

Company Flash

18 September 2007 | 8 pages

Glenmark Pharmaceuticals (GLEN.BO)

Buy: Active Months Ahead

- A lot of action ahead** — Our meeting with the management indicates that the next few months would be critical on the R&D front. It is awaiting the US FDA's response on Oglemilast, even as it continues outlicensing discussions on GRC-6211. Besides, 2 more NCEs are set to enter the clinic over the next 2 months. We reiterate Glenmark as the best innovative R&D play in Indian pharma.
- Waiting to hear from FDA on Oglemilast** — Forest & Glenmark have submitted the pre-clinical data required by the US FDA on Oglemilast, and expect a reply over the next few months. The management is confident of a positive response from the FDA, which will pave the way for large-scale phase II trials and, we believe, will trigger off the next milestone payment for Glenmark.
- More moving to the clinic** — Glenmark expects GRC-4039 (PDE4 inhibitor for RA & multiple sclerosis) & GRC-10693 (CB2 agonist for pain) to enter the clinic by Sept & October end respectively. With this, Glenmark will have 5 NCEs in the clinic by CY07 end – each being a potential outlicensing candidate.
- Two outlicensing deals by end FY08** — Glenmark reiterated that it will conclude 2 R&D deals by end FY08. With 3 non-partnered molecules in the clinic, we believe this is quite possible and could act as strong catalysts for the stock.
- Steady base business** — Glenmark's base business continues to witness good traction, especially in the US and LatAm markets. The management indicated that it has built in adequate buffer in its earnings guidance to make up for the sharp appreciation in the rupee.

Buy/Medium Risk	1M
Price (18 Sep 07)	Rs380.55
Target price	Rs427.00
Expected share price return	12.2%
Expected dividend yield	0.2%
Expected total return	12.4%
Market Cap	Rs92,833M
	US\$2,294M

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	118.1	24.3	25.5	0.1
2007A	3,093	11.54	258.0	33.0	13.3	58.5	0.1
2008E	5,432	20.27	75.6	18.8	3.7	56.9	0.2
2009E	6,812	25.42	25.4	15.0	2.4	43.7	0.2
2010E	7,641	28.51	12.2	13.3	1.7	33.7	0.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	118.1	33.0	18.8	15.0	13.3
EV/EBITDA adjusted (x)	71.1	23.5	15.0	12.0	10.2
P/BV (x)	24.3	13.3	3.7	2.4	1.7
Dividend yield (%)	0.1	0.1	0.2	0.2	0.2
Per Share Data (Rs)					
EPS adjusted	3.22	11.54	20.27	25.42	28.51
EPS reported	3.22	11.54	20.27	25.42	28.51
BVPS	15.65	28.58	101.73	157.68	220.52
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	-11,061	-13,545	-16,177
EBIT	1,140	3,840	6,198	7,538	8,444
Net interest expense	-147	-384	-125	0	0
Non-operating/exceptionals	128	157	165	302	555
Pre-tax profit	1,121	3,613	6,238	7,840	8,999
Tax	-241	-513	-797	-1,020	-1,350
Extraord./Min.Int./Pref.div.	-16	-8	-8	-8	-8
Reported net income	864	3,093	5,432	6,812	7,641
Adjusted earnings	864	3,093	5,432	6,812	7,641
Adjusted EBITDA	1,372	4,263	6,603	7,953	8,888
Growth Rates (%)					
Sales	23.3	74.1	41.2	22.2	16.8
EBIT adjusted	-18.2	237.0	61.4	21.6	12.0
EBITDA adjusted	-11.9	210.7	54.9	20.5	11.7
EPS adjusted	-20.9	258.0	75.6	25.4	12.2
Cash Flow (RsM)					
Operating cash flow	-268	932	4,314	4,703	5,912
Depreciation/amortization	232	423	405	416	444
Net working capital	-1,657	-3,263	-1,815	-2,737	-2,451
Investing cash flow	-2,568	-2,688	-735	-200	-500
Capital expenditure	-2,553	-2,711	-735	-200	-500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	2,505	1,891	-4,481	-1,354	-104
Borrowings	2,886	2,088	-4,266	-1,250	0
Dividends paid	-205	-117	-90	-104	-104
Change in cash	-331	136	-901	3,150	5,308
Balance Sheet (RsM)					
Total assets	13,416	19,346	21,925	28,514	37,249
Cash & cash equivalent	1,056	1,058	156	3,306	8,614
Accounts receivable	3,816	5,712	7,615	9,884	11,866
Net fixed assets	5,805	8,104	8,435	8,219	8,275
Total liabilities	9,502	12,482	9,712	9,584	10,773
Accounts payable	1,719	2,329	3,664	4,582	5,502
Total Debt	7,354	9,367	5,102	3,852	3,852
Shareholders' funds	3,915	6,864	12,214	18,930	26,476
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.5	34.9	38.3	37.7	36.1
ROE adjusted	25.5	58.5	56.9	43.7	33.7
ROIC adjusted	10.6	25.4	32.1	34.0	32.7
Net debt to equity	160.9	121.1	40.5	2.9	-18.0
Total debt to capital	65.3	57.7	29.5	16.9	12.7

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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 Rs427/share. Our positive outlook on the stock takes into consideration the following: a) R&D pipeline has broadened with six molecules expected by the company to be in the clinic by mid-CY07; b) With two molecules licensed out, the R&D option value or value at risk is now spread across two molecules; c) the base business has witnessed significant traction, especially in the USA and Latin America; d) potential risk triggers still appear some way off, while potential nearer-term catalysts exist - especially in the form of a fresh R&D out licensing deal. We believe that with the faster than expected scale-up in the base business, the option value built into the stock for its R&D efforts (primarily Oglemilast & GRC-8200) has fallen. The risk reward, we believe, is thus in favor of investors, especially as the potential risk triggers that could lead to partial or full erosion of the option value appear some way off, while there remain potential upside catalysts over the next few months.

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 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 Rs119/share for Oglemilast. We use a similar approach for GRC-8200 and arrive at a value of Rs45/share. 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 mid-FY09E earnings, we value Glenmark's base business at Rs263/share. This takes the total valuation of the company to Rs427/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

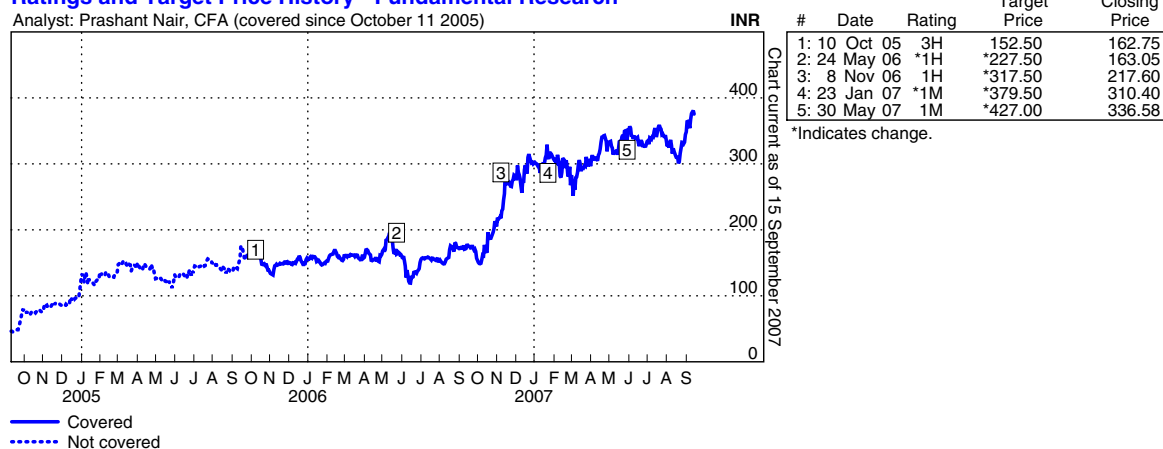
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Analyst: Prashant Nair, CFA (covered since October 11 2005)



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