27 July 2010 | 11 pages

Glenmark Pharmaceuticals (GLEN.BO)

Equity ☑
Target price change ☑

Buy: Another Mixed Quarter – P&L Subdued; B/S Better

- **Another Mixed Quarter** — 1QFY11 was another mixed quarter and is unlikely to act as the catalyst for GLEN to break out of the current range. While the balance sheet is much better, profitability was below expectations. Although the latter is largely seasonal, there are some signs of strain on currency and cost fronts. We expect a pick up from 2Q, led by key launches in the US but do not expect a re-rating till this reflects in financials. We raise TP to Rs350 on roll over to Sept 11E EPS.
- **Steady Revenues** — Revenues (excl R&D) grew 11% YoY, led primarily by India (+17%) and LatAm specialty biz (+21%), while generics (+10%) saw steady growth. Adverse currency affected growth in all international businesses while the branded EU biz was also hit by channel inventory in Poland. GLEN also received R&D income of Rs895m, taking overall topline growth to 26.9% for the quarter.
- **Margin Pressure** — Excluding R&D income, EBIDTA margin dipped 542bps (to 23.8%) – well below our estimate – even as gross margin improved 150bps YoY. Sharply higher staff cost (+26%) and other expenses (+33%) caused the dip. The management indicated that the former was a seasonal spike. We also expect other exp / sales to normalize over the year as revenues scale up.
- **Balance Sheet Improves** — Net debt declined by cRs1.6bn in 1Q, as cash released from working capital (debtor days down to 131) was used to repay debt. GLEN was also able to restructure its debt to bring down cost – visible in the sharp 37% dip in interest cost. We expect further improvement over the full year.
- **Expect Ramp Up from 2Q** — led primarily by key launches in the US market. The “at risk” launch of generic Tarka (GLEN is the sole generic and likely to enjoy extended exclusivity) and royalties from its proprietary derma product (launched as a brand by Taro) would be the key drivers, while seasonal pick up in other markets should help as well. This should also reflect in better profitability.

Buy/Medium Risk	1M
Price (27 Jul 10)	Rs284.85
Target price	Rs350.00
from Rs335.00	
Expected share price return	22.9%
Expected dividend yield	0.4%
Expected total return	**23.2%**
Market Cap	Rs76,885M
	US$1,634M

Price Performance (RIC: GLEN.BO, BB: GNP IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	6,321	23.59	104.4	12.1	4.7	57.4	0.2
2009A	2,739	10.22	-56.7	27.9	4.5	17.6	0.1
2010E	3,592	13.18	28.9	21.6	3.3	18.4	0.4
2011E	5,712	20.95	59.0	13.6	2.7	22.2	0.4
2012E	5,939	21.78	4.0	13.1	2.3	19.0	0.4

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	12.1	27.9	21.6	13.6	13.1
EV/EBITDA adjusted (x)	10.6	15.6	13.4	9.5	9.0
P/BV (x)	4.7	4.5	3.3	2.7	2.3
Dividend yield (%)	0.2	0.1	0.4	0.4	0.4
Per Share Data (Rs)					
EPS adjusted	23.59	10.22	13.18	20.95	21.78
EPS reported	23.59	7.22	11.73	20.95	21.78
BVPS	61.03	63.79	85.43	105.47	126.36
DPS	0.69	0.40	1.00	1.00	1.00
Profit & Loss (RsM)					
Net sales	19,757	20,865	24,695	29,556	32,111
Operating expenses	-12,469	-16,042	-19,043	-21,681	-24,207
EBIT	**7,288**	**4,823**	**5,651**	**7,876**	**7,904**
Net interest expense	-632	-1,405	-1,576	-1,177	-977
Non-operating/exceptionals	458	-729	-269	101	142
Pre-tax profit	**7,115**	**2,689**	**3,806**	**6,800**	**7,070**
Tax	-794	-754	-609	-1,088	-1,131
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**6,321**	**1,935**	**3,197**	**5,712**	**5,939**
Adjusted earnings	6,321	2,739	3,592	5,712	5,939
Adjusted EBITDA	8,005	5,850	7,065	9,439	9,606
Growth Rates (%)					
Sales	61.7	5.6	18.4	19.7	8.6
EBIT adjusted	89.8	-33.8	17.2	39.4	0.4
EBITDA adjusted	87.8	-26.9	20.8	33.6	1.8
EPS adjusted	104.4	-56.7	28.9	59.0	4.0
Cash Flow (RsM)					
Operating cash flow	**3,718**	**159**	**5,017**	**6,801**	**6,859**
Depreciation/amortization	717	1,027	1,413	1,563	1,702
Net working capital	-3,846	-3,877	-621	-1,768	-1,843
Investing cash flow	**-5,099**	**-9,502**	**-2,199**	**-2,099**	**-1,908**
Capital expenditure	-5,174	-9,561	-2,400	-2,200	-2,050
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,785**	**8,747**	**-2,991**	**-3,492**	**-4,292**
Borrowings	692	9,838	-5,235	-2,000	-3,000
Dividends paid	-201	0	-315	-315	-315
Change in cash	**404**	**-596**	**-173**	**1,210**	**659**
Balance Sheet (RsM)					
Total assets	**29,256**	**42,089**	**44,534**	**48,944**	**52,481**
Cash & cash equivalent	1,565	715	1,012	2,222	2,881
Accounts receivable	8,069	9,553	9,878	11,470	12,844
Net fixed assets	12,557	21,117	22,103	22,740	23,088
Total liabilities	**14,062**	**26,076**	**21,503**	**20,517**	**18,430**
Accounts payable	3,030	4,399	4,939	5,735	6,422
Total Debt	9,909	20,943	15,708	13,708	10,708
Shareholders' funds	**15,194**	**16,013**	**23,031**	**28,428**	**34,051**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	40.5	28.0	28.6	31.9	29.9
ROE adjusted	57.4	17.6	18.4	22.2	19.0
ROIC adjusted	32.3	13.3	13.4	17.1	16.2
Net debt to equity	54.9	126.3	63.8	40.4	23.0
Total debt to capital	39.5	56.7	40.5	32.5	23.9

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Powered by: dataCentral

1QFY11 Results Snapshot

Figure 1. Glenmark Pharma – 1QFY11 Consolidated Income Statement (Rs m, %)

Year Ended March 31	1Q FY10	1Q FY11	*% ch YoY*	4Q FY10	% Ch QoQ
Net Sales	5,437	5,924	*9.0*	7,091	*(16.5)*
Other Operating Income	50	145	*186.8*	34	*331.6*
Net Revenues (Core Biz)	**5,487**	**6,068**	***10.6***	**7,125**	***(14.8)***
R&D Income	-	895		-	
Net Revenues (incl R&D)	**5,487**	**6,963**	***26.9***	**7,125**	***(2.3)***
Material cost	1,776	1,878	*5.7*	2,379	*(21.0)*
% of Net Sales	*32.4*	*30.9*	*-142 bps*	*33.4*	*-243 bps*
Staff cost	821	1,034	*25.9*	804	*28.5*
% of Net Sales	*15.0*	*17.0*	*208 bps*	*11.3*	*575 bps*
Other exp	1,286	1,711	*33.0*	2,103	*(18.6)*
% of Net Sales	*23.4*	*28.2*	*476 bps*	*29.5*	*-132 bps*
Total Expenditure	3,883	4,623	*19.1*	5,286	*(12.5)*
EBITDA (Excl Milestones)	**1,604**	**1,445**	***(9.9)***	**1,839**	***(21.4)***
EBITDA Margins (%) - core biz	***29.2***	***23.8***	***-542 bps***	***25.8***	***-200 bps***
EBITDA (Incl Milestones)	1,604	2,340	*45.9*	1,839	*27.2*
EBITDA Margins (%)	*29.2*	*33.6*	*437 bps*	*25.8*	*780 bps*
Interest	438	277	*(36.7)*	378	*(26.6)*
Depreciation	312	327	*5.1*	371	*(11.8)*
Other income	25	26	*1.1*	38	*(32.5)*
PBT	880	866	*(1.5)*	1,128	*(23.2)*
Tax	83	69	*(16.9)*	240	*(71.2)*
Effective Tax rate	*9.5*	*8.0*	*-148 bps*	*21.3*	*-1332 bps*
Adjusted Net Profit (Core biz)	**796**	**797**	***0.1***	**888**	***(10.2)***
Non recurring items (net of tax)	(262)	758		139	
Reported Net Profit	535	1,555	*191.0*	1,026	*51.6*

CIRA Comments

Conclusion: 1QFY11 was mixed – disappointing on profitability but good signs on the balance sheet

Revenue (core biz) growth was mainly driven by India & Latin America, while SRM markets struggled. US & API sales witnessed decent growth too

Overall revenues buoyed by R&D income – Rs895m from Sanofi on licensing out of an NCE

Given seasonally weak sales & higher than trend staff cost (annual incentives & increments), EBIDTA margins, excluding R&D income, dipped considerably – expect this to trend back up over the next few quarters as revenues pick up

Debt repayment (cRs1.6bn in 1Q) & restructuring leads to lower interest cost

Non recurring items include R&D income of Rs895m & forex gain of Rs90m

Source: Company Reports and CIRA Estimates

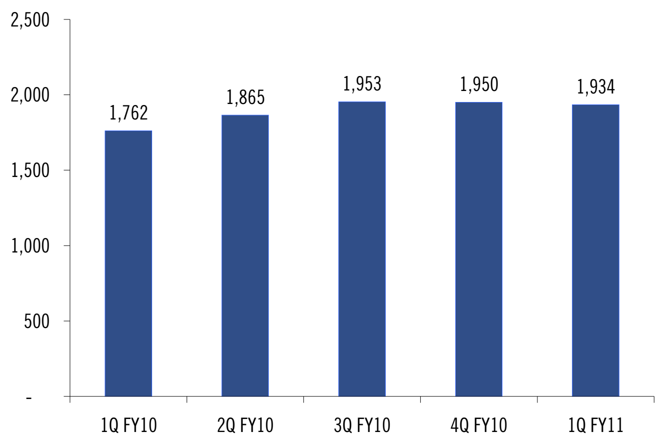
Figure 2. Glenmark Pharma – 1QFY11 Consolidated Revenue Breakdown (Rs m, %)

Year Ended March 31	1Q FY10	1Q FY11	*% ch YoY*	4Q FY10	*% Ch QoQ*	CIR Comments
Generics Business						
USA + Europe	1,762	1,934	*9.8*	1,950	*(0.8)*	US sales does not include upside from Tarka at risk launch – to reflect from 2Q
% of Total Generics	*73.8*	*73.4*		*71.4*		
Latin America (Argentina)	68	75	*10.4*	80	*(6.1)*	Steady sales in other geographies – slowly gaining traction in respective markets
% of Total Generics	*2.9*	*2.9*		*2.9*		
API	557	627	*12.6*	703	*(10.8)*	
% of Total Generics	*23.3*	*23.8*		*25.7*		
Total Generics	**2,387**	**2,636**	***10.4***	**2,733**	***(3.5)***	**Steady, but unspectacular, growth across segments**
Specialty Business						
Formulations						
Latin America (Brazil & Others)	335	406	*21.1*	346	*17.4*	Latin America witnessing the benefits of restructuring carried out in Brazilian operations last year
% of Total Speciality Revenues	11.0	9.7		7.9		
Rest of World	786	733	*(6.7)*	1,370	*(46.5)*	RoW / SRM markets hit by currency (sales flat in constant currency terms) as well as high channel inventory – secondary sales strong across most markets
% of Total Speciality Revenues	25.8	17.5		31.4		
Europe	269	212	*(21.3)*	459	*(53.8)*	Europe hit by channel inventory in Poland and some destocking in Romania
% of Total Speciality Revenues	8.8	5.1		10.5		
India	1,659	1,936	*16.7*	2,184	*(11.4)*	
% of Total Speciality Revenues	54.4	46.3		50.1		India remains a strong market – growth expected to continue
Total Formulations	**3,050**	**3,288**	***7.8***	**4,359**	***(24.6)***	**Formulations** growth led by India & Latin America, while adverse currency hits other markets. EU also hit by high channel inventory
R&D Income	-	895		-		
Total Specialty Revenues	**3,050**	**4,183**	***37.1***	**4,359**	***(4.0)***	
Consolidated Revenues	**5,437**	**6,819**	***25.4***	**7,091**	***(3.8)***	**R&D income** reflects the upfront payment received from Sanofi Aventis under the recent NCE licensing deal

Source: Company Reports and CIRA Estimates

Update on Key Businesses

Figure 3. Regulated Markets (US, EU) formulation sales – Generics Biz (Rs m)

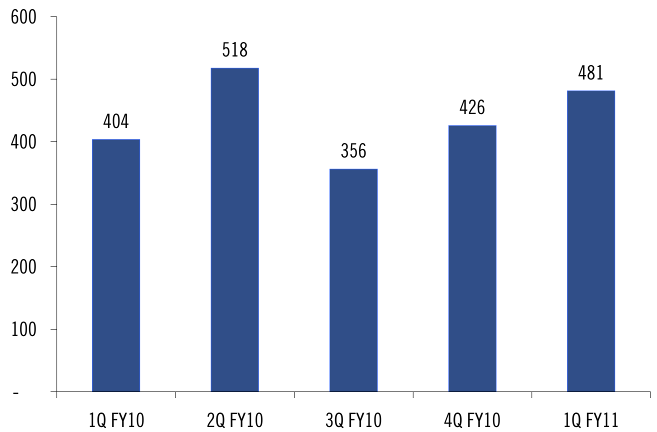


Source: Company Reports and Citi Investment Research

CIRA Comments

- Largely US sales – includes Rs103m from EU operations in 1QFY11 (Rs41m in 1QFY10).
- Launched Tarka at risk in the US market – only player in the market – very low sales in 1Q - expects 10-12 final approvals in this fiscal
- Launched its first product in the hormone segment & currently has three products in the oral contraceptives segment – expects more launches in these categories going forward
- Filed four ANDAs in 1QFY11; over 50 ANDAs pending approval with the US FDA – 11 Para IVs – four sole FTFs
- Launch of proprietary derma product in partnership with Taro likely over the next one or two quarters

Figure 4. Latin America formulation sales – Generics & Specialty (Rs m)

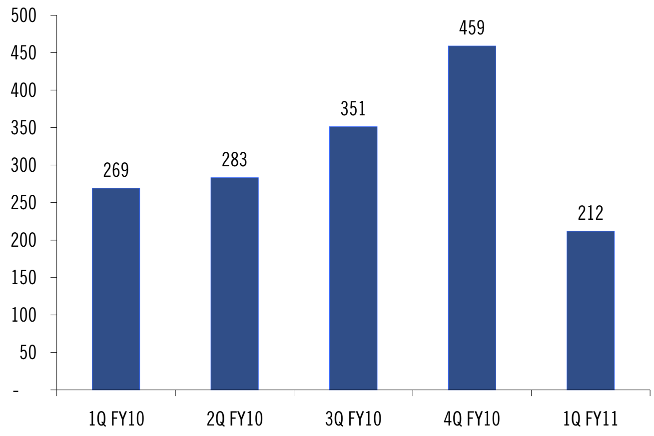


Source: Company Reports and Citi Investment Research

CIR Comments

- Includes Rs406m from specialty business in LatAm & Rs75m from the generics business in Argentina – driven by benefits of restructuring in Brazil and contribution from new markets such as Mexico & Venezuela
- YoY growth to be quite consistent going forward in these markets
- The Argentina based Oncology business submitted 28 product dossiers worldwide

Figure 5. Europe formulation sales – Specialty Business (Rs m)

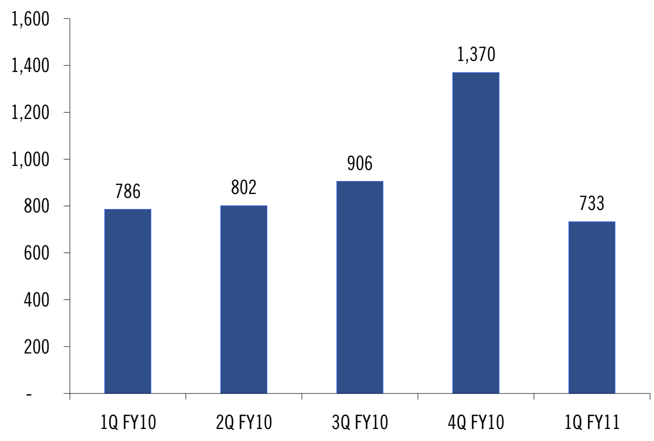


Source: Company Reports and Citi Investment Research

CIR Comments

- Revenues down 21% YoY due to higher channel inventory in Poland
- Romania is another difficult market in light of the lengthening credit periods
- New product launches continue – Clopidogrel in Czech Republic, Slovakia & Poland; Donepezil in Romania
- Seeking inlicensing opportunities to scale up this business

Figure 6. Semi Regulated Markets Formulation Sales – Specialty (Rs m)

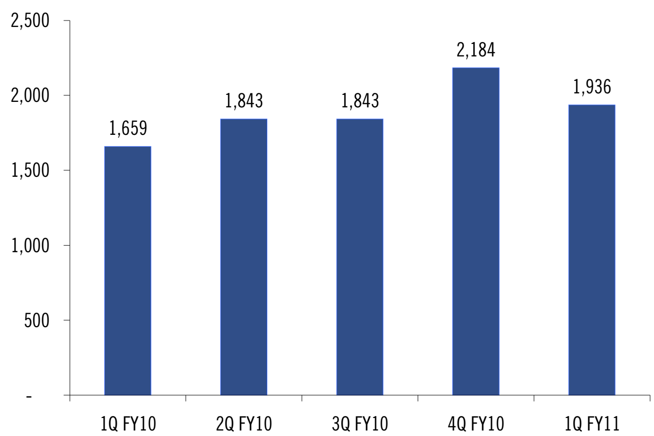


Source: Company Reports and Citi Investment Research

CIR Comments

- Sales down 7% YoY, hurt mainly by adverse currency movement – revenues are flat in constant currency terms
- A high base in 1QFY10 (channel restocking) and higher-than-normal sales in 4QFY10 also contributed to the dip
- Management expects growth to resume from 2Q
- Good growth in secondary sales across most markets

Figure 7. India formulation sales (Rs m)



Source: Company Reports and Citi Investment Research

CIR Comments

- Good traction in India continues – 17% YoY growth in revenues, driven by strong growth in most key brands
- Higher growth as per ORG IMS (27.23% for Apr-June'10)
- Five new products launched in 1QFY11

Figure 8. Glenmark's R&D Pipeline

Compound	Target	Status	CIRA Comments
Melogliptin	DPP IV	Phase II complete	Phase IIb completed & set to enter Phase III trials – looking for a partner (Ph 3 trials unlikely unless licensed out)
Revamilast (GRC 4039)	PDE 4	Phase I	Phase I completed; Expects to initiate multiple Ph II trials in 3QFY11
Tedalinab (GRC 10693)	CB 2 agonist	Phase I	Completed Ph I trials; Expects to initiate Ph 2 trials in 3QFY11 – targeted primarily at neuropathic pain
GRC 15300	TRPV 3	Phase I	Undergoing Ph I trials in the UK – recently licensed out to Sanofi Aventis
Acquired from Chromos			
GBR 500	MAb	Phase I	Ph I trials are ongoing in the US – proof of concept trial in multiple sclerosis in 2HFY11
GBR 600	MAb	Pre clinical	Has received approval from the MHRA UK to commence Phase I studies
In licensed from Napo			
Crofelemer	Chronic Diarrhoea	Phase III	NDA with USFDA to be filed in first half of CY10; Has been given fast track approval status by USFDA; Glenmark expects to launch the product in RoW markets in CY11

Source: Company Reports

Glenmark Pharmaceuticals

Company description

Glenmark Pharmaceuticals is a fully integrated research-based pharmaceutical company, with a business model spanning drug discovery research, APIs and formulations in the domestic and international markets. It operates in more than 65 countries, including the regulated markets of the US and Europe, with around 60% of its revenues coming from overseas markets. The company came into the limelight in September 2004 after it licensed out the US market rights of its first new chemical entity (NCE), GRC-3886, to Forest Laboratories.

Investment strategy

We have a Buy/Medium Risk (1M) rating on Glenmark. At current levels, the stock trades at reasonable valuations for the base business and does not appear to build in any value for its R&D pipeline. Meanwhile, there are signs of a turnaround in the company's core (non R&D) business and we believe that the worst may be behind us. We now have more comfort on the sustainability of positive trends in the core biz, with Glenmark being able to bring down debtor days, generate cash and pay down debt. We believe the recent underperformance in the stock and the signs of a recovery in Glenmark's core business have improved the risk reward in the stock for investors.

Valuation

Our target price for Glenmark Pharmaceuticals of Rs350 is based on 16x Sept-11E EPS for the base business. We are now more comfortable with the sustainability of the positive trends seen in Glenmark's key markets. This, along with the improvement in balance sheet (lower leverage, tighter working capital) lead us to use a multiple of 16x – a 10-20% discount (to factor in the higher risk / uncertainty in the biz and weaker balance sheet) to what we use for sector leaders such as Sun, Cipla, Dr Reddy's & Lupin – to value the base biz. At 16x Sept '11E EPS we arrive at a value of Rs325/sh for the base biz. Our TP also includes an option value of Rs25/sh for Glenmark's R&D deal with Sanofi for GRC-15300. Cumulatively, we arrive at a TP of Rs350/sh.

Risks

We rate Glenmark as Medium Risk, as we do not see any major downside on the R&D front in the near to medium term. Downside risks to our target price include: (1) Continued delay in product approvals would impact sales and profitability; (2) Glenmark's efforts to build its own front-end in regulated markets, if poorly executed, could prove to be a drag on earnings; and (3) Growing competition, rapid price erosion, and fragmented market share are risks inherent to the generics business.

Appendix A-1

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Glenmark Pharmaceuticals (GLEN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Prashant Nair, CFA

Date	Rating	Target Price	Closing Price
1 30-Oct-07	1M	*575.00	474.20
2 7-Nov-07	1M	*632.00	486.45
3 6-Mar-08	1M	*592.00	480.20
4 29-Apr-08	1M	*770.00	657.75
5 9-Dec-08	*1H	*467.00	281.75
6 27-Jan-09	*3H	*180.00	188.15
7 9-Jun-09	3H	*225.00	222.40
8 3-Sep-09	*2M	*250.00	226.25
9 16-Nov-09	2M	*275.00	230.05
10 2-Feb-10	*1M	*300.00	247.05
11 3-May-10	1M	*335.00	279.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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% of companies in each rating category that are investment banking clients	47%	45%	40%

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Investment ratings are a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

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