

Alkem Laboratories



Uniquely positioned

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Alkem Laboratories

BSE Sensex

33,619

S&P CNX

10,370

CMP: INR1,968

TP: INR2,500(+27%)

Upgrade to Buy



Stock Info

Bloomberg	ALKEM IN
Equity Shares (m)	119.6
52-Week Range (INR)	2238 / 1535
1, 6, 12 Rel. Per (%)	4/-6/-12
M.Cap. (INR b)	231.5
M.Cap. (USD b)	3.6
Avg Val, INRm	87.3
Free float (%)	33.0

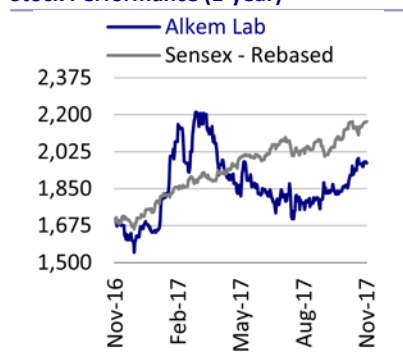
Financial Snapshot (INR b)

Y/E Mar	2017	2018E	2019E
Sales	58.5	61.8	72.5
EBITDA	10.0	11.6	13.8
NP	8.9	8.1	10.7
EPS (INR)	74.6	68.0	89.5
EPS Gr. (%)	6.0	-8.9	31.7
BV/Sh. (INR)	373.7	426.4	495.7
RoE (%)	21.9	17.0	19.4
RoCE (%)	20.1	16.0	21.5
P/E (x)	26.5	29.0	22.1
P/BV (x)	5.3	4.6	4.0

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	67	67	66.9
DII	2.3	2.4	3.3
FII	4.1	4.2	3.7
Others	26.6	26.4	26.1
FII Includes depository receipts			

Stock Performance (1-year)



Uniquely positioned

Fundamentals strong; valuations reasonable

- Domestic business set to grow at >20% over next three quarters:** Alkem Laboratories (ALKEM) has guided for GST-adjusted (impact of ~7%) growth of mid-teens in the domestic market in FY18. This would translate into >20% growth in 2HFY18 (growth will be >25% if we normalize it for GST). Also, in 1QFY19, we expect similar growth levels due to a low base effect (had lost almost one month of sales in 1QFY18 due to GST-related channel destocking). We expect strong growth over the next three quarters, given 1) a low base of 2HFY17 (impacted by demonetization) and 1QFY18 (impacted by GST) and 2) likely recovery of 8-10 days of sales in 3QFY18 due to channel restocking post GST. Also, the domestic business EBITDA margin has historically been >21% (>25% in Acute). Thus, high growth in the domestic business will lead to ~20% EBITDA margin over the next three quarters, as against a normalized EBITDA margin of ~17-17.5% for the company.
- Lower tax rate from FY19 to boost PAT by ~10%:** Tax rate for ALKEM has shot up to ~23% in FY18, as two of its three plants have come out of the tax haven status. However, given that the new Sikkim plant has become operational and will enjoy full tax benefits, the tax rate is expected to come down significantly to ~15-16% in FY19. Besides this, ALKEM is planning to shift production of profitable products to the new Sikkim plant, which will ensure tax savings.
- Opportunity for margin improvement in medium term:** Acute business (ex Indchemie and Cachet), which accounts for ~52-53% of its total sales, makes an EBITDA margin of >25%. However, the consolidated EBITDA margin for ALKEM was significantly low at ~17% in FY17 and 17.5% in 1HFY18E, primarily because all the other business verticals (~48% of revenue) make sub-par EBITDA margin of ~7%. Indchemie, Cachet and Chronic businesses make EBITDA margin of 5-9% in the domestic market, ~5-7% in the US and 11-12% in ROW. The US and domestic chronic businesses have been delivering lower margins, as these verticals were in the investment phase and achieved breakeven only 12-18 months back. There is scope for improvement though, in our view – if only the US and Chronic business EBITDA margins improve to ~20%, the consolidated EBITDA margin can improve by ~400bp to ~21%.
- Chronic – low base and efficiency improvement to drive growth:** Chronic has delivered top-line growth of ~21% over the last four years. We expect this segment to continue delivering robust growth, led by the low base effect, the focus on high-growth therapies (cardio, derma, anti-diabetic, etc.) and the contribution from its specialized sales team of ~1,700 people. We expect salesforce productivity in Chronic to improve considerably (currently at ~INR3m v/s company average of INR6.5m), led by deeper therapy penetration, insignificant addition to the team and investment in brand building. This will help fuel growth and drive profitability due to better operating leverage.

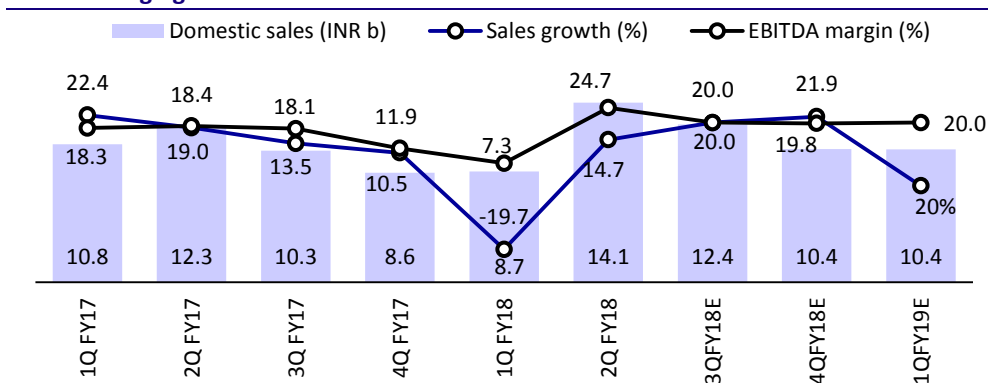
- **Strong presence in Acute (~90% of domestic sales) to provide stability:** We expect ALKEM to continue outperforming industry growth of ~10% in the Acute segment. This will be driven by its leadership status in key therapies (anti-infectives, GI, Pain/ analgesics and Vitamin), bridging of gaps in the product portfolio, and strong relationships with specialists (prescription coverage of >70%).
- **OTC business – a new growth avenue:** ALKEM has been investing over the last 12 months to establish presence in the INR145b OTC segment. Currently, OTC sales for ALKEM stand at ~INR700-800m. Tiger Balm is the main product in this segment, with secondary sales of INR600-700m. According to Emami investor presentation, the pain relief balm market is ~INR9b, with Zandu Balm holding ~56% market share. In FY17, ALKEM entered into an alliance with Haw Par Healthcare to exclusively market Tiger Balm. Given that 90% of balm sales happen through chemists, the company is gearing up to gain a market share in this segment. The company has also roped in Bollywood celebrities to promote its condom brand 'Playguard' (market size: ~INR4-5b) and pregnancy detection kit 'Pregakem' (market size: ~INR2.5-3b).
- **Indchemie, Cachet a drag on margins, but scope of recovery visible:** Indchemie and Cachet subsidiaries account for ~9-10% of the company's revenue. Although Indchemie (6% contribution to revenue) has a higher gross margin (~68%), its EBITDA margin stands at only ~9%. Cachet (5% contribution) has a very low gross margin (~46%) and EBITDA margin (1%). Given that Indchemie enjoys a better gross margin, cost efficiencies can help improve EBITDA margin for this subsidiary. We believe that margin improvement for Cachet may take time, as this would require a change in the product line, along with cost efficiencies.
- **US business: Two thirds of pending portfolio to be approved in next 24 months:** ALKEM's US business has already crossed breakeven point in 1HFY16. Its own front-end presence, coupled with ramp-up of existing products and new launches, will help drive profitability, in our view. The US business margin will continue improving led by operating leverage, as ~30 ANDA approvals are expected for ALKEM over the next 24 months.
- **Arguing for a multiple re-rating:** We have upgraded ALKEM to **Buy** from Neutral, with a target price of INR2,500 @24x December 2019E PER (v/s INR1,950 @ 1HFY20E PER. We argue for a multiple re-rating, given the company's superior earnings growth profile (>25% EPS CAGR over FY18-20E), improving return ratios (RoIC to improve to ~30% by FY20E from ~20% in FY18E), net cash balance sheet, and high exposure to the domestic business which accounts for ~90% of its profits.

Domestic business to grow at >20% over next three quarters

Alkem Laboratories (ALKEM) has guided for GST-adjusted (impact of ~7%) growth of mid-teens in the domestic market in FY18. This would translate into >20% growth in 2HFY18 (growth will be >25% if we normalize it for GST). Also, in 1QFY19, we expect similar growth levels due to a low base effect (had lost almost one month of sales in 1QFY18 due to GST-related channel destocking).

We expect strong growth over the next three quarters, given 1) a low base of 2HFY17 (impacted by demonetization) and 1QFY18 (impacted by GST) and 2) likely recovery of 8-10 days of sales in 3QFY18 due to channel restocking post GST. Also, the domestic business EBITDA margin has historically been >21% (>25% in Acute). Thus, high growth in the domestic business will lead to ~20% EBITDA margin over the next three quarters, as against a normalized EBITDA margin of ~17-17.5% for the company.

Exhibit 1: High growth in 2HFY18 on back of lower base



Source: Company, MOSL

Commencement of Sikkim facility to boost PAT

Over the past five years, the company's PAT has grown at a 17% CAGR. We expect its profit before tax to grow by ~15% YoY to INR11.1 in FY18. However, PAT is expected to decline by ~6% to INR8.4b in FY18 due to a higher tax rate (23% v/s 6.2% in FY17). Sikkim – Kumrek, which is the largest domestic facility of ALKEM in terms of capacity, moved out of the complete tax benefit of 100% in FY17, while Baddi – Betalactam facility moved out of the partial tax benefit of 30% in FY16.

However, the ramp-up of revenue from the new facility (with full tax benefit) will help boost company's PAT in FY19 by ~10%, as the consolidated tax rate is expected to come down to 15%.

Exhibit 2: Tax benefit to boost FY19E PAT by ~9%

	FY18E	FY19E	FY19E tax @ 23%	Tax benefit impact on PAT
PBT	11,045	12,914	12,914	
Tax	2,540	1,937	2,970	
Tax rate (%)	23	15	23	
PAT	8,505	10,977	9,944	(9.4)

Source: Company, MOSL

Exhibit 3: Key facilities and their contribution to domestic sales

Facility	Manufacturing capabilities	Capacity (millions)	Contribution to domestic sales
Sikkim - Kumrek	Tablets	2,556	45-50%
	Injectables	134.3	
	Dry syrup	9.2	
Sikkim - Samardund	Tablets	221.8	5-8%
	Injectables	135	
	Dry syrup	41.4	
Baddi - Betalactam	Tablets	280.9	5-8%
	Injectables	24.5	
	Dry syrup	21.1	
	Caspules	332.6	
Indchemie + Cachet + Contract manufacturing			35-40%

Source: Company, MOSL

Improvement in Chronic and US business margin to drive overall margin improvement

ALKEM's EBITDA margin expanded over the last 4-5 years from 13% to 17% (as of FY17), as the company increased its focus on high-growth and high-margin Chronic and US businesses. Currently, Chronic and US businesses contribute 4% and 8-8.5% of EBITDA, respectively, with ~7% EBITDA margin each. Although both the segments hold immense potential, their contribution has been subdued as they were in the expansion phase. This has restricted the company's overall margin to 16-17%.

The company's subsidiaries Indchemie and Cachet contribute ~9% of domestic revenue and 10-12% of total revenue, but only ~4% of EBITDA. Although Indchemie (6% contribution to revenue) has a higher gross margin (~68%), its EBITDA margin stands at only ~9%. Cachet (5% contribution) has both low gross margin (~46%) and EBITDA margin (1%).

On the other hand, peers Torrent Pharma and Eris Life Sciences, which have a greater share of Chronic, generate EBITDA margin of >35% in the domestic market.

We believe that once Chronic and US businesses pick up momentum (clocking ~20% margins), ALKEM's overall margin can reach ~21%.

Exhibit 4: FY17 EBITDA margin scenario

FY17 EBITDA margin	Sales contribution (%)	EBITDA contribution	EBITDA margin (%)
Indchemie+ Cachet	9.0	2.4	4.5%
Chronic	10.0	4.1	7.0%
US	20.6	8.4	7.0%
ROW	6.2	4.4	12.0%
Sub Total (Ex Acute)	45.8	19.3	7.2%
Acute (Ex Indchemie + Cachet)	54.2	80.7	25.4%
Total	100.0	100.0	17.1%

Source: Company, MOSL

Exhibit 5: EBITDA margin assuming 20% EBITDA margin in Chronic and US businesses (on base of FY17 sales)

Assuming 20% margin in US and chronic business	Sales contribution (%)	EBITDA contribution	EBITDA margin (%)
Indchemie+ Cachet	9.0	1.9	4.5%
Chronic	10.0	9.5	20.0%
US	20.6	19.5	20.0%
ROW	6.2	3.5	12.0%
Sub Total (Ex Acute)	45.8	34.5	15.9%
Acute (Ex Indchemie + Cachet)	54.2	65.5	25.4%
Total	100.0	100.0	21.0%

Source: Company, MOSL

Building presence in lucrative chronic segment

Industry CAGR in the chronic segment was ~13% over September 2013-17 v/s ~9% in the acute segment, indicating the promising prospects in the chronic business.

ALKEM is building its acute portfolio and also expanding its presence in the high-growth chronic segment. The company's sales in the chronic segment have grown at a 21% CAGR over September 2013-17, led by a lower base effect, an enhanced focus on high-growth therapies (CNS, Derma, Respiratory and Anti-diabetic), and investments in building a specialized sales force.

Exhibit 6: Chronic market grew at 13% CAGR over 2013-17

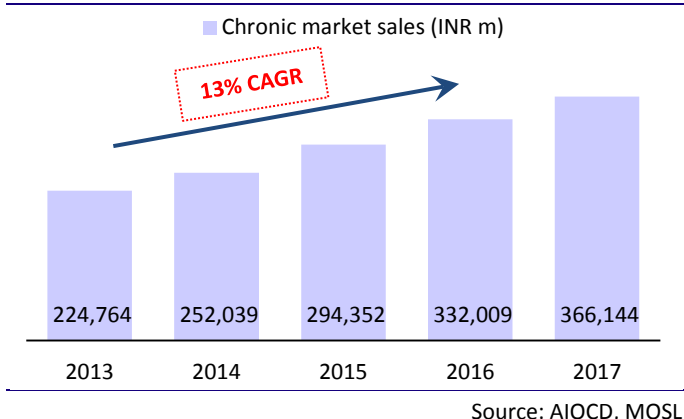
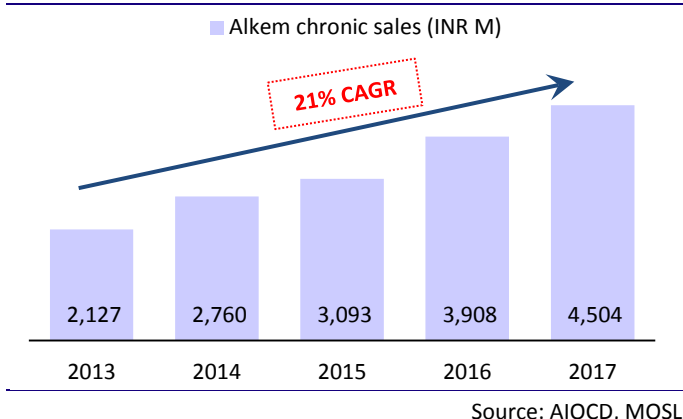


Exhibit 7: Alkem's chronic portfolio grew at 21% CAGR



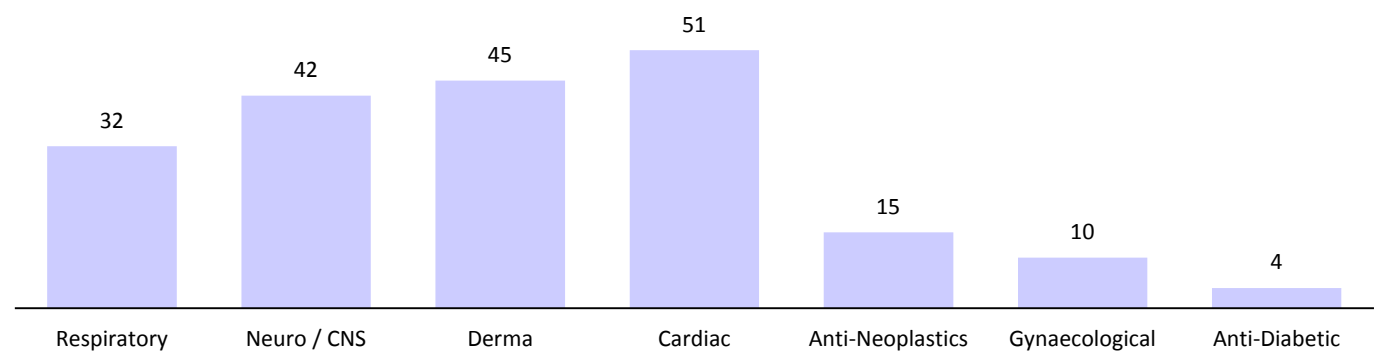
Superior performance in chronic therapies

In the chronic portfolio, anti-diabetic, derma and cardiac are the fastest-growing segments in India. In anti-diabetic, the market grew at a CAGR of 20.4% over FY13-17, while ALKEM outperformed with a CAGR of 54.3%. In the derma segment too, the market grew at a CAGR of 16.2%, while the company grew at 18%. Except for respiratory, the company has outperformed significantly in therapies like cardiac, CNS and gynecological.

Exhibit 8: Superior growth in chronic therapies

Therapy	Rank	Domestic sales (INR m)	Market share (%)	CAGR (13-17)	Overall Therapy market (INR m)	CAGR (13-17)
Neuro / CNS	10	1,773	2.6%	15.3%	68,195	11.5%
Derma	16	1,550	1.7%	18%	68,269	16.2%
Respiratory	23	893	1.1%	6.8%	84,861	11.9%
Cardiac	30	999	0.7%	28.7%	137,311	12.0%
Anti diabetic	23	1,068	1.1%	54.3%	97,451	20.4%
Gynecological	19	780	1.4%	15.8	57,531	9.5%

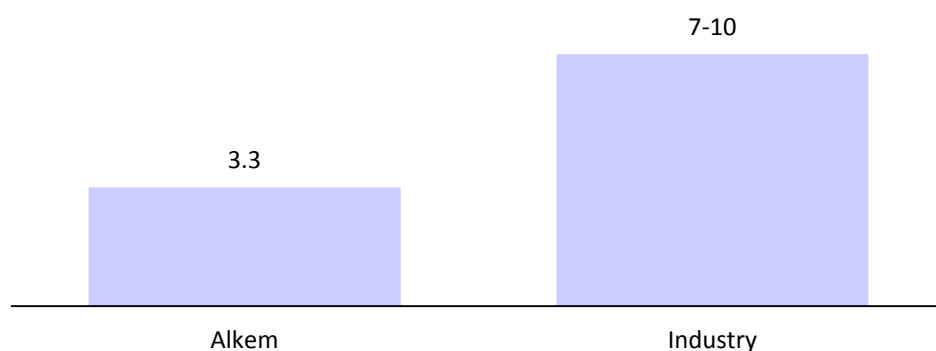
Source: AIOCD, MOSL

Exhibit 9: Launches in key chronic therapies over last five years

Source: AIOCD, MOSL

Strengthening chronic segment

Over the last four years, the company's chronic segment outperformed market growth by a big margin and has inched up in rankings as well. In the last five years, ALKEM has made significant investment in the chronic therapy segments of cardiac, anti-diabetic, neuro/CNS and dermatology. In FY18, it also forayed into urology. Notably, the company has a field force of 1,700 medical representatives dedicated for chronic therapy. We believe the momentum in chronic therapy will not only drive the company's top-line but also profitability over the long term.

Exhibit 10: Alkem's chronic segment MR productivity (INR m)

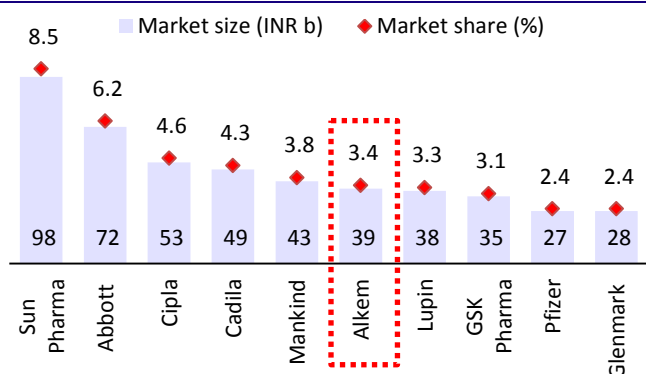
Source: Company, MOSL

ALKEM is a relatively new player in the chronic segment. Thus, its MR productivity is just INR3.3m, as against industry average of INR7-10m. We believe that as the gap between the company and industry narrows, not only the company's overall productivity (currently at INR6.5m) but also EBITDA margin would improve.

Dominant acute player

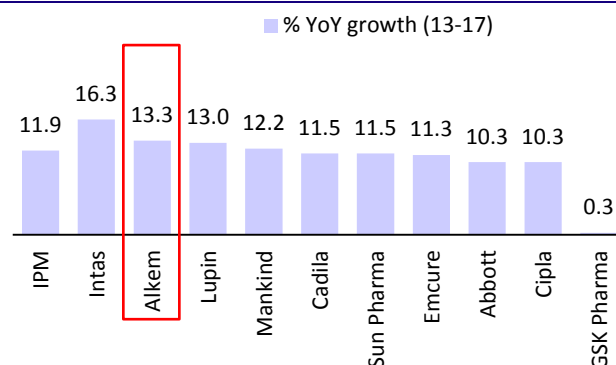
India business revenue for ALKEM grew at a CAGR of 20% over FY13-17. The company continues to be a dominant player in the India acute market, with leadership in anti-infective, gastro and vitamins therapies. Till today, the acute-chronic mix is largely skewed toward acute products (with ~90% sales coming from acute portfolio). Currently, it markets 700+ brands in the Indian pharma market.

Exhibit 11: 6th largest company in India



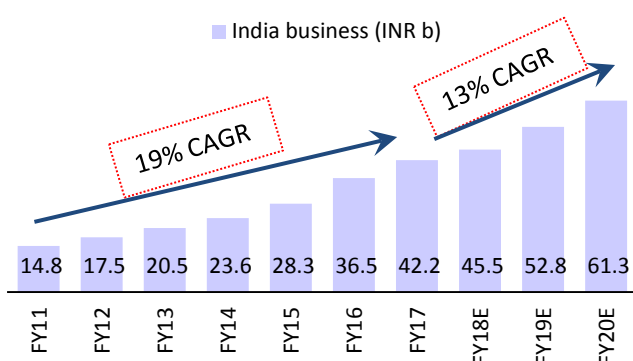
Source: AIOCD, MOSL

Exhibit 12: 2nd fastest growing company among top 10



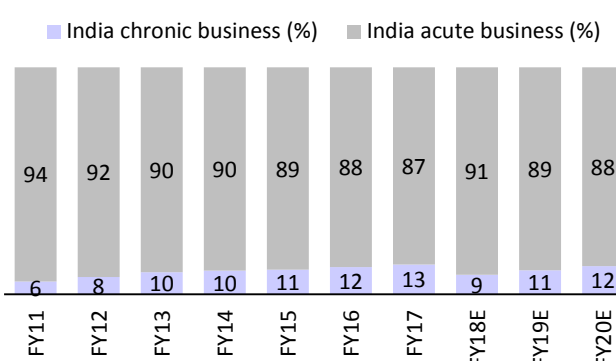
Source: AIOCD, MOSL

Exhibit 13: Domestic sales (INR b) (CAGR growth)



Source: Company, MOSL

Exhibit 14: Chronic segment contribution improving



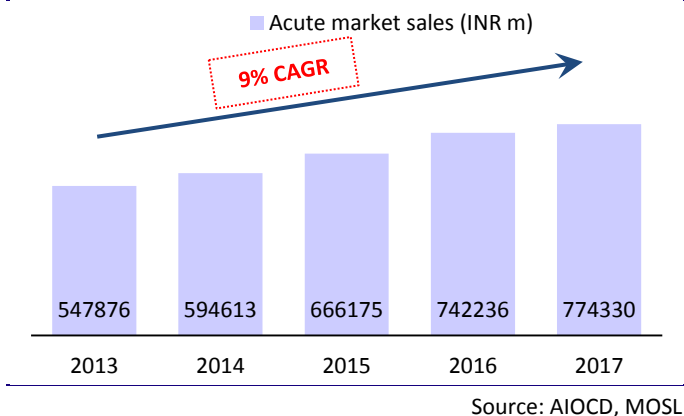
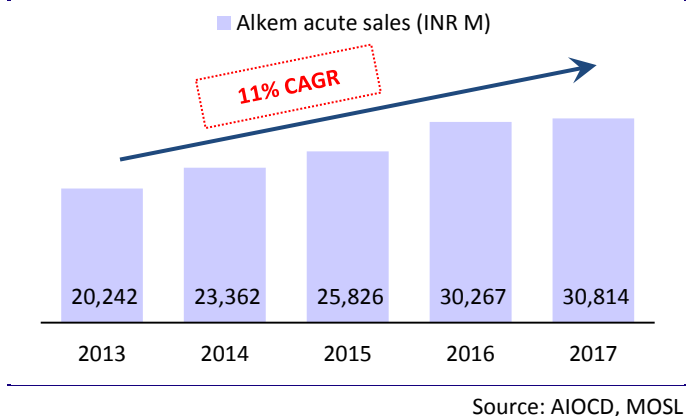
Source: Company, MOSL

Market leader in key acute therapies

According to the IMS, ALKEM is ranked 1st in anti-infective therapy, with a 12% market share. Similarly, it is ranked third in the gastro and pain segments, with market shares of 6% and 5.3%, respectively. It stands sixth in the vitamin market, with ~4% market share.

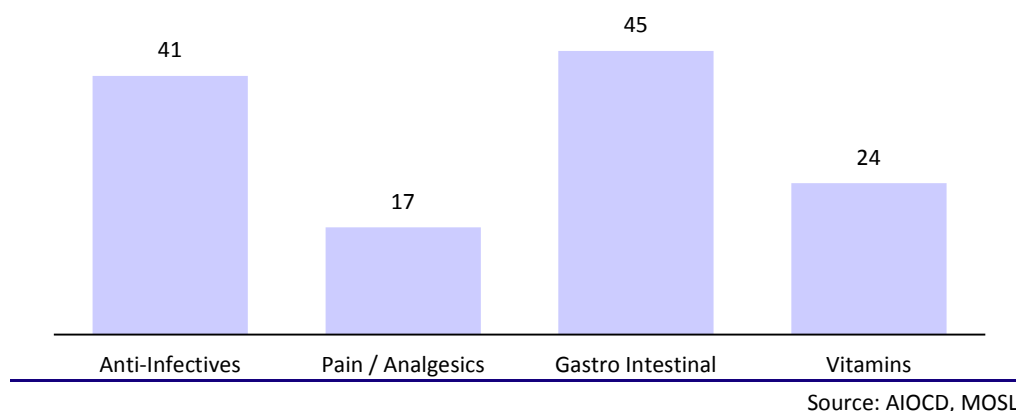
Leader but still outperforming market growth

ALKEM has been a market leader in the acute segment for the past seven years. Despite a high base effect, it has consistently grown ahead of the market. Industry CAGR for the acute segment stood at ~9% over September 2013-17, while ALKEM has grown at ~11% over the same period. This growth is primarily driven by its new product launches, brand loyalty, aggressive pricing strategy, and vast distribution reach across India.

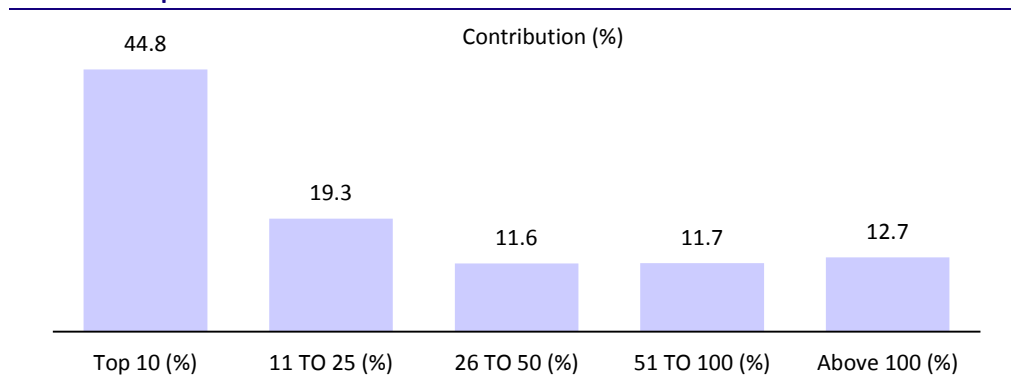
Exhibit 15: Acute market grew at 9% CAGR over Sept 2013-17**Exhibit 16: Alkem's Acute portfolio grew at 11% CAGR****Exhibit 17: Established player in key acute therapies**

Therapy	Rank	Domestic sales (INR m)	Market share (%)	CAGR (13-17)	Overall Therapy market (INR m)	CAGR (13-17)
Anti-infectives	1	14342	12.1	9.4	118529	5.6%
Gastro intestinal	3	6443	6.0%	17.0%	107383	12.3%
Pain / analgesics	3	4058	5.3%	15.6%	76566	10.5%
Vitamins	6	2879	3.7%	15.6%	77811	12.2%

Source: IMS, MOSL

Exhibit 18: Launches in key acute therapies over last five years**Diversified brand portfolio**

ALKEM has a well-diversified portfolio, with no over-dependence on any single brand (top-10 brands contribute ~45% of domestic sales and top-25 brands contribute ~60%).

Exhibit 19: Top 10 brands contribute 46% of total domestic sales

Source: AIOCD, MOSL

Exhibit 20: ALKEM's top 25 brands contribute ~60% of total sales (MAT Oct-17)

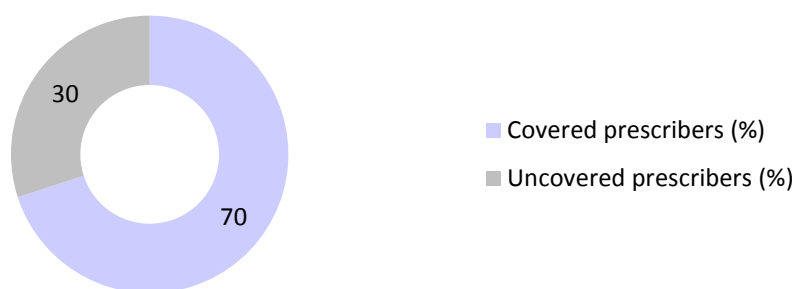
BRAND	MAT sales (INR m)					% YoY growth			
	Oct -13	Oct -14	Oct -15	Oct -16	Oct -17	Oct -14	Oct -15	Oct -16	Oct -17
CLAVAM	1,891	2,211	2,278	2,732	2,840	16.9	3.0	20.0	3.9
PAN	1,321	1,545	1,844	2,319	2,566	17.0	19.4	25.8	10.7
PAN D	977	1,262	1,509	1,881	2,267	29.1	19.6	24.7	20.5
TAXIM O	1,627	1,625	1,837	2,064	1,882	-0.1	13.0	12.4	-8.9
A TO Z NS	674	760	844	1,051	1,294	12.7	11.0	24.6	23.1
TAXIM	1,484	1,619	1,767	1,504	1,290	9.1	9.2	-14.9	-14.2
GEMCAL	667	839	961	1,072	1,085	25.8	14.6	11.6	1.2
XONE	808	837	896	1,060	999	3.6	6.9	18.4	-5.7
ONDEM	603	673	799	904	899	11.6	18.7	13.1	-0.5
SUMO	705	793	844	996	887	12.6	6.4	18.1	-11.0
PIPZO	413	586	642	815	789	41.9	9.5	27.0	-3.3
ZOCEF	447	536	653	719	749	20.0	21.8	10.2	4.1
XONE XP	378	455	553	727	672	20.2	21.5	31.6	-7.6
SWICH	378	460	487	642	650	21.8	5.8	31.9	1.1
UPRISE D3	267	364	505	598	560	36.3	38.7	18.6	-6.3
GLUCORYL M	129	223	275	337	465	73.2	23.2	22.3	38.2
SUMO L	157	208	243	442	454	32.8	16.7	82.3	2.6
ENZOFLAM	272	324	364	384	443	19.2	12.5	5.4	15.4
HEMFER	375	394	399	460	432	5.2	1.2	15.4	-6.2
GLUCORYL-MV	49	132	193	300	380	167.5	46.1	55.1	26.9
TAXIMAX	260	291	310	323	268	11.9	6.6	4.1	-16.8
SWICH XP	194	199	225	290	267	2.6	13.4	28.5	-7.7
A TO Z GOLD	151	148	173	233	265	-2.5	17.3	34.4	13.7
SWICH CV	119	151	165	233	253	26.5	9.3	41.3	8.6
SATROGYL O	158	193	196	232	252	22.3	1.7	18.0	8.5

Source: AIOCD, MOSL

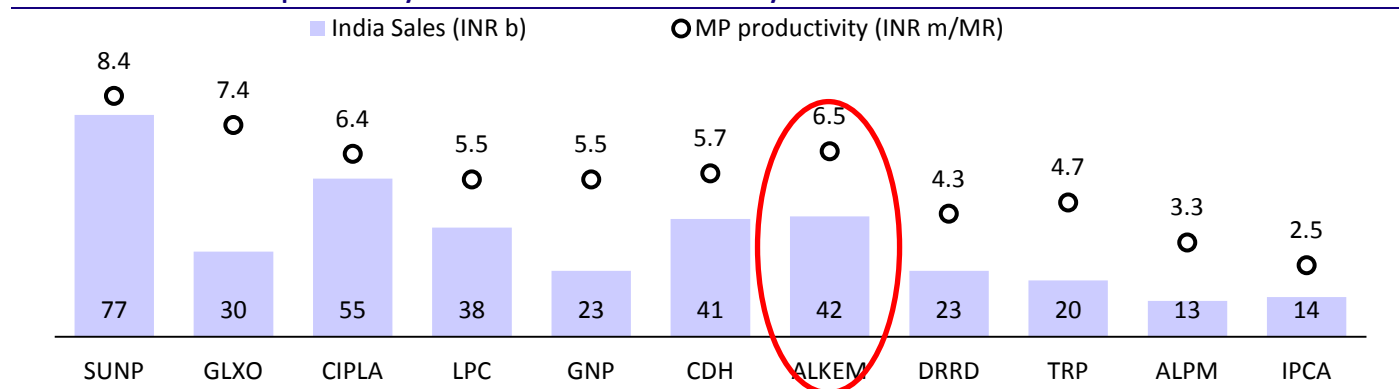
Strong marketing capability and sales force productivity to drive growth

ALKEM has a specialized team of over 6,500+ sales representatives, which enable it to market its products to 220,499 prescribers. Its sales representatives cover almost 70% of total prescribers in India.

Its domestic distribution network includes 40 sales depots, and approximately 7,000+ stockists. Current sales productivity at INR6.5m per sales representative is at par with industry average. Of the 6,500+ MRs, one fourth are dedicated to the chronic segment. Given that ALKEM is still new in chronic, there is scope for productivity improvement in this segment, in our view.

Exhibit 21: ALKEM covers 70% of total prescribers in India

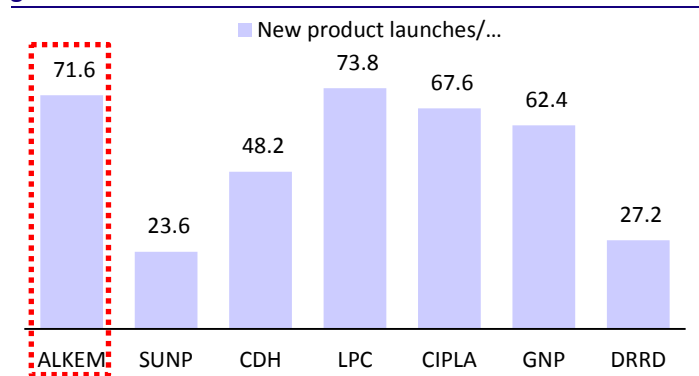
Source: Company, MOSL

Exhibit 22: ALKEM's MR productivity is one of the best in the industry

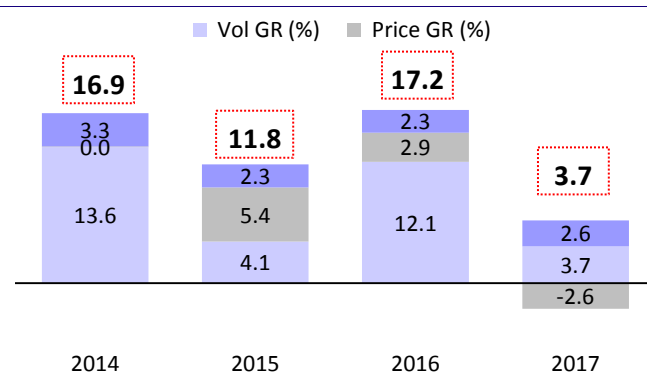
Source: Company, MOSL

Fair mix of volume, price and new launches driving growth

Over the last five years, ALKEM has launched 342 products in the market in various therapies. Majority of the products were launched cardiac therapy (51), followed by derma (45), Neuro / CNS (42) and Anti-infectives (41).

Exhibit 23: Aggressive launches over last five years driving growth

Source: AIOCD, MOSL

Exhibit 24: Increase in volumes has been key growth driver for ALKEM

Source: AIOCD, MOSL

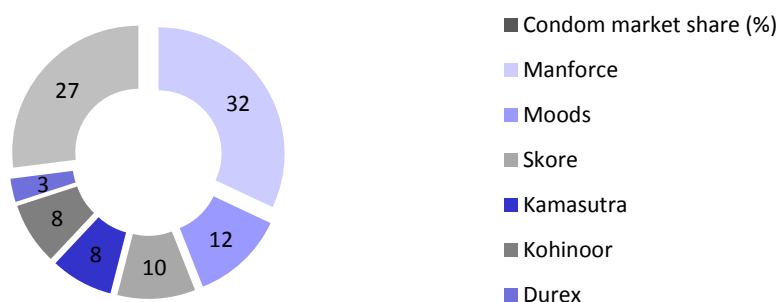
Enhancing footprint in OTC business

ALKEM also made investments in FY17 to foray into the INR145b Indian OTC market. The company is a pan-India player, with a vast distribution network of 7,000+ stockists, 40 sales depots, and eight central warehouses. ALKEM will leverage these strengths to build a formidable OTC business in India over the medium-to-long term.

The company has also entered into an alliance with Haw Par India (in the INR5b balm market segment) to exclusively market, sell and distribute its Tiger Balm range of products in India. Tiger Balm has high consumer recall and is trusted by millions of people in more than 100 countries.

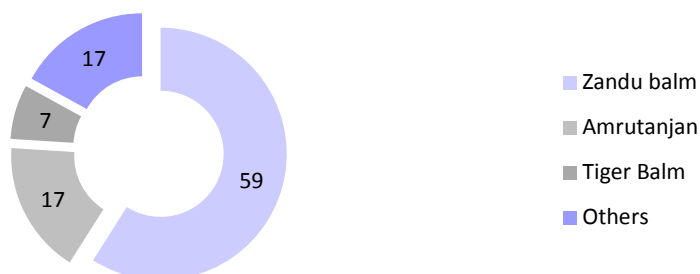
The company also invested in marketing its key brands like Livoerb and Pregakem to increase brand awareness and recall. It is also present in condoms (with its brand of Playguard), which is an INR10b market. With population of 125cr and penetration of only 5% in the condom segment, there is a huge scope of growth, going forward, in our view.

Exhibit 25: Condom market share of top players (INR10b market)



Source: Media article, MOSL

Exhibit 26: Balm market share of top players (INR9b market)



Source: Media article, MOSL

ALKEM in a very short span has generated revenue of INR1b in the OTC segment, and we believe that it has the potential to grow this business to INR3b in the next 3-4 years. With a slew of new products in the pipeline, the company is looking forward to enhance its portfolio and emerge as a significant player in the India OTC space.

Indchemie and cachet remain a drag; scope of improvement visible, though

The company's subsidiaries Indchemie and Cachet contribute ~9% of domestic revenue and 10-12% of total revenue, but only ~4% of EBITDA. Although Indchemie (6% contribution to revenue) has a higher gross margin (~68%), its EBITDA margin stands at only ~9%. Cachet (5% contribution) has both low gross margin (~46%) and EBITDA margin (1%).

Given that Indchemie enjoys a better gross margin, cost efficiencies can help improve EBITDA margin for this subsidiary. We believe that margin improvement for Cachet may take time, as this would require a change in the product line, along with cost efficiencies.

Exhibit 27: Cost efficiencies to drive Indchemie margins; Cachet to remain a drag in near term

FY17 (INR m)	Alkem	Indchemie	Cachet
Sales	58,525	3,502	3,019
Gross profit	36,310	2,374	1,379
Gross margin (%)	62.0	67.8	45.7
EBITDA	9,990	327	27
Margin (%)	17.1	9.3	0.9
PAT	8,920	245	-41

Source: Company, MOSL

Strong focus on US business to continue

ALKEM established its front-end in the US market through the acquisition of Ascend Labs in July 2010. Subsequently, it also acquired two manufacturing facilities in the US – Norac Pharma (API unit) in December 2012 and Long Pharma (formulation unit) in June 2015. Strategically, the US has become an important business for ALKEM, with sales contribution rising from 2% in FY11 to 21% in FY17. In FY17, the company generated sales of ~USD180m from the US. We believe US sales will contribute ~20% FY20 (12% CAGR over FY17-20E).

Opportunities aplenty; less than 50% of filed portfolio is approved

As of 30th Sept 2017, ALKEM had filed 95 ANDAs in the US, of which 43 have been approved and 52 are pending with the US FDA (including 5 tentative approvals). These include 38 Para IVs and few FTF filings. Most of these filings are in the areas of CVS, CNS and antibiotics. With 50+ pending filings and 50-55% of these older than two years, we believe ALKEM can launch ~15 products annually over the next three years in the US to support 12% CAGR over FY17-20E.

Exhibit 28: US sales

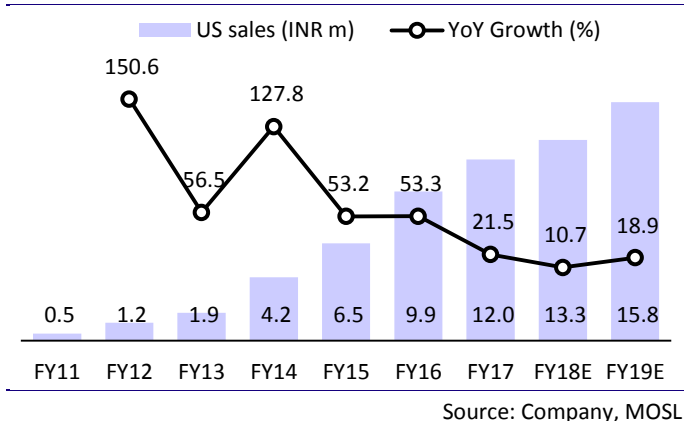
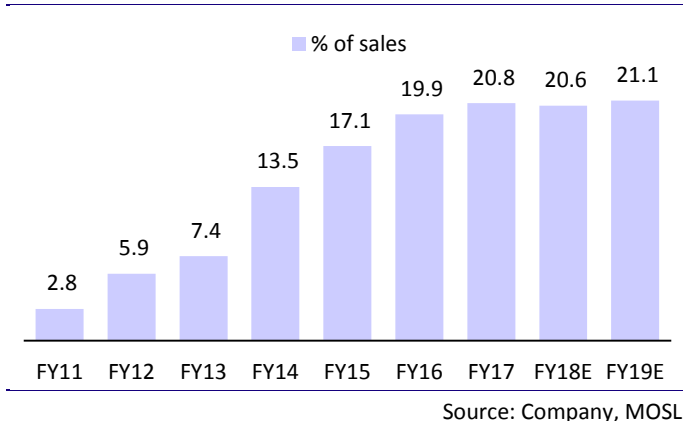


Exhibit 29: US sales contribution



Better than average sales/ANDA for a new company

Compared with Torrent and Alembic (which are of comparable size in the US), ALKEM has a much better sales/ANDA ratio of USD6.2m. We believe this can be attributed to some of the key products it has launched in the US, such as silver sulfadiazine, ibuprofen, mycophenolate, methadone and nimodipine.

Exhibit 30: Sales/ANDA improving

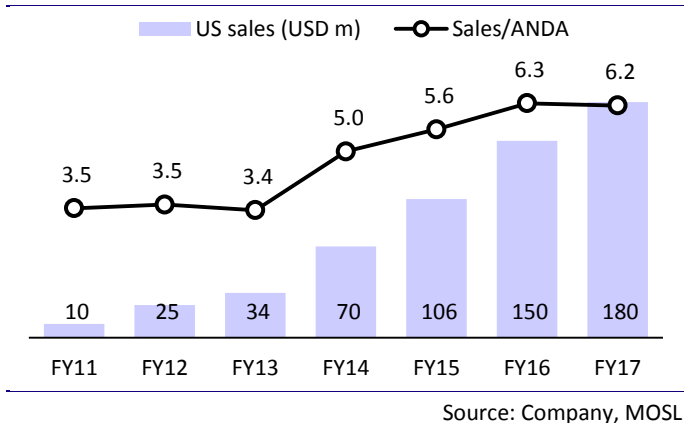
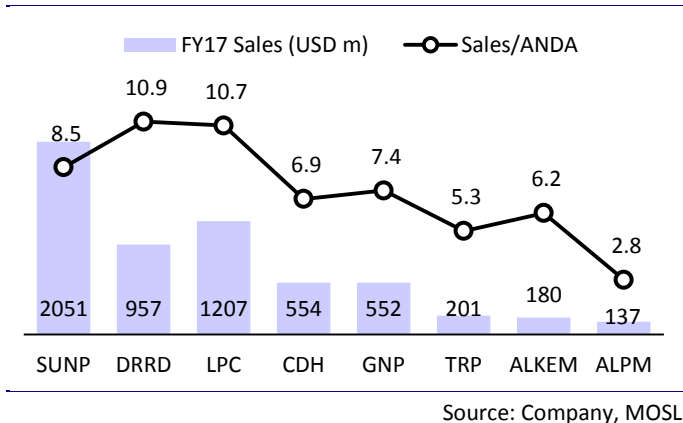


Exhibit 31: Better than average sales/ANDA for ALKEM



Key products for ALKEM

Silver sulfadiazine (topical antibacterial)

- This was the first product launched by ALKEM in the US as a contract manufacturer. The partner has an NDA for the topical version, with USD50m market size. We believe ALKEM has generated USD10m-15m sales from this contract.

Ibuprofen – in-licensed (analgesic)

- Ibuprofen is an in-licensed product for ALKEM. Although it is a crowded market, it is dominated by only few players, and the company has acquired a 30% market share. Current market size for Ibuprofen stands at USD50m per annum.

Mycophenolate mofetil suspension (immunosuppressant)

- ALKEM is the only player in the suspension version of mycophenolate mofetil. It has a 60% market share, and is likely generating USD15m of annual sales from this product.

Methadone (analgesic)

- Methadone is an important product for ALKEM in the US, with a 30% market share and USD10m annual sales. There are only four other generic players in this market.

Nimodipine (high blood pressure)

- ALKEM launched this product in FY15. Though it is a partnered product, we believe the company is generating annual sales of USD9m-10m from Nimodipine.

Exhibit 32: Recently launched products

Molecule	Indication	Time of approval	Number of players
Amlodipine Besylate	Blood pressure	5/4/2009	36
Methadone Hydrochloride (PN product)	Pain (controlled substance)	11/25/2009	5
Cefuroxime Axetil	Bacterial infections	6/7/2010	10
Metformin Hydrochloride	Diabetes	11/1/2010	30
Cephalexin	Anti-biotic	12/20/2010	7
Gabapentin	Control seizures (antiepileptic)	12/17/2010	12
Hydralazine Hydrochloride	Blood pressure	12/7/2012	10
Quetiapine Fumarate	Mood/ mental conditions	2/12/2013	13
Lamotrigine	Control seizures (antiepileptic)	6/14/2013	15
Nimodipine (PN product)	Treat bleeding (in brain)	4/7/2014	5
Benzonatate (PN product)	Cough	9/24/2014	8
Isonazid (PN product)	Tuberculosis (TB) infections	10/29/2014	
Mycophenolate Mofetil	Immuno-suppresant	11/14/2014	1
Nebivolol Hydrochloride	Blood pressure	6/24/2015	No Launch
Linezolid	Anti-biotic	8/27/2015	8
Olanzapine	CNS	10/23/2015	11
Duloxetine hydrochloride	Anti-depressant	8/26/2015	>10
Fesoterodine Fumarate	Neuro/CNS	12/10/2015	3
Rizatriptan Benzoate	Pain (migraine headaches)	2/18/2016	>10
Riluzole	Nerve disease	3/30/2016	6
Minocycline Hydrochloride	Infections	9/21/2016	5
Finasteride Tablet 5mg	Hormonal therapy	1/5/2017	9
Finasteride Tablet 1mg	Hormonal therapy	1/6/2017	9
Itraconazole	Fungal infections	1/12/2017	9
Lidocaine	Anesthesia	3/10/2017	>10
Rosuvastatin Calcium	Hypercholesterolemia	3/21/2017	>10
Olmесartan Medoxomil	Blood pressure	4/24/2017	>10
Tamsulosin Hydrochloride	Treatment prostate gland	8/11/2017	>10
Amlodipine and Olmesartan Medoxomil		8/14/2017	9
Azelastine Hydrochloride	Allergy	8/18/2017	6
Esomeprazole Magnesium	Gastro	8/20/2017	7
Rasagiline Mesylate	Hypertension	8/30/2017	4

Source: USFDA, MOSL

Robust ANDA pipeline provides comfort

Of the 50+ pending ANDAs with the US FDA, 38 are para IV opportunities. We have tracked 10 para IV opportunities for ALKEM, and most of these are expected to fructify FY18/FY19 onward. Some of the key products include Pradaxa, Solodyn and Multaq.

Exhibit 33: Known pending product approvals

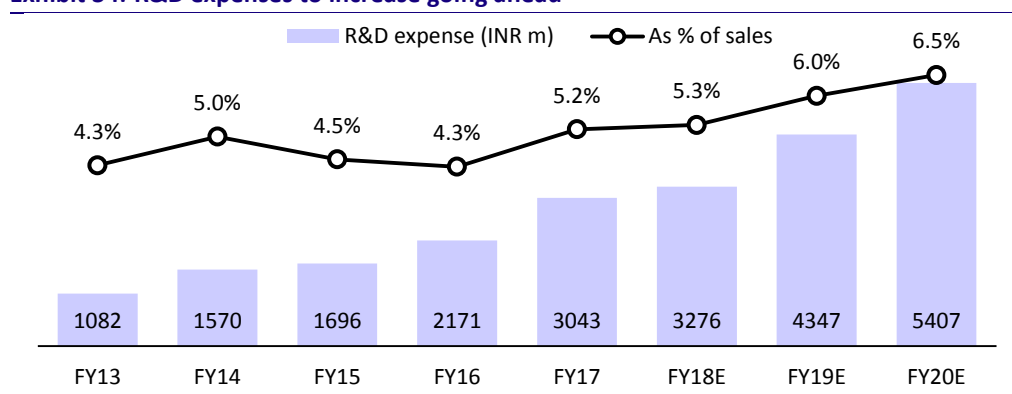
Generic Name	Brand name	Therapy	Patent expiration	Para IV filing	Market Size (USD m)
Lanthanum Carbonate	Fosrenol	Renal disease	26-Oct-18	13-Jan-11	125
Minocycline	Solodyn	Acne	19-Feb-18	6-Dec-12	300
Tapentadol hydrochloride	Nucynta ER	Pain	22-Sep-28	26-Dec-13	
Fesoterodine Fumarate	Toviaz	GI	3-Jul-22	24-Jun-13	236
Dabigatran	Pradaxa	CVS	18-Feb-18	15-Dec-14	800
Dalfampridine	Ampyra	CNS	30-Jul-18	11-Jul-14	348
Dronedarone hydrochloride	Multaq	CVS	19-Jun-18	19-Mar-14	500
Prasugrel	Effient	CVS	Approved (to be launched in Q4)		500
Esomeprazole	Nexium	GI	Expired		1800
Aripiprazole	Abilify	CNS	Expired		6000

Source: Company, MOSL

Enhanced focus on R&D to pay rich dividend

- ALKEM intends to increase R&D initiatives to enhance its differentiated product portfolio in both the domestic and international markets, and also to add ANDA filings in the US.
- The company's R&D spend in FY17 was 5.2% of total revenues v/s 4.3% in FY16. It plans to increase its R&D spend further to 6-7% of revenues. ALKEM has four R&D facilities (two in India and two in the US), with more than 500 scientists and a state-of-art clinical research facility with 100+ beds.
- As part of the strategy, it will continue focusing on formulation development and API research. With an increased focus to tap the biosimilar market, the company has made investments through its subsidiary Enzene Biosciences, a biotech-focused R&D company. ALKEM will focus on the high-growth therapeutic areas such as oncology, autoimmune disorders and osteoporosis.
- ALKEM is also working toward developing capabilities and expertise in niche areas with high entry barriers, such as modified release products, transdermal products and osmotic controlled release oral delivery systems.
- Further, it has an integrated clinical research organization facility, where bioequivalence/bioavailability studies for generic drugs are carried out in relation to filings in various countries. This unit is audited by DCGI, USFDA, UK-MHRA and other international regulatory agencies.

Exhibit 34: R&D expenses to increase going ahead



Source: Company, MOSL

Adding new capabilities

ALKEM has been manufacturing only oral solids for the US market. However, through the acquisition of St Louis facility, it has also built capabilities to manufacture controlled substances, nasals, semi-solids, liquids and ointments for the US market. These are niche product areas of low competition and high margins. Launching products in a niche category will help ALKEM to raise its average sales/ANDA ratio, going forward.

Manufacturing capabilities

ALKEM has 20 manufacturing facilities in India and the US (18 facilities at five locations in India and two in the US). Of these, five facilities are US FDA approved – three formulation plants (Daman, Baddi and St Louis) and two API units (California and Ankleshwar). At present, the Daman facility accounts for 60% of US sales, while the remaining 40% are from the Baddi facility.

In June 2015, ALKEM added another US-approved facility through an inorganic route. Through this acquisition, it gained semi-solid, liquid and nasal formulation capabilities. This will help it enter the niche control substances market.

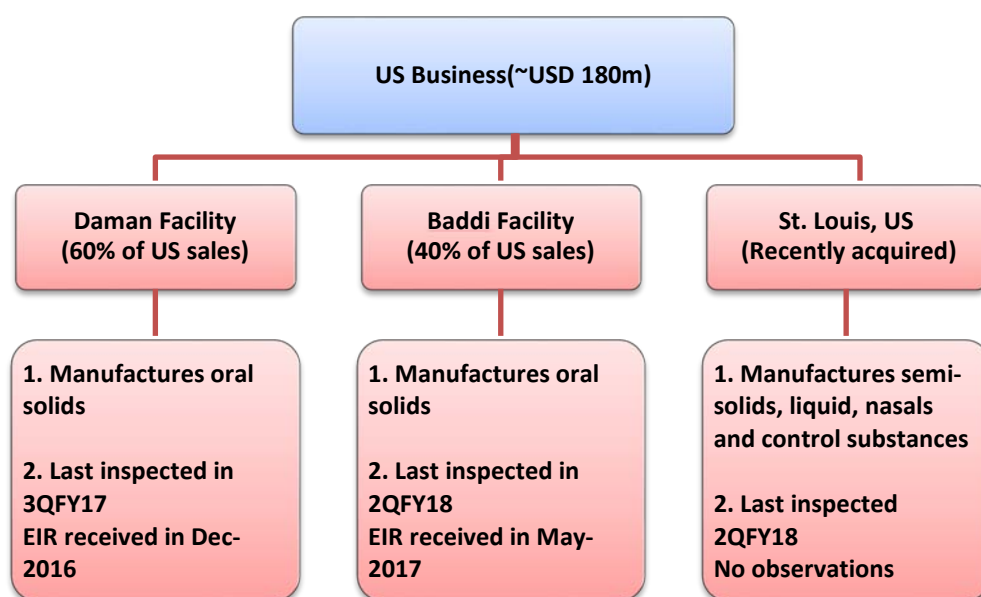
The St. Louis facility was recently inspected by the US FDA and no observations were issued. The Daman facility was inspected in 3QFY17 by the regulator with 13 observations and received EIR in Dec-16, while the Baddi facility was inspected by US FDA in 2QFY18 with two observations and received EIR in May-17.

Exhibit 35: Manufacturing facilities

Manufacturing facilities	No. of facilities	Manufacturing capabilities
Baddi, India	4	Formulations - Tablet, Injectables, Dry syrup
Sikkim, India	7	Formulations - Tablet, Injectables, Dry syrup
Daman, India	5	Formulations - Capsule, Tablet, Injectables, Dry syrup
Mandva, India	1	APIs
Ankleshwar, India	1	APIs
California, United States	1	APIs
St. Louis (Missouri), United States	1	Formulations - Liquids, Nasal sprays, Semisolids and Solids
R&D Facilities		
Taloja, Maharashtra, India	1	-
Pune, Maharashtra, India	1	-
California, United States	1	-
St. Louis (Missouri), United States	1	-

Source: Company, MOSL

Exhibit 36: Daman followed by Baddi are key manufacturing facilities for US



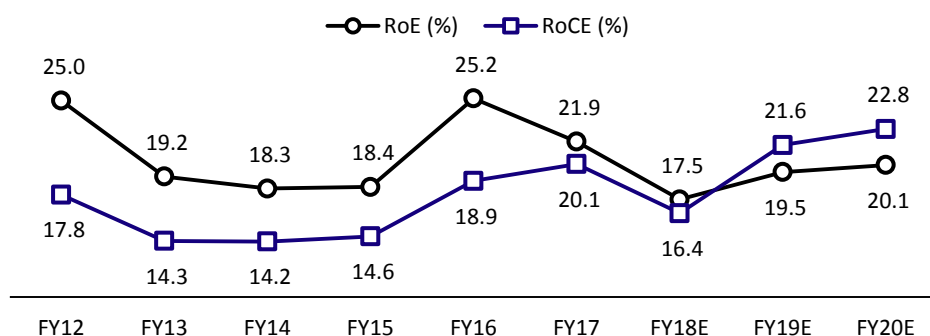
Source: Company, MOSL

Financials

RoCE to improve with better margins and lower investments

Increasing contribution from the chronic business and operating leverage in the US are likely to result in better margins over the next two years. It will also improve the return ratio from 17.5% in FY18 to 20% in FY20.

Exhibit 37: RoCE to improve to 22.8% by FY20E

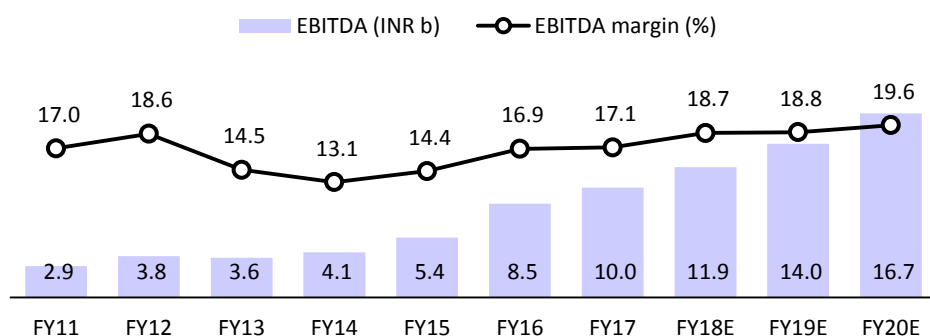


Source: Company, MOSL

Improving EBITDA margin

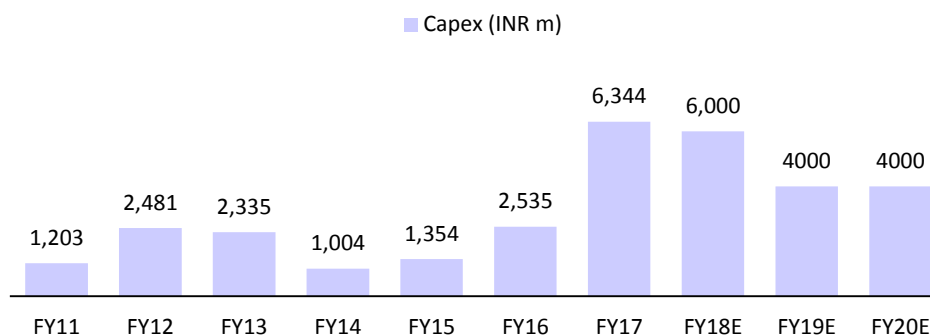
We believe that with approvals for key products in the US market, ramp-up of the chronic segment and increasing contribution from the OTC segment, ALKEM's EBITDA margin should expand by ~250bp to ~20% in FY20.

Exhibit 38: Better business mix to drive profitability



Source: Company, MOSL

Exhibit 39: Capex to slow down FY19 onwards



Source: Company, MOSL

Valuation view

Over the last 10 years, ALKEM has outperformed most of the Indian pharma companies in the domestic market, driven by its consistent launches in acute therapies like anti-infective, pain/analgesic and vitamins, while also growing its presence in high-growth chronic therapies like CNS, cardiac, derma and anti-diabetic.

Globally, ALKEM has launched 20 products in the US market and has 50+ pending ANDAs. On the back of improved presence in the chronic business and significant leverage from the US segment, we expect ALKEM's earnings to grow at a 14% CAGR over the next three years. This will be supported by 12% revenue CAGR and 300bp margin expansion over FY17-20E.

We have upgraded ALKEM to **Buy** from Neutral, with a target price of INR2,500 @24x Dec 19E PER (v/s INR1,950 @ 1HFY20E PER). We argue for a multiple re-rating for ALKEM due to:

- Strong EPS outlook: >25% CAGR over FY18-20E, backed by 16% revenue CAGR
- Improvement in RoIC from 19.6% in FY18E to 29.6% by FY20E
- Net cash balance sheet
- High exposure to domestic business (~90% of profit comes from domestic business)

Key catalysts to drive stock performance over medium term

- Improvement in US profitability (25% of sales) led by niche product launches
- Improvement in sales force productivity in chronic segment
- Improvement in subsidiaries

Risks to our investment thesis:

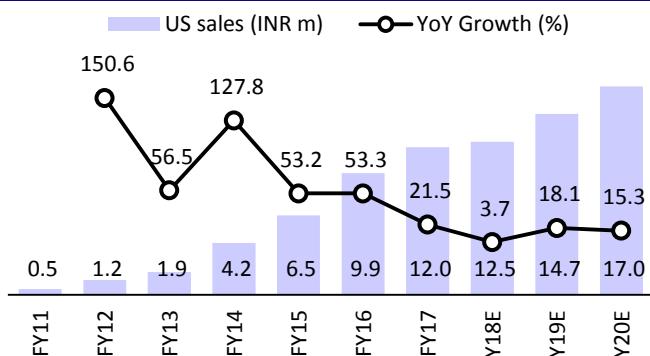
- Addition to NLEM list in domestic markets
- Implementation of Pharma draft policy in current form
- Incremental competition in existing key products in US business
- Delay in approvals of key products

Exhibit 40: Valuation matrix

Company	Reco	CMP (INR)	TP (INR)	(%) Upside	Mkt Cap (USD B)	EPS			P/E (x)			EV/EBITDA (x)			ROE (%)		
						FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
India Focus																	
Alembic Pharma	Neutral	513	540	5	1.5	21.6	21.6	24.9	25.0	25.0	21.7	15.7	15.2	13.0	23.0	19.9	19.8
Alkem Lab	Neutral	1,972	1,950	-1	3.7	74.6	68.8	90.7	26.1	28.3	21.5	23.3	20.7	15.9	21.9	17.2	19.6
Cipla	Neutral	615	600	-2	7.7	15.9	21.1	27.0	37.7	28.4	22.2	21.4	16.9	14.1	10.2	12.1	13.6
Torrent Pharma.	Neutral	1,285	1,400	9	3.4	55.2	50.0	61.4	25.4	28.0	22.8	16.8	15.5	11.1	23.8	18.3	19.9
Eris Lifescience	Not rated	674	-	-	1.4	17.6	23.0	31.0	38.3	29.3	21.8	30.9	26.3	18.4	57.7	46.0	41.3
Others																	
Ajanta Pharma	Buy	1,364	1,606	18	1.9	57.3	52.7	64.1	28.0	30.5	25.1	17.2	18.7	15.0	36.7	26.4	25.7
Aurobindo Pharma	Buy	719	900	25	6.5	39.3	44.6	50.3	22.9	20.2	17.9	12.9	11.1	9.6	27.6	24.6	22.3
Biocon	Neutral	415	335	-19	3.9	10.2	6.1	10.5	32.8	54.9	31.8	21.8	26.8	18.8	12.3	7.2	11.4
Cadila Health.	Buy	444	555	25	7.0	14.2	17.5	23.7	39.1	31.8	23.4	25.6	17.2	13.1	23.0	23.4	26.1
Divi's Lab.	Neutral	1,040	1,100	6	4.3	39.9	32.4	43.7	27.5	33.9	25.1	18.1	22.5	16.2	22.0	16.3	21.2
Dr Reddy's Labs	Neutral	2,297	2,575	12	6.1	72.6	60.6	115.2	35.5	42.5	22.4	17.0	17.0	10.6	9.7	8.2	14.1
Glenmark Pharma.	Neutral	591	650	10	2.6	39.3	37.9	42.8	16.5	17.1	15.2	11.2	11.0	9.9	24.7	19.6	18.4
Granules India	Buy	125	200	60	0.4	7.2	8.0	11.0	27.7	25.0	18.2	10.5	8.1	6.1	21.1	17.7	18.8
Glaxosmit Pharma	Neutral	2,482	2,500	1	3.3	34.4	44.2	54.9	72.7	56.6	45.5	58.2	49.0	36.4	14.5	22.0	31.4
Ipca Labs.	Neutral	533	550	3	1.0	16.1	18.6	26.5	34.2	29.6	20.7	16.2	15.9	11.8	8.6	9.2	12.0
Jubilant Life	Buy	647	861	33	1.6	36.9	44.2	55.0	23.3	19.5	15.6	10.1	8.9	7.4	18.0	18.4	19.2
Lupin	Buy	831	1,000	20	5.8	56.6	37.6	42.7	17.7	26.6	23.4	9.5	11.9	10.6	20.9	12.0	12.5
Sanofi India	Buy	4,431	5,000	13	1.6	129.1	139.0	156.2	38.7	36.0	32.0	18.3	17.1	14.9	17.1	17.1	17.6
Shilpa Medicare	Buy	654	797	22	0.8	14.0	18.1	29.9	56.9	44.0	26.6	30.6	26.9	19.6	14.4	14.7	20.5
Strides Shasun	Buy	821	1,214	48	1.1	32.3	41.8	69.2	37.6	29.1	17.5	14.2	11.4	8.0	10.8	12.9	18.3
Sun Pharma.Inds.	Buy	550	610	11	20.5	26.1	14.4	22.9	23.3	42.5	26.7	14.1	22.6	15.4	18.1	9.2	13.7
Syngene Intl.	Not Rated	520	-	-	1.6	13.0	16.1	18.0	39.9	32.2	28.9	23.1	18.6	16.0	22.2	22.5	20.7

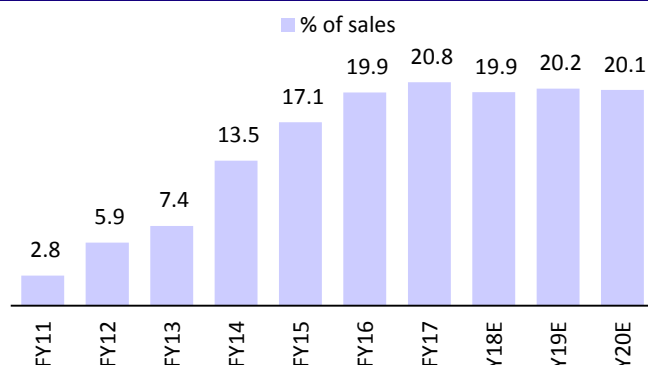
Story in charts

Exhibit 41: US sales to be driven by new launches



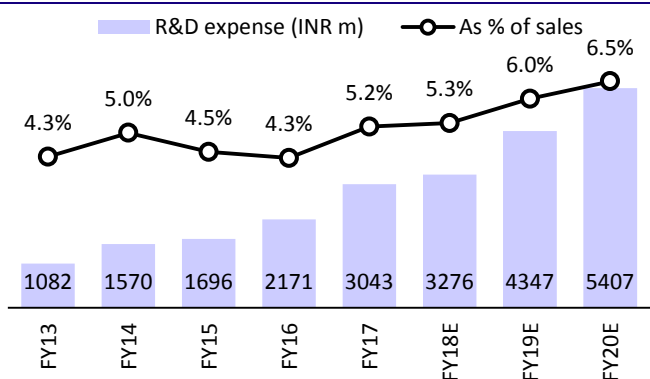
Source: Company, MOSL

Exhibit 42: Increasing US sales contribution



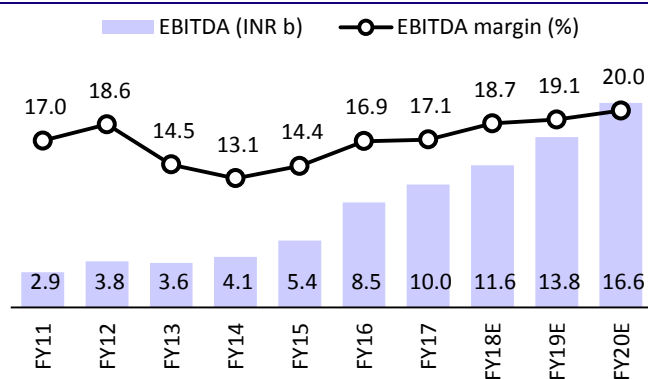
Source: Company, MOSL

Exhibit 43: R&D expense to be 5.5-6.5% of sales in FY18-20



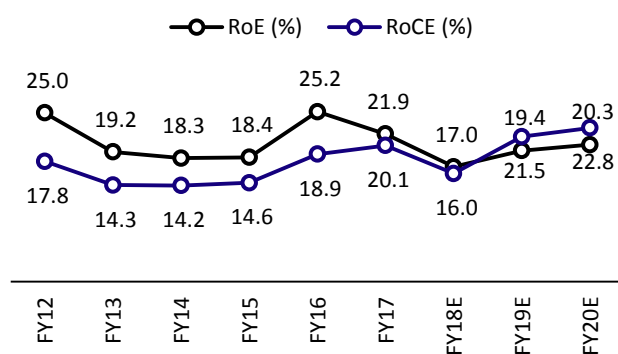
Source: Company, MOSL

Exhibit 44: Better business mix to drive profitability



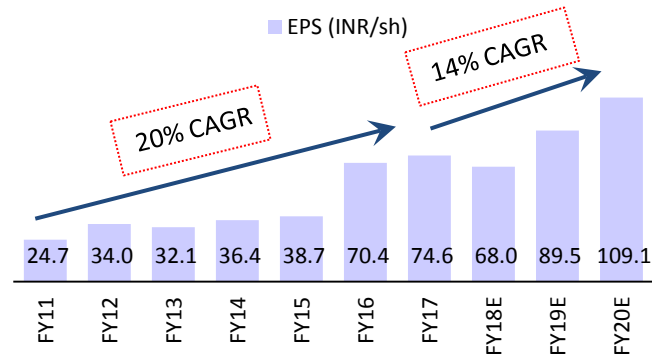
Source: Company, MOSL

Exhibit 45: Improving return ratios



Source: Company, MOSL

Exhibit 46: Earnings to grow at 14% CAGR over FY17-20E



Source: Company, MOSL

Financials and Valuations

Consolidated - Income Statement

INR million

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Total Income from Operations	31,260	37,887	50,479	58,525	61,818	72,453	83,179
Change (%)	25.3	21.2	33.2	15.9	5.6	17.2	14.8
EBITDA	4,100	5,445	8,533	9,990	11,560	13,839	16,636
Margin (%)	13.1	14.4	16.9	17.1	18.7	19.1	20.0
Depreciation	523	703	933	1,012	1,312	1,472	1,673
EBIT	3,578	4,742	7,599	8,978	10,248	12,367	14,963
Int. and Finance Charges	931	811	712	452	556	458	392
Other Income	1,653	1,810	2,397	1,120	1,047	867	1,173
PBT bef. EO Exp.	4,300	5,741	9,284	9,646	10,740	12,776	15,743
EO Items	0	-574	0	0	0	0	0
PBT after EO Exp.	4,300	5,167	9,284	9,646	10,740	12,776	15,743
Current Tax	25	85	1,762	600	2,470	1,916	2,519
Deferred Tax	-79	457	0	0	0	0	0
Tax Rate (%)	-1.2	10.5	19.0	6.2	23.0	15.0	16.0
Less: Mionrity Interest	0	0	114	126	143	161	182
Reported PAT	4,353	4,625	7,409	8,920	8,127	10,698	13,042
Adjusted PAT	4,353	5,139	8,419	8,920	8,127	10,698	13,042
Change (%)	13.4	18.1	63.8	6.0	-8.9	31.6	21.9
Margin (%)	13.9	13.6	16.7	15.2	13.1	14.8	15.7

Consolidated - Balance Sheet

INR million

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Equity Share Capital	120	239	239	239	239	239	239
Total Reserves	25,730	29,752	36,681	44,437	50,734	59,024	69,129
Net Worth	25,850	29,991	36,920	44,676	50,973	59,263	69,368
Minority Interest	0	857	950	1,152	1,152	1,152	1,152
Deferred Tax Liabilities	781	1,256	10	5	5	5	5
Total Loans	11,284	13,059	5,876	6,539	6,539	6,539	6,539
Capital Employed	37,915	45,162	43,756	52,373	58,670	66,959	77,065
Net Fixed Assets	9,797	11,429	10,310	13,945	18,027	21,434	23,936
Goodwill on Consolidation	1,903	3,421	4,185	4,026	4,026	4,026	4,026
Capital WIP	0	0	1,724	2,993	3,599	2,720	2,544
Total Investments	5,880	4,808	5,086	5,530	5,530	5,530	5,530
Curr. Assets, Loans&Adv.	25,414	33,008	28,878	32,225	35,327	43,913	54,511
Inventory	6,203	7,842	9,094	12,060	10,327	12,044	13,673
Account Receivables	3,669	5,271	5,675	7,136	6,775	7,940	9,115
Cash and Bank Balance	2,063	7,908	7,809	3,993	8,917	17,929	24,835
Loans and Advances	13,478	11,987	6,300	9,036	9,308	5,999	6,888
Curr. Liability & Prov.	5,251	7,796	11,589	13,308	14,801	17,626	20,445
Account Payables	3,057	4,619	5,805	7,414	6,609	7,708	8,751
Other Current Liabilities	1,267	1,667	3,908	3,628	3,832	4,491	5,156
Provisions	926	1,510	1,877	2,266	4,360	5,426	6,538
Net Current Assets	20,163	25,212	17,288	18,917	20,526	26,287	34,066
Deferred Tax assets	172	292	5,162	6,963	6,963	6,963	6,963
Appl. of Funds	37,915	45,162	43,756	52,373	58,670	66,959	77,065

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Basic (INR)							
EPS	36.4	38.7	70.4	74.6	68.0	89.5	109.1
Cash EPS	40.8	48.9	78.2	83.1	79.0	101.8	123.1
BV/Share	216	251	309	374	426	496	580
DPS	2.0	4.0	6.2	12.7	12.9	17.0	20.7
Payout (%)	6.4	12.3	11.9	20.1	22.5	22.5	22.5
Valuation (x)							
P/E				26.5	29.0	22.1	18.1
Cash P/E				23.8	25.0	19.4	16.0
P/BV				5.3	4.6	4.0	3.4
EV/Sales				4.1	3.8	3.1	2.6
EV/EBITDA				23.9	20.2	16.2	13.1
Dividend Yield (%)				0.6	0.7	0.9	1.1
FCF per share				-22.1	53.6	93.5	77.3
Return Ratios (%)							
RoE	18.3	18.4	25.2	21.9	17.0	19.4	20.3
RoCE	14.2	14.6	18.9	20.1	16.0	21.5	22.8
RoIC	13.7	13.6	20.0	24.4	19.6	25.8	29.6
Working Capital Ratios							
Asset Turnover (x)	0.8	0.8	1.2	1.1	1.1	1.1	1.1
Inventory (Days)	72	76	66	75	61	61	60
Debtor (Days)	41	49	40	45	39	39	39
Creditor (Days)	36	45	42	46	39	39	38
Leverage Ratio (x)							
Debt/Equity	0.4	0.4	0.2	0.1	0.1	0.1	0.1

Consolidated - Cash Flow Statement

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
OP/(Loss) before Tax	4,300	5,142	9,284	9,646	10,740	12,776	15,743
Depreciation	523	703	933	1,012	1,312	1,472	1,673
Interest & Finance Charges	-555	-1,196	-599	-592	-492	-409	-781
Direct Taxes Paid	-1,111	-1,056	-1,982	-2,640	-2,470	-1,916	-2,519
(Inc)/Dec in WC	-364	-963	101	-3,639	3,316	3,251	-873
CF from Operations	2,793	2,630	7,737	3,788	12,406	15,173	13,244
Others	107	652	-478	-90	0	0	0
CF from Operating incl EO	2,900	3,281	7,258	3,698	12,406	15,173	13,244
(Inc)/Dec in FA	-1,004	-1,354	-2,535	-6,344	-6,000	-4,000	-4,000
Free Cash Flow	1,897	1,928	4,724	-2,646	6,406	11,173	9,244
(Pur)/Sale of Investments	25	1,028	325	0	0	0	0
Others	-3,814	3,406	4,233	3,484	1,047	867	1,173
CF from Investments	-4,792	3,081	2,023	-2,859	-4,953	-3,133	-2,827
Issue of Shares	0	0	0	0	0	0	0
Inc/(Dec) in Debt	-4,732	871	-6,714	1,134	0	0	0
Interest Paid	-914	-793	-713	-636	-556	-458	-392
Dividend Paid	-319	-567	-1,845	-863	-1,830	-2,409	-2,936
Others	-35	-29	0	0	-143	-161	-182
CF from Fin. Activity	-6,000	-518	-9,273	-366	-2,528	-3,028	-3,511
Inc/Dec of Cash	-7,892	5,845	8	473	4,925	9,012	6,906
Opening Balance	9,955	2,063	1,262	1,193	1,666	6,591	15,603
Closing Balance	2,063	7,908	7,809	3,993	8,917	17,929	24,835

NOTES

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