

BSE Code: 539523
NSE Code: ALKEM
Reuters Code: ALKE:NS
Bloomberg Code: ALKEM:IN

Poised for robust growth

Alkem Labs is a leading Indian pharmaceutical company engaged in the manufacturing of branded generics, generic drugs, active pharmaceutical ingredients ("APIs") and Nutraceuticals. Indian business contributes 73% to overall sales while international business contributes for the rest.

Investment Rationale

🌀 **Domestic business to outperform the IPM growth:** Alkem has a comprehensive portfolio of over 700 brands spanning across major therapeutic segments such as Anti-infectives (42% of sales), Gastro-intestinal (18% of sales), Pain / Analgesics (12% of sales) and Vitamins / Minerals (8% of sales). The company has been consistently outperforming the IPM over the past ten years with improving market share in Anti-infectives (12% market share), Gastro-intestinal (6% market share) and Pain / Analgesics (5% market share). Importantly during FY16, 5 of the company's leading brands were featured among the top 50 while 14 brands were among the top 300 in the Indian pharmaceutical industry.

.....Robust strategy to help overcome regulatory hurdles

Given the company's strong presence in the domestic formulation space, the regulatory headwinds related to NLEM (National List of Essential Medicines) and ban on FDC (fixed-dose combination) products are bound to impact revenues in FY17. However, Alkem has a robust strategy in place to overcome these hurdles. The company on one hand is consolidating its position in the established acute therapies and other hand expanding presence through new launches in the fast-growing chronic therapies (53 new products launched during FY16) while also taking price hikes. We believe all these initiatives will enable Alkem to report strong growth in FY18/19E and hence, we expect domestic business to grow at a CAGR of 17% over FY16-19E.

🌀 US to drive the exports revenue

US is a major contributor to international formulations & thus is a key focus market for the company. The company is witnessing strong demand for its products and is well placed to capitalize on the market opportunities given its established front end. Further, it has a healthy product pipeline of 77 ANDAs (31 of these are Para IV filings) and will continue to file 12-15 ANDAs every year. With this, the advantages of GDUFA (Generic Drug User Fee Act) system in terms of reducing approval timelines will lead to more product launches going forward and revenue to grow at a CAGR of 22.3% over FY16-19E.

Valuation: We expect revenue and PAT to grow at a CAGR of 18.5 & 21.7% respectively over FY16-19E. Further, EBITDA margin is expected to improve by 280bps on account of increasing launches in chronic products coupled with consolidation in acute therapies. Hence, we initiate Alkem with a BUY rating with a TP of Rs.1926 based on 19x FY19E EPS.

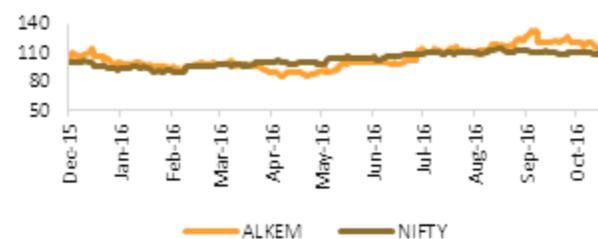
Market Data

Rating	BUY
CMP (Rs.)	1,637
Target (Rs.)	1,926
Potential Upside	18%
Duration	Long Term
Face Value (Rs.)	2.0
52 week H/L (Rs.)	1,853/1,175
Adj. all time High (Rs.)	1,853
Decline from 52WH (%)	11.6
Rise from 52WL (%)	39.0
Beta	0.7
Mkt. Cap (Rs.Cr)	19,577

Fiscal Year Ended

Y/E	FY16	FY17E	FY18E	FY19E
Net sales (Rs.Cr)	4,876.9	5,711.1	6,762.2	8,116.9
Adj. profit (Rs.Cr)	673	878	956	1,212
EPS (Rs.)	56.3	73.4	80.0	101.4
P/E (x)	29.1	22.3	20.5	16.2
P/BV (x)	5.6	4.7	3.9	3.3
ROE (%)	20.7	22.8	20.8	22.1

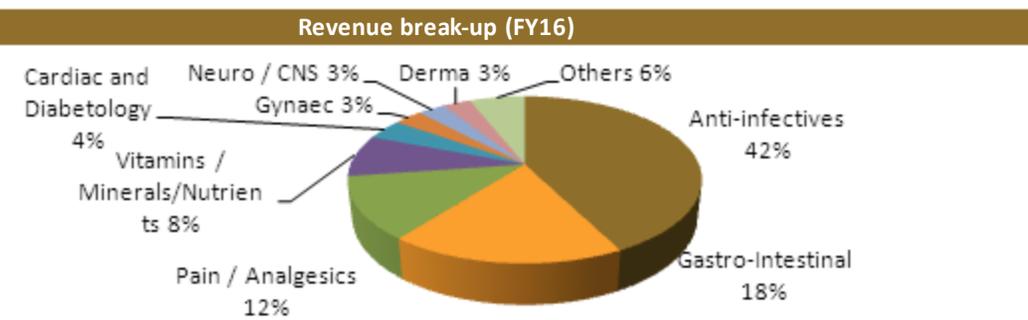
One year Price Chart



Shareholding Pattern	Sept-16	Jun-16	Chg.
Promoters (%)	66.8	66.8	0
Public (%)	33.2	33.2	0

Company Overview

Alkem Labs, a leading Indian pharmaceutical company is engaged in the manufacturing of branded generics, generic drugs, active pharmaceutical ingredients (“APIs”) and Nutraceuticals. Indian business contributes 73% to overall sales while international business contributes the rest. Alkem markets its products in India and 55 countries internationally. The company has 16 manufacturing facilities - 14 in India and 2 in the US (6 of its facilities are USFDA approved). Some of the company’s manufacturing plants enjoy fiscal benefits that are available for different periods.



Source: Company, In-house research

Domestic business: On strong foothold despite regulatory headwinds

The company is the fifth largest pharmaceutical company and is also the third fastest growing company among the top ten pharmaceutical companies in the Indian domestic formulations market. The Indian formulations business contributed 72.5% to total revenues in FY16 and grew at a CAGR of 19.4% over FY11-16 led by mainly led by strong growth in acute products. In FY16, domestic business reported 30.3% growth vs. Indian pharmaceutical market (IPM) growth of 13.5%. Alkem’s domestic business comprises of established therapies and emerging therapies. The established therapies consist of anti-infectives; gastrointestinal; pain and analgesics; vitamins, minerals and nutrients, which together account for 80% of the total domestic sales. The company has been outperforming the market consistently in these therapies led by market share gains and new product introductions. The emerging therapies (comprise of Neuro/CNS, Derma, Cardiac and Anti-diabetes) contribute just 10% to the domestic sales however there is huge scope for growth on account of increasing chronic ailments.

Alkem has a comprehensive portfolio of over 700 brands spanning across major therapeutic segments such as Anti-infectives (42% of sales), Gastro-intestinal (18% of sales), Pain / Analgesics (12% of sales) and Vitamins / Minerals (8% of sales). The company has been consistently outperforming the IPM over the past ten years with improving market share in Anti-infectives (12% market share), Gastro-intestinal (6% market share) and Pain / Analgesics (5% market share). Importantly during FY16, 5 of the company’s leading brands were featured among the top 50 while 14 brands were among the top 300 in the Indian pharmaceutical industry.

Alkem’s top therapies Market size in India (FY16)

	Rs. Cr
Anti-infectives	11,300
Gastro-intestinal	9,800
Pain/Analgesics	7,100
Vitamins/Minerals/Nutrients	7,000

Source: Company, In-house research

Company's Therapeutic performance

Therapeutic area	Alkem rank	Alkem's sales in Rs. Cr	Mkt. share	Mkt. size in Rs. Cr	Company's CAGR	Market CAGR
	FY15				FY11-15	
Anti-infectives	1	1,191	11.2%	10,555	10.1%	6.8%
Gastro-intestinal	3	467	5.6%	8,409	17.5%	12.8%
Pain/Analgesics	3	312	5.0%	6,269	12.0%	10.9%
Vitamins/Minerals	6	225	3.7%	6,018	19.1%	12.1%
Gynaecology	9	100	2.4%	4,226	11.2%	10.4%
Respiratory	18	95	1.5%	6,463	8.3%	11.4%
Neuro/CNS	15	90	1.9%	4,662	33.7%	12.8%
Derma	15	76	1.5%	5,087	36.8%	17.5%
Cardiac	31	46	0.5%	9,022	40.1%	13.3%
Anti-diabetic	29	45	0.7%	6,232	69.7%	21.1%
Others	NA	72	0.8%	9,439	21.1%	12.3%

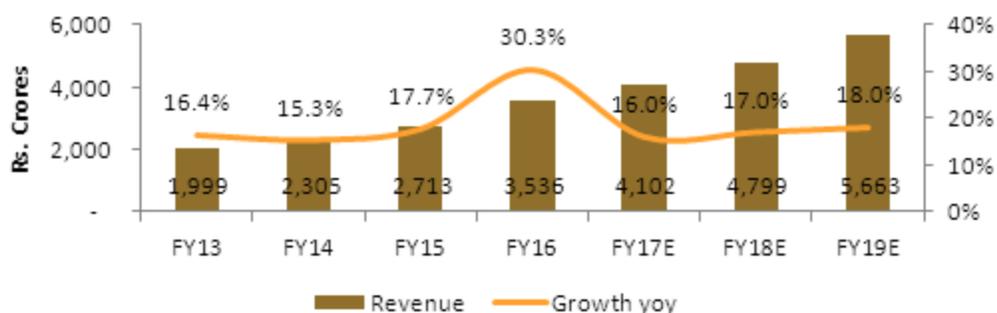
Source: Company, In-house research

Given the company's strong presence in the domestic formulation space, the regulatory headwinds related to NLEM (National List of Essential Medicines) and ban on FDC (fixed-dose combination) products are bound to impact revenues in FY17. However, Alkem has a robust strategy in place to overcome these hurdles. The company on one hand is consolidating its position in the established acute therapies and other hand expanding presence through new launches in the fast-growing chronic therapies (53 new products launched during FY16) while also taking price hikes. We believe all these initiatives will enable Alkem to report strong growth in FY18/19E and hence, we expect domestic business to grow at a CAGR of 17% over FY16-19E.

Therapeutic Areas	Rank FY16	Market Share (FY 2016)	Annual sales range (In Rs. Cr)
Anti-infectives	1	12%	>200
Gastro intestinal	3	6%	150-200
Pain/Analgesics	3	5%	50-150
Vitamins/Minerals/Nutrients	5	4%	25-50

Source: Company, In-house research

Domestic business to grow at a CAGR of 17% during FY16-19E

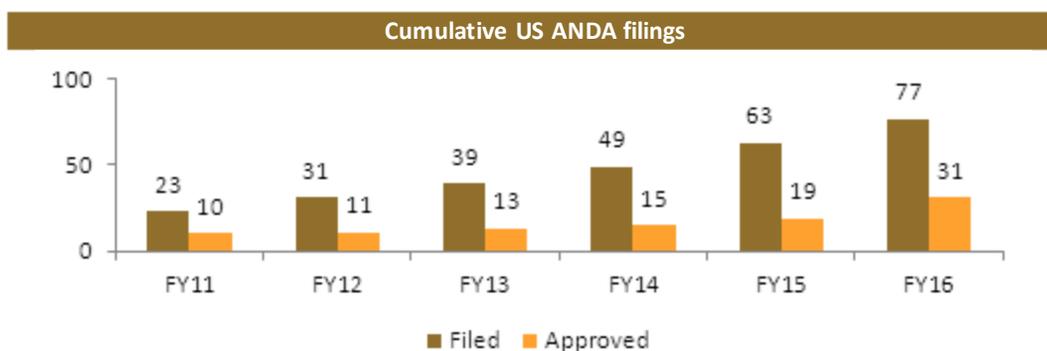


Source: Company, In-house research

International business: Poised for strong growth

US is a major contributor to international formulations & thus is a key focus market for the company. The company is witnessing strong demand for its products and is well placed to capitalize on the market opportunities given its established front end. Further, it has a healthy product pipeline of 77 ANDAs (31 of these are Para IV filings) and will continue to file 12-15 ANDAs every year. With this, the advantages of GDUFA (Generic Drug User Fee Act) system in terms of reducing approval timelines will lead to more product launches going forward and revenue to grow at a CAGR of 22.3% over FY16-19E.

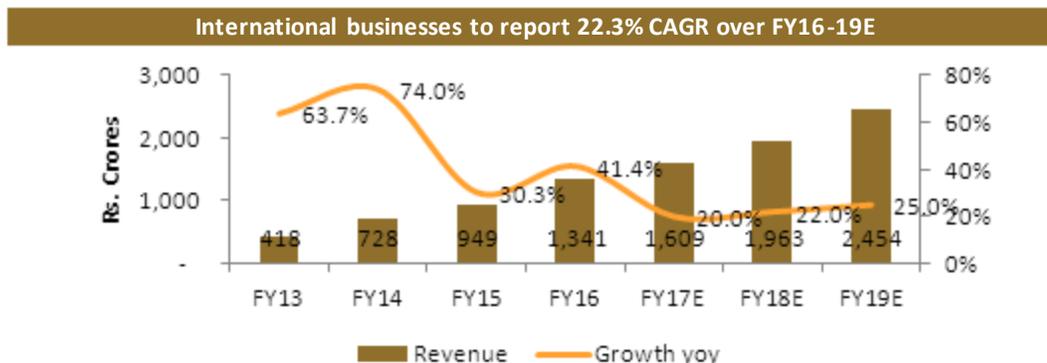
Apart from US, the company also has presence in other markets such as Australia, Europe, South East Asia, Latin America, Africa and CIS. Though US is the key market for Alkem, the company is focusing on select other international markets to create strong local presence with required infrastructure and is developing capabilities to exploit growth opportunities.



Source: Company, In-house research

Acquisition of manufacturing facility to deepen its presence in US

In June 2015, the company acquired a formulation manufacturing facility along with its R&D capabilities from Long Pharmaceuticals LLC, in the US. This acquisition supports the company in diversifying its manufacturing footprint and also provides it with manufacturing capabilities in dosage forms like semi-solids, liquid and nasal formulations. The company is further scaling up the manufacturing capacity as it looks to file ANDAs in niche areas. Hence, we expect International revenue to grow at a CAGR of 22.3% over FY16-19E.



Source: Company, In-house research

Key Risks:

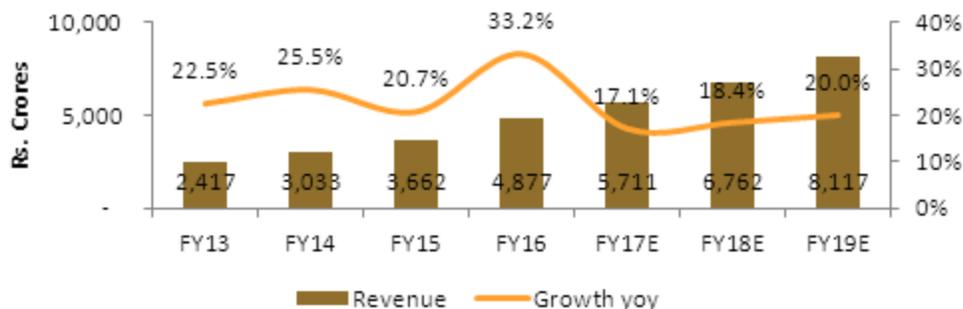
- New drugs inclusion in NLEM and FDC list.
- USFDA inspections and delay in key ANDA approvals.

Financials

Revenue to grow at CAGR of 18.5% with EBITDA margin expansion of 280 bps

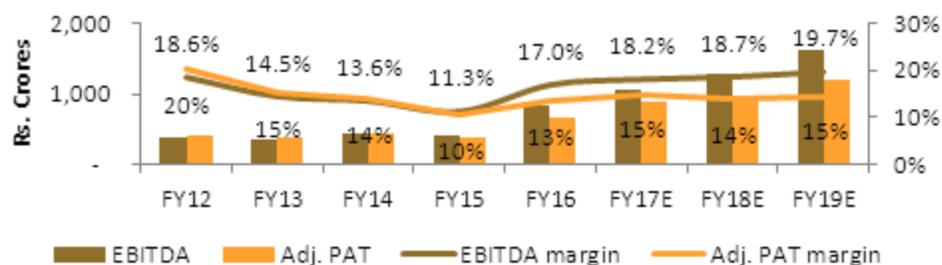
We expect revenue to grow at a CAGR of 18.5% over FY16-19E driven by: 1) consolidation of its leadership position in acute therapies 2) increasing presence in chronic therapies through new product launches 3) strong growth in US. Further, we expect EBITDA margin to expand by 280bps over FY16-19E led by improving profitability in chronic therapies & shift to non-FDC products. Hence, we expect PAT to grow at a CAGR of 21.7% over FY16-19E.

Revenue to grow at a CAGR of 17% over FY16-19E



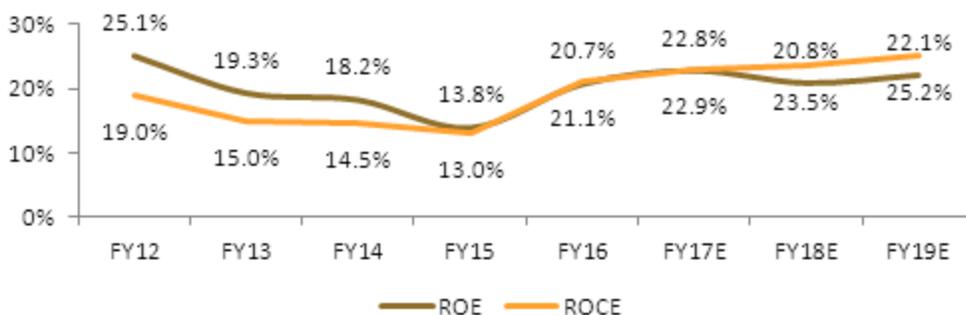
Source: Company, In-house research

EBITDA & PAT margin to improve by 280 bps, 110 bps respectively



Source: Company, In-house research

Return ratios trend



Source: Company, In-house research

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Total operating Income	4,992	5,845	6,921	8,308
Raw Material cost	1,961	2,264	2,647	3,096
Employee cost	917	1,028	1,217	1,461
Other operating expenses	1,265	1,492	1,765	2,110
EBITDA	848	1,061	1,292	1,640
Depreciation	101	148	178	202
EBIT	748	914	1,114	1,438
Interest cost	67	45	45	45
Other Income	165	142	142	142
Profit before tax	845	1,011	1,212	1,535
Tax	161	121	242	307
Profit after tax	685	890	969	1,228
Minority Interests	11	12	13	16
P/L from Associates	-	-	-	-
Adjusted PAT	673	878	956	1,212
E/o income / (Expense)	-	-	-	-
Reported PAT	673	878	956	1,212

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Paid up capital	24	24	24	24
Reserves and Surplus	3,482	4,176	4,950	5,979
Net worth	3,506	4,200	4,974	6,003
Minority interest	97	108	121	138
Total Debt	655	655	655	655
Other non-current liabilities	175	183	183	183
Total Liabilities	4,432	5,147	5,934	6,979
Total fixed assets	1,089	1,513	1,766	1,914
Capital WIP	172	180	100	100
Goodwill	353	353	353	353
Investments	422	422	422	422
Net Current assets	1,512	1,786	2,401	3,298
Deferred tax assets (net)	-	8	8	8
Other non-current assets	884	884	884	884
Total Assets	4,432	5,147	5,934	6,979

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY16	FY17E	FY18E	FY19E
Pretax profit	845	1,011	1,212	1,535
Depreciation	101	148	178	202
Chg. in Working Capital	(30)	(142)	(194)	(218)
Others	8	(97)	(97)	(97)
Tax paid	(198)	(121)	(242)	(307)
Cash flow from operating activities	726	797	856	1,115
Capital expenditure	(257)	(580)	(350)	(350)
Chg. in investments	32	-	-	-
Other investing cashflow	411	142	142	142
Cash flow from investing activities	186	(438)	(208)	(208)
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	(671)	-	-	-
Dividend paid	(185)	(183)	(183)	(183)
Other financing activities	(71)	(45)	(45)	(45)
Cash flow from financing activities	(927)	(228)	(228)	(228)
Net chg in cash	(15)	132	420	679

Key Ratios (Consolidated)

Y/E	FY16	FY17E	FY18E	FY19E
Valuation(x)				
P/E	29.1	22.3	20.5	16.2
EV/EBITDA	23.0	18.3	14.7	11.2
EV/Net Sales	4.0	3.4	2.8	2.3
P/B	5.6	4.7	3.9	3.3
Per share data (Rs)				
EPS	56.3	73.4	80.0	101.4
DPS	12.7	12.7	12.7	12.7
BVPS	293.2	351.3	416.1	502.1
Growth (%)				
Net Sales	33.2	17.1	18.4	20.0
EBITDA	101.1	25.1	21.8	26.9
Net profit	71.9	30.4	9.0	26.7
Operating Ratios				
EBITDA Margin (%)	17.0	18.2	18.7	19.7
EBIT Margin (%)	15.0	15.6	16.1	17.3
PAT Margin (%)	13.5	15.0	13.8	14.6
Return Ratios (%)				
RoE	20.7	22.8	20.8	22.1
RoCE	21.1	22.9	23.5	25.2
Turnover Ratios (x)				
Net Sales/GFA	3.3	3.1	2.9	3.0

Rating Criteria

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

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

* Alkem is a Large-cap company

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Contact Us:

Funds India

Uttam Building, Third Floor |
No. 38 & 39 | Whites Road |
Royapettah | Chennai – 600014 |

T: +91 7667 166 166

Email: contact@fundsindia.com

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