MJP

Equity Research

Equity Research Report - Pharma

Date: Dec 31, 2023

Alkem Laboratories Ltd

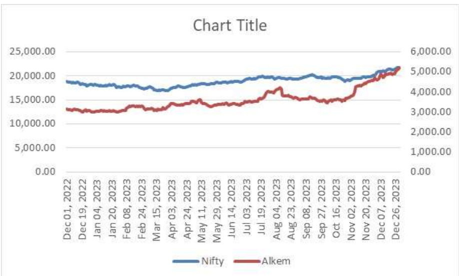
Analyst Recommendation: BUY

BSE Code: 539523 **NSE:ALKEM**

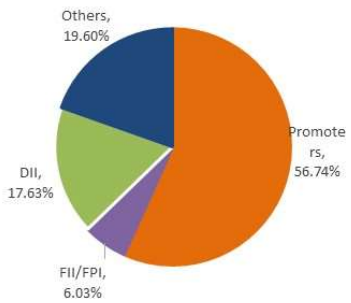
CMP:	**Rs 5203**
2 Year Target:	**Rs 6295**

Face Value	2.0
Market Cap (Rs cr)	62,205
52 week high/low	5217/2835
Shares O/S (Cr)	12
Book Value per Share (Rs)	823
Sensex	72,240
Nifty	21,730

1 yr. Price Chart of Stock and Nifty



Shareholding pattern as on 30th Sep 2023.



Investor's Rationale

Alkem Laboratories (ALKEM) is ranked fifth in IPM and numero uno in anti-infectives. After a prolonged investment phase with 5,000 MR additions over last five years, it's focus is now on margins (which tanked to 14% in FY23). To this end, it is targeting the high-growth chronic market by launching products and plugging portfolio gaps

Strong acute business; chronic pivot to add momentum: AKLEM has built a solid domestic business, mainly in the acute segment and trade generics. However, its diluted chronic segment focus has reflected in overall domestic growth over the past few years; we believe the company will fix this with its aggressive approach as given the appointment of an industry veteran to lead the business. Plugging of portfolio gaps and increased MR servicing intensity would ensure prescriptions from KOLs, facilitating market share gains in a highly fragmented segment. We expect an 11% domestic business CAGR despite a slow 1HFY24

We expect higher domestic margins (+650-700bps over FY23-FY26E) for AKLEM ahead with (a) better productivity of chronic MRs, (b) full-year benefit of recent NLEM price hikes, and (c) a greater chronic market share. Closure of the St. Louis facility (100-120bps impact) would aid further. A possible correction in Pen-G prices after Aurobindo's Pen-G plant commissioning could buoy gross margins.

- **Valuation**

With a strong earnings CAGR and ROICs of 33% (FY23: 14%), we expect a multiple re-rating. Initiate coverage with LONG and a Mar'25 TP of Rs 6,295 at 30x P/E.

	FY23A	FY24E	FY25E	FY26E
Revenue (Rs. Million)	1,15,993.0	1,30,145.0	1,42,484.0	1,58,081.0
EBITDA (Rs. Million)	16,095.0	24,557.0	29,761.0	35,351.0
Adj. profit (Rs. Million)	10,872.0	19,874.0	24,198.0	25,913.0
ROE	12.3	20.6	22.1	20.8
ROIC	10.1	17.7	19.5	19
P/E	54.9	30	24.7	23
EV/EBITDA	9.8	22.7	18.3	15
EV/Sales	1.4	4.3	3.8	3.3

Domestic Business – Margins to improve, Chronic segment in focus

Margins hit a low of 14% in FY23

ALKEM's margins have been under pressure owing to (a) investments in its chronic business, (b) losses in the US market and (c) investments in biosimilars through its Enzene subsidiary. We see better margins ahead as the company benefits from strong operating leverage with (a) closure of its St. Louis facility,

(b) MR hiring behind and better PCPM and (c) no further investments in Enzene towards regulated markets.

Prolonged investment phase with continuous MR additions: ALKEM has been in an investment phase with more than 3,000 MR additions over the last five years. As promotional activities were absent during COVID, there was limited impact of new MRs recruited during FY20-FY22. However, resumption of field force activity along with new MR costs pulled down EBITDA margins to a low of 14% in FY23.

US business – Favourable despite a commoditised portfolio; cost optimisation to boost overall margin profile

ALKEM's US business constitutes ~20% of overall revenues driven by commoditised generic products. Margins for this market have been under stress owing to intense pricing pressure, leading to stagnant revenue over the last four years and losses at its St. Louis facility (focused on controlled substances).

ALKEM has recently shut its St Louis facility as the opportunity size in controlled substances has thwarted and the scope for margin expansion remains limited. Closure of the facility would boost consolidated margins by 100-120bps, implying annual savings of Rs 1bn-1.1bn in FY24.

To benefit from small base, 8-10 new launches each year

ALKEM has a relatively small base in the US business with revenues at US$360mn (2QFY24 annualized). Owing to its small base we see limited impact of price erosion in the US, and it shall continue to grow with 8-10 new launches each year.

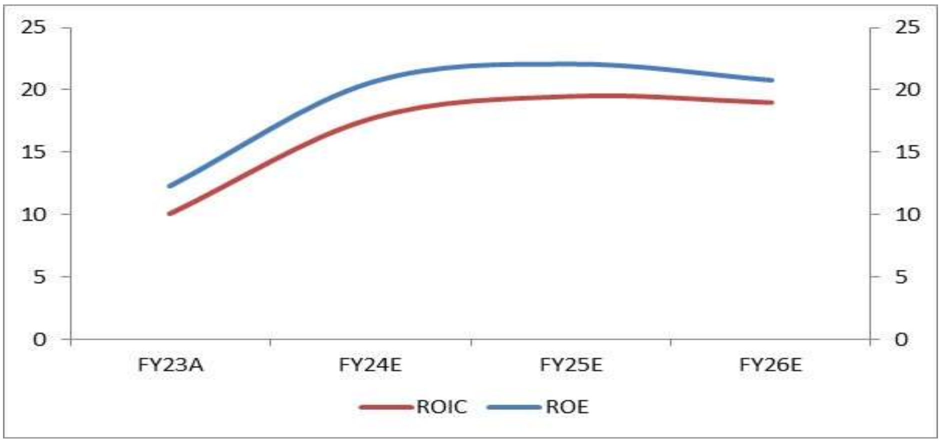
Pipeline broadly commoditised

Our analysis of ALKEM's US pipeline suggests that a large part of its pipeline is commoditised and would see intense generic competition from Day-1. Thus, contribution from each ANDA would be limited to US$ 1.5mn-2mn annually

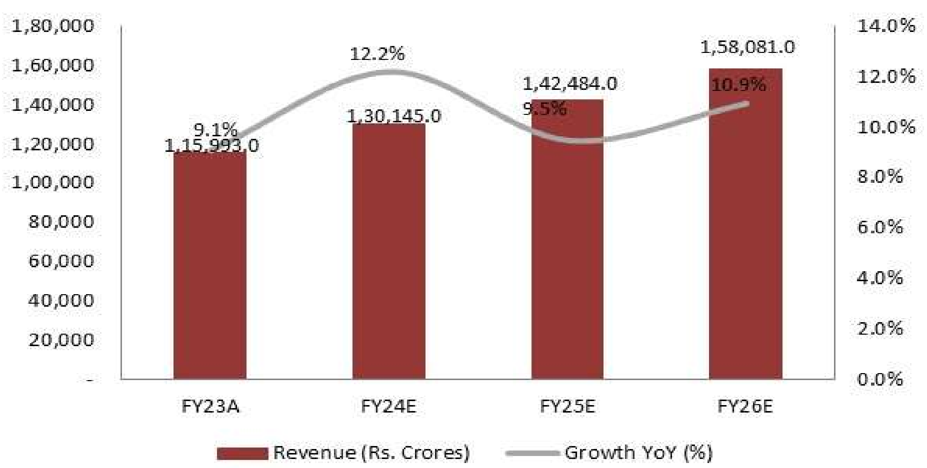
Cost optimisation to aid margins

- AKLEM has seen a sharp increase in opex over the last three years owing to MR additions, escalated price erosions in the US, and higher Pen-G prices. All combined led to a sharp 130bps margin contraction over FY19-FY23.
- With MR additions now over, Enzene R&D spends already peaked, and cost optimisation measures (loss-making St Louis facility shut down) undertaken, we believe opex will see an inflationary increase going forward. Moreover, with commercialisation of Aurobindo's Pen-G plant, we believe supply in the market will increase, pulling down Pen-G prices.
- Solid revenue growth along with cost optimisation measures would bring in strong operating leverage and pave the way for margin improvement to 22% in FY26E from 14% in FY23. We model for sharp margin gains as against the company's guidance of 100bps expansion each year over its FY24E guided margin of 16.5%
- Closure of St. Louis facility – a margin lever: AKLEM's API (or formulation) facility in St. Louis is for controlled substances. The company is anticipating Rs 1bn-1.1bn of annualised savings from the closure of this facility. This is expected to improve EBITDA margins by 100bps-120bps and will be factored in FY24.
- Correction in Pen-G prices to help gross margins: ALKEM has high dependence on Pen-G which has seen a sharp 5x increase in prices (over FY19) following COVID-led disruptions. As global supplies are normalising and Aurobindo is to add a 15k MT plant under the PLI scheme, we expect Pen-G prices to cool off over the coming years. While this could buoy gross margins and positively surprise our as well street estimates, we are not building in any margin improvement from Pen-G prices as of now..

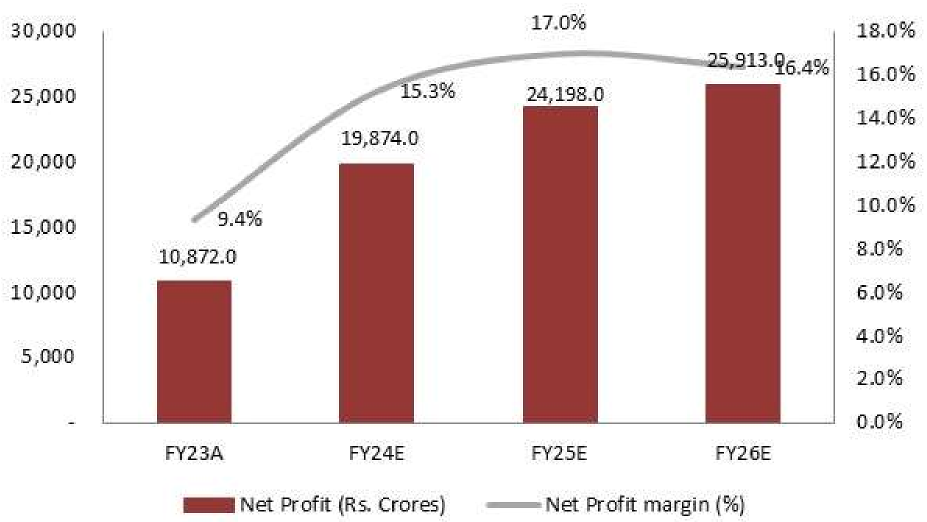
Return ratios to show strong growth in future



Revenue will experience Strong growth



Net profit will experience a growth trajectory



Outlook and Valuation

Domestic heavy companies saw massive rerating barring ALKEM: ALKEM's weak profitability as well as tepid EBITDA CAGR of 10% has been an overhang on its valuation multiple over the past years. Companies with heavy contribution from domestic biz has seen a massive re-rating from 25x PE to 30- 35x PE over the past years.

Strong growth on cards with margin improvement in sight: We expect ALKEM's EBITDA to growth at 30% CAGR over FY23-FY26E to Rs. 35bn. Strong growth over the next 3 years shall lead to a strong return profile improvement to 35bn/22% from 16bn/14% in FY23.

Branded generics to outperform US generics: Overall product concertation across all the companies have risen over the last 12 months with majority of products going to run a short stint and with a bleak pipeline in sigh across the companies, we believe replacing these products with new ones is going to be a tall task for them. Considering improving margins and sustainable earnings growth in domestic biz, we believe branded generics will be preferred over the US generics.

Initiate with Long: Strong CAGR of 11%/30% in revenue/EBITDA over next three years along with ROIC improvement to 33%, we believe multiple between ALKEM and other domestic heavy companies with narrow down over the coming years. We believe street estimates will be revised up over the coming period. We initiate coverage on ALKEM with a Mar'25 TP of Rs. 6,295 set at 30x P/E

Alkem Laboratories Ltd- Company Overview

Alkem is the fifth largest player in domestic formulation market with a market share of 3.9% as on March 31, 2022. It has established its leadership position in acute therapy, with a strong market position in anti-infective, gastrointestinal, pain management, vitamins, minerals, and nutrient segments.

Product Portfolio-Branded Generics, Generic Drugs, API, Nutraceuticals and Biosimilars

.Alkem has 21 manufacturing facilities (19 in India + 2 in US) as on March 31, 2022. Within India, its manufacturing facilities are located in Daman, Baddi, Indore, and Sikkim with 3,000+ employees. The manufacturing facilities possess the requisite regulatory approvals from several drug regulatory agencies. They are routinely audited to ensure compliance with current Good Manufacturing Practices (GMP).

Balance sheet (Consolidated)

(Rs million)	FY23A	FY24E	FY25E	FY26E
Liabilities				
Equity Capital	239	239	239	239
Reserves	90,214	1,02,138	1,16,657	1,32,205
Net worth	**90,453**	**1,02,377**	**1,16,896**	**1,32,444**
Total Debt	13,072	8,072	3,072	72
Other long term liabilities	6,145	6,145	6,145	6,145
Minority Interest	3,897	3,964	3,964	3,964
Total Liabilities	**1,13,567**	**1,20,558**	**1,30,077**	**1,42,625**
Assets				
Net Fixed Assets	22,697	22,560	21,959	21,102
Capital WIP	3,232	3,232	3,232	3,232
Long Term Investments	3,046	3,046	3,046	3,046
Other current assets	21,295	21,295	21,295	21,295
Net Current Assets	63,297	70,425	80,545	93,950
Total Assets	**1,13,567**	**1,20,558**	**1,30,077**	**1,42,625**

Profit & Loss Account (Consolidated)

(Rs million)	FY23A	FY24E	FY25E	FY26E
Total operating Income	**1,15,993**	**1,30,145**	**1,42,484**	**1,58,081**
EBITDA	**16,095**	**24,557**	**29,761**	**35,351**
Depreciation	**3,104**	**3,136**	**3,602**	**3,857**
EBIT	**12,991**	**21,421**	**26,159**	**31,494**
Interest cost	1,074	932	252	6
Other Income & Extraordinary Items	2,161	2,258	2,561	3,062
Profit before tax	**14,078**	**22,747**	**28,468**	**34,551**
Tax	2,980	2,806	4,270	8,638
Minority Interests	226.00	67.00	-	-
P/L from Associates				
Other				
Adjusted PAT	**10,872**	**19,874**	**24,198**	**25,913**

Cashflow Statement (Consolidated)

Y.E March (Rs Million)	FY23A	FY24E	FY25E	FY26E
Profit Before Tax	**14,078**	**22,747**	**28,468**	**34,551**
Depreciation	3,104	3,136	3,602	3,857
Others	-6,604	-	-	-
Tax paid	-2,980	-2,806	-4,270	-8,638
Change in WC	3,268	-1,009	1,165	1,561
Cash flow from operating activities	**10,866**	**22,068**	**28,965**	**31,331**
Change in Invest.	1,955	-	-	-
Others	1,471	3,136	3,602	3,857
Investing Cashflow	1,128	-136	-602	-857
Change in Debt	-13,023	-5,000	-5,000	-3,000
Change in Equity	**1,615**	**-**	**-**	**-**
Others	-6,200	-7,949	-9,679	-10,365
Financing Cashflow	**-17,608**	**-12,949**	**-14,679**	**-13,365**
	-	-	-	-
Net Change in Cash	**-5,614**	**8,982**	**13,684**	**17,109**

Key Ratios & Valuations (Consolidated)

Y.E March	FY23A	FY24E	FY25E	FY26E
Per share data (Rs.)				
BVPS	754.00	853.00	974.00	1,104.00
EPS	90.60	165.60	201.60	215.90
DPS	44.00	66.00	81.00	87.00
Margin (%)				
EBITDA	13.9%	18.9%	20.9%	22.4%
NPM	9.4%	15.3%	17.0%	16.4%
Return Ratios (%)				
ROE	12.30	20.60	22.10	20.80
ROIC	10.10	17.70	19.50	19.00
Valuation(x)				
P/E	54.9	30.0	24.7	23.0
EV/EBITDA	9.8	22.7	18.3	15.0
EV/Sales	1.4	4.3	3.8	3.3

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Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Between 10% & -5%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than -5%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.*

Member: BSE, NSE, MCX, MCX-SX, CDSL

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