

Company Focus

31 October 2007 | 11 pages

Glenmark Pharmaceuticals (GLEN.BO)

Buy: Strong 2Q; Robust Trends; Imminent Guidance Revision

- Maintain Buy (1M)** — We rate Glenmark as one of the best innovative plays in the Indian pharma sector. At the same time, 2Q results underline the robust trends in the base generics business across key markets. With a mature & widening R&D pipeline and excellent traction & profitability in the base business, we expect multiple growth and valuation drivers going forward.
- 2Q beats expectations** — with 52% & 87% growth in sales & PAT respectively. Despite the strong appreciation in the rupee, gross & EBIDTA margins have improved by 475 bps & 724 bps YoY respectively as Glenmark is through with the investment phase in all key markets. As such, operating leverage is playing out in a big way on the back of very strong sales growth across markets.
- Guidance revision imminent** — Glenmark indicated that it intends to raise its guidance for its base business at an analyst meeting next week. While this was anyway in the cards, given the unexpected exclusivity in Trileptal, we believe there could be some upside outside of this opportunity as well. Glenmark also intends to outline its long term plans at the analyst meeting.
- Other key takeaways** — a) R&D deals are on course – management expects milestone from Forest shortly & does not see any problem with the GRC-8200 development program despite Merck’s decision to pull out of diabetes research; b) No fund raising plans at present; c) EBIDTA margins could improve in the short term, but should settle in the 28-30% range over time

Buy/Medium Risk	1M
Price (31 Oct 07)	Rs489.50
Target price	Rs575.00
Expected share price return	17.5%
Expected dividend yield	0.1%
Expected total return	17.6%
Market Cap	Rs119,495M US\$3,040M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	864	3.22	-20.9	151.9	31.3	25.5	0.1
2007A	3,093	11.54	258.0	42.4	17.1	58.5	0.1
2008E	5,328	19.88	72.3	24.6	9.8	56.4	0.1
2009E	6,761	25.23	26.9	19.4	6.3	44.2	0.1
2010E	7,608	28.39	12.5	17.2	4.5	34.1	0.1

Source: Powered by dataCentral

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¹Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	151.9	42.4	24.6	19.4	17.2
EV/EBITDA adjusted (x)	90.5	29.7	18.6	14.9	12.8
P/BV (x)	31.3	17.1	9.8	6.3	4.5
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1
Per Share Data (Rs)					
EPS adjusted	3.22	11.54	19.88	25.23	28.39
EPS reported	3.22	11.54	19.88	25.23	28.39
BVPS	15.65	28.58	50.09	77.45	108.34
DPS	0.35	0.40	0.60	0.70	0.70
Profit & Loss (RsM)					
Net sales	7,020	12,220	17,259	21,082	24,621
Operating expenses	-5,880	-8,380	-11,019	-13,438	-16,015
EBIT	1,140	3,840	6,240	7,644	8,606
Net interest expense	-147	-384	-227	0	0
Non-operating/exceptionals	128	157	106	136	354
Pre-tax profit	1,121	3,613	6,118	7,781	8,960
Tax	-241	-513	-782	-1,012	-1,344
Extraord./Min.Int./Pref.div.	-16	-8	-8	-8	-8
Reported net income	864	3,093	5,328	6,761	7,608
Adjusted earnings	864	3,093	5,328	6,761	7,608
Adjusted EBITDA	1,372	4,263	6,801	8,270	9,297
Growth Rates (%)					
Sales	23.3	74.1	41.2	22.2	16.8
EBIT adjusted	-18.2	237.0	62.5	22.5	12.6
EBITDA adjusted	-11.9	210.7	59.5	21.6	12.4
EPS adjusted	-20.9	258.0	72.3	26.9	12.5
Cash Flow (RsM)					
Operating cash flow	-268	932	4,466	4,861	6,125
Depreciation/amortization	232	423	561	626	691
Net working capital	-1,657	-3,263	-1,815	-2,737	-2,451
Investing cash flow	-2,568	-2,688	-1,535	-1,000	-1,000
Capital expenditure	-2,553	-2,711	-1,535	-1,000	-1,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	2,505	1,891	-3,642	-2,472	-200
Borrowings	2,886	2,088	-3,243	-2,273	0
Dividends paid	-205	-117	-172	-200	-200
Change in cash	-331	136	-711	1,388	4,925
Balance Sheet (RsM)					
Total assets	13,416	19,346	22,759	28,176	36,780
Cash & cash equivalent	1,056	1,058	346	1,734	6,659
Accounts receivable	3,816	5,712	7,615	9,884	11,866
Net fixed assets	5,805	8,104	9,078	9,452	9,761
Total liabilities	9,502	12,482	10,731	9,579	10,767
Accounts payable	1,719	2,329	3,664	4,582	5,502
Total Debt	7,354	9,367	6,124	3,852	3,852
Shareholders' funds	3,915	6,864	12,028	18,597	26,013
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.5	34.9	39.4	39.2	37.8
ROE adjusted	25.5	58.5	56.4	44.2	34.1
ROIC adjusted	10.6	25.4	31.8	33.0	31.5
Net debt to equity	160.9	121.1	48.0	11.4	-10.8
Total debt to capital	65.3	57.7	33.7	17.2	12.9

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Robust Trends; Imminent Guidance Revision

We rate Glenmark as one of the best innovative plays in the Indian pharma sector. At the same time, strong 2Q results underline the robust trends in the base generics business across key markets. With a mature & widening R&D pipeline and excellent traction & profitability in the base business, we expect multiple growth and valuation drivers going forward. Management indicated that it would be revising its base business guidance upwards at its forthcoming analyst meeting on November 7, 2007. We believe there is further upside to our current “ahead of guidance” estimates and maintain Glenmark as one of our top picks in the Indian pharma sector.

Strong 2Q – ahead of expectations

Figure 1. Consolidated Earnings Summary (Rupees in Million, Percent)

Year Ended March 31	2Q FY07	2Q FY08	% Ch YoY	1Q FY08	% Ch QoQ	CIR Comments
Gross Sales	2,557	3,839	47.5	3,594	7.7	
Excise Duty	88	90	3.4	81	12.2	Excise duty benefits from Baddi
Net sales	2,469	3,749	51.8	3,514	6.7	US and Latin America sales drive YoY growth; Domestic sales
Material cost	807	1,028	27.4	984	4.5	Past the investment phase in all key markets – particularly
% of Net Sales	32.7	27.9	-475 bps	28.8	-84 bps	impressive given the strong appreciation in rupee v/s the dollar
Staff cost	377	503	33.4	504	(0.3)	
Other exp	685	1,034	51.0	1,000	3.4	
Total Expenditure	1,869	2,565	37.3	2,489	3.1	
EBITDA	601	1,184	97.0	1025	15.5	Margin expansion driven by lower material costs and despite a doubling of R&D spend
<i>EBITDA Margins (%)</i>	<i>24.3</i>	<i>31.6</i>	<i>724 bps</i>	<i>29.2</i>	<i>241 bps</i>	
Interest	87	158	82.4	144	10.1	Likely to decline going forward as cash is used to repay debt
Depreciation	98	162	64.7	143	13.2	Investment in new facilities
Other income	29	53	84.1	25	112.2	Includes forex loss of Rs16m
PBT	444	916	106.2	763	20.1	
Tax	42	165	289.0	191	(13.7)	
<i>Effective Tax rate</i>	<i>9.6</i>	<i>18.0</i>	<i>847 bps</i>	<i>25.1</i>	<i>-707 bps</i>	
Net Profit	402	751	86.9	572	31.5	

Source: Company Reports and Citi Investment Research

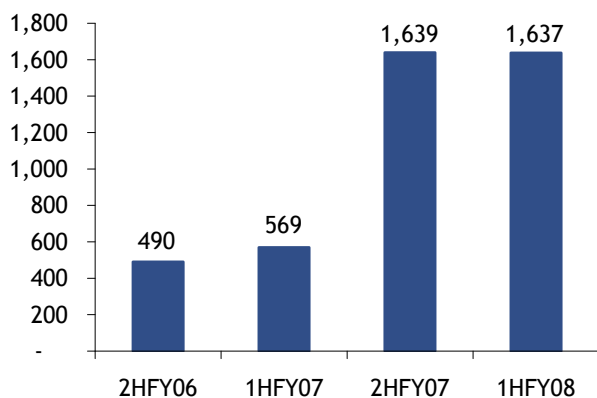
Figure 2. Consolidated Sales Breakup (Rupees in Million, Percent)

Year Ended March 31	2Q FY07	2Q FY08	% Ch YoY	1Q FY08	% Ch QoQ	CIR Comments
Formulations						
USA	338	811	139.9	826	(1.9)	3 new product launches; sales moved to a new level in 3QFY07 and appears to be sustaining in that broad range despite strong currency appreciation
% of total Formulations	15.1	23.7		25.8		
Europe	-	68	nm	93	(26.9)	Recent entry through acquisition of Medicamenta in the Czech Republic; we expect more inorganic measures
% of total Formulations	-	2.0		2.9		
Latin America	268	572	113.1	553	3.4	Consistent new product launches; revenues moved to a new base in 4QFY07 and appears to be sustaining at those levels
% of total Formulations	12.0	16.7		17.3		
Rest of World	525	545	3.8	446	22.1	Robust growth in Russia; we believe the muted YoY growth is more of a timing issue than a trend – some hit due to INR appreciation
% of total Formulations	23.4	16.0		14.0		
India	1,108	1,418	28.0	1,281	10.7	Driven by new product launches
% of total Formulations	49.5	41.5		40.0		
Total Formulations	2,240	3,414	52.4	3,199	6.7	
% of Total revenue	87.6	88.9		89.0		
API	317	426	34.2	395	7.8	International API business degrowth due to higher captive consumption; however offset by strong growth in India
% of Total revenue	12.4	11.1		11.0		
Total Revenues	2,557	3,839	50.2	3,594	6.8	

Source: Company Reports and Citi Investment Research

Robust trends across key businesses

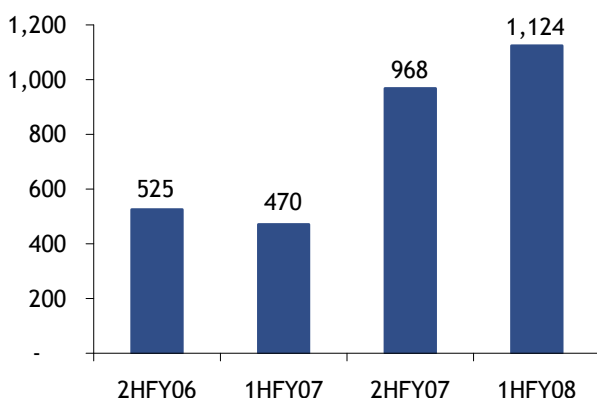
Figure 3. US formulation sales (Rupees in millions)



2Q Update & CIR Comment

- 3 ANDAs approved – carvedilol, topamax, trileptal
- 180 day exclusivity for trileptal – product already launched – expected to add Rs 4.7 to FY08E EPS (not in estimates currently)
- Cumulative launches at 20; with 35 ANDAs pending approval
- Four potential FTFs – including desloratadine, ezetimibe & atomoxetine – potential sole exclusivity in ezetimibe
- Ability to consistently grow revenues despite rupee appreciation v/s the dollar is creditable

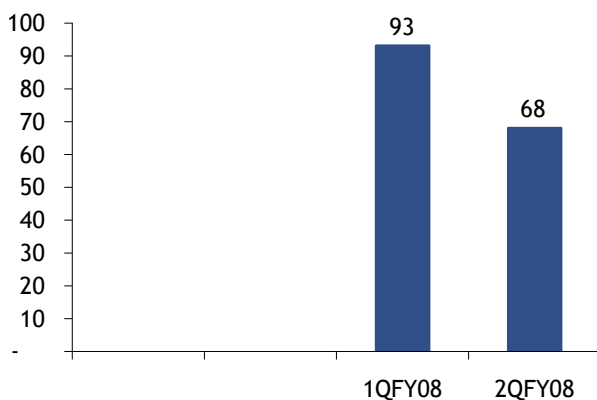
Figure 4. Latin America formulation sales (Rupees in millions)



2Q Update & CIR Comment

- Seven new dossiers filed in Brazil. Company expects to file 25 dossiers and launch 18 products during FY08.
- Six new dossiers filed in Argentina. 35 oncology dossiers filed and 17 oncology products launched in various markets during the quarter.
- We expect Latin American business to contribute increasingly to profitability from here on, as operating leverage begins to play out

Figure 5. Europe formulation sales (Rupees in millions)

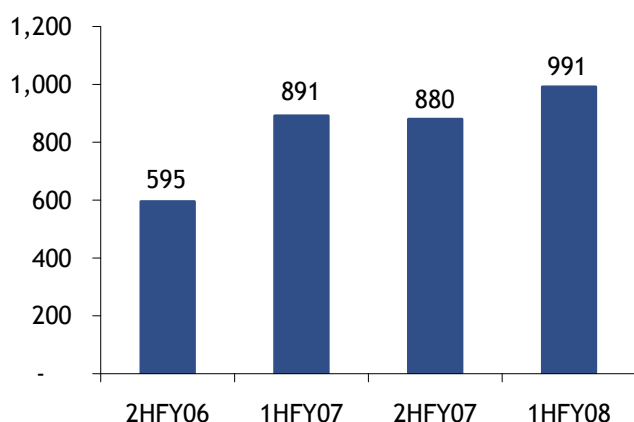


2Q Update & CIR Comment

- Completed the co-development of one more product with Mylan (as part of the earlier agreement with Merck Generics). Total number of products under registration review increased to 3.
- Plans to use the Medicamenta manufacturing site in Czech Republic as a central site for European operation
- We expect Glenmark to focus on small acquisitions in Europe in order to expand its presence

Source for figures 3-5: Company Reports and Citi Investment Research

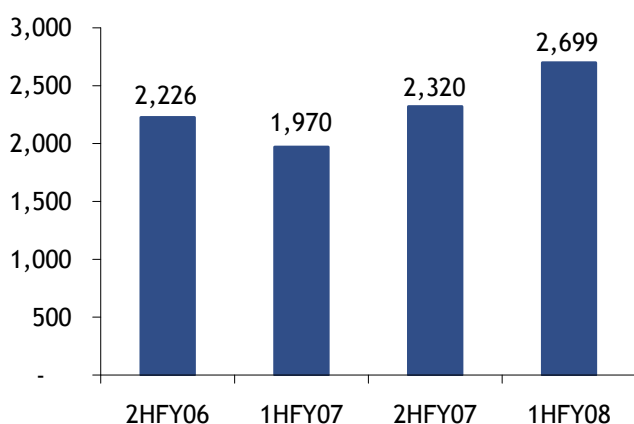
Figure 6. Semi Regulated Markets formulation sales (Rupees in millions)



2Q Update & CIR Comment

- Filed 93 products and received registrations for 58 formulation products in 2QFY08
- Focus on developing brands in niche segments in Russia. Filed two products in 2QFY08
- We expect Russia / CIS to remain a key growth driver
- Glenmark’s focus is on creating a platform to ultimately sell its own proprietary products – note that Glenmark has retained marketing rights for all semi-regulated markets in every NCE it has licensed out so far

Figure 7. India formulation sales (Rupees in millions)



2Q Update & CIR Comment

- Twelve products launched in 2QFY08. Plans to launch 19 products in the next quarter.
- One DMF filed during the quarter and in line to file 15 DMFs in FY08
- We expect steady growth to continue in this segment – management indicated that Glenmark is not affected by the ongoing confusion over the alleged marketing of “irrational” combinations by Indian companies

Source for figures 6-7: Company Reports and Citi Investment Research

3 molecules licensed out

Glenmark expects to get US\$30m from Forest over the next few months

Glenmark reiterated that it would conclude one more licensing deal before the end of FY08

Already received US\$45m as research income from Eli Lilly

Figure 8. Growing & Diversified R&D Pipeline

Compound (Partner)	Target	Primary indications	Status
GRC 3886 (Forest)	PDE 4	Asthma, COPD	Phase II
GRC 8200 (Merck KgaA)	DPP IV	Diabetes (Type II)	Phase II
GRC 6211 (Eli Lilly)	VR 1	Osteoarthritis, Migraine, Incontinence	Phase II
GRC 10693	CB 2	Neuro pain, Osteoarthritis & other pain	Phase I by CY07 end
GRC 10801	CB 1	Obesity	Phase I by end FY08
GRC 4039	PDE 4	Rheumatic Arthritis, Inflammation	Phase I by CY07 end
Tie-up with Dyax			
3 anti-bodies	Unknown	Unknown 1 st NBE into clinic in 2009	
Chromos			
CHR-1103	MAB	Multiple Sclerosis; Rheumatic Arthritis	Pre clinical
CHR-1201	MAB	Acute Thrombosis	Pre clinical
Napo			
Crofelemer	Chronic Diarrhoea	Chronic Diarrhoea	Phase II

Source: Company Reports and Citi Investment Research

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 50% 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 the stock with a target price of Rs575/share. Our positive outlook on the stock takes into consideration the following: a) R&D pipeline has broadened with seven molecules expected by the company to be in the clinic by end FY08; b) With three molecules licensed out, the R&D option value or value at risk is now spread across a larger number of molecules; c) the base business has witnessed significant traction, especially in the USA and Latin America. We also believe that the rapid scale up in the base business adds another catalyst for the stock apart from the option value being built in by its R&D effort (primarily Oglemilast, GRC-8200 & GRC-6211). The risk reward, we believe, remains in favor of investors. Although there are potential risk triggers (especially related to Oglemilast) that could lead to partial erosion of the option value, we believe that any such decline is a buying opportunity since Glenmark has a robust pipeline that would enable it to shore up the R&D value over time via new outlicensing deals.

Valuation

We use sum of the parts to value the stock, valuing the R&D deals and the base business separately. We believe probability-adjusted DCF is appropriate to calculate the option value from Oglemilast, GRC-6211 and GRC-8200 as it captures the reducing probability of success as the molecules progress on the clinical path. We have used the licensing deal with Forest Laboratories for the US market as a benchmark as well as a 13% discount rate (in-line with Glenmark's WACC) following our adjustment for the higher-risk income streams by probability of success. We arrive at a value of Rs125/share for Oglemilast. We use a similar approach for GRC-8200 and GRC-6211 arriving at a value of Rs47/share and Rs95/share respectively. We value Glenmark's base business (excluding R&D income) on P/E in view of the healthy growth expected in earnings. Our valuation is based on 20x forward earnings, which is at a premium to the range that we use for other mid-sized pharma companies. We believe Glenmark deserves a premium given its higher value addition in its business and the ability to execute and leverage its assets. Based on 20x March 09E earnings, we value Glenmark's base business at Rs307/share. This takes the total valuation of the company to Rs575/share.

Risks

We rate Glenmark Medium Risk, even though its risk rating according to our quantitative model is Low, as we believe the element of R&D related option value built into the stock warrants a higher risk rating. The main downside risks to our target price and estimates include: (1) Glenmark's efforts to build its own front-end in regulated markets could prove to be a drag on earnings if it is unable to effectively execute its plans; (2) growing competition, rapid price erosion and fragmented market share are risks that are inherent to the generics business; and (3) the failure of Oglemilast or GRC-8200 could lead to the R&D milestone payments getting taken off our estimates. If any of these factors has a greater impact than we expect, the stock could have difficulty achieving our target price.

Appendix A-1

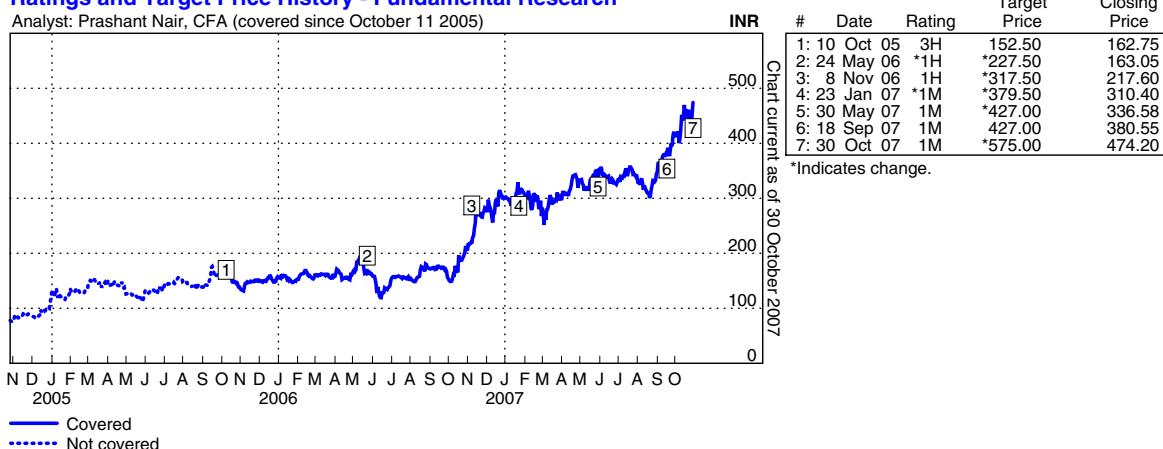
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Glenmark Pharmaceuticals (GLEN.BO) Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since October 11 2005)



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Data current as of 30 September 2007

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