

Alembic (ALECHE)

RESULT UPDATE ✓

WHAT'S CHANGED...

PRICE TARGET.....	Unchanged
EPS (FY08E).....	(Rs 8.45)
EPS (FY09E).....	(Rs 9.30)
EPS (FY10E).....	(Rs 12.40)
RATING.....	Unchanged

Current price Rs 65	Target price Rs 93
Potential upside 43%	Time Frame 12 months

OUTPERFORMER

Raghvendra Kumar
raghvendra.kumar@icicidirect.com

Performance hit by poor margins ...

Alembic's results for Q3FY08 were below expectations. The company's net profit from continuing business declined 18.40% y-o-y due to a drastic fall in EBIDTA margin by 669 bps and increase in interest cost by 177%. It reported a net profit of Rs 42 crore in on account of profit on sales of land to the tune of Rs 22.55 crore. Top line grew 40% y-o-y to Rs 260 crore on the back of a 132% y-o-y growth in exports to Rs 91.63 crore, and a 14% growth in domestic revenues to Rs 173.63 crore. The crash in prices of Pen-G was the main reason for the pressure on EBIDTA margin. From Q4FY08 onwards, we expect EBIDTA margins to return to 17-18% as the company is working at a downstream product Pen-G where realizations are healthy. The improvement in the regulated market exports is a positive sign.

EBIDTA margin declined 669 bps

EBIDTA margin plunged 669 bps largely due to a drastic decline in Pen-G prices from US\$18 per bu to US\$7 per bu. The crash was due to increased exports from China. Pen-G contributed around Rs 30 crore (around 12%) to the company's top line in Q3FY08 at an average price of below US\$10. Gross contribution on Pen-G was almost zero, leading to a significant pressure on EBIDTA. Outsourcing costs increased 76% during the quarter y-o-y (on percent-to-sales, the purchase of finished goods increased by 3.3%). This was mainly due to outsourcing of production for the products under non-oncology business of Dabur Pharma. In-house production lead to a saving in excise due to production site in Baddi in Himachal Pradesh (an excise-free zone). For the continuing business, the company had a 65:35 mix of in-house and outsourced production. New formulation increased outsourcing and thus excise, which in turn impacted EBIDTA margin. Moreover, higher R&D cost (4.3% of sales), which grew by 65% y-o-y in Q3FY08 on account of increased ANDA and DMF filings for the regulatory markets also impacted the EBIDTA margins.

Valuation

In our initiating report (Aug 19, 2006), we had observed that the CRAMS business is likely to gain more traction in FY08. We witnessed a significant jump in CRAMS business in Q3FY08. We continue to be bullish on the stock and reiterate our OUTPERFORMER rating. At the current price of Rs 65, the stock trades at 6.99x FY09E EPS of Rs 9.30 and 5.24x FY10E EPS of Rs 12.40. of 37%.

Key Financials

Year to March	(Rs crore)									
	Q3FY07	Q3FY08	% change	9MFY07	9MF08	% change	FY07	FY08E	FY09E	FY10E
Net Sales	185.80	260.62	40	536.66	740.45	38	700.66	949.49	1,059.28	1,189.56
EBIDTA	33.43	29.45	-12	92.02	111.91	22	115.85	177.05	210.55	255.93
EBIDTA margin (%)	18	11		17	15		17	18	19	20
Depreciation	7.53	8.38	11	21.55	24.02	11	29.06	30.08	29.25	28.69
Interest (Net)	3.03	8.38	177	5.18	23.83	360	7.52	31.42	34.18	29.60
Add: Profit on sale of land	0.00	22.55		0.00	22.55		0	22.55	0.00	0.00
Profit after tax	25.10	42.02	67	59.63	96.85	62	70.69	117.01	128.79	171.72
Equity capital (FV: Rs 2)	27.69	27.69		27.69	27.69		27.69	27.69	27.69	27.69
Basic & diluted EPS	1.81	3.04		4.31	7.00		5.1	8.45	9.30	12.40

Source: ICICIdirect Research

Domestic business grew at 14%

The largest revenue contributor, the domestic business, grew 14% y-o-y to Rs 173.63 crore (as per our expectations). Domestic formulation grew 17% to Rs 152.12 crore, while the domestic bulk business de-grew 2% to Rs 21.51 crore. Alembic's own formulations business grew 4% while the recently acquired non-oncology business of Dabur Pharma contributed around Rs 17 crore. In the absence of the acquisition of the Dabur Pharma business, the company would have reported lower growth. Lower continuing business growth and decline in Pen-G prices impacted the domestic sales growth. In order to reduce the de-risk from the Pen-G price vagaries, Alembic is foraying into production of some downstream product of Pen-G.

Handsome growth in regulatory market export

Alembic's high-margin formulation export to regulated markets grew by 471% to Rs 26 crore, while API exports to regulatory markets grew by 424% y-o-y to Rs 33 crore. The company recorded overall export growth 132% y-o-y in Q3FY08 on the back of a 128% rise in formulation exports and 136% rise in API exports. We expect the growth trend to continue in the quarters to come as the company is supplying formulations and APIs under long-term contract. With the rise in exports to regulatory markets, we believe margins would improve. The company is also working on few deals for the regulated market export. If the deal clicks, growth would be even higher.

Aggressive filing – increase the depth

Alembic has increased its focus on ANDA filings. So far, the company has filed 8 ANDA and is working on 10, which it expects to file in next 12 to 18 months. We believe more traction in regulatory market formulation revenue as the company is likely to start getting approvals in next 6 to 12 months.

RATING RATIONALE

ICICIDirect endeavours to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more

Performer: Between 10% and 20%

Hold: \pm 10% return

Underperformer: -10% or more

Harendra Kumar

Head - Research & Advisory

harendra.kumar@icicidirect.com

**ICICIdirect Research Desk,
ICICI Securities Limited,
Mafatlal House, Ground Floor,
163, H T Parekh Marg,
Churchgate, Mumbai – 400 020**

research@icicidirect.com

Disclaimer

The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities Ltd (I-Sec). The author of the report does not hold any investment in any of the companies mentioned in this report. I-Sec may be holding a small number of shares/position in the above-referred companies as on date of release of this report. This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This report may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. I-Sec and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. I-Sec may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject I-Sec and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.