs, APIs and nutraceutical products. Company sells its drugs in India and ~50 countries including the US. It has 16 manufacturing facilities of which 14 are in India and two in the USA.. Company has recently entered into an alliance with Haw Par to exclusively market Tiger Balm range of products in India.

**Profit and loss statement**

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
<b>Total operating income</b>	<b>3,743</b>	<b>4,992</b>	<b>6,050</b>	<b>6,839</b>	<b>8,077</b>
% chg	19.7	33.3	21.2	13.1	18.1
<b>Total Expenditure</b>	<b>3,322</b>	<b>4,143</b>	<b>4,918</b>	<b>5,485</b>	<b>6,461</b>
Cost of Materials	1,691	1,961	2,323	2,599	3,069
Personnel	646	917	1,053	1,149	1,341
Others Expenses	985	1,265	1,543	1,737	2,052
<b>EBITDA</b>	<b>422</b>	<b>848</b>	<b>1,131</b>	<b>1,354</b>	<b>1,615</b>
% chg	2.9	101.1	33.4	19.7	19.3
(% of Net Sales)	11.3	17.0	18.7	19.8	20.0
Depreciation & Amortisation	71	101	110	130	155
<b>EBIT</b>	<b>351</b>	<b>748</b>	<b>1,021</b>	<b>1,224</b>	<b>1,460</b>
% chg	(1.9)	113.1	36.6	19.9	19.3
(% of Net Sales)	9.4	15.0	16.9	17.9	18.1
Interest & other Charges	81	67	47	47	47
Other Income	181	165	100	100	100
(% of PBT)	40.2	19.5	9.3	7.8	6.6
Share in profit of Ass.	-	-	-	-	-
<b>Recurring PBT</b>	<b>451</b>	<b>845</b>	<b>1,074</b>	<b>1,277</b>	<b>1,513</b>
% chg	4.8	87.5	27.1	18.9	18.5
Prior Period & Extra. Exp.	-	-	-	-	-
<b>PBT (reported)</b>	<b>451</b>	<b>845</b>	<b>1,074</b>	<b>1,277</b>	<b>1,513</b>
Tax	59	161	118	217	257
(% of PBT)	13.1	19.0	11.0	17.0	17.0
<b>PAT (reported)</b>	<b>392</b>	<b>684</b>	<b>956</b>	<b>1,060</b>	<b>1,256</b>
Add: Share of earnings of ass.	-	-	-	-	-
Less: Minority interest (MI)	-	11	-	-	-
<b>PAT after MI (reported)</b>	<b>392</b>	<b>673</b>	<b>956</b>	<b>1,060</b>	<b>1,256</b>
<b>ADJ. PAT</b>	<b>392</b>	<b>673</b>	<b>956</b>	<b>1,060</b>	<b>1,256</b>
% chg	(10.0)	74.8	39.7	10.8	18.5
(% of Net Sales)	10.5	13.5	15.8	15.5	15.5
<b>Basic EPS (₹)</b>	<b>32.8</b>	<b>56.3</b>	<b>80.0</b>	<b>88.7</b>	<b>105.1</b>
<b>Fully Diluted EPS (₹)</b>	<b>32.8</b>	<b>56.3</b>	<b>80.0</b>	<b>88.7</b>	<b>105.1</b>
% chg	(10.0)	74.8	39.7	10.8	18.5

**Balance sheet statement**

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
<b>SOURCES OF FUNDS</b>					
Equity Share Capital	24	24	24	24	24
Reserves & Surplus	2,975	3,479	4,244	5,039	5,918
<b>Shareholders' Funds</b>	<b>2,999</b>	<b>3,503</b>	<b>4,268</b>	<b>5,063</b>	<b>5,942</b>
Minority Interest	86	97	97	97	97
Total Loans	1,381	739	750	750	750
Deferred Tax Liability	126	153	153	153	153
<b>Total Liabilities</b>	<b>4,591</b>	<b>4,490</b>	<b>5,267</b>	<b>6,062</b>	<b>6,941</b>
<b>APPLICATION OF FUNDS</b>					
Gross Block	1,745	1,889	2,389	2,939	3,539
Less: Acc. Depreciation	371	447	557	687	842
<b>Net Block</b>	<b>1,374</b>	<b>1,442</b>	<b>1,832</b>	<b>2,252</b>	<b>2,697</b>
Capital Work-in-Progress	111	172	250	300	300
Investments	481	422	422	422	422
Current Assets	3,325	3,394	3,925	4,415	5,095
Inventories	784	909	1,110	1,255	1,483
Sundry Debtors	527	565	663	750	885
Cash	791	796	651	714	724
Loans & Advances	175	240	290	328	388
Other Assets	1,048	884	1,210	1,368	1,615
Current liabilities	733	998	1,220	1,385	1,631
<b>Net Current Assets</b>	<b>2,592</b>	<b>2,396</b>	<b>2,705</b>	<b>3,030</b>	<b>3,464</b>
<b>Deferred Tax Asset</b>	<b>34</b>	<b>58</b>	<b>58</b>	<b>58</b>	<b>58</b>
Mis. Exp. not written off	-	-	-	-	-
<b>Total Assets</b>	<b>4,591</b>	<b>4,490</b>	<b>5,267</b>	<b>6,062</b>	<b>6,941</b>

Note: Cash includes cash with scheduled banks on dividend current accounts

**Cash flow statement**

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
Profit before tax	451	845	1,074	1,277	1,513
Depreciation	71	101	110	130	155
Change in Working Capital	(12)	14	(454)	(262)	(424)
Interest / Dividend (Net)	(53)	(59)	47	47	47
Direct taxes paid	(106)	(198)	(118)	(217)	(257)
Others	(26)	24	-	-	-
<b>Cash Flow from Operations</b>	<b>325</b>	<b>726</b>	<b>659</b>	<b>975</b>	<b>1,034</b>
(Inc.)/ Dec. in Fixed Assets	(235)	189	(578)	(600)	(600)
(Inc.)/ Dec. in Investments	-	-	-	-	-
<b>Cash Flow from Investing</b>	<b>(235)</b>	<b>189</b>	<b>(578)</b>	<b>(600)</b>	<b>(600)</b>
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	87	(671)	11	-	-
Dividend Paid (Incl. Tax)	(57)	(185)	(191)	(265)	(377)
Interest / Dividend (Net)	569	598	(47)	(47)	(47)
<b>Cash Flow from Financing</b>	<b>599</b>	<b>(258)</b>	<b>(227)</b>	<b>(312)</b>	<b>(424)</b>
Inc./(Dec.) in Cash	690	657	(145)	63	10
<b>Opening Cash balances</b>	<b>101</b>	<b>140</b>	<b>796</b>	<b>651</b>	<b>714</b>
<b>Closing Cash balances</b>	<b>791</b>	<b>796</b>	<b>651</b>	<b>714</b>	<b>724</b>



**Key ratios**

Y/E March	FY15	FY16	FY17E	FY18E	FY19E
<b>Valuation Ratio (x)</b>					
P/E (on FDEPS)	56.1	32.6	23.0	20.7	17.5
P/CEPS	4.5	47.5	28.0	20.6	18.5
P/BV	7.3	6.3	5.1	4.3	3.7
Dividend yield (%)	1.4	0.3	0.8	0.9	1.2
EV/Sales	5.9	4.3	3.6	3.2	2.7
EV/EBITDA	52.3	25.3	19.1	15.9	13.4
EV / Total Assets	4.1	3.9	3.3	2.9	2.5
<b>Per Share Data (₹)</b>					
EPS (Basic)	32.8	56.3	80.0	88.7	105.1
EPS (fully diluted)	32.8	56.3	80.0	88.7	105.1
Cash EPS	407.7	38.7	65.7	89.2	99.5
DPS	26.6	4.7	15.4	16.0	22.2
Book Value	250.9	293.0	357.0	423.5	497.0
<b>Dupont Analysis</b>					
EBIT margin	9.4	15.0	16.9	17.9	18.1
Tax retention ratio	0.9	0.8	0.9	0.8	0.8
Asset turnover (x)	1.2	1.7	1.5	1.5	1.5
ROIC (Post-tax)	9.8	20.0	23.0	21.7	21.9
Cost of Debt (Post Tax)	0.1	0.1	0.1	0.1	0.1
Leverage (x)	0.0	(0.1)	(0.1)	(0.1)	(0.1)
Operating ROE	10.2	17.3	21.3	20.1	20.4
<b>Returns (%)</b>					
ROCE	8.0	17.6	20.4	21.1	21.8
Angel ROIC (Pre-tax)	11.3	24.7	25.9	26.2	26.3
ROE	13.1	19.2	22.4	20.9	21.1
<b>Turnover ratios (x)</b>					
Asset Turnover (Gross Block)	2.1	2.6	2.5	2.3	2.3
Inventory / Sales (days)	76	67	67	67	67
Receivables (days)	51	41	40	40	40
Payables (days)	45	42	42	42	42
WC cycle (ex-cash) (days)	82	65	65	65	65

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	Alkem Laboratories
1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

**Ratings (Based on expected returns over 12 months investment period):**

Buy (> 15%)

Accumulate (5% to 15%)  
Reduce (-5% to -15%)

Neutral (-5 to 5%)  
Sell (< -15)