



Glenmark Pharmaceuticals

BSE SENSEX 17,194	S&P CNX 5,199	CMP: INR296	TP: INR323	Neutral								
Bloomberg	GNP IN	Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
Equity Shares (m)	269.8	End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
52-Week Range (INR)	351/242	03/10A	24,616	3,310	11.6	174.9	-	-	14.1	12.7	-	-
1,6,12 Rel. Perf. (%)	-10/-6/3	03/11A	29,491	3,548	12.5	7.2	23.7	3.9	17.4	13.4	3.4	16.7
M.Cap. (INR b)	79.9	03/12E	38,980	2,850	10.0	-19.7	29.5	3.6	13.0	10.9	2.6	10.5
M.Cap. (USD b)	1.6	03/13E	43,945	5,843	20.6	105.0	14.4	2.9	21.1	17.3	2.2	10.9

Note - Company has commenced IFRS accounting wef FY11. Estimates exclude one-off upsides

- GNP's 3QFY12 operational performance was in-line with estimates. Excluding generic Malarone exclusivity upside in US, revenues were higher than estimates with 33.4% growth to INR10b vs est of INR9.12b, EBITDA was up 10.5% to INR1.84b (vs est of INR1.85b) and EBITDA Margins declined 380bps to 18.4% vs est of 20.3%.
- Topline growth was mainly led by INR238m of NCE licensing income and higher than expected growth in the branded business. US generic revenues increased 56% YoY.
- Excluding NCE research income of INR238m, core EBITDA margins were at 16.4% vs est of 18.2%. EBITDA margins were lower than estimates due to significant increase in costs. However GNP has been able to compensate lower margins by better topline.
- Adjusted PAT at INR83m (excl both NCE research & Malarone upsides) was higher than our est of a net loss of INR314m mainly due to lower than expected forex losses. The company reported MTM forex loss of INR1.02b vs our estimates of INR1.39b.

Outlook and View: GNP has differentiated itself among Indian pharmaceutical companies through its significant success in NCE research. Given this success, Glenmark has been aggressive in adding new NCEs to its pipeline, which will raise R&D costs in the short-to-medium term. Also, likely absence of strong forex gains (INR1.3b for FY11 vs INR1.75b forex loss in 9MFY12) will temper down the earnings growth for FY12. High debt and low return ratios remain our main concerns despite the strong growth traction. Based on our revised estimates, we expect EPS of INR10 for FY12 and INR20.6 for FY13. The stock currently trades at 29.5x FY12E and 14.4x FY13E earnings. Maintain **Neutral** with TP of INR323 (15x FY13E EPS + INR14 DCF value of Crofelemer & Para-IV pipeline).

Y/E March	(INR Million)									
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Revenues (Core)	6,818	7,243	7,508	7,922	8,683	10,554	10,311	9,432	28,596	38,980
YoY Change (%)	25.4	22.7	21.4	11.7	27.4	45.7	37.3	19.1	16.2	36.3
EBITDA	2,292	1,699	1,664	267	2,966	2,983	2,046	1,513	5,923	9,510
Margins (%)	33.6	23.5	22.2	3.4	34.2	28.3	19.8	16.0	20.7	24.4
Depreciation	230	343	344	29	264	247	231	262	947	1,005
Interest	370	308	304	584	408	291	357	326	1,566	1,382
Other Income	130	353	342	580	125	-808	-912	227	1,405	-1,368
PBT before EO Expense	1,823	1,401	1,359	233	2,420	1,637	545	1,152	4,816	5,755
Extra-Ord Expense	0	0	0	0	0	1,317	0	0	0	1,317
PBT after EO Expense	1,823	1,401	1,359	233	2,420	321	545	1,152	4,816	4,438
Tax	118	284	263	-160	319	-238	84	241	505	406
Rate (%)	6.4	20.3	19.4	-68.8	13.2	-74.2	15.4	20.9	10.5	9.1
Reported PAT (incl one-offs)	1,705	1,116	1,096	393	2,101	559	461	1,094	4,311	4,215
Adj PAT (excl one-offs)	927	988	972	661	1,100	754	83	912	3,548	2,850
YoY Change (%)	73.4	22.1	3.4	-35.6	18.7	-23.6	-91.4	37.9	7.2	-19.7
Margins (%)	13.6	13.6	13.0	8.3	12.7	7.1	0.8	9.7	12.4	7.3
US Sales	1,830	2,238	2,041	2,243	2,512	3,001	3,190	2,993	8,352	11,696
YoY Change (%)	6.4	26.4	8.2	21.1	37.2	34.1	56.3	33.5	15.5	40.0
R&D licensing income	895	0	0	0	1,112	1,185	238	0	895	2,535
YoY Change (%)					24.3					183.2

Note: 2Q, 3Q, 4Q numbers are not comparable due to shift to IFRS accounting. 1Q numbers are comparable as per IFRS

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Topline growth driven by branded formulations portfolio

GNP's 3QFY12 operational performance was in-line with estimates. Topline grew by 37% to INR10.31b, EBITDA by 23% to INR2.04b while reported PAT declined by 58% to INR461m. Excluding generic Malarone exclusivity upside in US, revenues were higher than estimates with 33.4% growth to INR10b vs est of INR9.12b, EBITDA was up 10.5% to INR1.84b (vs est of INR1.85b) and EBITDA Margins declined 380bps to 18.4% vs est of 20.3%. However GNP has been able to compensate lower margins by better topline. We estimate generic Malarone to have contributed INR297m to revenues and INR208m to EBITDA.

Topline growth was mainly led by INR238m of NCE licensing income and higher than expected growth in the branded business (up 24% YoY, partly due to favourable currency). India formulations growth at 6.5% was disappointing with management indicating that it has reduced its inventory in the trade. This is likely to temporarily impact the revenues for this segment.

While US generic revenues increased 56% YoY to INR3.19b, they grew by only 6% QoQ despite the an extremely favourable currency (GNP does not have any forex hedges). Adjusted for Malarone exclusivity upside, QoQ revenues in US were flat at INR2.9b. Management has indicated that it has undertaken a restructuring of its US portfolio regarding certain low-end products which has impacted revenues.

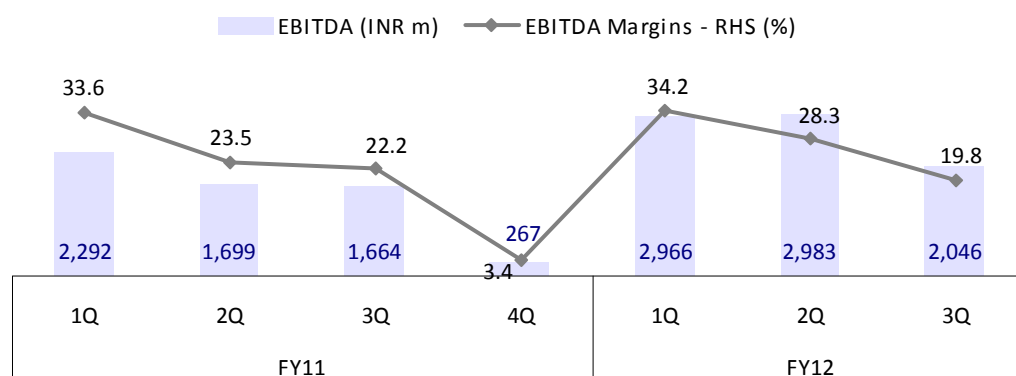
Revenue mix (INR m)

	3QFY12	3QFY11	% YoY	2QFY12	% QoQ
Formulation	9,139	6,758	35.2	8,361	9.3
Branded	5,607	4,521	24.0	5,134	9.2
India	2,547	2,390	6.5	2,539	0.3
Europe-branded	664	448	48.3	378	75.9
Latam-branded	825	528	56.1	738	11.7
Semi-regulated mkts	1,571	1,154	36.1	1,479	6.2
Generics	3,533	2,238	57.9	3,227	9.5
Latin America	36	43	-17.2	41	-14.1
North America	3,190	2,041	56.3	3,001	6.3
Europe	307	154	99.1	185	65.4
API & others	933	750	24.4	1,009	-7.5
NCE Income	238	0		1,185	
Net Sales	10,311	7,508	37.3	10,554	-2.3

Source: Company/MOSL

Core EBITDA at INR1.8b was in-line with our estimate

Excluding NCE research income of INR238m, core EBITDA margins were at 16.4% vs estimate of 18.2%. EBITDA margins were lower than estimate due to significant increase in costs with RM cost up by 49%, staff costs up by 45% and other expenses (excl forex losses) up by 30.6%. This was partly due to increase in R&D expenses and partly due to adverse impact of INR depreciation on USD-denominated costs. We note that even though the EBITDA margins are below our estimates, absolute EBITDA is in line with estimates due to better than expected revenues.

EBITDA & Margin Trend

Source: Company/MOSL

Adjusted PAT at INR83m (excl both NCE research & Malarone upsides) was higher than our estimate of a net loss of INR314m mainly due to lower than expected forex losses. The company reported MTM forex loss of INR1.02b vs our est of INR1.39b.

Balance sheet highlights

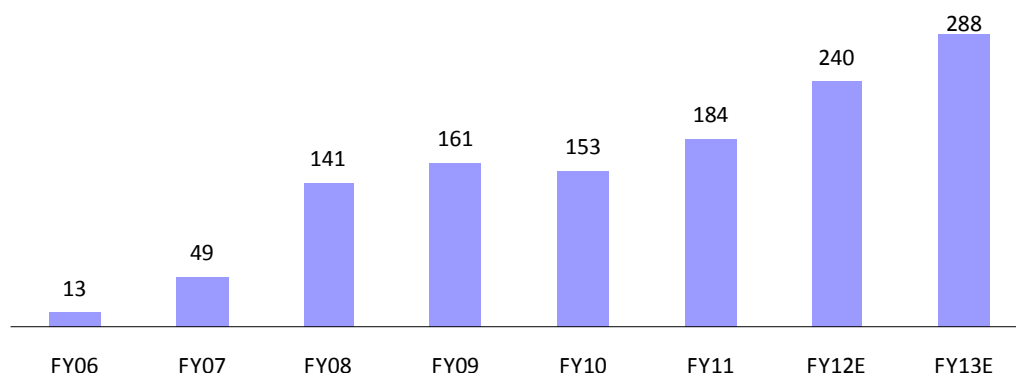
- Debtor days have remained constant QoQ at 116 days.
- Net debt has increased by ~INR2b QoQ to INR20.74b mainly due to mark-to-market of forex debt of USD350m for a depreciating currency.
- The company had converted a large portion of local debt to forex debt in 1QFY12 due to which there is an increase in MTM forex losses for past two quarters.

Guidance for base business (excluding R&D licensing income)

Mgmt has cut its core EBITDA guidance for FY12 from the previous 22-23% to 20%, although the company is tracking topline growth much higher than its guidance of 20-25% growth. We believe that the guidance is a bit aggressive and model core EBITDA Margin of 19% for FY12. Core EBITDA guidance for FY13 is indicated at 20-21%. It has also raised its R&D expenses guidance for FY12 from INR2-2.25b to INR2.5-2.6b. Capex for FY12 and FY13 will be INR2.5b each while tax rate will move up from 9-10% to 14-15% by FY13.

Trying to build a differentiated portfolio for the US market - Expect strong growth ahead

Glenmark currently has ~43 ANDAs pending US FDA approval (with 4 FTFs). It has already launched 5 oral contraceptives (OCs) in the US over the past few quarters although, the company is yet to record meaningful revenues from them. It expects 3-5 more OC approvals over the next 12 months. We note that the company has commenced filings for niche opportunities in the Dermatology, Controlled Substances and Hormones categories and has also started receiving some approvals in these categories which is a long-term +ve. Management believes that ~75% of the pending ANDAs are in the niche / low-competition category and will thus result in a differentiated portfolio in the long-term.

Glenmark - US Revenue ramp-up (USD M)

Source: Company/MOSL

Strong growth ahead but balance sheet improvement needed

We expected GNP to record strong topline CAGR of 22% over FY11-13 led by a 30% CAGR for the generics business and 22% CAGR for the branded formulations business. Core EPS is also expected to record a strong 28% CAGR over FY11-13 (albeit on a low base) led by strong topline growth and gradual expansion in EBITDA margins. However, we note the company has a high debt of ~INR22.7b (as of 31-Dec-2011) which is impacting its return ratios. We believe that the company needs to reduce its debt significantly to ensure an improvement in return ratios and get a better valuation multiple.

Valuation & view

GNP has differentiated itself among Indian pharmaceutical companies through its significant success in NCE research. Given this success, Glenmark has been aggressive in adding new NCEs to its pipeline, which will raise R&D costs in the short-to-medium term. Also, likely absence of strong forex gains (INR1.3b for FY11 vs INR1.75b forex loss in 9MFY12) will temper down the earnings growth for FY12. Based on our revised estimates, we expect EPS of INR10 for FY12 and INR20.6 for FY13. We have cut our core EPS estimates for FY12 by 8% to take into account the lower EBITDA margins and forex losses. While we have also cut our EBITDA estimates for FY13 by 2%, our EPS has remained flat mainly due to reversal of forex losses expected in FY13. High debt and low return ratios remain our main concerns despite the strong growth traction. The stock currently trades at 29.5x FY12E and 14.4x FY13E earnings. Maintain **Neutral** with TP of INR323 (15x FY13E EPS + INR14 DCF value of Crofelemer & Para-IV pipeline).

Glenmark Pharmaceuticals: an investment profile

Company Description

Glenmark is one of the second tier integrated pharmaceutical companies which has differentiated itself through its success in NCE research. The company has pipeline of 9 Novel drugs in different phases of clinical studies. It is also one of the leading Indian generic companies in US with focus on niche generics segments. Glenmark has large presence in semi-regulated markets.

Key investment arguments

- Glenmark has adopted differentiated generic strategy for US business which focuses on niche segments like Hormones, dermatology, controlled release etc which has limited competition and better profitability
- It is the most successful Indian company in novel drug discovery research and has earned US\$202m in milestone payments so far.

Key investment risks

- Given the significant contribution of the success of Glenmark's NCE research (to its market capitalization), any NCE failures are likely to have significant adverse impact on investor returns.
- Glenmark is targeting to replicate the success of its NCE research for its generics business as well. This is likely to involve an aggressive ramp up in Glenmark's

presence in various markets as the company tries to catch up with the sector leaders. We do not rule out execution risks for such an aggressive ramp up strategy.

Recent developments

- Paid USD28m to Paul capital for termination of royalty agreement for dermatology products in the US.
- Receives USD5m from Sanofi Aventis towards milestone payment

Valuation and view

- The stock currently trades at 29.5x FY12E and 14.4x FY13E earnings.
- Maintain **Neutral** with target price of INR323 (15x FY13E EPS + DCF value of INR14/sh for Crofelemer and Para-IV upsides).

Sector view

- Regulated markets would remain the key sales and profit drivers in the medium term. Japan is expected to emerge as the next growth driver, particularly for companies with a direct marketing presence.
- We are overweight on companies that are towards the end of the investment phase, with benefits expected to start coming in from the next fiscal.

Comparative valuations

		Glenmark	DRL	Cipla
P/E (x)	FY12E	29.5	22.2	25.2
	FY13E	14.4	19.7	19.9
P/BV (x)	FY12E	3.6	5.2	3.8
	FY13E	2.9	4.6	3.3
EV/Sales (x)	FY12E	2.6	3.4	4.1
	FY13E	2.2	3.1	3.5
EV/EBITDA (x)	FY12E	10.5	17.3	17.9
	FY13E	10.9	15.5	14.6

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	48.3	48.3	48.3
Domestic Inst	5.1	6.4	6.7
Foreign	34.8	33.2	31.9
Others	11.8	12.1	13.1

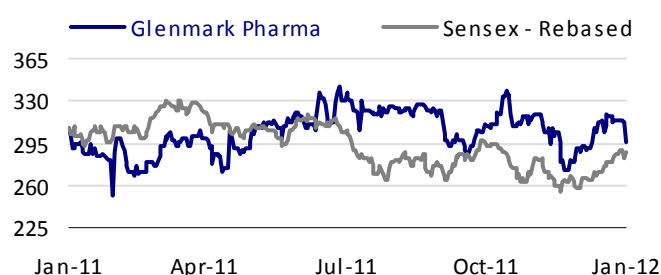
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	10.0	19.5	-48.6
FY13	20.6	21.2	-2.8

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
296	323	9%	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement					Ratios				
(INR Million)									
Y/E March	2010	2011	2012E	2013E	Y/E March	2010	2011	2012E	2013E
Net Sales	24,616	29,491	38,980	43,945	Basic (INR)				
Change (%)	18.0	19.8	32.2	12.7	EPS (Fully diluted)*	11.6	12.5	10.0	20.6
Materials Consumed	8,061	9,918	12,646	14,865	Cash EPS	15.9	15.8	13.6	24.7
Personnel Expenses	3,425	5,103	6,328	7,277	BV/Share	87.6	75.4	81.3	102.4
R&D Expenses	1,200	1,386	2,551	2,725	DPS	2.0	3.7	3.7	5.0
Other Expenses	5,966	7,161	7,945	10,056	Payout (%)	3.8	5.2	5.9	5.2
Total Expenditure	18,653	23,568	29,470	34,922	Valuation (x)				
EBITDA	5,963	5,923	9,510	9,023	P/E (Fully diluted)		23.7	29.5	14.4
Change (%)	76.4	-0.7	60.6	-5.1	PEG (x)		3.3	-1.5	0.1
Margin (%)	24.2	20.1	24.4	20.5	Cash P/E		18.7	21.8	12.0
Adjusted EBITDA	5,963	5,028	6,975	8,798	P/BV		3.9	3.6	2.9
Margin (%)	24.2	17.6	19.1	20.1	EV/Sales		3.4	2.6	2.2
Depreciation	1,206	947	1,005	1,186	EV/EBITDA		16.7	10.5	10.9
EBIT	4,757	4,976	8,505	7,837	Dividend Yield (%)		1.3	1.3	1.7
Interest	1,640	1,566	1,382	1,271	Return Ratios (%)				
OI & forex gains/losses	722	1,405	-1,368	446	RoE	14.1	17.4	13.0	21.1
PBT before EO Expense	3,839	4,816	5,755	7,012	RoCE	12.7	13.4	10.9	17.3
Change (%)	42.8	25.4	19.5	21.8	Working Capital Ratios				
PBT after EO Exp.	3,839	4,816	4,438	7,012	Fixed Asset Turnover (x)	1.5	1.5	1.8	1.9
Tax	529	237	406	973	Debtor (Days)	160	140	117	125
Tax Rate (%)	13.8	4.9	9.1	13.9	Inventory (Days)	105	100	84	90
Reported PAT	3,310	4,578	4,032	6,039	Working Capital (Days)	266	203	162	166
Adj PAT**	3,310	3,548	2,850	5,843	Leverage Ratio (x)				
Change (%)	194.3	7.2	-19.7	105.0	Current Ratio	4.7	3.4	3.0	2.8
Margin (%)	13.4	12.4	7.8	13.4	Debt/Equity	0.8	1.0	1.0	0.7

** - Excl NCE upsides & incl adjustment for R&D exp capitalizat

Balance Sheet					Cash Flow Statement				
(INR Million)					(INR Million)				
Y/E March	2010	2011	2012E	2013E	Y/E March	2010	2011	2012E	2013E
Equity Share Capital	269	270	270	270	Op. Profit/(Loss) before	5,963	5,923	9,510	9,023
Fully Diluted Eq Cap	284	284	284	284	Interest/Dividends Recd	722	1,405	-1,368	446
Reserves	23,282	20,102	21,693	27,418	Direct Taxes Paid	-388	-2,029	-406	-973
Net Worth	23,551	20,372	21,964	27,688	(Inc)/Dec in WC	-2,441	1,530	-915	-2,678
Minority Interest	130	267	267	267	CF from Operations	3,857	6,829	6,820	5,819
Loans	18,693	21,258	21,258	19,758	CF frm Op.incl EO Exp.	3,857	6,829	5,503	5,819
Deferred liabilities	710	-1081	-1081	-1081	(Inc)/Dec in FA	-3,970	810	-2,500	-2,500
Capital Employed	43,085	40,816	42,407	46,632	CF from Investments	-3,970	682	-2,500	-2,500
Gross Block	21,586	25,899	28,399	30,899	Change in Networth	4,386	-7,521	-2,205	0
Less: Accum. Deprn.	3,929	4,876	5,881	7,067	Inc/(Dec) in Debt	-2,151	2,701	0	-1,500
Net Fixed Assets	17,656	21,023	22,519	23,833	Interest Paid	-1,640	-1,566	-1,382	-1,271
Capital WIP	6,224	1,100	1,100	1,100	Dividend Paid	-126	-236	-236	-315
Investments	181	309	309	309	CF from Fin. Activity	468	-6,621	-3,823	-3,086
Intangibles (net)	7,259	10,329	9,606	8,934	Inc/Dec of Cash	354	890	-820	233
Curr. Assets	24,210	25,988	27,599	33,277	Add: Beginning Balance	715	1,069	1,959	1,139
Inventory	7,085	8,070	8,986	10,836	Closing Balance	1,069	1,959	1,139	1,372
Account Receivables	10,783	11,308	12,481	15,050					
Cash and Bank Balance	1,069	1,959	1,139	1,372					
Others	5,273	4,651	4,992	6,020					
Curr. Liability & Prov.	5,186	7,605	9,120	11,888					
Account Payables	4,987	7,560	8,720	11,438					
Provisions	200	44	400	450					
Net Current Assets	19,023	18,384	18,479	21,390					
Appl. of Funds	43,085	40,816	42,407	46,632					

E: MOSL Estimates

NOTES

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Glenmark Pharmaceuticals

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