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Initiating Coverage Alembic Pharmaceuticals Ltd.

24-September - 2020



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pharmaceuticals	Rs 914.8	Buy in the band of Rs 840-850 and add on dips to Rs 762-772	Rs 924	Rs 972	2 quarters

HDFC Scrip Code	ALEPHAEQNR
BSE Code	533573
NSE Code	APLLTD
Bloomberg Code	ALPM: IN
CMP Sep 23, 2020	914.8
Equity Capital (Rscr)	39.3
Face Value (Rs)	2
Equity Share O/S (cr)	19.65
Market Cap (Rscr)	17985
Book Value (Rs)	240
Avg. 52 Wk Volumes	581249
52 Week High	1128
52 Week Low	436

Share holding Pattern % (Aug, 2020)	
Promoters	70.0
Institutions	17.2
Non Institutions	12.8
Total	100.0

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Our Take

Alembic Pharma recorded highest ever revenues and net profit in FY20 as US business recorded robust performance during the year. Company registered 17% yoy revenues growth at Rs 4606cr which was mainly driven by robust US generics growth. US business grew 53% yoy at ~Rs 1980cr (double in 2 years) in FY20 on the back of new launches and continued traction from Sartans (Valsartan, losartan, irbesartan and other “Sartan” drugs are a class of medicines known as angiotensin II receptor blocker (ARBs) used to treat high blood pressure and heart failure). With US business, consistently being around US\$ 70mn in the three quarters, management commented that now this is the quarterly base rate for US business. Company has invested ~Rs1700crover the last three years towards setting-up manufacturing capabilities for the US business which is expected to show even better results in the US market from FY22. The reason behind continued outperformance has been right capital allocation, strong regulatory compliance and ability to capitalize on shortages and limited competition products. Alembic’s business in the US has registered robust 45% CAGR on the back of around 60 products launches in the last 5 years. The company has made significant investments of around Rs 700cr or around 14% of the total revenues of FY20 in R&D. The company expects these investments to start yielding dividends from FY22. These investments along with sustained filing momentum of 20-25 ANDA per annum remain key levers for the US business growth. Company has spent ~Rs 2200cr in R&D over the past four years. It filed 25 ANDAs in FY20 and has 65 ANDAs pending approval.

Alembic Pharma raised around Rs 750cr by issuing ~80 lakh equity shares at Rs 932 per share to marquee funds and investors in Aug-2020. Company would use around Rs 400cr for debt repayment, while the remaining will be used for expanding API, injectibles manufacturing facilities. Company derives 60-65% of domestic revenues from chronic and sub-chronic while the balance from acute. The company’s strategy has been to launch a few products with an emphasis on profits. In the last few quarters, company has taken steps to rationalise existing distributors (to derisk customer concentration) and also revised the rebate model which had affected growth in FY20. Company indicated COVID-19 had a neutral impact so far and it expects domestic growth rate to be sustainable in the coming years. Company said that it has gained market share in the key brands in the domestic market.

Valuation & View

The total envisaged multi-year capex outlay of ~Rs2000cr (large part in the final stage of completion) will give it a foothold in niche capabilities such as oncology injectables, ophthalmology, derma, etc. The heavy capex phase should peak out in FY21 with a large part of the

commercial upside starting from H2 FY22. We expect R&D and capacity scale-up to spur growth post FY22. New capacity should accelerate US launches to > 20 products annually. We estimate 13% revenue CAGR on the back of strong 15% growth in US business while domestic business may see 9.5% CAGR over FY20-22E. RoW markets and API business would see 11% and 13% CAGR respectively over the same period. We believe that margins may remain around 25-27% given the higher base in FY20 and competitive environment in some of the products in US. We project 10% PAT CAGR on the back of subdued operating performance (on a high base) and higher depreciation expenses. Strong return ratios and improving revenue visibility coupled with better quality of the pipeline has led to sharp re-rating in the last few months. Limited competition ANDA approvals and continuing shortages in Sartans remain key near term triggers. Also, going forward, lower capex intensity post FY21 is likely to further reduce debt and improve Alembic's free cash flow generation and return ratios. We feel that investors can buy the stock in the band of Rs 840-850 (16.5x FY22E EPS) and add on dips to Rs 762-772 (15.0x FY22E EPS) for base case target of Rs 924 (18.0x FY22E EPS) and bull case target of Rs 972 (19.0x FY22E EPS).

Financial Summary

Particulars (Rs cr)	Q1 FY21	Q1 FY20	YoY (%)	Q4 FY20	QoQ (%)	FY19	FY20	FY21E	FY22E
Total Revenues	1341.3	949	41.3	1207	11.1	3,935	4,606	5,168	5,858
EBITDA	407.4	225	81.1	327.3	24.5	873	1223	1361	1486
Depreciation	41.5	35.4	17.2	44	-5.7	115	157	198	239
Other Income	0.3	3.3	-90.9	0.9	-66.7	9	5	7	12
Interest Cost	6.7	5	34.0	7.8	-14.1	18	27	28	20
Tax	66.8	36.1	85.0	63	6.0	157	198	231	258
APAT	301.5	123.7	143.7	224.6	34.2	585	829	930	1007
EPS (Rs)						31.0	44.0	47.3	51.2
RoE (%)						23.7	27.9	23.4	19.7
P/E (x)						29.7	20.9	19.4	18.0
EV/EBITDA						20.2	14.4	13.0	11.9

(Source: Company, HDFC sec)

Q1FY21 result highlights

Revenue/EBITDA/PAT grew by 41%/81%/102% yoy to Rs 1341cr/Rs 407cr/ Rs 302cr. Gross margin declined 360bps YoY to 74.8% on account of increase in contribution of the API business to overall mix. EBITDA margin improved by 670bps YoY to 30.4% and was aided by lower R&D and other expenses. Other expenses (incl. R&D)/sales declined by 820bps YoY. R&D expense was impacted by lockdown during the quarter and is expected to inch up in subsequent quarters. The decline in other expenses was primarily on account of lower promotional and travel spends.

US generics business registered strong 73% rise on sustained base and Sartan opportunity. Company filed 8 ANDAs during the quarter and received approval for 6 products. As on Jun-2020, cumulative ANDA filings stood at 191. International revenues (ex-US) also grew by 62% yoy at Rs 175cr. API business recorded 54% rise during the quarter. R&D expenses were lower due to shutdown and company has guided Rs 700cr spend in FY21. Company said that about US\$ 250mn of capex produces incremental about US\$ 400mn in sales over following 3 years. Company has spent ~Rs 2200cr in R&D over the past four years.

Domestic formulations revenue declined 6% yoy to Rs 306cr with lockdown having significant impact on Alembic's liquids (cough & cold and antibiotics) and gynaecology portfolios. Acute sales declined 3% YoY and Specialty sales declined by 7% YoY. Given the low FY20 base and significant scope for improvement in MR (Medical Representatives) productivity, Alembic's domestic business is likely to grow faster than the market.

US Business to register 15% CAGR over FY20-22E

The Sartan opportunity and new product launches in the US helped Alembic to double its business in the last two years. US business grew 53% yoy at ~Rs 1980cr in FY20 on the back of new launches (launched 22 new products in US as against 9 products in FY19) and continued traction from Sartans. With US business, consistently being around US\$ 70mn in the past three quarters, management commented that now this is the quarterly base rate for US business. Company said that total of 15 different combination products of Sartans are in the US. Company has invested heavily over the last three years across R&D and manufacturing, which is likely to show better results in the US market from H1FY22. Alembic R&D spends got doubled from Rs 320cr in FY16 to Rs 700cr in FY20 which are mainly focusing on US markets. Alembic Pharma filed for 25 ANDAs and received 30 final approvals in FY20. Company had launched 22 products in the US market in FY20. Company had received 16 ANDA approvals in FY19. Further, it plans to launch 10 products in H1FY21. Company has launched 76 products in US markets as on Mar-2020. Alembic has cumulatively done 183 ANDA filings with 119 approvals which includes 12 tentative

approvals. Not only the number of filings but also the quality of fillings have improved with higher proportion of non- orals. Alembic Pharma is the one of the largest spenders on R&D in the mid-sized pharma players.

Company has spent 13-14% as a percentage of its sales on R&D over the past 4 years and we believe the trend to continue over FY20-22E as well. We estimate ~15% revenue CAGR in US business over FY20-22E led by strong base business and new launches, despite a higher base in FY20.

Riding High on Sartans

In July 2018, US FDA notified for a voluntary recall of several drug products containing valsartan. The recall was due to an impurity (N-Nitrosodimethylamine or NDMA) found in the products. The companies, whose drugs were recalled, needed to change the source of their APIs, take fresh approvals for the product containing the new API, and launch it again in the US market. As a result, existing players including Alembic massively benefited from the shortage and will continue to benefit till the time supplies come back into the market. Backward integration in terms of in-house APIs for Sartans helps Alembic to have secured line of supply and also reduces regulatory risks. As per management, Sartans benefit will still be there in H1FY21, however in the second half, it may fade off and come to normalcy in the US markets as supply will come from other players. We have assumed Sartan revenues to taper off in H2FY21 based on management guidance; if it persists; there could be earnings surprises not factored by us.

Successful US FDA inspections bode well

Alembic has a successful history of USFDA inspections, with no warning letters, OAI, or import alerts received for any of its plants to date. The regulatory compliance, especially with USFDA norms, lowers the risk of adverse regulatory action and the resultant impact on exports to the US.

In May-2020, Alembic Pharma said that US FDA has classified General Oral Solid Formulation Facility located at Panelav as Voluntary Action Indicated (VAI). Inspection at the said Facility was conducted by US FDA from 9th March, 2020 to 13th March, 2020. VAI means US FDA accepted the Company's response to its observations.

In May-2020, the company said that Aleor Dermaceuticals (Aleor), a 60:40 Joint Venture between Alembic Pharmaceuticals and Orbicular Pharmaceutical Technologies (Orbicular), has received Establishment Inspection Report (EIR) from the US FDA for inspection carried out by them at Aleor's Formulation Facility at Karakhadi, Gujarat, India during the period from 6th Jan, 2020 to 8th Jan, 2020.

US FDA has conducted an inspection at Alembic Pharmaceuticals General Oral Solid formulation facility at Panelav in March-2020. This was a scheduled inspection and at the end of the inspection, the US FDA issued a Form 483 with four procedural observations. None of the observations were related to data integrity or repetitive in nature.

Domestic business to return to growth from FY21

India formulation business contributed 31% of FY20 revenues and gives good chunk to overall profitability despite an acute-heavy portfolio. In the last five years, the business has grown in line with the market at a modest 7%. This was largely due to the impact of demonetisation, GST, NLEM expansion and higher API prices in the last two years. Management's focus in India has been on select therapies, while maintaining brand positioning. Company has around 4000 MRs across ~15 marketing divisions. Company has five brands among the top 300 brands in India. Anti-Infectives, Cardiac, Respiratory and Gynaecology form ~61% of its domestic revenues. Around 14% of the products are in NLEM list. Company derives 60-65% of domestic revenues from chronic and sub-chronic while the balance comes from acute. Top 10 brands contribute ~75-80% of domestic revenues. The company's strategy has been to launch a few products with an emphasis on profits. By the end of FY19, company had undertaken voluntary corrective action to reduce the extra discounts. The company took steps to rationalise existing distributors (to derisk customer concentration) and also revised the rebate model (reducing discounts to stockists mainly in chronic areas). This had affected revenues in FY20 (+3% yoy). Company indicated COVID-19 had a neutral impact so far and it expects domestic growth rate to be sustainable in the coming years. Company said that it has gained market share in key brands.

Management indicated though they have been gaining new Rx, a cut in discounting offered to the channel has led to volume underperformance. Since company is gaining prescriptions in the absence of volume discounts, underlying business can return to stronger growth once the base effect is digested in the sales. We project 9.5% revenue CAGR over FY20-22E led by healthy growth from chronic therapy and new launches. Alembic Pharma's domestic sales reported 5% CAGR over FY16-20 vs. the industry CAGR of 9%. Traction has been good in key therapies such as Cardiology (8.7% CAGR), Gynecology (4.7%), and Gastro (6.5% CAGR); however, performances have been adversely impacted for the past couple of years, partly due to GST-led inventory re-stocking in the initial phase, followed by demonetization.

MR productivity yet to see pickup

Alembic's MR productivity was in the range of Rs 0.25-0.28mn in sales/MR per month over FY15-19. Productivity increased to Rs 0.31mn sales/month in FY20. The sales/MR per month ratio has been the strongest for Torrent Pharma, Eris Life and Alkem Labs among its peers. ALPM's MR productivity has been lower than the industry average of Rs 0.4mn in sales/MR per month.

API business to grow at 13% CAGR over FY20-22E

API division acts as a support division to the formulation business and accounted for ~15% of FY20 revenues. Company's Oral Solid portfolio is largely backward integrated, in terms of in-house API; however for newer areas such as ophthalmics, dermatology, injectables, etc. it would depend on API sourced from outside. From a risk perspective as well, an in-house API unit helps to mitigate supply side disruptions as faced by other pharmaceutical companies. Over the past two to three years, Alembic has doubled its API capacity to 1,100 metric tonnes per annum in order to meet the rising demand. Company has two API units at Panelav and one in Kharkhadi, all of which are US FDA approved. Company filed 9 DMFs in FY20 and total tally of DMF stands at 109 as on Mar-2020. Over the last five years, API revenues have grown at 8% CAGR and we estimate a similar rate over the next two years. API business, as is seen with most other pharma companies, has been on a strong footing as prices have stayed strong due to disruption in supplies from China. As per the management, despite softness in API segment in FY20, there's a strong likelihood of 15-20% growth in FY21.

RoW markets to see 11% CAGR over FY20-22E

Alembic Pharma has presence in Europe, Canada, Australia, Brazil and South Africa in the Ex-US generics space with key being Europe and Australia. The RoW business has registered 16% revenue CAGR over FY17-20 due to an improved success rate in tender applications, especially in Europe. The company is also developing a strategy to penetrate other high-growth regions such as China, Philippines to leverage its existing portfolio. Company said that it will focus on new launches across the key markets and its plants are audited by key regulatory authorities across the globe.

Aleor Dermaceuticals

In order to enhance its focus in the Dermatology space, Alembic had entered into a JV (60:40) with Orbicular Pharmaceutical Technologies (Orbicular) in 2016 to develop, manufacture and commercialize dermatology products for the global markets. Under the terms of the JV, Alembic will be responsible for all the marketing and even the litigation costs will be borne by Alembic, however, Orbicular will continue to be the R&D partner. For the purpose of this JV, a greenfield facility is set up at Karakhadi, which received US FDA approval on October 2018.

What could go wrong?

Supplies coming back for Sartans

Currently, Sartans form a significant part of the US portfolio. The current prices are holding on account of shortages created in the market as a result of recalls. However, entry of any significant player with fresh approvals may dampen the pricing in Sartans and may have a significant impact on the US business.

US regulatory risk

While the compliance track record with the FDA has been clean so far, plant concentration risk remains. Alembic Pharma is working towards derisking its current manufacturing concentration to other newer units, but this is still almost two years away. As large part of growth post FY22 would be led by US business. Commercialisation of new facilities and regulatory audits remain key to company's growth momentum.

Domestic business underperformance

Company has not done well in the domestic market and has been losing market share in many of its key segments. We have estimated it to be back to at around industry level growth rate over FY20-22E.

Drug inclusion in NLEM

Addition of drugs in the National List of Essential Medicines (NLEM) could hurt revenues and margins of the domestic business.

Adverse currency movement may impact its profitability as a large part of its sales are from US and other export markets.

Delay in approvals of plant/products/ANDA/DMF could postpone the revenue growth for Alembic.

An entry into niche areas like oncology, injectables, derma, etc. is fraught with a new set of challenges - both anticipated and unanticipated.

Company background

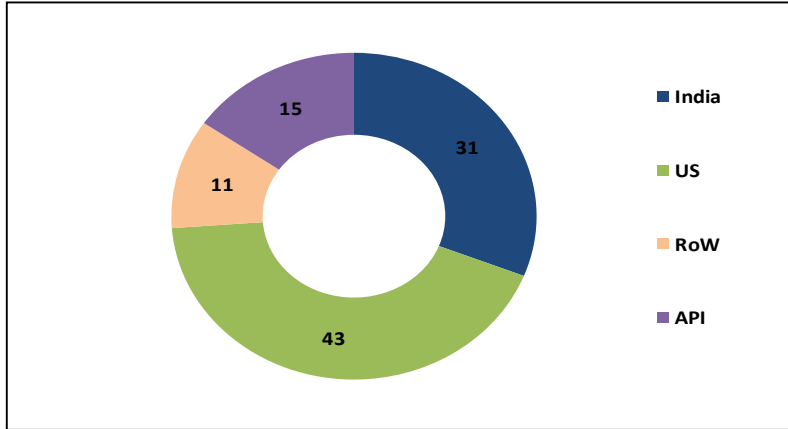
Founded in 1907, Alembic Pharma manufactures branded formulations, international generics and APIs for the global market. The company is coming up with three new plants i.e. oncology oral solids & injectables, ophthalmic & new oral solid plant. As at FY20, ANDA filings stood at 183 of which 119 are approved and 76 are launched. Apart from US, other key geographies include Europe, Australia, Canada, LATAM, South Africa, etc., which contribute ~11% of total sales in FY20. Company spends 13-14% of its revenues as R&D expenditure. Domestic formulations constituted ~31% of revenues in FY20. In the domestic market, Alembic is into two segments namely (1) acute and (2) specialty. The company's domestic branded portfolio is gradually shifting to the specialty business segment. Around 60-65% of domestic revenues come from chronic and sub-chronic while the balance from acute. The key brands in domestic market include Azithral, Althrocine, Wikoryl, Roxid, Gestofit, Ulgel etc. API business accounts for ~15% of revenues and a large part of it is captively consumed. As on FY20, the company has cumulatively filed 109 DMFs. Company has a small segment for veterinary products (~3% of domestic revenues).

Peer Comparison

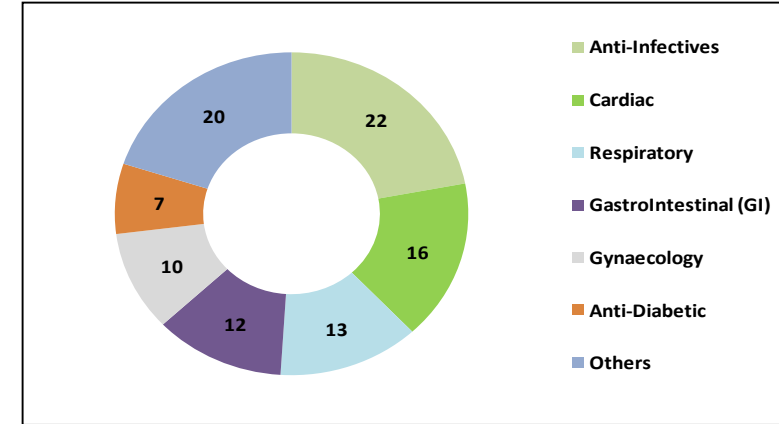
Company	CMP	Mcap (Rs cr)	Revenues* (Rs cr)	Operating Profit* (Rs cr)	PAT* (Rs cr)	RoE* (%)	RoCE* (%)	P/E* (x)	P/B* (x)
Ajanta Pharma	1559	13609	3228	900	634	19.5	22.0	22.3	4.0
Alembic Pharma	916	15986	5858	1486	1007	19.7	18.9	18.0	3.3
Alkem Labs	2743	32793	10168	2061	1537	19.7	18.0	21.2	3.9
Cadila Healthcare	384	39302	16728	3595	2097	16.5	13.5	18.8	2.9
Torrent Pharma	2660	45008	9430	2817	1535	23.5	19.0	29.5	7.1

Source: Company, HDFC sec Research *FY22E Consolidated

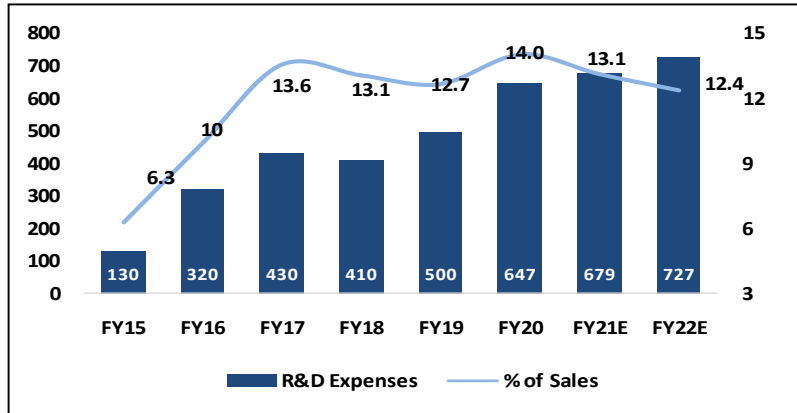
Revenues Mix (%)



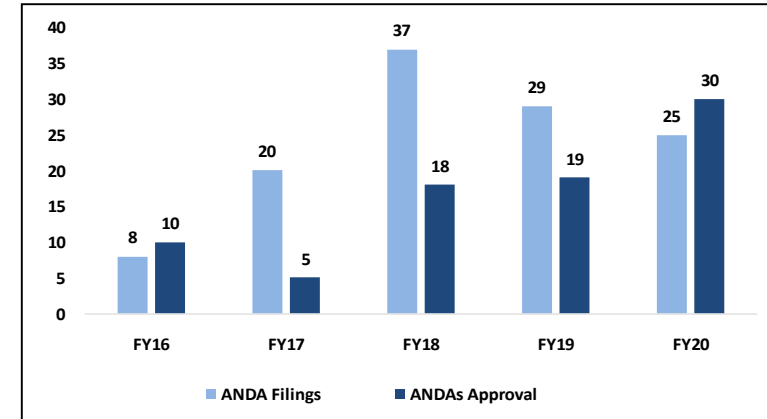
Domestic Revenues Mix (%)



R&D and its trend (%)



US ANDA (#)



Source: Company, HDFC sec Research

Alembic Pharmaceuticals Ltd

Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Total Revenue	3131	3935	4606	5168	5858
Growth (%)	-0.1	25.7	17.1	12.2	13.4
Operating Expenses	2488	3062	3383	3806	4372
EBITDA	643	873	1223	1361	1486
Growth (%)	4.6	35.8	40	11.3	9.2
EBITDA Margin (%)	20.5	22.2	26.6	26.3	25.4
Depreciation	106	115	157	198	239
EBIT	538	758	1066	1163	1247
Other Income	7	9	5	7	12
Interest expenses	3	18	27	28	20
PBT	541	749	1000	1144	1242
Tax	120	157	198	231	258
RPAT	413	585	829	930	1007
Growth (%)	2.4	41.6	41.9	12.2	8.2
EPS	21.9	31	44	47.3	51.2

Balance Sheet

As at March	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share Capital	37.7	37.7	37.7	39.3	39.3
Reserves	2183	2681	3182	4681	5479
Shareholders' Funds	2220	2719	3220	4721	5518
Long Term Debt	500	499	960	489	387
Net Deferred Taxes	36	19	12	15	15
Long Term Provisions & Others	41	52	75	80	88
Total Source of Funds	2797	3289	4237	5304	6007
APPLICATION OF FUNDS					
Net Block (incl. CWIP)	1838	2439	3100	3552	3693
Intangibles	166	270	299	299	299
Long Term Loans & Advances	113	110	129	151	188
Total Non Current Assets	2117	2819	3528	4002	4179
Inventories	734	967	1188	1235	1404
Trade Receivables	526	489	865	949	1048
Cash & Equivalents	90	206	81	472	651
Other Current Assets	474	296	330	360	396
Total Current Assets	1824	1958	2464	3014	3499
Short-Term Borrowings	208	429	861	732	578
Trade Payables	759	702	626	690	765
Other Current Liab& Provisions	143	326	227	245	277
Short-Term Provisions	34	32	38	44	49
Total Current Liabilities	1144	1488	1754	1712	1671
Net Current Assets	680	470	709	1302	1827
Total Application of Funds	2797	3289	4237	5304	6007

Alembic Pharmaceuticals Ltd

Cash Flow Statement

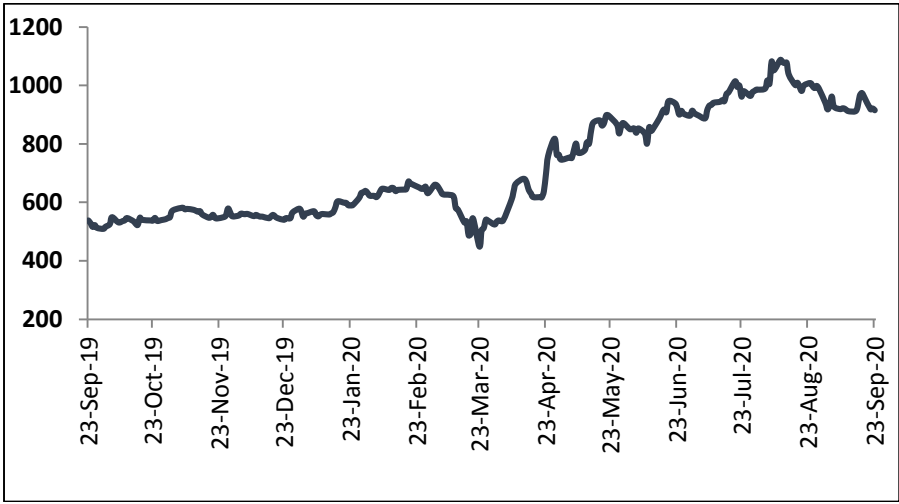
(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Reported PBT	541	749	1000	1144	1242
Non-operating & EO items	-7	-9	-5	-7	-12
Interest Expenses	3	18	27	28	20
Depreciation	106	115	157	198	239
Working Capital Change	-69	326	-367	-202	-347
Tax Paid	-120	-157	-198	-231	-258
OPERATING CASH FLOW (a)	454	1043	614	929	884
Capex	-918	-817	-907	-650	-380
Free Cash Flow	-464	225	-293	279	504
Investments	4	3	-15	-22	-37
Non-operating income	7	9	5	7	12
INVESTING CASH FLOW (b)	-907	-805	-917	-665	-405
Debt Issuance / (Repaid)	482	-7	477	-463	-94
Interest Expenses	-3	-18	-27	-28	-20
FCFE	15	200	156	-211	390
Share Capital Issuance	0	0	-29	781	0
Dividend	-90	-124	-223	-163	-186
FINANCING CASH FLOW (c)	389	-149	198	127	-300
NET CASH FLOW (a+b+c)	-64	89	-106	391	179

Key Ratios

	FY18	FY19	FY20	FY21E	FY22E
EBITDA Margin	20.5	22.2	26.6	26.3	25.4
EBIT Margin	17.2	19.3	23.1	22.5	21.3
APAT Margin	13.4	15.1	17.4	17.7	16.8
RoE	20	23.7	27.9	23.4	19.7
RoCE	17.9	20.4	20.9	19.3	18.9
Solvency Ratio					
Net Debt/EBITDA (x)	1	0.8	1.4	0.6	0.2
D/E	0.3	0.3	0.6	0.3	0.2
Net D/E	0.3	0.3	0.5	0.2	0.1
PER SHARE DATA					
EPS	21.9	31	44	47.3	51.2
CEPS	27.5	37.1	52.3	57.4	63.4
BV	117.8	144.2	170.8	240.2	280.7
Dividend	4	5.5	10	7	8
Turnover Ratios (days)					
Debtor days	61	45	69	67	65
Inventory days	80	79	85	87	88
Creditors days	145	106	85	85	83
VALUATION					
P/E	42	29.7	20.9	19.4	18
P/BV	7.8	6.4	5.4	3.8	3.3
EV/EBITDA	27.5	20.2	14.4	13	11.9
EV / Revenues	5.6	4.5	3.8	3.4	3
Dividend Payout	18.3	17.7	22.7	14.8	15.6

Alembic Pharmaceuticals Ltd

One Year Price Chart



Disclosure:

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