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Alembic Ltd.

Payback time

Management meet

October 18, 2010

Reco	Changed from
NR	**NR**
CMP	Target Price
Rs 63	**NR**

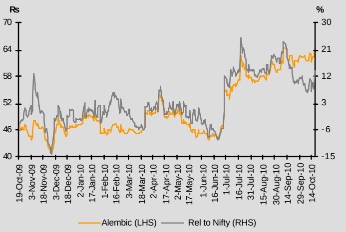
EPS change FY11E/12E (%)	NR
Target Price change (%)	NR
Nifty	6,063
Sensex	20,125

Price Performance

(%)	1M	3M	6M	12M
Absolute	2	12	31	34
Rel. to Sensex	0	1	15	16

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Pharmaceuticals
Bloomberg	ALBC@IN
Equity Capital (Rs mn)	267
Face Value(Rs)	2
No of shares o/s (mn)	134
52 Week H/L	66/40
Market Cap (Rs bn/USD mn)	8/189
Daily Avg Volume (No of sh)	542159
Daily Avg Turnover (US$mn)	0.8

Shareholding Pattern (%)

	S'10	**J'10**	**M'09**
Promoters	63.5	63.5	63.5
FII/NRI	9.9	8.6	8.3
Institutions	2.7	2.2	2.2
Private Corp	1.8	2.3	3.1
Public	22.1	23.5	23.0

Source: Capitaline

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- **De-merger to insulate core pharma business from the volatility of the Pen G business**
- **Real estate development presents strong value unlocking potential**
- **Growth drivers for pharma are in place; strong growth trajectory ahead**
- **Significant room for margin expansion.**
- **Trading at 30-40% discount to comparable peers; provides substantial room for upside**

Key highlights of management meet

De-merger to sharpen focus on pharma business; unlocking shareholders value

Alembic's decision to de-merge its pharma business into a separate entity will enable company to sharpen its focus on the profitable pharma business. Post de-merger, Alembic Pharma Limited (APL) will be a fully owned subsidiary of Alembic Ltd and apply for a separate listing (expect listing to happen by March'11). The residual business comprising of 115 acres land in Vadodara (45 acres plant area), Pen G manufacturing facility (made a loss of Rs242mn in FY10) and 11MW co-generation power assets (4 wind mills of 5MW) will be retained by the parent (Alembic Ltd). Swap ratio for the de-merger is 1:1 i.e. one share of APL will be issued for every share held in Alembic Ltd. Post de-merger, APL will issue fresh equity of 188.5mn shares, of which, Alembic Ltd (parent) will hold 29.2% and the balance 71% will be held by existing shareholders of Alembic Ltd.. As a result of this de-merger, the shareholders can reap the benefits of its profitable pharma business (In the past, the profitability of its pharma business was marred by the ailing PenG business). Moreover, with the pharma business being a separate entity, the company can channelie its focus on the remaining diverse businesses. We believe its huge land bank of 70 acres developmental land, promises strong value unlocking potential. The company plans to develop commercial and residential properties over the next 4-5 years

Shareholding pattern (post de-merger)

	Shares(mn)	% of total
Alembic Ltd	55	29.2
ALBC Shareholders	133.5	70.8
Promoters	84.8	45
Public	48.8	25.9
Total Shares to be issued	**188.5**	**100**
Shareholder Equity (Rs mn)	377	

Financial Snapshot **Rs Mn**

YE-Mar	Net Sales	EBITDA Core	EBITDA (%)	APAT	EPS (Rs)	EPS % chg	RoE (%)	P/E	EV/ EBITDA	P/BV
FY07	6,904	1,255	18.2	835	6.3	26.6	23.3	10.0	8.1	2.2
FY08	10,477	1,809	17.3	843	6.3	1.0	24.8	9.9	6.9	2.4
FY09	11,441	897	7.8	177	1.3	(79.0)	5.3	47.2	14.4	2.5
FY10	11,346	1,189	10.5	393	2.9	121.8	11.8	21.3	10.3	2.5

Business Snapshot

	Pharma Undertaking	Vadodara Undertaking	Power Assets	Real Estate Assets
Overview	▪ **Generic business** - largely driven by the regulated markets and R&D activities ▪ Domestic formulations ▪ International API	▪ Engaged in manufacturing & marketing of fermentation and chemistry based APIs ▪ Also engaged in R&D	▪ Engaged in power generation through - Cogeneration & Wind mills ▪ Currently entire power is used for captive consumption	▪ Currently holds land assets at Vadodara ▪ Real estate activity will be planned in the future
Key Statistics	**FY10 Financials** Revenues - Rs10.2bn PBT - Rs680mn	**FY10 Financials** Revenues - Rs1.15bn PBT - Rs(240)mn	**Co-generation** 3 plants of total 11MW **Wind Power** 4 windmills of total 5 MW	

Financial highlights (post de-merger)

(Rs mn)	Before De-merger			Post De-merger					
	Consolidated			Alembic			Alembic Pharma		
	FY10	FY09	Growth	FY10	FY09	Growth	FY10	FY09	Growth
Net Sales	11424	11212	1.9%	1150	1223	-6.0%	10275	9986	2.9%
PBT	438	91	381.3%	-242	-178	36.0%	680	269	152.8%
% of Sales	3.8%	0.8%		-21.0%	-14.6%		6.6%	2.7%	
Interest	301	401		50.9			250.1		
Depreciation	430	383		151			279		
Other income	43	51		15.1			28		
EBIDTA	1126			-55.263			1181		
EBIDTA %	9.9%			-4.8%			11.5%		
Balance Sheet									
Net Worth	3381	3305		1440	1689		1941	1616	
Total Debt	4084	4754		691	811		3393	3943	
Fresh Equity							377		
DE	1.21	1.44		0.48	0.48		1.75	2.44	
Gross Block	7124	6818		2500			4624	-	

Pharma business was in investment mode so far; time to reap benefits

In the last 4-5 years, Alembic has been steadily ramping up its pharma business in order to attain scale as well as de-risk its domestic formulation business by entering into newer therapeutic areas. In order to reduce its dependency on Anti-infectives (c44% of revenue), particularly macrolides in the domestic market, it acquired the non-oncology business of Dabur in 2007 for Rs1.59bn (revenue of Rs800mn). Through this acquisition, company forayed into high margin high growth segments such as CVS, Diabetes, Gastro and Gynacology. Now this business is doing very well and growing over 25-30% since last three years. Similarly, in order to improve its focus on customers, company has created 11 marketing divisions out of 2 existing divisions and added 1000 people over the last 12-18 months, the benefits of which, are already visible now. Further, company has invested substantial amount in creating R&D infrastructure as well as ANDA pipeline for the US and other regulated markets. Today, it has built up an ANDA pipeline of 31 products with 9 approvals and 8 launched. We are of the view that, with various growth drivers already in place, Alembic is going to witness strong growth trajectory in the pharma business over the next few years.

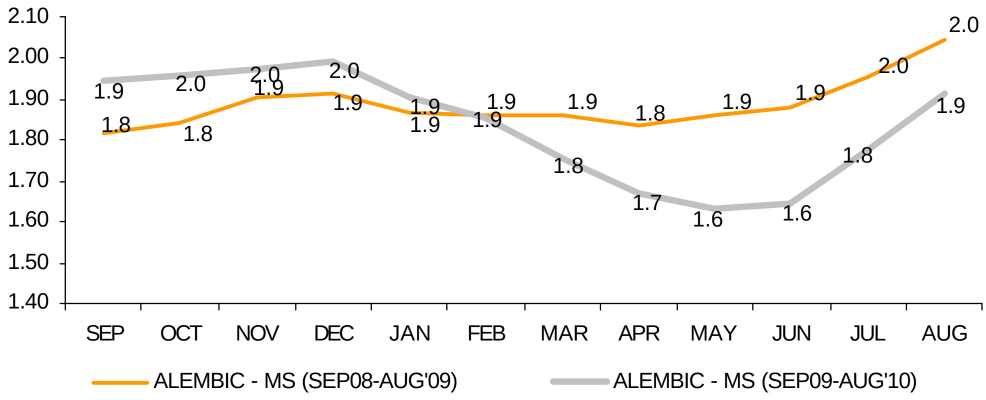
Domestic pharma business to remain key growth driver

57% of APL's revenues come from its domestic formulation business. Over the years, APL has built a formidable presence in macrolides and currently enjoys over 37% market share in this segment. All the 3 brands in this segment such as Azithromycin, Roxithromycin and Erythromycin are leaders in their respective categories and its Azithromycin brand (Azithral) has already achieved a feat of Rs100cr revenue in the domestic market. Despite being one of the dominant players in early 2000, the last few years have seen Alembic lose its aggression as well as market ranking because of its old and mature portfolio. However, in order to revamp its domestic business, company has taken series of initiatives under the leadership of Mr Shaunak Amin. These initiatives such as a) de-risking the business model by acquiring Dabur's non-oncology business in order to enter the high growth high margin chronic segments such as CVS, diabetes, gastro and gynecology b) creating specialty wise task forces by dividing its existing two marketing divisions into 11 specialty divisions, c) adding 1000 people (total field strength is now 2100) in order to increase its reach, d) entering into other high growth segments such as Opthal, derma and Ortho and e) focus on prescription generation rather than achieving primary targets, are already yielding positive results for the company. The acquired business (Rs800mn at the time of acquisition) is growing at 25% annually and currently, contributes ~27% of its domestic revenues. Similarly, company's domestic market share has improved from 1.9% in FY09 to 2.05% in FY10 (ORG IMS- Aug'2010).Going forward, management expects its domestic business to grow 200-300bps higher than the industry growth

Therapy-wise domestic revenue break-up

Domestic Formulations	FY09	FY10	YoY Gr. (%)
Anti-Infective	2674	2553	-4.5
Cough & Cold	639	701	9.8
Ortho	273	325	19.1
Gastro	544	593	9.0
Cardiovascular	299	369	23.3
Diabetes	109	154	41.9
Gynecology	464	470	1.4
Ophthalmology	3	27	828.5
Others	535	657	22.8
Total	**5538**	**5849**	**5.6**

Alembic market share movement (%)



US will be a key focus territory for international formulation business

International formulation business, which currently contributes 38% of export revenues, is largely dominated by regulated markets (c 70% of export formulation). US is one of the key focus geographies for Alembic and contributes over 70% of its regulated market business (~Rs700mn). Currently, the company has a pipeline of 31 ANDAs, out of which, 9 are approved and 8 launched. Company has built this franchise in the last two-three years and currently has a run rate of ~US2mn per product (in-line with other mid tier companies). Going forward, company plans to file 10-12 ANDAs and expect 7-8 approvals every year. Over the next three years, management is looking to build a portfolio of 30 products with revenue of US$60-65mn from the current level of US$15mn (40% CAGR over FY10-14E).

	FY09	FY10	YoY Gr. (%)
Total Exports	**4451**	**4338**	**-2.5**
Formulations	1197	1478	23.5
Regulated	720	1020	41.7
RoW	477	458	-4.0
API	3254	2860	-12.1

Significant room for margin expansion

Despite 57% revenues coming from domestic formulation business, APL's operating margins in the pharma business are just 12%, which is way below the average operating margins of mid-sized pharma companies (around 19-22% range).The lower operating margins are mainly because of the fact that company has been investing aggressively both in the domestic as well as international markets, the fruits of which will be visible from Q2FY11E onwards. With the ramp up in its field force and R&D investments turning revenue accretive, management expects its operating margins to expand annually by 200bps to 18-20% range over the next 3-4 years. In the domestic market, company expects the productivity of its sales force to increase from Rs2.36mn per annum to Rs2.9mn per annum over the next two years. With its export formulation business gaining momentum, we expect its investments in R&D and filing cost to start yielding revenues, thereby improving profitability. We expect its R&D expenses to remain stable at $9-10 mn p.a. Moreover, the return ratios (RoCE and RoE) are also expected to improve, going forward driven by higher revenue growth and strong operating performance. Moreover, management expects overall leverage of APL to reduce, as it is expected to have positive cash flow and will incur capex of Rs1.5bn over the next 3 years

Snapshot of operating performance

	FY10	
	EBITDA (Rs mn)	EBITDA margin (%)
Ipca Labs	3459.3	21.7
Elder Pharma	1267.2	17.6
Indoco Remedies	581.3	14.5
Unichem Labs	1730	23.2
Torrent Pharma	3970.2	27.9
Alembic Pharma	**1189.3**	**11.5**

Value unlocking through real estate development

Management plans to unlock the value of its real estate assets by developing it for residential and commercial uses. Out of 70 acres developmental land, company is going to announce residential projects on 12 acres in next 6-9 months (first phase). This project will be developed in collaboration with a non-listed promoter group company, which is already in this business and will incur the all development cost. Company plans to develop and sell the entire 70 acres land over the next 4-5 years. Our channel check from the market sources indicates that the commercial value of this 70 acres land itself is Rs4.0bn (Rs30 per share). With regard to PenG business, company expects the losses to come down going forward and it is also planning to use the spare capacity for higher margin products. Overall, the book value of its residual business is Rs2.5bn (Rs19/share) and debt of Rs691mn

Current valuations leave significant room for upside

Adjusting to the book value of gross fixed assets of residual business (Rs19/share), the pharma business is available at 9.2X FY11E EPS and 7.15x FY11E EV/EBIDTA, which is 30-40% discount to its comparable peers on all valuation parameters. With improved focus on pharma business, strong earnings growth (expect 30% earning CAGR over FY10-12E) and improved balance sheet coupled with strong return ratios, the current valuations leave significant room for upside. We do not have formal rating on the stock. However, we are positively biased on the company

Peer Comparison

	Sales (Rs mn) FY11E	EBITDA (Rs mn) FY11E	EPS (Rs) FY11E	ROE (%) FY11E	EV/Sales FY11E	EV/EBITDA FY11E	P/E (x) FY11E
Indoco Remedies	4895	705	43.38	15.6	1.2	8.3	9.9
Elder Pharma	8166.5	1565	36.85	16.6	1.6	8.5	10.7
IPCA labs	18872	3963	20.0	25.7	2.3	10.8	14.7
Unichem Labs	10558	2599	51.5	26.1	2.2	9.1	10.9
Alembic	**11283**	**1580**	**4.64**	**37**	**1**	**7.2**	**13.5**

Key Risks

- Slow recovery in the domestic formulation business
- Increase in losses in Pen-G business
- Inability to monetize real assets value

Financials

Income Statement (Rs. mn)

(Year Ending Mar 31)	FY07	FY08	FY09	FY10
Sales Turnover	7188	10222.4	11248.2	11373.4
Excise Duty	272	321.7	254.9	161.9
Net Sales	**6916**	**9900.7**	**10993.3**	**11211.5**
Other Income	190.7	386.8	139.9	156.4
Stock Adjustments	-202.8	189.2	307.3	-22.1
Total Income	6903.9	10476.7	11440.5	11345.8
Total Expenditure	**5648.9**	**8667.4**	**10544**	**10156.5**
Raw Materials	2972.6	5024	5818.9	5631.5
Power & Fuel Cost	184.7	280.5	380.8	339.8
Employee Cost	785.7	976.2	1316.9	1454.7
Other Mfg expenses	379.4	475	559.2	483.6
Selling and Admin. Exp	1247	1765.4	1956.4	2122.4
Misc. Expenses	79.5	146.3	511.8	124.5
EBITDA	**1255**	**1809.3**	**896.5**	**1189.3**
EBITDA margin (%)	*18.2*	*17.3*	*7.8*	*10.5*
Interest	258.6	345.6	422.1	320.9
Gross Profit	**996.4**	**1463.7**	**474.4**	**868.4**
Depreciation	290.6	327.7	383.1	430.2
Profit Before Tax	**705.8**	**1136**	**91.3**	**438.2**
Tax	-1	14.1	-16.9	42.8
Net Profit	**706.8**	**1121.9**	**108.2**	**395.4**
Extraordinary Items	-128	278.6	-68.9	2.6
Adjusted Net Profit	**834.8**	**843.3**	**177.1**	**392.8**
Adj. net profit margin (%)	*12.1*	*8.0*	*1.5*	*3.5*

Balance Sheet (Rs. mn)

(Year Ending Mar 31)	FY07	FY08	FY09	FY10
Share Capital	277	277	274	267
Reserves & Surplus	3572	3137	3036	3106
Networth	**3849**	**3414**	**3310**	**3373**
Secured Loans	2080	2776	2158	2493
Unsecured Loans	1274	1459	2597	1591
Total Debt	**3354**	**4235**	**4754**	**4084**
Net Def tax liability	398	-48	64	138
Total Liabilities	**7601**	**7600**	**8129**	**7595**
Gross Block	5141	6055	6818	7124
Less: Accumulated Dep	2086	2389	2770	3192
Net Block	**3054**	**3666**	**4048**	**3932**
Capital Work in Progress	512	220	72	39
Investments	208	141	83	84
Current Assets	**5327**	**5384**	**5950**	**5912**
Inventories	1231	2028	2384	2450
Sundry Debtors	1659	2305	2130	1929
Cash and Bank	1517	187	164	239
Loans and Advances	920	864	1272	1296
Current Liab & Prov	**1501**	**1810**	**2024**	**2372**
Current Liabilities	1058	1522	1882	2182
Provisions	443	288	142	190
Net Current Assets	**3826**	**3574**	**3926**	**3540**
Total Assets	**7601**	**7600**	**8129**	**7595**

Cash Flow (Rs. mn)

(Year Ending Mar 31)	FY07	FY08	FY09	FY10
Opening Cash	**8.8**	**1517.1**	**186.6**	**164.1**
Net Cash from Operations	873.3	535.4	1230.9	1490.9
Net Cash Used in Investing	-618.2	-2251.4	-555.5	-235
Net Cash Used in Financing	1253.2	385.5	-697.9	-1181.5
Net Inc/(Dec) in Cash	1508.3	-1330.5	-22.5	74.4
Closing Cash	**1517.1**	**186.6**	**164.1**	**238.5**

Key Ratios

(Year Ending Mar 31)	FY07	FY08	FY09	FY10
Profitability (%)				
EBITDA Margin	18.2	17.3	7.8	10.5
Net Margin	12.1	8.0	1.5	3.5
ROCE	18.0	15.7	7.5	9.8
ROE	23.3	24.8	5.3	11.8
Per Share Data (Rs)				
EPS	6.3	6.3	1.3	2.9
CEPS	8.4	8.8	4.2	6.2
BVPS	28.8	25.6	24.8	25.3
DPS	1.0	1.6	0.4	0.5
Valuations (x)				
PER	10.0	9.9	47.2	21.3
P/CEPS	7.4	7.1	14.9	10.1
P/BV	2.2	2.4	2.5	2.5
EV / Sales	1.5	1.3	1.2	1.1
EV / EBITDA	8.1	6.9	14.4	10.3
Dividend Yield (%)	1.7	2.5	0.7	0.8
Gearing Ratio (x)				
Net Debt/ Equity	0.5	1.2	1.4	1.1
Net Debt/EBIDTA	1.5	2.2	5.1	3.2

Source: Capitaline

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