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ALEMBIC PHARMACEUTICALS LTD.

November 25, 2011

BSE Code: 533573 **NSE Code:** APLLTD **Reuters Code:** ALPM:IN **Bloomberg Code:** ALEM.NS

Alembic Pharmaceuticals Ltd (APL) is an Indian pharmaceutical major, with dominance in the Macrolides segment of anti-infective drugs in the country. Its 3 brands namely Azithral in Azithromycin, Roxid in Roxithromycin and Althrocin in Erythromycin figure among the Top100 brands in India. Even in the respiratory segment the company has built large brands like Zeet and Wikoryl. Over the last couple of years, APL has grown its life style portfolio in Diabetes, Cardiovascular, Gynaecology, Opthalmics, Ortho and Urology. The company derives 57% of its revenues from its ₹7 billion domestic branded formulation business while it's ₹3 billion API business and ₹2 billion generics business is gaining good traction.

Investor's Rationale

- The recent demerger of the erstwhile Alembic into Alembic and Alembic Pharma has positioned the latter as a pure pharma play, helping it to focus on stirring its growth momentum. We believe that this ₹12 billion enterprise trading at 5xFY'13E earnings is a good value pick.

- The ₹7 billion domestic formulation franchise is today no longer just driven by its leadership in the Macrolide segment of anibiotics but by life style segments growing at rates faster than the category growth. With a consistent flow of product launches, improvement in field force productivity and focus on chronic therapies, APL is expected to sustain healthy double-digit growth in the coming years.

- Domestic branded portfolio has strong brand equity with prescribers as its entire 3 Macrolides figure among the Top100 brands and even its brands like Zeet and Wikoryl from the mature cough and cold segment feature among the Top300 brands.

- APL's ₹2 billion formulation exports to regulated markets, which contributes around 19% to the total revenues is gaining traction with 41 ANDA filings and 56 DMF filings and is expected to make additional contribution to its revenue basket with gradual approval in products.

- As a part of ongoing restructuring, APL is aggressively ramping up its capacity in order to cater the increasing demand for the drugs in the regulated markets. It will invest ₹1 billion in a new drugs facility, which will not only boost the productive capacity of the pharma major but will also soar up its revenue basket.

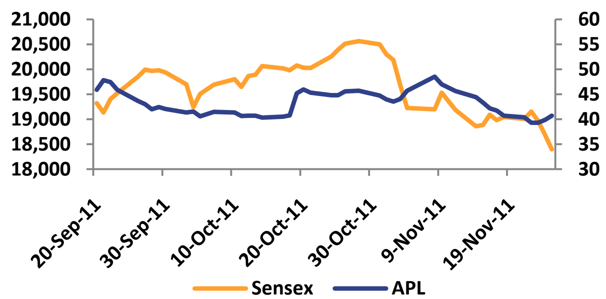
Market Data

Rating	**BUY**
CMP (₹)	40
Target (₹)	**58**
Potential Upside	~45%
Duration	Long Term
52 week H/L (₹)	53/38
All time High (₹)	53
Decline from 52WH (%)	24.5
Rise from 52WL (%)	5.2
Beta	0.65
Mkt. Cap (₹ mn)	7,540
Enterprise Val (₹ mn)	10,760

Fiscal Year Ended

	FY10A	FY11A	FY12E	FY13E
Revenue (₹mn)	11,270	11,840	14,500	16,820
Net Profit(₹mn)	390	850	1,200	1,560
Share Capital	267	377	377	377
EPS (₹)	2.9	4.5	6.4	8.3
PE (x)	13.7	8.9	6.3	4.8
P/BV (x)	1.5	2.5	1.9	1.4
EV/EBITDA (x)	8.4	7.5	5.0	4.0
ROE (%)	10.6	28.6	30.2	29.2
ROCE (%)	8.8	18.1	24.2	26.3

One year Price Chart



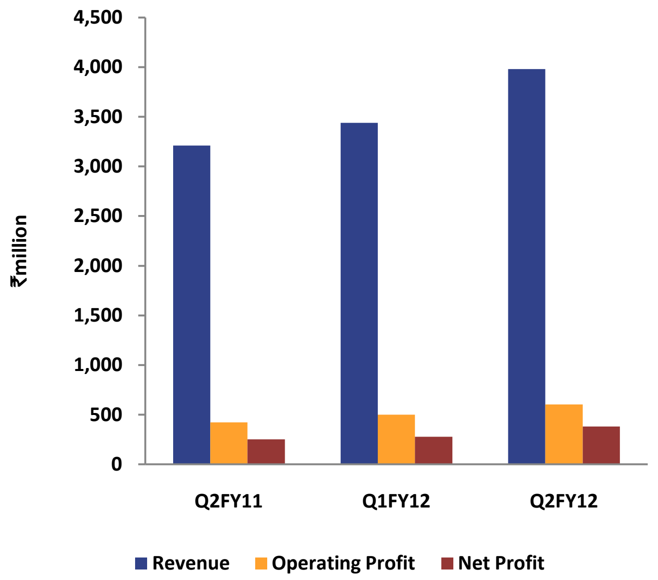
Shareholding Pattern	Sep'11	Jun'11	Diff.
Promoters	74.1%	-	-
Institutional	7.8%	-	-
General Public	15.5%	-	-
Others	2.7%	-	-

Robust Q2 FY'12 performance; profit growth ~ 51% on yoy basis

During the second quarter ended September 2011, APL reported strong revenue growth of 24% yoy to ₹3,980 million. The growth was driven by exports and the domestic formulation business, as restructuring of the business segment has now started showing results. The domestic formulation business grew by 10% at ₹2,270 million, performed well given the slow growth in the industry. Domestic API segment's sales grew strongly by 40.3% yoy to ₹220 million, driven by volume offtake. Exports segment witnessed robust growth of 51.2%, led by both API and formulation business which grew by 49.5% and 52.4%.

Operating profit for the quarter came at ₹600 million as against ₹500 million in Q1FY12, growth of 20.1%. OPM during the quarter improved to 15.19% as against 14.6% qoq and 13.21% yoy, on the back of higher contribution from the domestic formulation business (from 50% in Q1FY12 to 57% in Q2FY12). Net profits of APL stood at ₹380.4 million, registering an impressive growth of 51.2% yoy. The robust bottom-line of the company is primarily driven by revenue growth and surge in operating profit.

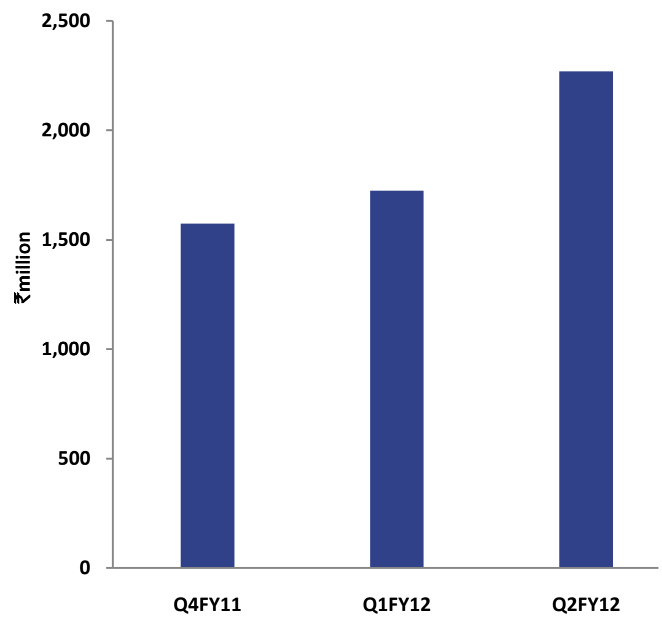
Increased export numbers drives Q2FY12 revenue



Strong domestic formulation business will drive growth

Domestic formulation business is a very significant component of ALBC's business as it contributes 91% the company's overall domestic sales. Anti-infectives is the company's leading therapeutic category, followed by the cough and cold segment. Domestic branded portfolio has strong brand equity with prescribers, as its entire 3 Macrolides figure among the Top100 brands and even its brands like Zeet and Wikoryl from the mature cough and cold segment feature among the Top 300 brands. The ₹7 billion domestic formulation franchise is today no longer just driven by its leadership in the Macrolide segment of antibiotics but by life style segments growing at rates faster than the category growth. The growth in the Life-Style segment is mainly driven by new product launches. Moreover, the company provided a boost to its domestic Pharma business in 2007 with the acquisition of Dabur Pharma's non-oncology portfolio. The acquisition brought in key chronic therapies to the portfolio, including cardiology, gynecology and anti-diabetes. The company has now made a mark in specialized therapies such as Diabetology, Cardiology and Gynaecology as well under Life-Style segment. It has also renewed its focus on penetrating rural segment which we believe will be the next growth driver. With a consistent flow of product launches, improvement in field force productivity and focus on chronic therapies.

Domestic Formulation Sales Trend

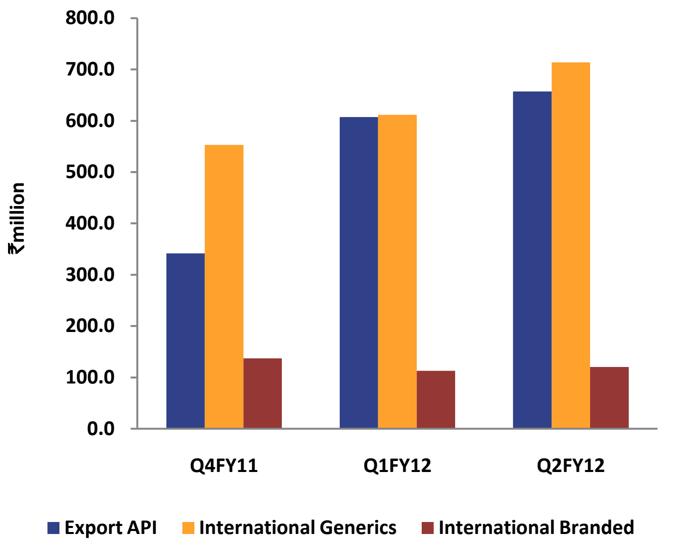


APL is confident of maintaining the momentum seen in the domestic formulations business during FY'11. Strong double-digit growth in the segment is expected to sustain in the coming years. With a pipeline of product filings in the US and EU generic markets, formulation sales to regulated markets are expected to grow between 45% and 50%, while growth in exports to RoW markets is likely to settle in early-double digits.

Strong foothold in the International market will expand market size and support growth

APL's export formulation business to regulatory markets of US, Canada and Europe is gaining traction and has reached a turnover of ₹2 billion. On the export front, formulations contribute around 21% to the total revenues during Q2FY12. The company has filed 41 ANDAs till date, of which 15 products have been approved and cumulative DMF filings stands at 15. In formulation exports, APL strategically partners with innovator and generic companies and retail chains to leverage on their marketing and sales capabilities. It shares the investment and return with the marketing partners which helps it to de-risk its ANDA programme and reduces the upfront investment in the development stage. The company expects revenue from regulated markets to grow faster than RoW formulation sales. Over the next few years, the revenue mix is expected to tilt further in favor of regulated sales on the back of product approvals.

Revenue mix across segments



Restructuring initiatives to trigger growth in long term

Over the last four years, the company is streamlining its business portfolio, to enhance its presence in the Life-style segment. In line with this, the company has re-jigged its marketing strategy to focus on the Life-style segments including Cardiovascular, Diabetics and Gastrointestinal, which would aid in improving the company's growth and operating recital. The company's domestic formulation business contributed over 57% to total sales in FY'2011, with 75% of its revenue coming from the anti-infective, respiratory, gynaecological and gastro therapeutic space. The company currently to its credentials has the backup of over 2,700 MRs in its field force. On the export front, the formulation business contributed 14% to the total turnover, with majority of the contribution coming from Europe and the US. The international API business contributes 28% to the total turnover. Going forward, the company expects its domestic formulation business to grow at industry pace. Further, revenue from the US generic market is expected to scale up on the back of product approvals.

Capacity expansion would ensure growth in coming years

As a part of ongoing restructuring, APL is aggressively ramping up its capacity in order to cater the increasing demand for the drugs in the regulated markets. It will invest ₹1 billion in a new drugs facility which will make generic drugs for regulated markets. It will now focus on drugs in the cardiac, gynecology and ophthalmology segments from the facility that would start production early next year.

The market remains dominated by acute therapies; however chronic segments such as Cardio Vascular, Diabetes, Central Nervous System and specialty segments like Oncology are growing faster at 18-19% versus the current industry growth of 15%.

Vertical integrated APIs business

APLs APIs division which contributed around 29% of its revenues in Q2FY'12, supplies APIs and Intermediates to both domestic as well as international regulated players. The company's Panelav facility is USFDA approved. It supplies API's for various therapeutic segments including anti-infectives, cardio-vascular, central nervous system, musculoskeletal, erectile dysfunction and Gastro-Intestinal. The rationale behind its API Business is to contribute to the business performance of the company through the marketing of APIs globally and to capture the Contractual supplies opportunities in the Drug Intermediate's business. APL forayed into the CRAMS segment in FY2003 with Contract Research Services through its Vadodra-based Alembic Research Center (erstwhile BioArc). Moreover, it also provides necessary vertical integration to Formulations business which ensures the regular supplies of the intermediates and helps in achieving cost efficiency.

Increasing expenditure on R&D to fuel growth

APLs expenditure on R&D has steadily increased over the years. This reflects that the company is focused towards growth from research driven products. The innovative products help in creating the brand value and capture larger market share as there would be less competition. This can be visible as the entire 3 Macrolides figure among the Top100 brands and even its brands like Zeet and Wikoryl from the mature cough and cold segment feature among the Top300 brands. APL is focused on increasing its R&D expenditure to file more products in the international market. The company has already filed 41 ANDA's in various therapeutic segments and planning to launch products with higher margins. Till FY11, 386 patents for Active Pharmaceutical Ingredients (APIs) and Intermediates as well as 219 patents for formulations have been filed. The company has close to 300 scientists across two development centers. APL also consistently increasing its work force for R&D to achieve a fast-paced growth.

Risk

- APL is a late entrant in regulated markets and many pharmaceutical companies from India already have a significant presence.
- APL derives more than 60% of revenues from its export business and rupee appreciation can adversely impact financial performance.
- Delay in getting approvals for its new launches from authorities of respective countries could hamper future revenue flows.
- Risk of economic and political instability in any of its exporting countries could hamper its operations.

Demerger~ to rerate pharma business

In a bid to separate a bleeding Penicillin-G business from its other businesses, the 103-year-old Alembic Ltd has demerged its core pharma division into a new entity, the recent demerger of the erstwhile Alembic into Alembic and Alembic Pharma, has positioned the latter as a pure pharma play and we believe this would add value to the stakeholder's of the company but also value the APL with other pharma companies. The company has strategically demerger its Pharma business, that would allow APL to focus on stirring momentum in the segment on the one hand, while unlocking the value of its land bank on the other.

Indian Pharmaceutical Industry

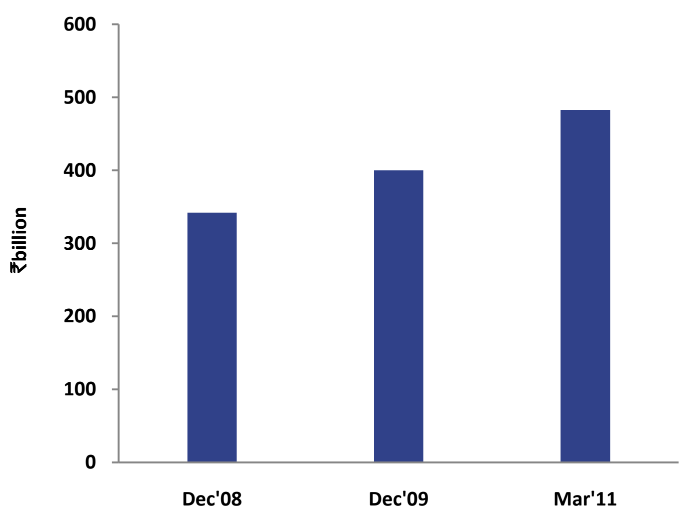
Size & Growth of the Industry

The Indian pharmaceutical industry (IPI) currently ranks 3rd in terms of volume of production (10% of global share) and 14th by value. India's Domestic Pharma Market offers immense potential, which is currently, valued at approximately ₹482.39 billion, reflecting strong growth of 15.3% for the twelve months ending March, 2011 (IMS MAT March, 2011). IPI is expected to be around $20bn by 2015 and in terms of scale, it will rank among the top 10 in the world, overtaking Brazil, Mexico, South Korea and Turkey. India has 17% of the world population but lacks necessary healthcare infrastructure, the lowest healthcare spending. However, with changing demographics, improving income levels, changing lifestyles and rising insurance penetration will result in larger opportunity to private players who dominate the market. Over the next few years, generics will continue to dominate the market as the patent laws will provide an impetus to the launch of patent-protected products. By 2015, as per McKinsey & co, five therapies i.e. anti-cancer, central nervous system, anti-infective, gastro-intestinal and cardio vascular will likely to contribute 60 to 70% of total patented launches.

India is fastest growing pharmaceutical markets in the world

The Indian pharmaceuticals market has maintained its growth trajectory as it grew by 15.3% in FY2011 to over ₹480 billion driven by growth in the levels of income followed by an increasing awareness about healthcare and higher government spending on healthcare. The sustained performance of the chronic therapies dominates the market and outperformed acute therapies in terms of growth. Apart from this, the significant growth in the sales of the generic products in the developed regulated markets and the emerging markets has contributed to the sharp rise in the exports of pharmaceutical goods from India. Further, with having significant opportunities in terms of cost competitiveness relating to the product development and manufacturing along with a large resource skilled talent has helped India emerge as a dominant player in the global generics space.

Indian Pharmaceutical Market



Future Outlook

Indian pharmaceutical industry is projected to show double-digit growth in near future owing to a rise in pharmaceutical outsourcing and rising investments by multinational companies. A large number of Pharma products produced in India are exported, which has led the leading players to expand their reach into the Western nations. Due to the investments in R&D and the quest for more and more ANDA filings, the clinical trials market is expected to grow at blistering pace in coming years.

The Pharma sector in India is expected to show robust growth in the next few years driven by growth in all 3 segments i.e.

- Domestic Formulations which are expected to grow at 15%
- Exports which will see huge growth due to the patent cliff in 2012 and emerging markets like Brazil, Mexico, South Africa driving growth
- CRAMS which is expected to grow at a rate of around 13% globally.

Indian companies have the largest number of US FDA (Food and Drug Administration) approved facilities outside US. They have made regulatory filings for around 70% of the drugs that are going off patent in 2012. Besides many companies have sizable US exposure in their overall revenue. The companies that will benefit the most are those which have a robust pipeline of products in the regulated markets, a favorable geographic mix (strong presence in India and US with some presence in emerging markets) and potential in biosimilars/niche products. Thus, the baseline for optimistic future outlook of the pharmaceutical market are patent expirations, changing demographics, improving income levels, changing lifestyles and rising insurance penetration.

Balance Sheet (Consolidated)

(₹million)	FY10A	FY11A	FY12E	FY13E
Share Capital	267.0	377.0	377.0	377.0
Reserve and surplus	3,410.0	2,590.0	3,601.5	4,973.0
Net Worth	**3,677.0**	**2,967.0**	**3,978.5**	**5,350.0**
Loan funds	4,210.0	3,280.0	3,268.5	2,800.0
Deferred Tax Liability	10.0	50.0	10.0	15.0
Capital Employed	**7,897.0**	**6,297.0**	**7,257.0**	**8,165.0**
Gross fixed assets	7,187.0	4,334.0	5,122.0	5,556.3
Less: accumulated depreciation	3,170.0	1,620.0	2,015.0	2,425.7
Net Fixed assets	4,017.0	2,714.0	3,107.0	3,130.6
Capital Work in Progress	70.0	270.0	80.0	80.0
Total of Fixed Assets	**4,087.0**	**2,984.0**	**3,187.0**	**3,210.6**
Investments	120.0	33.0	50.0	50.0
Net Current Assets	3,690.0	3,280.0	4,020.0	4,904.4
Capital Deployed	**7,897.0**	**6,297.0**	**7,257.0**	**8,165.0**

Profit & Loss Account (Consolidated)

(₹million)	FY10A	FY11A	FY12E	FY13E
Net Sales	**11,270.0**	**11,840.0**	**14,500.0**	**16,820.0**
Other operating income	113.0	-	-	-
Total Income	**11,383.0**	**11,840.0**	**14,500.0**	**16,820.0**
Expenses	10,260.0	10,400.0	12,346.8	14,263.4
EBITDA	**1,123.0**	**1,440.0**	**2,153.3**	**2,556.6**
EBITDA Margin %	9.9	12.2	14.9	15.2
Depreciation	430.0	300.0	395.0	410.7
EBIT	**693.0**	**1,140.0**	**1,758.3**	**2,145.9**
Interest	300.0	260.0	262.0	220.0
Other income	40.0	180.0	-	-
Profit Before Tax	**433.0**	**1,060.0**	**1,496.3**	**1,925.9**
Tax	43.0	210.0	296.3	365.9
Profit after Tax	**390.0**	**850.0**	**1,200.0**	**1,560.0**
NPM %	3.4	7.2	8.3	9.3

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	9.9	12.2	14.9	15.2
EBIT Margin (%)	6.1	9.6	12.1	12.8
NPM (%)	3.4	7.2	8.3	9.3
ROCE (%)	8.8	18.1	24.2	26.3
ROE (%)	10.6	28.6	30.2	29.2
EPS (₹)	2.9	4.5	6.4	8.3
CEPS(₹)	8.1	6.5	9.9	11.6
P/E (x)	13.7	8.9	6.3	4.8
BVPS	27.5	15.7	21.1	28.4
P/BVPS (x)	1.5	2.5	1.9	1.4
EV/Operating Income (x)	0.8	0.9	0.7	0.6
EV/EBITDA (x)	8.4	7.5	5.0	4.0

Valuation and view

Alembic Pharmaceutical is a pure pharma play with strong foothold in formulation business and increased focus on regulated markets, the formulation business is expected to escalate at higher pace and revenues from the US generic market are expected to scale up on the back of product approvals. The company to its credentials has 41 ANDA filings and 56 DMF filings. Considering the above aspects, we rate the stock as 'BUY' at the current market price of ₹40. At the current market price, the stock is trading at PE of 6.3x on FY'12E EPS of ₹6.4 and 4.8x on FY'13E EPS of ₹8.3.

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