



**INDIA**

GNP IN Outperform  
Price 22 Jun 11 Rs308.55

12-month target Rs 465.00  
Upside/Downside % 50.7  
Valuation Rs 465.00

- Sum of Parts

**GICS sector**

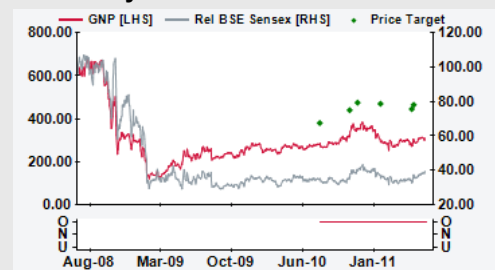
Pharmaceuticals, Biotechnology & Life Sciences

Market cap Rsm 83,395  
30-day avg turnover US\$m 3  
Market cap US\$m 1,859  
Number shares on issue m 270.3

**Investment fundamentals**

Year end 31 Mar		2010A	2011E	2012E	2013E
Revenue	m	24,383	28,641	33,301	39,130
EBIT	m	5,249	4,126	6,549	8,148
EBIT growth	%	34.6	-21.4	58.7	24.4
Recurring profit	m	3,612	3,920	5,982	7,774
Reported profit	m	3,245	4,578	7,505	7,872
Adjusted profit	m	3,012	3,683	5,204	6,763
EPS rep	Rs	12.02	16.94	27.77	29.13
EPS rep growth	%	60.1	40.9	64.0	4.9
EPS adj	Rs	11.16	13.63	19.26	25.02
EPS adj growth	%	-7.7	22.1	41.3	30.0
PER rep	x	25.7	18.2	11.1	10.6
PER adj	x	27.6	22.6	16.0	12.3
Total DPS	Rs	0.40	0.40	0.39	0.50
Total div yield	%	0.1	0.1	0.1	0.2
ROA	%	11.6	8.1	11.4	11.7
ROE	%	15.2	14.3	16.4	15.7
EV/EBITDA	x	15.1	19.7	13.3	10.9
Net debt/equity	%	74.4	58.7	38.3	16.0
P/BV	x	3.4	3.0	2.4	1.6

**GNP IN rel BSE Sensex performance, & rec history**



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, June 2011

(all figures in INR unless noted)

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24 June 2011

Macquarie Capital Securities India (Pvt) Ltd

# Glenmark Pharmaceuticals

## Is NCE franchise worth (-)ve value?

### Event

- We think the market currently is ascribing GNP's R&D initiative a negative market cap of ~US\$250m (~15% of current market cap). Expense of Rs1bn goes through the P&L but no value attaches to its innovation pipeline. We do not imply that de-merging the NCE business is the strategy to pursue, but such an analysis in our view does aid better understanding.
- We try to evaluate the core business value for Glenmark by excluding the NCE R&D expense from its P&L. Major peers (SUNP IN, RBXY IN) have de-merged the NCE business in the past, resulting in expansion of core business margins. GNP remains our top pick with a target price of Rs465.

### Impact

- **SPARC a case study:** SPARC has generated ~US\$35m in income from operations vs. total expense of ~US\$50m over last five years post de-merger from SUN and has a market cap of ~ US\$400m. SPARC currently spends ~Rs700m on research annually that is not expensed through SUN's P&L, contributing to a hypothetical market cap release of ~US\$200m for SUN adjusting for the tax credits. The total valuation boost is ~US\$600m for long-term SUN shareholders of SUN. (Please refer to Fig 2, Page 3)
- **GNP NCE research largely self funded over the last decade:** GNP has generated ~US\$ 200m in out-licensing income from six deals with large partners to-date (vs. total spend of ~US\$125m for the last seven years), which is unmatched by any of its peers. Because of a few setbacks in the past, we think the market is not assigning any upside to GNP's innovation franchise. While this is counterintuitive to us, even being conservative we believe given the track record it would be a reasonable assumption that GNP is not destroying value through its NCE research program.
- **Core business ex-NCE R&D expense largely explains our TP, innovation remains a free option:** If we adjust our FY12 estimates for the NCE R&D expense (Rs600m adjusted for tax credit), the EBITDA margin is boosted by 300bps and earnings by 11%. At our target multiple, this implies core business value (ex-NCE R&D) of Rs 445, 50% upside potential.

### Earnings and target price revision

- No change.

### Price catalyst

- 12-month price target: Rs465.00 based on a Sum of Parts methodology.
- Catalyst: 1) Malarone Launch (2QFY12) 2) Crofelemer approval and launch

### Action and recommendation

- Outlicensing of novel TRPV3 (in 2010) and GBR 500 (2011) to SNY reinforces our confidence in GNP's ability to discover and outlicense promising lead compounds. Valuations look attractive in our view, with GNP trading at a PER of 12x FY12E earnings, adjusted for exclusivity and NCE value.

## Scenario Analysis

We try to evaluate the core business value for Glenmark by excluding the NCE R&D expense from its P&L. We have valued GNP based on both the scenarios (including and excluding NCE R&D expense):

**Scenario 1:** In this scenario we strip out the NCE out-licensing income but include the NCE R&D expense in the P&L. We separately value the NCE franchise base product-wise. We arrive at a core FY12E EPS of Rs20/share and assuming a target multiple of 20x (ROE~20%, EPS growth~35% CAGR for FY11-13E) we arrive at a core business valuation of Rs400/share. To this we add Rs60/share of NCE value and Rs10/share valuation of Zetia (FY17 Launch). For the NCE franchise, we have valued only the two already out-licensed opportunities (GRC 15300 (TRPV3) and GBR500) @ 10% probability of success. Crofelemer (successful Phase III trials) is valued at Rs25/sh. We arrive at a SOTP value of Rs470/share.

**Scenario 2:** In this scenario we strip the NCE out-licensing income and also the NCE R&D expense from P&L. We separately value the NCE franchise as a separate company. We have valued GNP's NCE franchise at 10x average annual (trailing 7 yr) NCE income of US\$30m @Rs50/share. SPARC trades at 40x annual average (trailing 5 yr) NCE income of US\$10m. We arrive at a core FY12E EPS of Rs22.2/share and, assuming a target multiple of 20x ((ROE~23%, EPS growth~35% CAGR for FY11-13E), we arrive at a core business valuation of Rs444/share. To this we add Rs50/share of NCE value and Rs10/share valuation of Zetia (FY17 Launch). We arrive at a SOTP value of Rs504/share.

**Conclusion:** In a scenario where we completely ignore the NCE franchise, our SOTP valuation of Rs455 (Rs445/sh of core business + Rs10/sh of Zetia) largely accounts for our current target price on GNP (Rs465). This explains our thesis that GNP's NCE franchise is an option which is currently available for free.

**Fig 1 Scenario Analysis: NCE franchise available as a free option**

FY12 E	Scenario 1: Without Licensing Income	With Licensing Income	Scenario 2: Without Licensing Income & NCE R&D Expense
Sales (Rs Cr)	3400	3625	3400
<b>EBITDA Margin</b>	<b>23%</b>	<b>28%</b>	<b>26%</b>
EBITDA Rs Cr	782	1007	882
Depreciation	-100	-100	-100
Interest	-120	-120	-120
Other Income	60	60	60
Profit Before Tax	622	847	722
Tax Rate	13%	13%	17%
Tax amount Rs cr	81	110	121
PAT (Rs Cr)	541	737	601
Share Count	27.05	27.05	27.05
<b>EPS</b>	<b>20</b>	<b>27.2</b>	<b>22.2</b>
Target Multiple	20		20
<b>Glenmark core business Value (Rs/share)</b>	<b>400</b>		<b>444</b>
NPV of Zetia settlement (Rs /Sh)	10		10
NPV of NCE business	60		50
<b>Target Price</b>	<b>470</b>		<b>504</b>

Source: Company data, Macquarie Research, June 2011

**Fig 2 Case study: Comparison of GNP's NCE franchise valuation with SPARC**

Effective Tax Rate Assumption	20%			
USD/INR Assumption	45			
		<b>Comments</b>		
<b>Rs m</b>	<b>Glenmark</b>		<b>Rs m</b>	<b>SPARC</b>
NCE Research Expense (FY12E)	1000	FY12 Estimate	NCE Research Expense(FY11A)	681
R&D Tax Benefit (assuming 20% effective Tax and 200% weighted Tax deduction)	400		R&D Tax Benefit (assuming 20% effective Tax and 200% weighted Tax deduction)	272
Net adj expense through P&L of Glenmark	600		Net adj expense saving through P&L of Sun Pharma	409
GNP Valuation multiple	20	ROE~20%, EPS growth~35% cagr for FY11-13E)	Sun' Valuation multiple	24
Market Cap loss for GNP(US\$m)	-267	Ascribing negative value to decline in earnings (resulting in eventual loss in Market cap) from NCE expense	Market Cap gain for <b>SUNP</b> (if the expense was on Sun Pharma's P&L) (US\$m)	218
			SPARC Market Cap (US\$m)	400
<b>Reduction for GNP (US\$m)</b>	<b>-(267)</b>		<b>Total Gain for SUNP market Cap (US\$m)</b>	<b>618</b>
GNP has generating ~US\$ 200m in out-licensing income from six deals with large partners to date (vs. total spend of ~ US\$125m)				
SPARC has generated ~ US\$35m in income from operations Vs. total expense of ~ US\$ 50m over last 5 years.				
We think the market currently is giving Glenmarks R&D initiative a negative market Cap of ~ US\$ 250m (market cap reduced ~ 15%) (Expense goes through the P&L but no value attached to it's innovation Pipeline)				

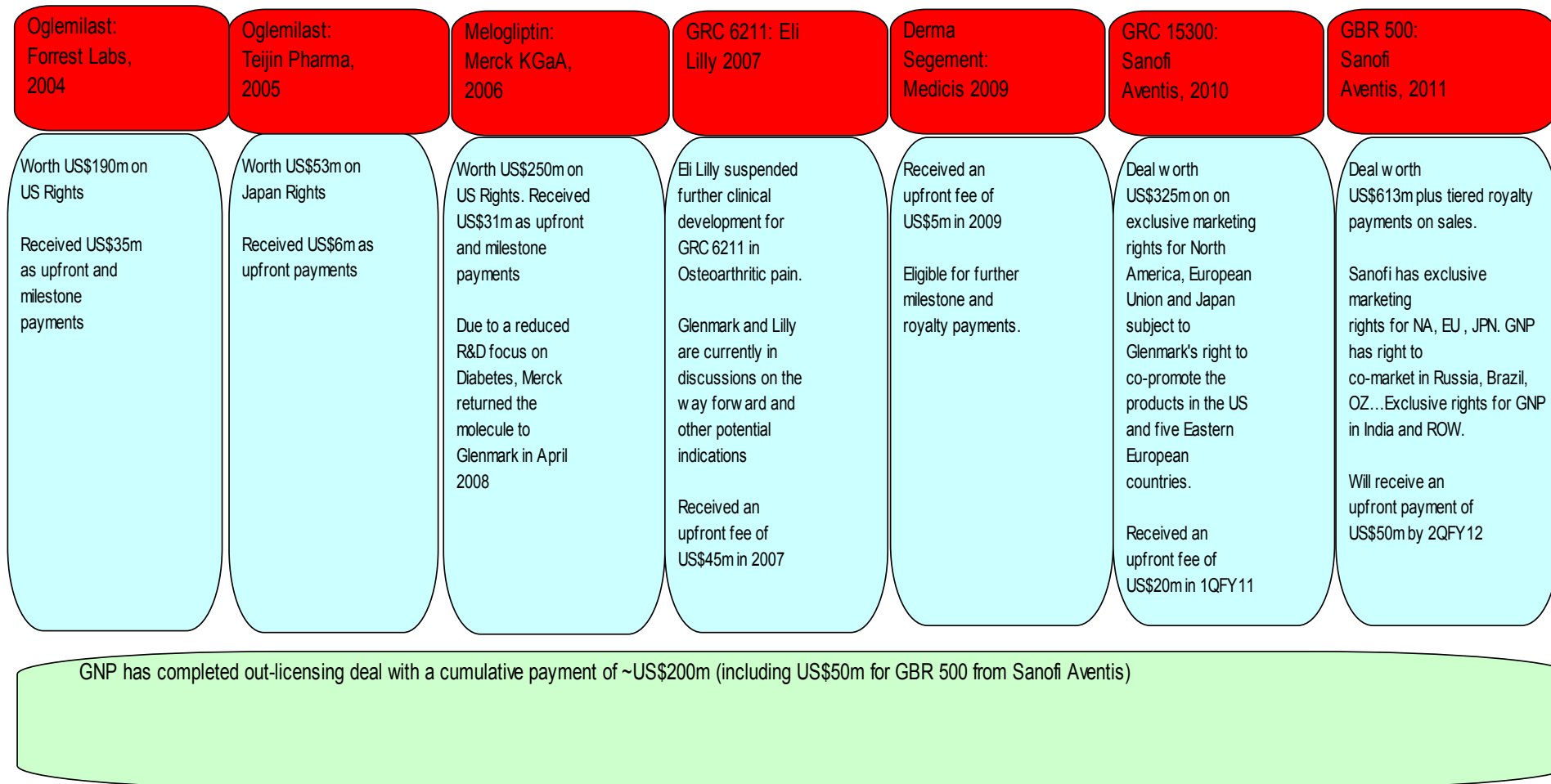
Source: Company data, Macquarie Research, June 2011

Major peers (SUNP IN, RBXY IN) have demerged the NCE business in the past, resulting in expansion of core business margins. We think the market currently is giving GNP's R&D initiative a negative market cap of ~ US\$250m (market cap reduced ~ 15%). Expense of Rs1b goes through the P&L but no value attaches to its innovation pipeline. We do not imply that demerging the NCE business is the strategy to pursue, but such an analysis in our view does aid better understanding.

The market cap loss to GNP because of the NCE R&D expenses of GNP is ~US\$267m. While on the other hand, the SUNP model of separately listing the NCE arm (SPARC) has resulted in a total market cap gain of ~US\$618m for long-term shareholders of SUN. Sun Pharma gains both with boosting its earnings by reducing NCE R&D expense and getting a separate valuation of US\$400m for SPARC.

GNP has generated ~US\$200m in out-licensing income from six deals with large partners to-date (vs. total spend of ~US\$ 125m for the last seven years), which is unmatched by any of its peers. SPARC has generated ~US\$35m vs total spend of US\$50m. Because of a few setbacks in the past, we think the market is not assigning any upside to GNP's innovation franchise. While this is counterintuitive to us, even being conservative we believe given the track record it would be a reasonable assumption that GNP is not destroying value through its NCE research program.

**Fig 3 GNP R&D capability: GNP has received ~US\$200m as Outlicensing income in the last 6-7 years**



Source: Company data, Macquarie Research, June 2011

## We value the NCE franchise @ Rs60/share

We have valued only the two already out-licensed opportunities (GRC 15300 (TRPV3) and GBR500) @ 10% probability of success. Crofelemer (successful Phase III trials) is valued at Rs25/sh.

**Fig 4 NCE Valuation**

GRC 15300	15	Outlicensed to Sanofi
Coreflemer	25	In licensed for RoW and API supply for Western mkts
GBR 500	20	Outlicensed to Sanofi
<b>NCE value</b>	<b>60</b>	

Source: Company data, Macquarie Research, June 2011

### GBR 500 – Antagonist of VLA-2 integrin- We value @ Rs20/sh

Glenmark's GBR 500 is a first-in-class monoclonal antibody, which is an antagonist of the VLA-2 (alpha2-beta1) integrin. Integrins regulate movement of leukocytes and cytokine release. VLA-2 integrin antagonist (GBR 500) targets integrin receptors. This therapeutic monoclonal antibody has established proof of concept in animal models across a range of anti-inflammatory conditions. These disease modifier agents target the initial stage of disease and have broad anti-inflammatory potential in MS (Multiple Sclerosis) and inflammatory diseases like IBD (Inflammatory Bowel Disease).

IBD Biologic market including Crohn's disease (primary indication) is worth US\$5bn, with more than 4m patients globally (according to Glenmark). Glenmark has completed Phase I dosing of GBR 500 in the US and the drug has been well tolerated with a good pharmacokinetic profile. Plans are in place to initiate clinical proof of concept studies in Crohn's Disease. Sanofi-Aventis (SAN FP, €46.88, Outperform, TP: €62.50, Peter Duellmann) has licensed the rights to all indications.

### Crofelemer: We value @ Rs25/sh

Post the promising Phase 3 data in treatment of HIV-associated diarrhoea, we value Crofelemer at an NPV of Rs25/sh. GNP has Crofelemer rights in over 140 countries and expects peak sales of US\$80m in ROW markets in the HIV-related diarrhoea indication alone, in addition to potential sales in another indication (pediatric/travelers diarrhoea). We value this opportunity at Rs18/sh. Salix (SLXP US, US\$39.99, Not rated) has rights to Crofelemer for the developed markets. They estimate the HIV-associated diarrhoea market opportunity in the US alone to be US\$300m annually. GNP has a 10-year commercial manufacturing and supply agreement for the Crofelemer API with Salix. In addition to customary margins on global supplies, GNP would be entitled to receive royalties on sales in western markets from Napo Pharmaceuticals. We value this opportunity at Rs7/sh.

Salix has licensed the rights to Crofelemer from Napo for all indications in the US, Europe (excluding certain smaller countries) and Japan, and worldwide for certain other indications, including irritable bowel syndrome. GNP and Salix have also entered into a 10-year commercial manufacturing and supply agreement for the Crofelemer API. In addition to customary margins on global supplies, GNP would be entitled to receive royalties on sales in western markets from Napo.

Up to 40% of the 1m people living with HIV in the US manage diarrhoea on a chronic basis. Salix estimates that the HIV-associated diarrhoeal market opportunity alone in the US may be US\$300m annually. We expect potential USFDA approval of Crofelemer in the US in 1H12. Once the NDA dossier for the US is ready, GNP will subsequently start filling for regulatory approval in RoW countries, with anticipated launch in 2H12.

### GRC 15300 – Out-licensed to Sanofi - We value @ Rs15/sh

GNP has outlicensed its vanilloid receptor (TRPV3) antagonist program, including the first-in-class clinical compound, GRC 15300, which has completed Phase I clinical development as a potential next-generation treatment for chronic pain, including diabetic neuropathic pain and osteoarthritic pain. Sanofi will have exclusive marketing rights for North America, the European Union and Japan, subject to Glenmark's right to co-promote the products in the US and five Eastern European countries. SNY will also have co-marketing rights in ten other countries, including Brazil, Russia and China, and Glenmark will retain exclusive rights in India and other countries.

GNP will receive an upfront payment of US\$20m, with the potential of total development, regulatory and commercial milestone payments reaching US\$325m before the commercial launch. GNP is also eligible to receive double-digit-tiered royalties on end sales of commercialized products under the license. GNP puts the potential peak sales of the product on launch at upward of US\$3bn given that, globally, the osteoarthritis market alone is worth ~US\$4bn and the neuropathic pain market is another ~US\$5bn. GRC 15300 is currently in Phase 1 and a launch is unlikely before FY15, we believe. We value the opportunity based on probability adjusted NPV at Rs15/sh.

#### Acne Vulgaris – Outlicensed to Medicis (505 b (2) application)

Glenmark has entered into an exclusive agreement with Medicis Pharma (MRX US, US\$36.56, Not rated) has to co-develop and commercialize a topical specialty dermatology product in North America for the treatment of acne vulgaris from GNP's pipeline. Pursuant to terms of the agreement, Glenmark has received a one-time upfront payment of US\$5m from Medicis, and it is eligible to receive additional payments on achieving certain development milestones and royalties upon commercialization. The 505 b (2) application for this product has already been filed with the FDA. We expect a launch in FY12, with peak sales potential of US\$40 m for this product. We value this opportunity on a risk-adjusted basis (we estimate a 70% probability of success) at Rs3/sh.

**Fig 5 Glenmark Novel Drug (NCE & NBE) Pipeline**

Compound	Primary Indication	Target	Development Stage	Deals (In-licensed/ Outlicensed deals)
Crofelemer	Anti-diarrheal	CFTR Inhibitor	Phase III completed	Inlicensed from Napo Pharma
GRC 4039 (Revamilast)	Asthma, COPD, Rheumatoid Arthritis	PDE IV Inhibitor	Phase II	
GRC 15300	Osteoarthritis Pain, Neuropathic Pain,	TRPV-3 Antagonist	Phase I completed	Outlicensed to Sanofi
GRC 17536	Respiratory disorders	TRPA 1 Inhibitor	Pre-Clinical completed	
GBR 500	Crohn's Disease, Multiple Sclerosis, Inflammatory Disorders	VLA-2 Antagonist	Phase I completed	Outlicensed to Sanofi
GBR 401	Lymphomas, Leukemias Autoimmune Disorders	Anti-CD19	Pre-Clinical	
GRC 600	Thrombocytopenic purpura Adjunct PCI/ ACS	Anti-Von Willebrand Factor	Pre-Clinical completed	
GBR 900	Pain	TArnktAagonist	Pre-Clinical	In-licensed from Lay Line Genomics

Source: Company data, Macquarie Research, June 2011

**Fig 6 Glenmark NBE capability**

GBR 500	Monoclonal antibody, first in class, Targets $\alpha$ I domain of human $\alpha$ 2 $\beta$ 1 integrin (VLA - 2) Inhibits retention of inflammatory cells at site of inflammation; Target expressed only during inflammation Potential Indications : Crohn's disease, inflammatory bowel disease; Multiple sclerosis; potentially other inflammatory diseases; potential to expand indications to oncology Phase I dosing completed – drug has been well tolerated with a good pharmacokinetic profile
GBR 600	Monoclonal antibody, first in class; Targets the A1 domain of human van Willebrand Factor (vWF) Excellent safety profile; Compelling efficacy in primate models (Baboon) Potential Indication: "Neutralization" of overactive/over expressed vWF & Platelet Inhibition
GBR 401	Anti - CD19 antibody; deplete malignant/auto reactive B cells upon binding; same proven concept as Rituximab Potential Indications: Initial focus oncology, Autoimmune diseases IND enabling studies ongoing

Source: Company data, Macquarie Research, June 2011



Fig 7 Target Price Calculation

Glenmark Consolidated Earnings Assumptions (Rs per share)		Comments
FY12E EPS	19.3	
Target P/E (x)	x 20	
Core business value	385	
Exclusive opportunity (GGL)		
Zetia FTF	13.0	Settled with Merck / Partner Par
Malarone FTF	5.0	Settled with GSK
Vanos Cream (Fluocinonide)	2.0	Settled with Medicis (AG launch in Dec-13)
Product specific Opportunity GGL	20	
NCE Valuation		
GRC 15300	15	Outlicensed to Sanofi
Crofelemer	25	In licensed for RoW and API supply for Western mkts
GBR 500	20	Outlicensed to Sanofi
NCE value	60	
<b>Target Price</b>	<b>465</b>	<b>12 month forward target price</b>

Source: Company data, Macquarie Research, June 2011

Fig 8 NCE/NBE/FTF opportunity for GNP

Niche Generic Opportunity	Brand Sales est.	Expected Launch	One time EPS upside (INR)			NPV INR / Share
			FY11E	FY12E	FY13E	
Oxycodone	US\$16mn	1QCY11	0.1	0.9	1.6	Part of Base Business
Dovonex (Branded Generic)	US\$200mn	3QCY10	0.2	1.1	1.6	
Felodipine	US\$100mn	3QFY11	0.4	1.3	1.1	
Cutivate	US\$45mn	4QFY12		0.2	1.3	
Rest of the business			13.0	15.8	19.5	
Base Business EPS			13.6	19.3	25.0	
FTF Exclusivity	Brand Sales est.	Expected Launch	One time EPS upside (INR)			NPV INR / Share
Ezetimibe / Zetia	US\$1,400mn	Dec-16				13
Malarone	US\$60mn	3QCY11		1.3	2.2	5
Trandolapril & Verapamil HCL (Tarka)	US\$60mn	Jul-10	1.4	0.0	0.0	
Vanos (Fluocinonide)	US\$40mn	Dec-13				2
FTF Exclusivity Contribution			1.4	1.3	2.2	20
Niche NCE Opportunity	Brand Sales est.	Expected Launch	One time EPS upside (INR)			NPV INR / Share
Crofelemer	Peak sales US\$80m	4QFY12		0.0	1.9	25
GBR 500 (Outlicensed to Sanofi)	Peak sales US\$1.75b	Post FY16		7.2		20
GRC15300	Peak sales US\$3 bn	post FY15	3.1			15
NCE-driven upside in estimates			3.1	7.2	1.9	60
Total NCE and Niche Generic potential upside			4.5	8.5	4.1	80
Core business EPS			13.6	19.3	25.0	385
Total Reported EPS			18.1	27.8	29.1	465

Source: Company data, Macquarie Research, June 2011





## Important disclosures:

**Recommendation definitions****Macquarie - Australia/New Zealand**

Outperform – return >3% in excess of benchmark return  
 Neutral – return within 3% of benchmark return  
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

**Macquarie First South - South Africa**

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
 Neutral – return within 5% of benchmark return  
 Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
 Neutral (Hold) – return within 5% of Russell 3000 index return  
 Underperform (Sell) – return >5% below Russell 3000 index return

**Volatility index definition\***

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ/Canada stocks only

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

**Financial definitions**

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

**Recommendation proportions – For quarter ending 31 March 2011**

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	45.65%	65.72%	59.70%	43.02%	68.91%	51.16%	(for US coverage by MCUSA, 14.36% of stocks covered are investment banking clients)
Neutral	39.49%	19.00%	29.85%	53.09%	26.43%	35.73%	(for US coverage by MCUSA, 17.55% of stocks covered are investment banking clients)
Underperform	14.86%	15.28%	10.45%	3.89%	4.66%	13.11%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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