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India Research

Sector: Pharmaceuticals

Update

Glenmark Pharmaceuticals Ltd.

(GLEN.BO/GNP.IN)

Moderate Outperform *(CMP: Rs. 256.75, Mkt Cap: Rs.64.2 bn (US $1.4 bn), Dec 03, '09)*

Relevant Index: CNX Nifty Index: 5,131.7 (Dec 03, '09)

Recent meeting with management reaffirms positive view…

Expected revival in emerging markets in H2FY10, likely outlicensing deal in near term, anticipated reduction in high debt levels & improving business prospects augur well…

Last report's recommendation: Moderate Outperform (MP: Rs. 217.1, Nov 04, '09)

Relevant Index: CNX Nifty Index: 4,710.8 (Nov 04, '09)

Relative performance since last rating change: CNX Nifty Index: up 9%, GLEN: up 18%

December 04, 2009

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Research Contact: *Associate Director, Research: Hitesh Kuvelkar Mob. +91 9833 732633*
Email: hitesh.kuvelkar@fglobal.com

Sales Offices: *India Sales: Tel. No: +91-22-400 12 440 Email: indiasales@fglobal.com*
fgasiasales@bloomberg.net

US Sales: Tel. No: 1-212-227 6611 Email: us@fglobal.com

Asia & Europe Sales: Tel.: 44-207-959 5300 Email: uk@fglobal.com

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Table of Contents

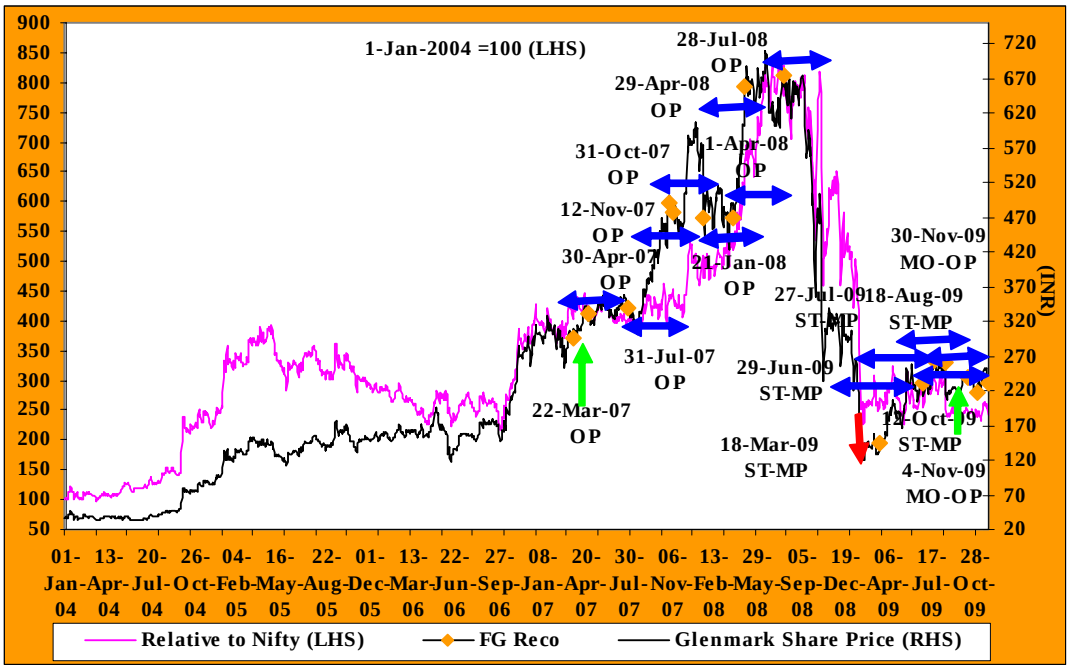
Price and Rating History Chart

Ratings Key

Positive Ratings	B = Buy	BD = Buy at Declines	OP = Outperform
	S-OP = Sector Outperform	M-OP = Market Outperform	MO-OP = Moderate Outperform
Neutral Ratings	H = Hold	MP = Market Perform	SP = Sector Perform
Negative Ratings	S = Sell	SS = Sell into Strength	UP = Underperform
	A = Avoid	MO-UP = Moderate Underperform	S-UP = Sector Underperform

ST: Short Term **MT: Medium Term** **LT: Long Term**

Glenmark Pharmaceuticals Ltd. (GLEN.BO/GNP.IN)



Represents an Upgrade

Represents a Downgrade

Represents Reiteration of Existing Rating

Details of First Global's Rating System given at the end of the report

Financial Snapshot# (Consolidated)

Key Financials						
(YE Mar 31st) (Figures in Rs. mn)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Total Revenue	7,044	12,241	19,800	21,162	25,917	31,010
Revenue Growth (Y-o-Y)	***23.3%***	***73.8%***	***61.8%***	***6.9%***	***22.5%***	***19.7%***
EBIDTA	1,396	4,283	8,048	4,847	5,867	7,269
EBIDTA Growth (Y-o-Y)	***-11.3%***	***206.9%***	***87.9%***	***-39.8%***	***21.0%***	***23.9%***
Net Profit	880	3,101	6,321	1,917	3,452	4,619
Net Profit Growth (Y-o-Y)	***-17.8%***	***252.2%***	***103.9%***	***-69.7%***	***80.1%***	***33.8%***
Net Profit (Excl. Extra-ordinaries)	827	3,021	6,032	1,785	3,452	4,619
Net Profit Growth (Excl. Extra-ordinaries)(Y-o-Y)	***-22.7%***	***265.1%***	***99.7%***	***-70.4%***	***93.4%***	***33.8%***
Shareholders Equity	3,731	6,864	15,179	15,982	20,620	26,208
Number of Diluted shares (in mn)	119	238	245	250	250	250
Key Operating Ratios						
(YE Mar 31st)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Diluted EPS (Rs) (Excl. Extra-Ordinaries)	3.21	11.27	23.82	6.99	13.52	18.10
EPS Growth (Y-o-Y)	***-23.5%***	***250.7%***	***111.5%***	***-70.6%***	***93.4%***	***33.8%***
CEPS (Rs.) (Excl. Extra-Ordinaries)	4.1	13.6	26.7	11.0	18.7	23.8
EBIDTA Margin (%)	**19.8%**	**35.0%**	**40.6%**	**22.9%**	**22.6%**	**23.4%**
NPM (%)	11.7%	24.7%	30.5%	8.4%	13.3%	14.9%
RoE (%)	23.6%	56.4%	54.2%	11.4%	18.8%	19.7%
RoCE (%)	**9.8%**	**23.3%**	**30.5%**	**8.8%**	**12.6%**	**14.2%**
Book Value per share (Rs.)	14.7	27.1	59.9	62.6	80.8	102.7
Debt/Equity (x)	1.88	1.36	0.65	1.31	0.82	0.53
Dividend payout ratio (%)	9%	3%	3%	5%	3%	2%
** Stock spit in ratio 1: 2 was carried out in 2008. Previous year EPS figures and growth rates have been adjusted for the same*						
Free Cash Flow Analysis						
(YE Mar 31st) (Rs. mn)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Operating cash flow	708	523	2,869	-383	4,891	4,921
Total Free Cash flow	-2,911	-1,707	-1,774	-9,848	2,960	3,073
Valuation Ratios						
(YE Mar 31st)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
P/E (x)					17.7	13.3
P/BV (x)					3.0	2.3
P/CEPS (x)					12.9	10.1
EV/EBIDTA (x)					13.0	9.9
Net cash/Mkt cap (%)					NM	NM
Market Cap./ Sales (x)					2.3	1.9
Dividend yield (%)					0.2%	0.0%
						**** Not meaningful***

Market Cap. And Enterprise Value data as on Dec 03, 2009		
Current Market Price (Rs.)	256.75	
No. of Basic Shares Outstanding (in mn)	269.6	
	Rs. bn	**US $ bn**
Market Cap	**69.2**	**1.5**
Total Debt*	20.9	0.45
Cash and Cash Equivalents*	0.7	0.01
Enterprise Value	**89.4**	**1.9**

**** Debt and cash and cash equivalents are as on 31st March 2009; Ex. Rate: INR 46.5***

DuPont Model						
(YE Mar 31st)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
EBIDTA/Sales (%)	20%	35%	41%	23%	23%	23%
Sales/Operating Assets (x)	0.8	0.9	0.9	0.7	0.7	0.8
EBIDTA/Operating Assets (%)	**15.2%**	**30.5%**	**38.0%**	**15.2%**	**15.0%**	**17.8%**
Operating Assets/ Net Assets (x)	0.9	1.0	1.0	1.0	1.0	1.0
Net Earnings/ EBIDTA (%)	58%	70%	75%	37%	59%	64%
Net Assets/ Equity (x)	2.9	2.7	1.9	2.0	2.1	1.7
Return on Equity (%)	**23.6%**	**56.4%**	**54.2%**	**11.4%**	**18.8%**	**19.7%**
Common sized Profit and Loss						
(YE Mar 31st)	**2006**	**2007**	**2008**	**2009**	**2010E**	**2011E**
Total Revenues	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Net Raw Material Consumed	34.9%	25.8%	23.8%	31.1%	33.6%	33.4%
Power & Fuel	1.4%	1.3%	0.9%	1.1%	1.5%	1.5%
Manufacturing Expenses	5.5%	0.3%	0.7%	0.6%	4.9%	4.5%
Personnel	11.0%	9.9%	8.8%	12.9%	10.9%	10.9%
Selling, Distn & Admn Exps	22.6%	18.4%	15.9%	22.4%	20.8%	20.8%
Miscellaneous Exp	4.8%	5.7%	5.4%	4.9%	5.6%	5.5%
EBITDA	**19.8%**	**35.0%**	**40.6%**	**22.9%**	**22.6%**	**23.4%**
Depreciation and Amortization	3.3%	3.5%	3.6%	4.9%	5.1%	4.7%
Interest	2.6%	3.1%	3.2%	6.6%	6.6%	4.6%
PAT	12.5%	25.3%	31.9%	9.1%	13.3%	14.9%
PAT (Excl. Extra-ordinaries)	**11.7%**	**24.7%**	**30.5%**	**8.4%**	**13.3%**	**14.9%**

 # The FY09 financials does not include the impact of the planned restructuring activity (separating out the generics business into a separate entity) that the company had announced

The Story…

We recently met with the management of Glenmark Pharmaceuticals Ltd. (GLEN.BO/GNP.IN) and came back with a positive view on the company. In spite of the company recording a topline growth of merely 11% in H1FY10, management remains quite confident of achieving it earlier topline growth guidance of 20-25% for the full year, on the back of a robust growth in the key markets of US, Latin America, and Europe, as well as India. Hence, H2FY10 is expected to be a far healthier period for Glenmark vis-à-vis H1FY10. Given the continued healthy performance expected from the key markets and the company's entry into newer markets, such as Australia and China, management continues to expect a topline growth of 20-25% going forward as well. Also, management has reiterated its FY10 consolidated net profit guidance of Rs.3-4 bn and expects to strike at least one R&D licensing deal at the earliest. Post our discussion with management, we are moderately raising our FY10 and FY11 EPS estimates from Rs.12.8 and Rs.15.5 to Rs.13.5 and Rs.18.1 respectively. Despite the short-term challenges currently being faced by Glenmark (delay in striking of out-licensing deal and setbacks in a few key markets, such as the US and Latin America), we continue to believe that the company's business model is among the best in the Indian Pharma sector. Glenmark's base business has grown at a respectable space and the company has also achieved major milestones in its NCE business. Glenmark is the only Indian Pharma company that has succeeded in bagging three world-class out-licensing deals and earned cumulative revenues of about $110 mn. Thus, to our mind, the stock deserves to trade at a premium to the sector average.

At 13x its FY11E earnings, the stock continues to trade at a significant discount to the industry average of 20x, indicating that their still remains sufficient room for further multiple expansion. With the valuations at a discount to the industry average and an overall improvement expected in the company's fundamentals, we believe that the risk-reward ratio for Glenmark remains quite favourable at the current levels. In view of the above factors, we had recently upgraded the stock to 'Moderate Outperform' and since then; it is up 18%, outperforming the NIFTY by 9 percentage points. With the emerging markets expected to witness a rebound in H2FY10, an outlicensing deal likely to be struck at the earliest, a reduction in the high debt levels post the cash infusion via the QIP and IPO routes, and improvement in business prospects, the overall outlook for Glenmark appears quite strong. The significant improvement expected in Glenmark's base business performance in H2FY10E, the striking of at least one R&D licensing deal in FY10E and the proposed IPO of Glenmark Generics (GGL) at a valuation of about $1 bn (Glenmark's current market cap is $1.4 bn) are likely to act as the key triggers. We reiterate our 'Moderate Outperform' rating on Glenmark.

With the valuations at a discount to the industry average and an overall improvement expected in the company's fundamentals, we believe that the risk-reward ratio for Glenmark remains quite favourable at the current levels...

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Comparative Valuations-Indian Pharma peers

Company	EPS (Rs.)		P/E (x)		P/S (x)		P/BV (x)		EV/EBITDA (x)		EV/Sales (x)		RoE (%)	RoCE (%)	EBITDA (%)	Y-o-Y Growth (%)	
																EPS	Revenues
	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY10E	FY10E	(FY11E/FY10E)	
Glenmark	**13.5**	**18.1**	**17.7**	**13.3**	**2.3**	**1.9**	**3.0**	**2.3**	**13.0**	**9.9**	**2.9**	**2.3**	**18.8%**	**12.6%**	**22.6%**	**33.8%**	**19.7%**
Ranbaxy	6.1	13.5	70.5	31.9	2.5	2.2	6.5	6.0	33.5	20.1	2.9	2.7	8.6%	6.3%	8.8%	121.1%	12.2%
Dr.Reddy's	44.7	52.5	24.9	21.2	2.6	2.3	4.4	3.8	14.3	12.1	2.7	2.4	19.0%	13.2%	18.8%	17.6%	10.7%
Cipla	14.6	16.4	21.8	19.4	4.2	3.7	4.7	3.9	20.3	17.3	4.2	3.6	23.1%	19.3%	20.6%	12.5%	13.2%
Sun Pharma	57.2	83.3	25.6	17.6	7.6	6.3	4.4	3.3	27.5	16.7	7.4	5.8	16.6%	16.7%	26.8%	45.6%	19.9%
Biocon@	14.6	17.0	17.7	15.2	2.2	1.9	3.0	2.6	11.4	9.5	2.4	2.0	17.5%	14.0%	20.8%	16.7%	14.1%
Lupin	74.4	87.3	18.5	15.8	2.5	2.1	5.7	5.6	15.7	13.4	2.7	2.3	35.1%	21.7%	17.1%	17.3%	18.9%
Divi's	22.8	28.8	25.8	20.5	8.3	6.8	4.7	4.0	19.8	14.9	7.8	6.1	23.0%	21.9%	39.4%	25.9%	22.3%
Orchid Pharma	9.5	25.9	19.3	7.1	0.8	0.7	1.6	1.2	8.2	6.4	2.3	1.8	9.0%	7.9%	27.6%	173.0%	17.9%
Jubilant Org	28.4	34.2	10.4	8.6	1.1	1.0	2.9	2.5	9.1	7.5	1.9	1.6	32.0%	11.2%	20.9%	20.2%	13.5%
Average			**29.3**	**19.9**	**4.3**	**3.7**	**4.7**	**4.1**	**21.4**	**15.3**	**4.4**	**3.7**	**19.8%**	**15.4%**	**1583.9%**	**40.1%**	**15.5%**

Key Highlights

Key takeaways from our discussion with Glenmark's management on November 27, 2009:

- ***Earnings recovery witnessed in Q1 FY10 and Q2 FY10 to continue***
- ***Growth in the US market expected to be back on track***
- ***Two deals struck with Medicis Pharma Corporation***
- ***Revenue from Latin America to remain robust due to reorganization measures underway***
- ***Entry into newer markets, restructuring of operations in emerging markets, like Brazil and Russia, and continued robust growth in domestic market and other key markets to facilitate topline growth of 20-25% Y-o-Y in FY10, as well as going forward***
- ***Pressure on EBIDTA margin witnessed in FY09 and H1FY10 to gradually ease***
- ***Bottomline of Rs.3-4 bn expected for FY10 and a much robust performance anticipated, going forward***
- ***Tight control being maintained on working capital***
- ***Huge debt burden likely to be brought down significantly, with management targeting a debt:equity ratio of 1-1.5x by the end of FY10***
- ***Major Capex is being completed in FY09 and normal Capex levels are expected ahead***
- ***Management expects to strike at least one NCE outlicensing deal at the earliest***
- ***The company has a strong ANDA pipeline and decent FTF basket with a market potential of about $1.6 bn, on which it expects to capitalize by FY11.***

Earnings recovery continues

Topline & bottomline performance over past few quarters

Figures in Rs. Mn	Q2 FY08	Q3 FY08	Q4 FY08	Q1 FY09	Q2 FY09	Q3 FY09	Q4 FY09	Q1 FY10	Q2 FY10
Total revenues (excl. outlicensing revenues)	3749	5001	5213	4608	5597	5814	4911	5437	5903
Revenue growth (%) (Y-o-Y)	*46.6%*	*63.1%*	*45.5%*	*28.2%*	*49.3%*	*16.3%*	*-5.8%*	*18.0%*	*5.5%*
Revenue growth (%) (Q-o-Q)	*4.3%*	*33.4%*	*4.2%*	*-11.6%*	*21.5%*	*3.9%*	*-15.5%*	*10.7%*	*8.6%*
Net earnings	751	2800	2198	1154	1174	814	-1207	535	809
Net earnings growth (%) (Y-o-Y	*86.9%*	*48.2%*	*247.5%*	*101.9%*	*56.2%*	*-70.9%*	*-154.9%*	*-53.7%*	*-31.1%*
Net earnings growth (%) (Q-o-Q)	*31.5%*	*272.7%*	*-21.5%*	*-47.5%*	*1.7%*	*-30.6%*	*-248.2%*	*-144.3%*	*51.3%*

Following the overall disappointing performance (both on the topline as well as bottomline front) exhibited in Q3 FY09 and Q4 FY09 respectively, due to a delay in ANDA approvals for the US market and currency devaluation in markets, such as Latin America, Glenmark bounced back by posting a consolidated net profit of Rs.535 mn (including forex translational losses of Rs.523 mn) in Q1 FY10 and Rs.809 mn (including forex translational losses of Rs.495 mn) in Q2 FY10. However, the company recorded a Y-o-Y decline due to the high base effect, as it had enjoyed co-exclusivity sales for generic *Trileptal (Oxcarbazepine)* in FY09. Also, Glenmark faced certain accounting issues that impacted its EBIDTA margin. The company is now expensing all its R&D related expenses in the same year itself, rather than capitalizing it over a period of time, as a result of which, the company's profitability was impacted.

In FY09, Glenmark enjoyed revenues of about $150 mn from Oxcarbazepine, which has declined to about $60 mn. Thus, the company did not record a very robust Y-o-Y revenue growth in H1FY10. Nevertheless, the company's overall revenue has been on an improving trend for the past two quarters, driven by a strong growth of 18% Y-o-Y in the domestic formulations business and a growth of 14-15% each in Europe and the RoW. With the strong performance from the domestic market expected to continue, the other markets, such as the US and Latin America witnessing a revival and the company entering newer markets, like China and Australia, management expects a topline growth of 20-25% for FY10 as well as going forward. The company's bottomline is also expected to improve with each passing quarter on the back of its strong topline performance, with its debt levels gradually declining and Capex requirements normalising. Thus, the significant reduction expected in the company's interest and depreciation expenses is likely to provide a boost to its profitability quarter after quarter.

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Growth in US market to be back on track

Sales performance of US formulations business

(Figures in Rs. mn)	Q1 FY09	Q2 FY09	Q3 FY09	Q4 FY09	Q1 FY10	Q2 FY10
US Formulation sales	1908.8	1761.3	2104.1	1563.6	1720.5	1771.2
Y-o-Y Growth (%)	*131.0%*	*117.3%*	*3.1%*	*-20.3%*	*-9.9%*	*0.6%*
Q-o-Q Seq Growth (%)	*-2.7%*	*-7.7%*	*19.5%*	*-25.7%*	*10.0%*	*2.9%*

The US business remained flat Y-o-Y as well sequentially in Q2 FY10, as Glenmark enjoyed exclusivity sales of about $150 mn on Oxcarbazepine in FY09. With competition creeping in, the product's sales have declined to about $60 mn, thus impacting Glenmark's overall US sales performance in H1FY10. However, management has maintained its full year US sales guidance of $160-180 mn. The company launched three products in Q2 FY10 and plans to launch another five products in the coming quarters.

Glenmark also recently signed two deals with Medicis Pharma Corporation, wherein the company: i) out licensed a specialty dermatological product for North America and received a payment of $5 mn as upfront milestone for the same and ii) entered into a settlement for the Para IV generic versions of *Loprox* gel 0.77 % and *Vanos* cream to be launched immediately and in December 2013 respectively.

Out of the two deals, the licensing deal for the anti-acne product is more lucrative, with a one-time upfront milestone income of $5 mn. Currently, the drug is in Phase III clinical trails and will take 2-3 years for commercialisation. Additionally, Glenmark could receive success-based milestones and royalty (estimated 8-10% of revenue) upon achieving certain developments milestones and royalties after the product's commercialisation. This is the first time that the company has earned income from its NDDS research activity. The product's annual size for the North American market is estimated to be $400-500 mn.

Glenmark Generics Inc., the US unit of Glenmark Generics Ltd., has settled all pending litigation with Medicis Pharmaceutical Corporation related to patent actions regarding Fluocinonide, the generic version of Medicis' Vanos cream and Ciclopirox Olamine, the generic version of Medicis' Laprox gel. Glenmark will be able to market and distribute its generic version of Vanos cream under license from Medicis by December 2013. In addition, Glenmark will have a license to launch a generic version of Laprox gel to be supplied by Medicis immediately. The product generated sales of $8 mn for a 12-month period ending September 2009. Though the deal is financially less lucrative, it eliminates litigation-related risks & costs.

Medicis is a leading independent specialty pharmaceutical company in the US that focuses primarily on the treatment of dermatological and aesthetic conditions. Hence, the use of Medicis' marketing strategies will allow Glenmark to earn higher revenues from the drug after its successful launch. The collaboration will also allow Glenmark to introduce a promising new treatment that will benefit patients. The total US dermatology market is worth around $4.3 bn and hence, there exists a huge opportunity for both the companies. The products are expected to be commercialised by 2012-13 and we, therefore, expect Glenmark to receive additional milestone and royalties by FY2013.

Thus, Glenmark's management is confident of regaining its growth momentum in the US market, which it expects to deliver a continued decent performance. A strong ANDA pipeline of 90+ products and FTF opportunities are the expected growth drivers for the US market. Glenmark has a total ANDA basket of 95 ANDAs, out of which 50 have been approved. The company filed three ANDAs in Q2 FY10 and has plans for three additional new filings in this year. It has >45 ANDAs currently pending approval. Management has targeted about 8-10 new product launches for FY11, which are expected to help Glenmark maintain its growth momentum in the US market.

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Fewer FTF opportunities likely in FY11

Product	Brand Name	Patent Holder	IMS Sales (YE Mar'09)
Ezetimide	Zetia	Schering Plugh	USD 1.4 bn
Trandolapril+Verapamil	Tarka	Abbott/Sanofi-Aventis	USD 72 mn
Fluticasone Lotion 0.005%	Cultivate	Nycomed	USD 37 mn

Ezetimide: For this FTF opportunity, Glenmark is likely to go in for a settlement with Merck/Schering Plough by October 2010 and expects to enter the market thereafter.

Tarka: A judgement related to this FTF is expected by April 2010, after which Glenmark will evaluate options to launch the molecule.

Cultivate: Glenmark plans to capitalize on this opportunity by mid 2010.

Thus, Glenmark plans to capitalize on these FTF opportunities in FY11, which addresses a total market potential of about $1.5 bn and will facilitate a much more robust performance from the US market, which in turn, will help the company record a robust topline and bottomline growth. Excluding these FTF upsides and in view of a continued strong performance in the key markets, such as the US, Latin America, Europe and India, we expect Glenmark to post a healthy Y-o-Y topline and bottomline growth of 20% and 34% respectively in FY11.

Strong growth in domestic market & entry into newer markets to drive topline growth of 20-25% in FY10 and beyond

In Q2 FY10, the domestic market and semi-regulated markets recorded a healthy growth of 18% Y-o-Y and 14% Y-o-Y respectively. Revenue from the Indian formulations business was up 18% Y-o-Y, with the company launching six new products in the market and increasing its market share in existing brands. Out of the company's overall growth, 6-7% came from the new launches, while price contributed 3-4%. Glenmark is targeting 6-7 new product launches/quarter for the domestic market on an ongoing basis and expects to continue outgrowing the Indian Pharma market.

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SRMs are also witnessing a positive trend, especially in secondary sales in some of the key markets. Latam was down 30% Y-o-Y (the Indian Rupee appreciated by 2% against the Brazilian currency), but grew sequentially. In the Latin American market, Glenmark is shifting from the tender based business to the prescription-based business, which impacted its overall performance in FY09. With a majority of the re-organization activities now completed, the growth in LatAm/SRM should pick up from hereon, as most of the de-stocking issues are over and the markets are expected to return to normalcy in the coming quarters. Also, the growth in Europe is expected to remain robust and Glenmark has entered Western Europe with four products.

Thus, in spite of a topline growth of 11% Y-o-Y in H1FY10, management remains confident of achieving its earlier topline growth guidance of 20-25% and expects a continued strong topline growth of 20%+ going forward as well. For FY10 and FY11, we estimate a topline of Rs.25.9 bn and Rs.31.0 bn, marking a healthy growth of 22% Y-o-Y and 20% Y-o-Y respectively.

Pressure on EBIDTA margins likely to ease

EBIDTA margin trends

	FY08	FY09	Q1 FY10	Q2 FY10
EBIDTA margin (%)	40.6%	22.9%	23.0%	28.0%

Glenmark's EBIDTA margin came under some strain in FY09 and H1FY10 on account of the pressure witnessed in certain markets, such as Latin America and the US. Also, Glenmark changed its accounting policy for R&D expenditure and the company is now expensing all the R&D related expenditure in its P&L in that year itself, unlike its earlier trend of capitalizing it over a period of time. These factors impacted the company's overall margins in FY09.

Glenmark expects to incur lower research and development (R&D) spending for the full year FY10 than what it had previously anticipated, due to a delay in some studies of new drugs. Glenmark expects to spend $30-35 mn for the full year, down from its earlier target of $40-45 mn. Some of Glenmark's projects on the NCE (new chemical entity) front have been postponed, which will result in lower R&D expenses for FY10. For FY11, Glenmark expects to incur an R&D expenditure of Rs.1.6-1.8 bn, as against Rs.900 mn in FY09. Thus, with the key markets normalizing and R&D expenditure likely to be moderate in FY10, the company expects its overall margins to remain flat in FY10 and record a moderate Y-o-Y improvement in FY11.

Huge debt burden likely to reduce gradually

Glenmark also plans to utilize a part of the money raised from the proposed IPO of Glenmark Generics Ltd. to further bring down its debt levels and expects a debt: equity ratio of 1 to 1.5x by the end of FY11. This, in turn, will reduce the company's interest costs, going forward, and drive an improvement in its profitability

Glenmark had a total debt of about Rs.21 bn at the end of FY09. The company's recently raised QIP worth Rs.4 bn was utilized entirely to retire a part of the debt, thus taking its current debt level to around Rs.17 bn. Glenmark also plans to utilize a part of the money raised from the proposed IPO of Glenmark Generics Ltd. to further bring down its debt levels and expects a debt: equity ratio of 1 to 1.5x by the end of FY11. This, in turn, will reduce the company's interest costs, going forward, and drive an improvement in its profitability.

Capex levels to normalise

Glenmark incurred a huge capex of Rs.5.2 bn and Rs.9.6 bn in FY08 and FY09 respectively, which resulted in a significant increase in its depreciation expenses. In H1FY10, the company's depreciation expenses were up 53% Y-o-Y, thus impacting its overall profitability. A majority of the capex was incurred for making certain brand acquisitions in Poland worth $30 mn, setting up formulations sites in India (Nashik and Goa), developing sites in Brazil, Argentina, and Szlovakia, building a clinical centre in Vashi, Navi Mumbai, etc. Management has guided for an overall capex of $20-25 mn for FY10-11 and the company has already spent around Rs.500 mn in H1FY10.

In view of the anticipated topline improvement, reduction in debt and lower capex spending for FY10-11, we expect an improvement in the company's profitability and estimate a bottomline growth of 93% Y-o-Y and 34% Y-o-Y in FY10 and FY11 respectively.

NCE pipeline ripe for providing further benefits

Glenmark has a pipeline of seven NCE and NBE molecules in clinical trials. In addition, the company has one in-licensed molecule, Crofelemer, which continues to progress well in Phase III clinical testing and interim Phase III data on the molecule is expected in the next 1-2 months. Glenmark expects to initiate the product's launch in Q4 FY10 and in rest of the world markets by FY11, thereby marking the company's first innovative product launch globally.

Crofelemer's launch in the rest of the world markets is expected in FY11 and management expects peak sales of $80 mn in 2-3 years, accompanied by decent profits, as the company expects to price it at a premium to the currently available treatment options in the target indication (HIV-related diarrhoea). Management further expects one outlicensing deal by the year-end (likely Melogliptin). In addition, it expects Phase IIb data in asthma studies for Oglemilast by Q4 FY10.

Progress of pipeline molecules that have entered clinical studies

Molecule	Target Launch	Indication	Outlicensing partners	Deal size ($ mn)	Milestone received ($ mn)	Comments
GRC-3886 (Oglimilast)	2011	Asthma, COPD	Forest in the US and Teijin in Japan	243	41	Forest is carrying out Phase IIb studies in asthma and its results are expected in Jan-Feb 2010
Revamilast	2012	Asthma, COPD. Also being studied for RA and Multiple Sclerosis	-	-	-	Currently undergoing Phase II studies. A follow up product to Oglimilast, in case Oglimilast fails
GRC-8200 (Melogliptin)	2012	Type II diabetes	Merck was the licensing partner in the US, but has pulled out	238	38	Phase IIb trials completed and would be soon entering Phase III trials. Another outlicensing partner expected in the next 6-12 months
GRC-6211	2012	Neuropathic pain	Eli Lilly for US, but has stopped trials on the molecule	350	45	Was undergoing Phase II trials and Eli Lilly has now stopped trials on the molecule
GRC-4039	2012	Rheumatoid arthritis, inflammation, Multiple sclerosis	-	Not yet licensed out		Phase I trials completed. To enter Phase II in Q2FY10
GRC-10693	2013	Neuropathic pain, osteoarthritis	-	Not yet licensed out		To initiate Phase IIb studies before the end of FY10
GRC-15300	2013	Osteoarthritic pain, Neuropathic pain, and other inflammatory pain conditions	-	Not yet licensed out		Received approval for Phase I trials with MHRA, UK. Glenmark plans to initiate Phase 1 testing in November 2009.
GBR-500	2014	Anti-inflammatory, Multiple Sclerosis	-	Not yet licensed out		Entered Phase I studies in US, which is likely to complete by FY10
GBR-600	2014	Anti-platelet monoclonal antibody	-	Not yet licensed out		To shortly enter Phase I studies, approval received from UKMHRA to commence Phase I studies

Tight control maintained on working capital

Key Working Capital Ratios

	FY06	FY07	FY08	FY09
Debtor days	184	165	147	165
Creditor days	70	73	72	77
Inventory days	102	124	124	141

The global market conditions and Glenmark's entry into new markets adversely impacted its working capital management, with its debtor and inventory levels increasing significantly in FY09. Management is now keeping a tight control on working capital and succeeded in bringing down the working capital cycle by about 10 days in H1FY10, with a further improvement of ten days expected in H2FY10. Thus, the company's working capital cycle is expected to improve, going forward.

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Free cash flow likely to turn positive in FY10

Glenmark's higher working capital requirements, increased capex and pressure on NOPLAT resulted in its free cash flow remaining in negative territory in FY09.

Free Cash Flow Analysis

Free Cash Flow Analysis YE March 31st (Figures in Rs. mn)	FY 06	FY 07	FY08	FY09	FY10E	FY11E
EBITA	**1,163**	**3,860**	**7,331**	**3,820**	**4,554**	**5,806**
Less: Adjusted Taxes	250	548	818	1,071	911	1,219
NOPLAT	**914**	**3,313**	**6,513**	**2,749**	**3,643**	**4,587**
Plus: Depreciation	232	423	717	1,027	1,313	1,463
Gross Cashflow	**1,146**	**3,735**	**7,230**	**3,776**	**4,956**	**6,049**
Less: Increase in Working Capital	1,853	3,212	4,361	4,159	65	1,128
Operating Cashflow	**-708**	**523**	**2,869**	**-383**	**4,891**	**4,921**
Less: Net Capex	2,534	2,722	5,170	9,586	2,786	2,650
Less: Increase in Net Other Assets	-323	-402	-239	17	-855	-802
FCF From Operation	**-2,919**	**-1,797**	**-2,062**	**-9,986**	**2,960**	**3,073**
Less: Inc./(Dec.) in Investment	45	-10	1	-7	0	0
FCF after Investment	**-2,964**	**-1,787**	**-2,063**	**-9,979**	**2,960**	**3,073**
Plus: Gain/(loss) on Extraordinary Items	53	80	289	132	0	0
Total FCF	**-2,911**	**-1,707**	**-1,774**	**-9,848**	**2,960**	**3,073**

However, given the expected normalisation of capex, reduction in working capital and improvement in overall performance, the company's free cash flow is expected to turn positive from FY10 onwards.

IPO listing of Glenmark Generics Limited (GGL)

For the IPO listing (IPO will be Rs.5.75 bn) of Glenmark Generics, Glenmark has filed the Draft Red Herring Prospectus (DRHP) and a part of the IPO proceeds are likely to be utilized to further retire the company's debt.

IMPORTANT DISCLOSURES

Price Target

Price targets (if any) are derived from a subjective and/or quantitative analysis of financial and nonfinancial data of the concerned company using a combination of P/E, P/Sales, earnings growth, and its stock price history.

The risks that may impede achievement of the price target/investment thesis are -

- **Significant upsides on the clinical research front/pipeline setbacks**
- **Ability of the management to strike an out-licensing deal for any of its research molecules**
- **Inability to turnaround and capitalize its recent acquisitions**
- **Litigation setbacks**

First Global's Rating System

Our rating system consists of three categories of ratings: Positive, Neutral and Negative. Within each of these categories, the rating may be absolute or relative. When assigning an absolute rating, the price target, if any, and the time period for the achievement of this price target, are given in the report. Similarly when assigning a relative rating, it will be with respect to certain market/sector index and for a certain period of time, both of which are specified in the report.

Rating in this report is relative to: CNX Nifty Index

Positive Ratings

(i) Buy (B) *– This rating means that we expect the stock price to move up and achieve our specified price target, if any, over the specified time period.*

(ii) Buy at Declines (BD) *– This rating means that we expect the stock to provide a better (lower) entry price and then move up and achieve our specified price target, if any, over the specified time period.*

(iii) Outperform (OP) *– This is a relative rating, which means that we expect the stock price to outperform the specified market/sector index over the specified time period.*

Neutral Ratings

(i) Hold (H) *– This rating means that we expect no substantial move in the stock price over the specified time period.*

(ii) Marketperform (MP) *– This is a relative rating, which means that we expect the stock price to perform in line with the performance of the specified market/sector index over the specified time period.*

Negative Ratings

(i) Sell (S) *– This rating means that we expect the stock price to go down and achieve our specified price target, if any, over the specified time period.*

(ii) Sell into Strength (SS) *– This rating means that we expect the stock to provide a better (higher) exit price in the short term, by going up. Thereafter, we expect it to move down and achieve our specified price target, if any, over the specified time period.*

(iii) Underperform (UP) *– This is a relative rating, which means that we expect the stock price to underperform the specified market/sector index over the specified time period.*

(iv) Avoid (A) *– This rating means that the valuation concerns and/or the risks and uncertainties related to the stock are such that we do not recommend considering the stock for investment purposes.*

FG Markets, Inc.
90 John Street, Suite 703,
New York, NY 10038
Dealing Desk (US):
Tel. No.: +1-212-227 6611
Email: us@fglobal.com

FIRST GLOBAL
Nirmal, 6th Floor, Nariman Point,
Mumbai - 400 021, India.
Dealing Desk (India):
Tel. No.: +91-22-400 12 400
Email: fgasiasales@bloomberg.net

FIRST GLOBAL (UK) Ltd.
13, Regent Street, London SW1Y 4LR,
United Kingdom
Dealing Desk (UK & Europe):
Tel. No.: +44-207-959 5300
Email: uk@fglobal.com