Alkem Laboratories Limited

December 14, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term / Short Term Bank Facilities	300.00	CARE AA+; Stable / CARE A1+ (Double A Plus; Outlook: Stable/ A One Plus)	Reaffirmed
Total Bank Facilities	**300.00 (Rs. Three Hundred Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Alkem Laboratories Limited (Alkem) continue to derive strength from its experienced promoters and management team along with long track record of the company in the pharmaceutical industry with its accredited manufacturing facilities. The ratings are further underpinned by its strong business profile backed by dominant position in the domestic formulation market with strong product portfolio across multiple therapeutic segments and an established marketing network, apart from gradual expansion in regulated markets along with its well-equipped research and development (R&D) facilities. The ratings also derive strength from healthy financial risk profile of Alkem marked by strong profitability and return indicators along with its comfortable debt coverage indicators and strong liquidity.

The above rating strengths are, however, partially off-set by Alkem's higher dependence on acute therapeutic segment where the company is exposed to price control with around 25%-30% of its products under National List of Essential Medicines (NLEM), recent increase in pricing pressure in the US market as well as rise in the cost of key starting materials (KSM) and active pharmaceutical ingredients (API), which is likely to result in some moderation in its operating profitability margin in the medium-term. The ratings further continue to be constrained on account of its exposure to inherent regulatory risk associated with the pharmaceutical industry, competitive industry scenario and foreign exchange fluctuation risk.

Rating Sensitivities

Positive factors - Factors that could lead to positive rating action / upgrade:

- Geographical and product portfolio diversification with greater share of chronic therapeutic segment in its revenue profile along with significant growth in its revenue and improvement in its PBILDT margin above 30% on a sustained basis.
- Efficient working capital management with net operating cycle remaining around 60 days on a consistent basis

Negative factors - Factors that could lead to negative rating action / downgrade:

- Decline in PBILDT margins below 15% on a sustained basis.
- Any large-size debt-funded organic or inorganic expansion leading to overall gearing ratio higher than 0.5 times (on gross debt basis) and net debt to PBILDT higher than unity on a sustained basis.

Detailed description of the key rating drivers

Key Rating Strengths

Long track record of operation of the company in pharmaceutical industry along with extensive experience of its promoters

Incorporated in 1973, Alkem has a track record of more than 40 years in the pharmaceutical industry. Alkem was founded by late Mr Samprada Singh along with his brother, Mr Basudeo Singh who is presently the Executive Chairman of the company with experience of over four decades in the industry. The day-to-day operations of the company are managed by a team of qualified and experienced management spearheaded by Mr Sandeep Singh (grandson of Mr Samprada Singh), who is presently the Managing Director of Alkem. Mr Sandeep Singh has more than 17 years of experience in of the pharmaceutical business.

Accredited manufacturing facilities supported with well-equipped R&D facilities

Alkem had 20 manufacturing facilities (out of which 18 are in India and 2 are in the United States) as on March 31, 2021. Within India, its manufacturing facilities are mainly located in Daman, Baddi, Indore and Sikkim. The manufacturing facilities possess the requisite regulatory approvals from drug regulatory agencies such as United States Food and Drug Administration (USFDA), Medicine and Healthcare products Regulatory Agency (MHRA – UK), South Africa Health Products Regulatory Authority (SAHPRA), Therapeutic Goods Administration (TGA), Australia, The National Health Surveillance Agency (ANVISA), Brazil, World Health Organization (WHO), Geneva, Therapeutic Products Directorate (TPD), Canada, Pharmacy and Poisons Board (PPB), Kenya, National Drug Authority (NDA), Uganda, Ministry of Health (MOH), Sudan, Colombia National Food and Drug Surveillance Institutes (INVIMA), Tanzania Food and Drug Authority (TFDA) among others. They are routinely audited to ensure compliance with current Good Manufacturing Practices (cGMP).

Moreover, Alkem spends on an average around 5%-6% of its revenue on R&D for development of branded generics, non-branded generics, APIs and nutraceutical products. Alkem's R&D team comprises more than 500 scientists for developing new

[1]*Complete definition of the ratings assigned are available at www.careedge.in and other CARE publications*

products at its six R&D centres spread across India and the US. Due to Alkem's continuous effort on R&D, the company has been able to regularly develop and launch new products which is crucial in the competitive pharmaceutical industry.

Dominant market position in domestic formulation market with diversified product portfolio

Alkem is the fifth largest player in the domestic formulation market with market share of 3.6% as on March 31, 2021 (Source: company). Alkem has established its position as one of the leading companies in India for acute therapy, with a strong market position in anti-infective, gastro-intestinal, pain-management and vitamin/minerals/nutrients therapy segments. Alkem is the largest player in the anti-infective therapy segment and among the top four in gastro-intestinal, pain-management and vitamin/minerals/nutrients therapy segments in the domestic market. During FY21 (refers to the period April 1 to March 31), Alkem earned 82% of its domestic revenue from top five therapeutic segment which includes Anti-infective (37%), Gastro-intestinal (19%), Vitamins/Minerals/Nutrients (11%), Pain/Analgesics (11%) and Neuro/ Central Nervous System (4%). Furthermore, Alkem earned around 38% of its domestic revenue from top ten brands during FY21 (P.Y.: 39%) thereby demonstrating a fairly diversified product portfolio. Each of its top ten brands (from acute therapy) held top two positions in their respective molecular category indicating its strong brand-recall. Alkem's 12 brands earned revenue of more than Rs.100 crore each during FY21 out of which six brands are among top 100 domestic formulation brands as on March 31, 2021 (Source: Company) indicating its dominant position in the domestic formulation market.

Wide and established marketing network with geographically diversified revenue stream

Over the years, Alkem has expanded its presence in the overseas market through both organic as well as through certain strategic acquisitions with primary focus on the US market. Alkem has presence in the regulated markets like US, Europe and Australia apart from presence in semi-regulated markets like Philippines, Chile, Kazakhstan, West Asia and East Africa, etc. Exports accounted for 34% of its total revenue in FY21, while domestic sales constituted the remainder. Alkem's export revenue grew at a compounded annual growth rate (CAGR) of 17% over the period of the last five years ended FY21 backed by healthy growth of revenue from the US market. In US, the company operates though limited risk distribution model wherein company supplies its products to large distributors who further market the products. Over the years, the company has developed pan-India supply chain and distribution network of over 7,000 stockiest which ensures assured demand offtake for existing and new products. Recently, during FY22, sharp price erosion in generic products has been witnessed in the US market due to increased competition which may temporarily impact the profitability of the company. However, due to large number of products going off-patent in US in medium term, it provides good opportunity to generic Indian players operating in US.

Growing scale of operations with healthy profitability and return indicators

The total operating income (TOI) of Alkem grew at a CAGR of 12% over five years ended FY21 backed by growth in domestic revenue at a CAGR of 9% and export revenue at a CAGR of 18% over the same period. TOI of the company grew by 7% on y-o-y basis during FY21 largely due to lower sales growth of 3.8% in the domestic market which was off-set by relatively healthy sales growth of 11.2% from the export market. The lower sales growth in the domestic market was largely due to lower prescription-based sales during H1FY21 in light of Covid-19 pandemic. Furthermore, TOI of the company grew by 26% on y-o-y basis during H1FY22 backed by healthy growth in domestic market majorly driven by volume led growth in the acute therapy. However, the company has witnessed decline of 6% in export sale during H1FY22 on y-o-y basis largely due to some loss of market share in US, price deflation coupled with higher base of H1FY21 in light of panic buying towards stock piling.

The PBILDT margin of the company significantly improved by 425 bps and stood healthy at 23.14% during FY21 as compared with 18.88% during FY20 largely backed by saving in expenses on marketing and travel cost in light of Covid-19 restrictions apart from improved product mix and better operating efficiency. The PBILDT margin of the company moderated by 400 bps and stood at 23% during H1FY22 as compared to 27% during H1FY21 largely due to normalization of marketing and selling expenses apart from pricing pressure witnessed in US sales. The profitability may see downward pressure in medium term due to continued pricing pressure in US sales along with rise in cost of KSM and APIs. On a steady-state basis, the company's operating profitability (PBILDT) margin is expected to remain at around 20%-21% supported by strong operating efficiencies and better product mix. The return indicators of the company marked by operating return on capital employed (ROCE) stood healthy at 25.36% during FY21 (P.Y.: 22.63%) and is expected to remain around 25% in the medium term.

Comfortable leverage and debt coverage indicators

Capital structure of the company continued to remain comfortable marked by overall gearing of 0.25 times (on gross debt basis) and total outside liabilities (TOL)/ Tangible Net-worth (TNW) of 0.55 times as on March 31, 2021. The company had strong net-worth base of Rs.7,164 crore as on March 31, 2021 as against outstanding debt of Rs.1,792 crore which largely includes working capital borrowings of Rs.1,636 crore as on even date. Moreover, the company had cash and liquid investment of Rs.2,363 crore as on March 31, 2021, out of which unencumbered cash & liquid investments stood at Rs.1,784 crore as on March 31, 2021 (excluding investments of Rs.129 crore in real estate funds and FD lien with banks). Going forward, the overall gearing of the company is expected to remain below 0.25 times over FY22-FY24 in the absence of any debt-funded capex plan over the same period. Furthermore, debt coverage indicators of the company also improved and remained comfortable marked by Total Debt/ Gross cash accruals of 1.06 times (gross debt basis) and PBILDT interest coverage of above 35 times in FY21. The debt coverage indicators are expected to remain strong in medium term with expectation of steady cashflow from operations and continued lower reliance on external debt.

Liquidity: Strong

Alkem's liquidity remained strong marked by strong cash accruals and cash flow from operation, healthy current ratio of 1.81x times as on March 31, 2021, and around 67% average utilization of fund-based working capital limits during trailing nine months ended September 2021. Cash flow from operations stood at around Rs.1,422 crore during FY21 (Rs.528 crore in FY20). Furthermore, the company's gross cash accruals are expected to remain sufficient for its capex requirement (majorly maintenance capex) and incremental working capital requirement over medium term. Furthermore, the liquidity of the company is also supported by unencumbered cash and liquid investments of Rs.1,784 crore (excluding line marked FD and real estate funds) as on March 31, 2021.

Key Rating Weaknesses

High dependence on the competitive acute therapeutic segment

Alkem earned around 80% of its revenue from the acute therapeutic segment, which is relatively slow growing and less margin accretive segment. Furthermore, nearly 25%-30% of its products fall under the drug price control order (DPCO) which restricts the pricing power and in turn restricts the profitability. In recent years, Alkem is consciously increasing its focus on chronic segment products including cardiovascular, neuropsychiatry, and oncology. Alkem has created separate division with a dedicated field force to focus on increasing its market share in chronic segment over medium to long term. Well-balanced portfolio of acute and chronic shall enable further strengthening of its business risk profile. However, acute segment shall continue to remain its significant revenue contributor over the medium term.

Inherent regulatory risk associated with pharmaceutical industry apart from competitive intensity

Alkem has its presence in multiple countries across the world and it has 20 production units. Considering the nature of the product usage and application, and consequent impact, Alkem is required to comply with various laws, rules and regulations. It operates under strict regulatory environment. Thus, infringement of any law, and any significant adverse change in the import/export policy or environmental/regulatory policies in the area of operations of the company, can have an impact on the operations of the company. Nevertheless, the company is continuously taking adequate steps to address the regulatory risks. Furthermore, all manufacturing sites continue to successfully clear regulatory audits, conducted by various leading global regulatory agencies. However, Alkem's St. Louis facility (USA) was inspected by USFDA and two observations were received in June 2021. Alkem's management has articulated that it has already replied to USFDA with the corrective and preventive action plan to resolve these observations. Although early resolution of the issue may lead to faster-than-anticipated growth in its US sales given the planned product filing and launches, however, presently the St. Louis facility had very negligible share of less than 1% in its consolidated revenue.
Alkem also faces competition and pricing pressure in global as well as domestic markets. Globally, the generic players are facing severe price erosion, significant government pressures to reduce prices along with intense competition, increasing regulation and heightened sensitivity towards product performance.

Foreign exchange fluctuation risk

The company derived around 34% of its overall revenue from exports, thus, it is exposed to inherent foreign currency fluctuation risk. In FY21, Alkem reported forex earnings of Rs.1,955 crore (P.Y.: Rs.1,606 crore) and a forex outgo of Rs.247 crore (P.Y.: Rs.248 crore). The currencies in which these transactions are primarily denominated are US Dollars, Euro, Australian dollars, Chilean Peso, and Kazakhstani Tenge. On a standalone basis, the company has reported net forex (transaction & translation) gains amounting to Rs.30.52 crore in FY21 (P.Y.: Rs.32.04 crore) and on a consolidated basis it reported net forex gains amounting to Rs.45.83 crore in FY21 (P.Y.: Rs.4.55 crore). Alkem normally avails foreign currency working capital borrowings against the export receivables to hedge against any adverse movement in foreign currency rates.

Analytical Approach: Consolidated. CARE Ratings has considered Alkem's credit assessment on a consolidated basis since it has considerable overseas operations and operational inter-linkages with its subsidiaries. (List of subsidiaries is given in **Annexure 3**).

Applicable Criteria

CARE's Policy on Default Recognition
Rating Methodology – Consolidation
Financial Ratios – Non-financial Sector
Liquidity Analysis of Non-financial sector entities
Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings
Criteria for Short Term Instruments
Rating Methodology – Manufacturing Companies
Rating Methodology – Pharmaceutical Sector

About the Company

Incorporated in 1973, Alkem has more than 40 years of experience in pharmaceutical industry. The company was founded by late Mr Samprada Singh along with his brother Mr Basudeo Singh. Alkem is engaged in the development, manufacturing and marketing of pharmaceuticals with operational footprints across 50+ countries. The company was engaged in contract manufacturing from 1973 till 2005. The Alkem group launched its first product in 2006 and since then its product portfolio has expanded to more than 800+ products in various therapeutic segments. The company offers a wide range of products spanning across multiple therapeutic areas such as Anti-infective, Gastroenterology, Pain Relief/Analgesic, Anti-diabetic, Cardiology, Oncology, Dermatology, Osteoporosis, Gynecology, Neurology, Central Nervous System and Vitamins, Minerals & Nutrients. Alkem has 20 manufacturing facilities (out of which 18 are in India and 2 are in the United States) and 6 R&D centres as on March 31, 2021. All the manufacturing facilities possess necessary regulatory approvals.

Brief Consolidated Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (UA)
Total operating income	8,442	9,002	5,620
PBILDT	1,594	2,083	1,306
PAT	1,149	1,618	1,039
Overall gearing (times)	0.29	0.25	NA
Interest coverage (times)	24.50	35.35	52.59

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: Not Applicable

Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments / Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	-	-	-	-	300.00	CARE AA+; Stable / CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	LT/ST*	300.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (05-Jan-21)	-	-

** Long Term / Short Term*

Annexure-3: List of subsidiaries of Alkem:

Names of Entities Consolidated	% Shareholding as on Mar.31, 2021	Extent of Consolidation
Ascend Laboratories (Pty) Ltd [formerly known as Alkem Laboratories (Pty) Ltd]	100.00	Fully Consolidated
Ascend Gmbh (formerly, Alkem Pharma Gmbh)	100.00	Fully Consolidated
Alkem Laboratories Corporation	100.00	Fully Consolidated
S & B Holdings BV	100.00	Fully Consolidated
Pharmacor Pty Ltd	100.00	Fully Consolidated
ThePharmaNetwork, LLC (wholly owned subsidiary of S & B Holdings BV)	100.00	Fully Consolidated
Ascends Laboratories SDN BHD	100.00	Fully Consolidated
Ascend Laboratories SpA	100.00	Fully Consolidated
Enzene Biosciences Ltd	99.84	Fully Consolidated
Alkem Laboratories Korea Inc	100.00	Fully Consolidated
Pharmacor Ltd	100.00	Fully Consolidated
S & B Pharma Inc	100.00	Fully Consolidated
The PharmaNetwork, LLP	100.00	Fully Consolidated
Ascend Laboratories, LLC (wholly owned subsidiary of The PharmaNetwork, LLC)	100.00	Fully Consolidated
Ascend Laboratories SAS	100.00	Fully Consolidated
Ascend Laboratories (UK) Ltd	100.00	Fully Consolidated
Cachet Pharmaceuticals Pvt Ltd	58.80	Fully Consolidated
Indchemie Health Specialities Pvt Ltd	51.00	Fully Consolidated
Ascend Laboratories Ltd	100.00	Fully Consolidated
Pharma Network SpA (wholly-owned subsidiary of Ascend Laboratories SAS)	100.00	Fully Consolidated
Alkem Foundation	100.00	Fully Consolidated
Connect 2 Clinic Pvt Ltd. (with effect from June 12, 2020)	100.00	Fully Consolidated
S&B Pharma LLC (wholly owned subsidiary of The PharmaNetwork, LLC; (with effect from April 08, 2020)	100.00	Fully Consolidated

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	Simple

Annexure 5: Bank Lender Details for this Company – Not Applicable

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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