

Alkem Laboratories

Performance Highlights

Y/E March (₹ cr)	4QFY17	4QFY16	% chg (yoy)	FY17	FY16	% chg (yoy)
Net Sales	1,251	1,149	9.0	5,853	4,992	17.2
EBITDA	149	156	(4.2)	999	848	17.8
EBITDA Margin (%)	11.9	13.6	-164 bp	17.1	17.0	7 bp
Adj. PAT	137	87	58.6	892	673	32.6

Source: Company, Angel Research

Slower growth in domestic and US business: Alkem reported yoy revenue grew of 9% in 4QFY17. Domestic revenue grew by 7% yoy to ₹856cr while exports grew by 14.5% to ₹385cr. US revenue grew by 19.4% yoy to ₹291cr. Other exports were flat at ₹95cr. Domestic business contributed 69% of the total revenue during the quarter. Exports mix remains unchanged (vs. 3QFY17), with US contribution remaining at 23% of total revenues in 4QFY17.

Gross margins declined by ~35bps on qoq basis but improved by 67bps on yoy basis. EBITDA declined by 4.2% yoy at ₹149cr vs. ₹156r in 4QFY16. EBITDA margins were at 11.9% vs. 13.6% in 4QFY16 and 18.1% in 3QFY17. The decline in EBITDA margins was largely on account of higher employee cost and increased R&D expenditure. PAT was at ₹137cr in 4QFY17 showing a yoy growth of 58.6%, due to the lower tax in the quarter.

Outlook and valuation: The stock at the CMP of ₹1,868 is available at P/E of 18.6x of FY19E EPS of ₹101. We have cut our EPS estimates by ~5% due to the recent slowdown in domestic business, likely disruption in the pharma industry due to higher GST and pricing pressure in the US. We expect company to report CAGR of 15.8% and 15.3% in top line and bottom line respectively in next two years. The company is expected to witness improvement in its return ratios owing to the rising profitability of US business. Moreover Alkem's all manufacturing facilities are current with USFDA which gives confidence that company will deliver strong results over next two years. Considering these factors, **we rate Alkem Buy with price target of ₹2,161 based on 21.5x of FY19E EPS.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	3,743	4,992	5,853	6,901	7,850
% chg	19.7	33.3	17.2	17.9	13.8
Net Profit	392	684	905	1,016	1,202
% chg	(10.0)	71.9	32.6	13.9	18.3
OPM (%)	11.3	17.0	17.1	18.4	19.1
EPS (₹)	32.8	56.3	74.6	85.0	100.5
P/E (x)	57.0	33.2	25.0	22.0	18.6
P/BV (x)	7.4	6.4	5.3	4.4	3.7
RoE (%)	13.1	19.2	21.1	20.2	20.1
RoCE (%)	8.0	17.6	18.0	19.7	20.0
EV/Sales (x)	6.0	4.4	3.8	3.2	2.8
EV/EBITDA (x)	53.2	25.8	22.2	17.5	14.7

Source: Company, Angel Research; Note: CMP as of May 30, 2017

BUY

CMP	₹1,868
Target Price	₹2,161

Investment Period	12 Months
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Stock Info

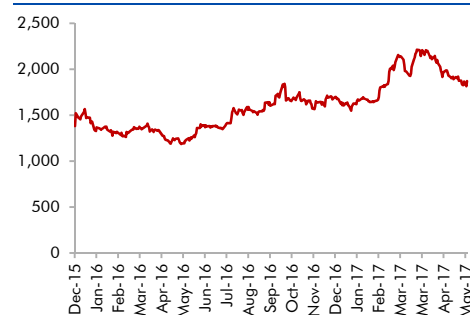
Sector	Pharma
Market Cap (₹ cr)	22,331
Net Debt (₹ cr)	(23)
Beta	0.3
52 Week High / Low	2,238/1,200
Avg. Daily Volume	67,071
Face Value (₹)	2
BSE Sensex	31,159
Nifty	9,625
Reuters Code	ALKE.BO
Bloomberg Code	ALKEM IN

Shareholding Pattern (%)

Promoters	67.0
MF / Banks / Indian FIs	2.5
FII / NRIs / OCBs	6.7
Indian Public / Others	23.8

Abs. (%)	3m	6m	1yr
Sensex	8.5	17.0	16.9
Alkem	(12.8)	10.1	48.4

3-year price chart



Source: Company, Angel Research

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Exhibit 1: Quarterly financial performance

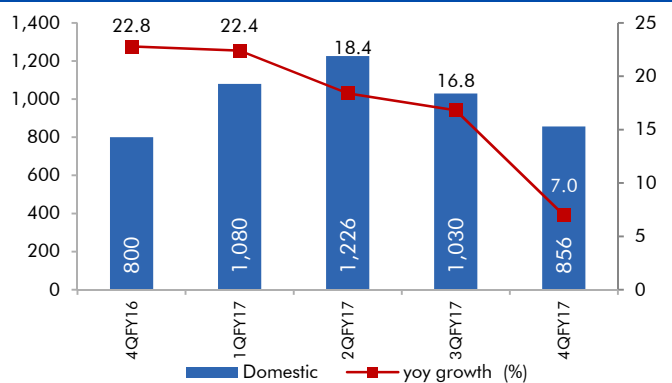
Y/E March (₹ cr)	4QFY17	4QFY16	% chg (yoy)	3QFY17	% chg (qoq)	FY17	FY16	% chg (yoy)
Net sales	1,251	1,149	9.0	1,482	(15.6)	5,853	4,992	17.2
Consumption of RM	461	431	7.0	540	(14.7)	2,222	1,961	13.3
(% of Sales)	36.8	37.5		36.5		38.0	39.3	
Staff costs	229	191	19.3	271	(15.7)	1004	917	9.5
(% of Sales)	18.3	16.7		18.3		17.2	18.4	
Other expenses	413	371	11.4	402	2.6	1628	1265	28.7
(% of Sales)	33.0	32.3		27.1		27.8	25.3	
Total Expenditure	1,102	993	11.0	1,214	(9.2)	4,854	4,143	17.1
Operating Profit	149	156	(4.2)	268	(44.3)	999	848	17.8
OPM	11.93	13.57		18.1		17.1	17.0	
Depreciation	26	24	9.2	26	0.0	101	101	0.6
Other income	25	104	(76.2)	25	(3.1)	112	165	(31.9)
Finance cost	11	10	13.8	12	(2.3)	45	67	(32.7)
PBT (excl. Extr. Items)	136	225	(39.6)	255	(46.7)	965	845	14.1
Extr. Income/(Expense)	0	0		0		0	0	
PBT (incl. Extr. Items)	136	225	(39.6)	255	(46.7)	965	845	14.1
(% of Sales)	10.9	19.6		17.2		16.5	16.9	
Tax	(1)	139	(100.7)	19	(104.7)	60	161	(62.7)
(% of PBT)	-0.7	61.6		7.5		6.2	19.0	
Reported PAT	137	87	58.3	236	(42.0)	905	684	32.2
Minority interest and Associate Company	(0)	0	(1,600.0)	3	(110.5)	12	11	8.9
Adj PAT	137	87	58.6	233	(41.2)	892	673	32.6
Adj. PATM	11.0	7.5		15.7		15.2	13.5	
Equity capital (cr)	24	24		24		24	24	
Adjusted EPS (₹)	11	7	58.6	20	(41.2)	75	56	32.6

Source: Company, Angel Research

- Alkem reported revenue grew of 9% yoy. Domestic revenue grew by 7% yoy to ₹856cr while exports grew by 14.5% to ₹385cr.
- In the therapeutic segments, company grew by 4.7% in the quarter underperforming industry growth of 6.6%. Main reason behind this is negative growth rate that company clocked in Anti-infective and respiratory segments.
- US revenue was at ₹291cr vs. ₹243cr in 4QFY16. US revenue growth was at 19.4% yoy, slower than our expectations. Other exports were flat on yoy basis to ₹95cr in 4QFY17. Company continues to focus on the US market which is clearly reflected in the numbers.
- The company continues to maintain its market share in the Anti-infective, GI and pain management segments. In the acute segment, company has mainly put a subdued performance, however in the chronic segment; company has gained market share, especially in derma, cardiac and anti-diabetic segments.
- Domestic business contributed 69% of the total revenue while exports contributed the rest.

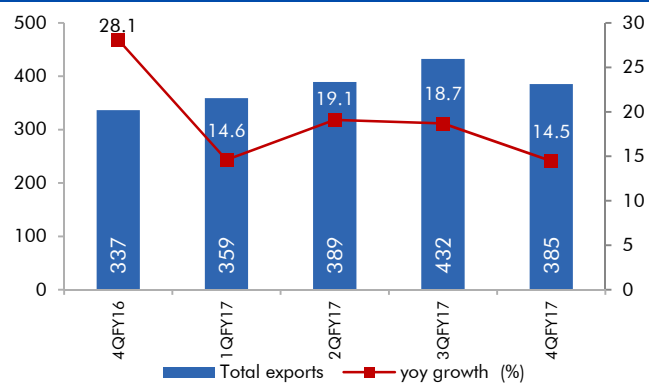
- Export mix remains unchanged with US contribution at 23% in 4QFY17 vs. 23.2% in 3QFY17. On yoy basis, this contribution has grown by 200bps.
- Gross margins improved by ~67bps on yoy basis but declined by 35bps on qoq basis.
- Staff costs was at ₹229cr, showing a yoy increase of 19.3%. As % of net sales, staff cost was at 18.3% in the quarter vs. 16.7% in 4QFY16 and 18.3% in 3QFY17.
- EBITDA came in at ₹149cr vs. ₹156cr in 4QFY16 showing a yoy decline of 4.2%.
- EBITDA margins at 11.9% in the quarter declined by ~164bps on yoy basis and by ~616bps on qoq basis, mainly due to higher R&D and staff costs as mentioned above.
- Net profit grew by 58.6% yoy from ₹87cr in 4QFY16 to ₹137cr in 4QFY17. This was due to lower tax rate in the quarter.

Exhibit 2: Domestic business growth at 7%



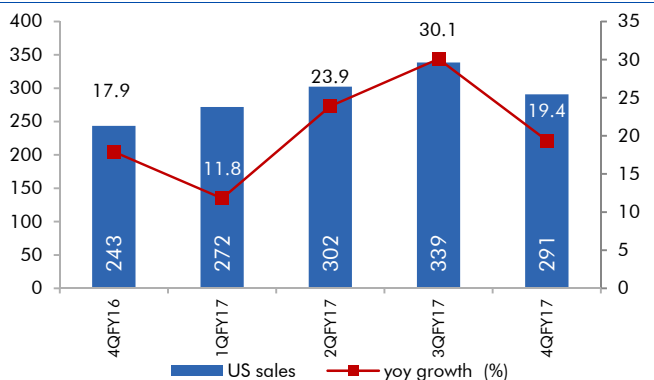
Source: Company, Angel Research

Exhibit 3: Exports continues to grow, albeit slowly



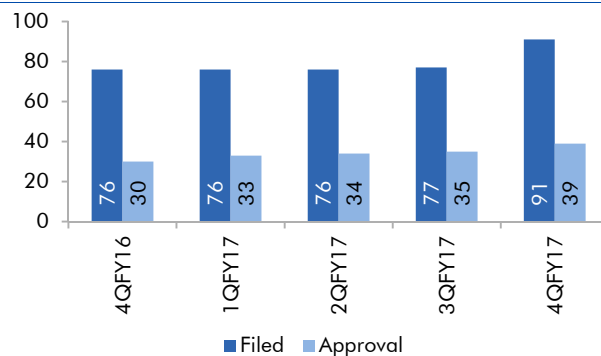
Source: Company, Angel Research

Exhibit 4: US growth at 19% due to seasonality



Source: Company, Angel Research

Exhibit 5: ANDA pipeline, 14 ANDA additions in 4Q

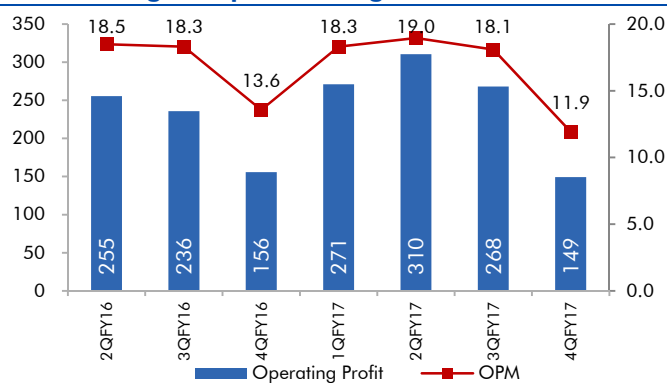


Source: Company, Angel Research

Conference call – Key highlights

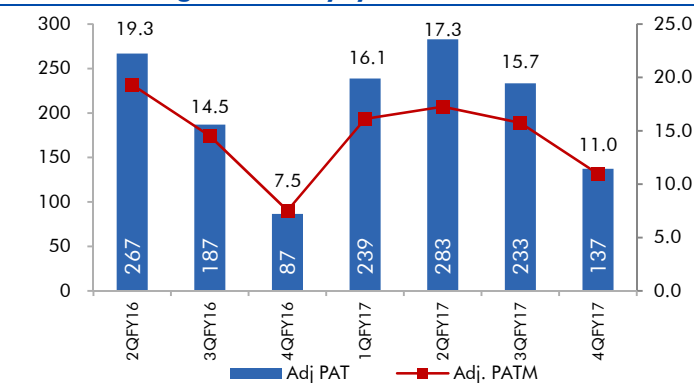
- Company has indicated of pricing pressure in the US. The 4th quarter lower EBITDA was due to the seasonality.
- The slower growth in the domestic revenues is on the account of demonetisation and DPCO initiated price cuts and negative WPI inflation.
- Anti-infective segment contributes ~40% of its top line and de-growth in this segment has hurt its overall growth in the quarter.
- In the chronic segment, company has grown faster than the market and has also moved higher in ranks of the respective segments.
- In the US, company has gained market share in its products, the growth in 4Q also was due to the new product launches. In the FY17, company has made 7 drug launches in US.
- The company has received EIR for all the three facilities on which it had earlier received minor observations.
- The effective GST rate would be 12% vs. current 9.5%. The industry is seeking government approval for price hike post-GST.
- Company expects higher single-digit products launches in the US this year.
- R&D expenses guidance of 6% of net sales for FY18E.
- FY18E capex likely to be ~₹600cr.
- Company maintains the guidance to launch high single digit ANDAs per year going ahead.

Exhibit 6: Margins dip due to high staff and R&D costs



Source: Company, Angel Research

Exhibit 7: PAT grows 58% yoy due to lower tax



Source: Company, Angel Research

Investment arguments

- **Strong domestic business**– Alkem is the 5th 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 report strong growth due to increasing market share as well as increasing productivity of its marketing and sales staff. We expect domestic sales to grow at 13.8% CAGR to ₹5,434cr in FY19E, vs. domestic industry growth of ~12% during the same period.
- **US revenue to double with increased ANDA monetization:** Alkem's ANDA pipeline increased 2.9x from 31 ANDAs in FY12 to 91 ANDAs in FY17. ANDA approvals also grew by 3.5x during the same period, of this 8 approvals came in FY17 itself. In next three years company expects increased ANDA launches on the back of approval to 2/3rd of its pipeline. This will see strong increase in its US revenue from ₹1,203cr in FY17 to ₹1,896cr 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 ₹1,868 is available at P/E of 18.6x of FY19E EPS of ₹101. We have cut our EPS estimates by ~5% due to the recent slowdown in domestic business, likely disruption in the business due to GST and pricing pressure in the US. We expect company to report CAGR of 15.8% and 15.3% in top line and bottom line respectively in next two years. The company is expected to witness improvement in its return ratios owing to the rising profitability of US business. Moreover Alkem's all manufacturing facilities are current with USFDA which gives confidence that company will deliver strong results over next two years. Considering these factors, **we rate Alkem Buy with PT of 2,161 based on 21.5x 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.

Profit and loss statement

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Total operating income	3,743	4,992	5,853	6,901	7,850
% chg	19.7	33.3	17.2	17.9	13.8
Total Expenditure	3,322	4,143	4,854	5,631	6,351
Cost of Materials	1,691	1,961	2,222	2,622	2,983
Personnel	646	917	1,004	1,215	1,366
Others Expenses	985	1,265	1,628	1,794	2,002
EBITDA	422	848	999	1,270	1,499
% chg	2.9	101.1	17.8	27.1	18.1
(% of Net Sales)	11.3	17.0	17.1	18.4	19.1
Depr. & Amort.	71	101	101	130	155
EBIT	351	748	898	1,140	1,344
% chg	(1.9)	113.1	20.1	27.0	18.0
(% of Net Sales)	9.4	15.0	15.3	16.5	17.1
Interest & other Charges	81	67	45	47	47
Other Income	181	165	112	117	133
(% of PBT)	40.2	19.5	11.6	9.7	9.3
Recurring PBT	-	-	-	-	-
% chg	451	845	965	1,210	1,431
Prior Period & Extraord. Exp./(Inc.)	4.8	87.5	14.1	25.4	18.3
PBT (reported)	-	-	-	-	-
Tax	451	845	965	1,210	1,431
(% of PBT)	59	161	60	194	229
PAT (reported)	13.1	19.0	6.2	16.0	16.0
Add: Share of earnings of asso.	392	684	905	1,016	1,202
Less: Minority interest (MI)	-	-	-	-	-
PAT after MI (reported)	-	11	12	-	-
ADJ. PAT	392	673	892	1,016	1,202
% chg	392	673	892	1,016	1,202
(% of Net Sales)	(10.0)	71.9	32.6	13.9	18.3
Basic EPS (₹)	10.5	13.5	15.2	14.7	15.3
Fully Diluted EPS (₹)	32.8	56.3	74.6	85.0	100.5
% chg	32.8	56.3	74.6	85.0	100.5

Balance sheet statement

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Equity Share Capital	24	24	24	24	24
Reserves & Surplus	2,975	3,479	4,204	5,007	5,956
Shareholders' Funds	2,999	3,503	4,228	5,031	5,980
Minority Interest	86	97	97	97	97
Total Loans	1,381	739	750	750	750
Deferred Tax Liability	126	153	153	153	153
Total Liabilities	4,591	4,490	5,227	6,030	6,979
APPLICATION OF FUNDS					
Gross Block	1,745	1,889	2,519	3,169	3,819
Less: Acc. Depreciation	371	447	548	678	833
Net Block	1,374	1,442	1,970	2,490	2,985
Capital Work-in-Progress	111	172	250	300	300
Investments	481	422	422	422	422
Current Assets	3,325	3,394	3,696	4,144	4,794
Inventories	784	909	1,074	1,267	1,441
Sundry Debtors	527	565	641	756	860
Cash	791	796	529	410	545
Loans & Advances	175	240	281	331	377
Other Assets	1,048	884	1,171	1,380	1,570
Current liabilities	733	998	1,169	1,385	1,580
Net Current Assets	2,592	2,396	2,527	2,759	3,214
Deferred Tax Asset	34	58	58	58	58
Mis. Exp. not written off	-	-	-	-	-
Total Assets	4,591	4,490	5,227	6,030	6,979

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	965	1,210	1,431
Depreciation	71	101	101	130	155
Change in Working Capital	(12)	14	(398)	(352)	(319)
Interest / Dividend (Net)	(53)	(59)	45	47	47
Direct taxes paid	(106)	(198)	(60)	(194)	(229)
Others	(26)	24	-	-	-
Cash Flow from Operations	325	726	653	842	1,085
(Inc.)/ Dec. in Fixed Assets	(235)	189	(708)	(700)	(650)
(Inc.)/ Dec. in Investments	-	-	-	-	-
Cash Flow from Investing	(235)	189	(708)	(700)	(650)
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	87	(671)	11	-	-
Dividend Paid (Incl. Tax)	(57)	(185)	(179)	(213)	(252)
Interest / Dividend (Net)	569	598	(45)	(47)	(47)
Cash Flow from Financing	599	(258)	(213)	(261)	(300)
Inc./(Dec.) in Cash	690	657	(267)	(119)	135
Opening Cash balances	101	140	796	529	410
Closing Cash balances	791	796	529	410	545

Key ratios

Y/E March	FY15	FY16	FY17E	FY18E	FY19E
Valuation Ratio (x)					
P/E (on FDEPS)	57.0	33.2	25.0	22.0	18.6
P/CEPS	4.6	48.3	28.4	22.2	19.5
P/BV	7.4	6.4	5.3	4.4	3.7
Dividend yield (%)	1.4	0.3	0.8	0.8	1.0
EV/Sales	6.0	4.4	3.8	3.2	2.8
EV/EBITDA	53.2	25.8	22.2	17.5	14.7
EV / Total Assets	4.2	4.0	3.5	3.0	2.6
Per Share Data (₹)					
EPS (Basic)	32.8	56.3	74.6	85.0	100.5
EPS (fully diluted)	32.8	56.3	74.6	85.0	100.5
Cash EPS	407.7	38.7	65.7	84.1	95.9
DPS	26.6	4.7	15.4	15.0	17.9
Book Value	250.9	293.0	353.7	420.8	500.2
Dupont Analysis					
EBIT margin	9.4	15.0	15.3	16.5	17.1
Tax retention ratio	0.9	0.8	0.9	0.8	0.8
Asset turnover (x)	1.2	1.7	1.5	1.4	1.4
ROIC (Post-tax)	9.8	20.0	20.9	19.3	19.6
Cost of Debt (Post Tax)	0.1	0.1	0.1	0.1	0.1
Leverage (x)	0.0	(0.1)	(0.0)	(0.0)	(0.0)
Operating ROE	10.2	17.3	19.9	19.0	18.9
Returns (%)					
ROCE	8.0	17.6	18.0	19.7	20.0
Angel ROIC (Pre-tax)	11.3	24.7	22.3	23.0	23.3
ROE	13.1	19.2	21.1	20.2	20.1
Turnover ratios (x)					
Asset Turnover (Gross Block)	2.1	2.6	2.3	2.2	2.1
Inventory / Sales (days)	49	67	67	67	67
Receivables (days)	33	41	40	40	40
Payables (days)	29	42	42	42	42
WC cycle (ex-cash) (days)	53	65	65	65	65

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Disclosure of Interest Statement

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)