29 July 2008 | 11 pages

# Glenmark Pharmaceuticals (GLEN.BO)

## Buy: 1Q Revenues Miss Estimates; Full Year on Course

- **Buy (1M)** — despite lower than expected top line in 1QFY09, as we believe that the miss is due to a combination of one-off factors, & Glenmark remains on course to achieve our full-year estimates. We believe Glenmark offers investors a combination of India's innovative R&D play & a quality generics business.
- **Revenue miss** — Sales growth, while healthy (30% YoY), missed our estimate due to declines in the speciality businesses in Latin America (down 36% YoY) & semi-regulated markets (down 12% YoY). The former was due to absence of institutional/tender business that was present in 1QFY08 while correction of pipeline stocks led to the latter. However, given the healthy growth in secondary sales, we believe that revenues will normalize over FY09.
- **Lower tax props net income** — Despite the top-line miss flowing through to PBT, net income was in-line due to lower effective tax rate. EBIDTA margins (up 142 bps to 30.6%) were also in-line despite higher than average staff cost, & reflects the benefits of operating leverage & improving sales mix.
- **Key earnings call takeaways** — a) FY09 guidance maintained with Latam & semi-regulated markets sales expected to bounce back over the rest of the year; b) 4 NCEs each in clinic & pre-clinical trials – GNP expects to commence P-I trials on its lead NBE in Aug'08 & to conclude 2 licensing deals in FY09; c) Glenmark Generics IPO on hold due to weak market conditions.

| Buy/Medium Risk | 1M |
|---|---|
| Price (28 Jul 08) | Rs672.30 |
| Target price | Rs770.00 |
| Expected share price return | 14.5% |
| Expected dividend yield | 0.1% |
| **Expected total return** | **14.7%** |
| Market Cap | Rs168,147M<br>US$3,988M |

**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 (%) |
|---|---|---|---|---|---|---|---|
| 2006A | 864 | 3.22 | -20.9 | nm | 43.0 | 25.5 | 0.1 |
| 2007A | 3,093 | 11.54 | 258.0 | 58.3 | 23.5 | 58.5 | 0.1 |
| 2008E | 6,305 | 23.53 | 103.9 | 28.6 | 12.5 | 63.8 | 0.1 |
| 2009E | 8,215 | 30.66 | 30.3 | 21.9 | 7.7 | 48.7 | 0.1 |
| 2010E | 10,866 | 40.55 | 32.3 | 16.6 | 5.1 | 41.6 | 0.1 |

Source: Powered by dataCentral

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**See Appendix A-1 for Analyst Certification and important disclosures.**


[1]Citigroup Global Markets India Private Limited

| Fiscal year end 31-Mar | 2006 | 2007 | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | nm | 58.3 | 28.6 | 21.9 | 16.6 |
| EV/EBITDA adjusted (x) | 126.0 | 41.1 | 21.8 | 17.3 | 12.8 |
| P/BV (x) | 43.0 | 23.5 | 12.5 | 7.7 | 5.1 |
| Dividend yield (%) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 3.22 | 11.54 | 23.53 | 30.66 | 40.55 |
| EPS reported | 3.22 | 11.54 | 23.53 | 30.66 | 40.55 |
| BVPS | 15.65 | 28.58 | 53.70 | 86.78 | 130.89 |
| DPS | 0.35 | 0.40 | 1.00 | 1.00 | 1.00 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 7,020 | 12,220 | 19,783 | 26,457 | 35,058 |
| Operating expenses | -5,880 | -8,380 | -12,468 | -17,146 | -22,631 |
| **EBIT** | **1,140** | **3,840** | **7,315** | **9,311** | **12,427** |
| Net interest expense | -147 | -384 | -637 | 0 | 0 |
| Non-operating/exceptionals | 128 | 157 | 446 | 142 | 367 |
| **Pre-tax profit** | **1,121** | **3,613** | **7,124** | **9,453** | **12,793** |
| Tax | -241 | -513 | -811 | -1,229 | -1,919 |
| Extraord./Min.Int./Pref.div. | -16 | -8 | -8 | -8 | -8 |
| **Reported net income** | **864** | **3,093** | **6,305** | **8,215** | **10,866** |
| Adjusted earnings | 864 | 3,093 | 6,305 | 8,215 | 10,866 |
| Adjusted EBITDA | 1,372 | 4,263 | 8,031 | 9,937 | 13,118 |
| **Growth Rates (%)** | | | | | |
| Sales | 23.3 | 74.1 | 61.9 | 33.7 | 32.5 |
| EBIT adjusted | -18.2 | 237.0 | 90.5 | 27.3 | 33.5 |
| EBITDA adjusted | -11.9 | 210.7 | 88.4 | 23.7 | 32.0 |
| EPS adjusted | -20.9 | 258.0 | 103.9 | 30.3 | 32.3 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **-268** | **932** | **4,658** | **5,017** | **6,493** |
| Depreciation/amortization | 232 | 423 | 716 | 626 | 691 |
| Net working capital | -1,657 | -3,263 | -3,195 | -4,078 | -5,456 |
| **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** | **-3,912** | **-2,804** | **-282** |
| Borrowings | 2,886 | 2,088 | -2,993 | -2,523 | 0 |
| Dividends paid | -205 | -117 | -282 | -282 | -282 |
| **Change in cash** | **-331** | **136** | **-788** | **1,212** | **5,212** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **13,416** | **19,346** | **24,675** | **31,955** | **45,140** |
| Cash & cash equivalent | 1,056 | 1,058 | 269 | 1,482 | 6,693 |
| Accounts receivable | 3,816 | 5,712 | 8,690 | 11,858 | 16,188 |
| Net fixed assets | 5,805 | 8,104 | 8,923 | 9,297 | 9,606 |
| **Total liabilities** | **9,502** | **12,482** | **11,780** | **11,119** | **13,711** |
| Accounts payable | 1,719 | 2,329 | 4,432 | 6,048 | 8,256 |
| Total Debt | 7,354 | 9,367 | 6,374 | 3,852 | 3,852 |
| **Shareholders' funds** | **3,915** | **6,864** | **12,895** | **20,836** | **31,429** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 19.5 | 34.9 | 40.6 | 37.6 | 37.4 |
| ROE adjusted | 25.5 | 58.5 | 63.8 | 48.7 | 41.6 |
| ROIC adjusted | 10.6 | 25.4 | 36.6 | 36.7 | 38.7 |
| Net debt to equity | 160.9 | 121.1 | 47.3 | 11.4 | -9.0 |
| Total debt to capital | 65.3 | 57.7 | 33.1 | 15.6 | 10.9 |

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Powered by: dataCentral

# 1Q Revenues Miss Estimates; FY09 on Course

**We maintain our Buy/Medium Risk (1M) rating on Glenmark despite lower than expected top line in 1QFY09, as we believe that the miss is due to a combination of one-off factors, & Glenmark remains on course to achieve our full-year estimates. We believe Glenmark offers investors a combination of India's innovative R&D play & a quality generics business**

## 1QFY09 Results Snapshot

**Figure 1. Consolidated Earnings Summary (Rs m, Percent)**

| YE Mar 31 | 1Q FY08 | 1Q FY09 | % Ch YoY | 4Q FY08 | % Ch QoQ |
|---|---|---|---|---|---|
| Gross Sales | 3,594 | 4,665 | 29.8 | 5,213 | (10.5) |
| *Excise Duty* | *81* | *56* | *(30.3)* | *95* | *(41.0)* |
| **Net sales** | **3,514** | **4,608** | **31.2** | **5,117** | **(9.9)** |
| R&D Income | - | - | nm | 610 | nm |
| Net Revenues | 3,514 | 4,608 | 31.2 | 5,727 | (19.5) |
| Material cost | 984 | 1,271 | 29.1 | 2,022 | (37.2) |
| *% of Net Sales* | *28.0* | *27.6* | *-44 bps* | *39.5* | *-1194 bps* |
| Staff cost | 504 | 729 | 44.6 | 349 | 108.7 |
| Other exp | 1,000 | 1,199 | 19.9 | 1,123 | 6.8 |
| Total Expenditure | 2,489 | 3,199 | 28.5 | 3,494 | (8.4) |
| **EBITDA (Excld Milestones)** | **1,025** | **1,410** | **37.5** | **1,623** | **(13.2)** |
| ***EBITDA Margins (%)*** | ***29.2*** | ***30.6*** | ***142 bps*** | ***31.7*** | ***-114 bps*** |
| EBITDA (Including Milestones) | 1,025 | 1,410 | 38 | 2,233 | (36.9) |
| Interest | 144 | 155 | 8.1 | 160 | (3.2) |
| Depreciation | 143 | 215 | 50.4 | 242 | (10.9) |
| Other income | 25 | 109 | 339.9 | 341 | (68.0) |
| PBT | 763 | 1,148 | 50.5 | 2,172 | (47.1) |
| Tax | 191 | (5) | (102.8) | (17) | (69.0) |
| *Effective Tax rate* | *25.1* | *(0.5)* | *nm* | *(0.8)* | *33 bps* |
| Net Profit | 572 | 1,154 | 101.9 | 2,190 | (47.3) |
| **Net Profit (Ex. Milestones, Net of Tax)** | **572** | **1,154** | **101.9** | **1,629** | **(29.2)** |

**CIR Comments**

Revenue growth driven by 131% YoY growth in US sales – however, misses our estimate due to lower sales in Latam & semi-regulated speciality businesses.

Other expenditure includes R&D cost of Rs180m.

Higher staff cost due to rising recruitment cost, incentives & ESOPs expensed.

Other income consists of forex gain of Rs60m & other operating items.

Effective tax rate is lower than the expected annual figure of c12-15%.

Net income is in-line owing to lower tax rate; however, PBT is lower than our estimate due to lower top line.

Source: Company Reports and Citi Investment Research

**Figure 2. Consolidated Revenue Breakup (Rs m, Percent)**

| YE Mar 31 | 1Q FY08 | 1Q FY09 | % ch YoY | 4Q FY08 | % Ch QoQ |
|---|---|---|---|---|---|
| **Generics Business** | | | | | |
| USA | 826 | 1,909 | 131.0 | 1,972 | (3.2) |
| Latin America (Argentina) | 62 | 71 | 14.0 | 60 | 18.2 |
| API | 395 | 426 | 7.8 | 591 | (27.9) |
| **Total Generics** | **1,284** | **2,406** | **87.4** | **2,623** | **(8.3)** |
| **Speciality Business** | | | | | |
| **Formulations** | | | | | |
| Latin America | 490 | 312 | (36.4) | 433 | (27.9) |
| Semi Regulated Markets | 446 | 394 | (11.7) | 533 | (26.0) |
| Europe | 93 | 124 | 32.8 | 83 | 48.2 |
| India | 1,281 | 1,429 | 11.6 | 1,541 | (7.3) |
| **Total Formulations** | **2,310** | **2,259** | **(2.2)** | **2,590** | **(12.8)** |
| Outlicensing revenues | - | - | nm | 610 | nm |
| *% of Total Speciality Revenues* | *-* | *-* | *nm* | *19.1* | *nm* |
| **Total Speciality Revenues** | **2,310** | **2,259** | **(2.2)** | **3,200** | **(29.4)** |
| **Consolidated Revenues** | **3,594** | **4,665** | **29.8** | **5,822** | **(19.9)** |

**CIR Comments**

US sales boosted by oxcarbazepine sales

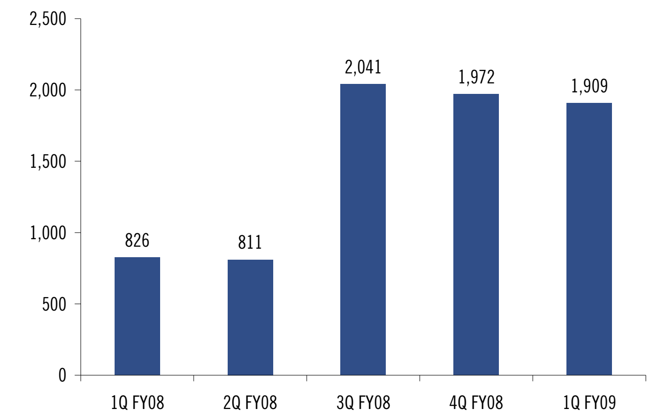
Decline in LatAm sales due to absence of institutional/ tender business that was present in 1QFY08 – as GNP focuses more on the retail business

Decline in SRM revenues due to inventory build-up; secondary sales figures indicate

Source: Company Reports and Citi Investment Research

# Update on key businesses

**Figure 3. US formulation sales – Generics Business (Rs m)**



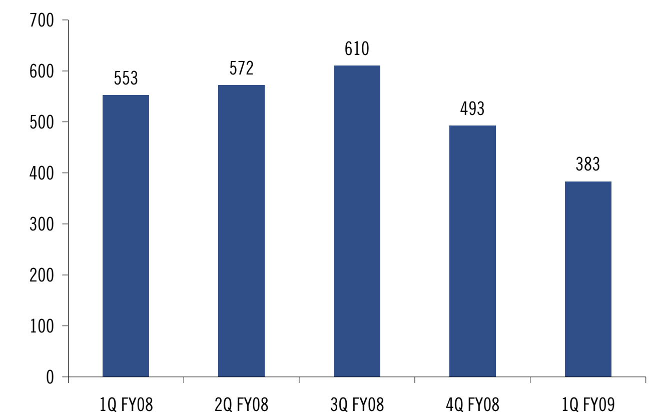

Source: Citi Investment Research

**CIR Comments**

- Ability to maintain revenues sequentially despite increased competition in oxcarba is impressive
- FDA approvals received for 3 products; 5 new products launched in the US till date in FY09
- 33 products in the market; Plans to launch 20 products in FY09
- 4 ANDAs filed during the quarter; Plans to file 8 ANDAs in 2QFY09
- 35 ANDAs pending with the FDA; 4-5 approvals expected in 2QFY09; 3 potential FTF filings

Source: Citi Investment Research

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



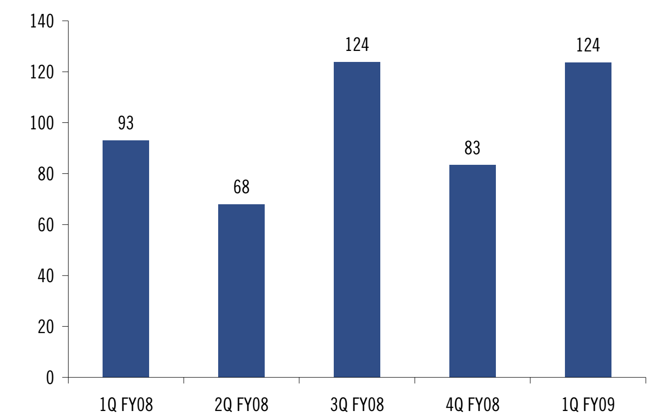

Source: Citi Investment Research

**CIR Comments**

- *Numbers include speciality as well as generics businesses*
- YoY degrowth due to lower sales in the institutional or tender business – owing to shift in focus to the retail business
- Latam speciality business declined 36% YoY but Latam generics business grew 14% YoY
- IMS reflects 89% YoY growth in Brazil sales
- Two inlicensed products added to the Oncology portfolio
- One product launched in Ecuador & Venezuela

Source: Citi Investment Research

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



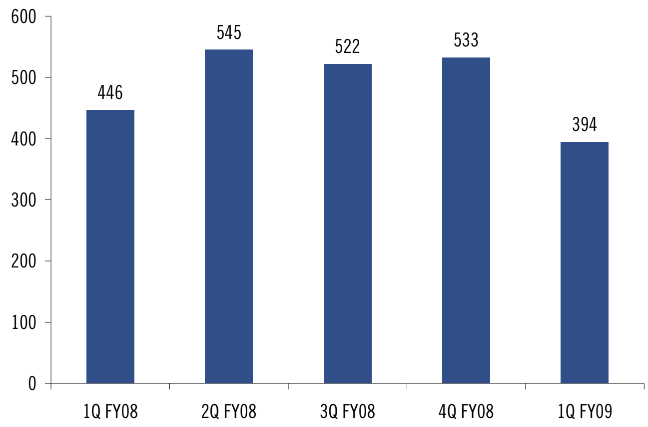

Source: Citi Investment Research

**CIR Comments**

- Revenues up 32% YoY in 1QFY09
- Initiated operations in Romania & Poland. 4-5 products to be launched in Poland in CY08. Acquired marketing rights for Aflen, a cardiovascular drug, in Romania
- In discussions to potential targets to initiate generic operations in Western Europe
- 7 MAAs filed in the quarter; 8 product submissions planned for the year

Source: Citi Investment Research

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



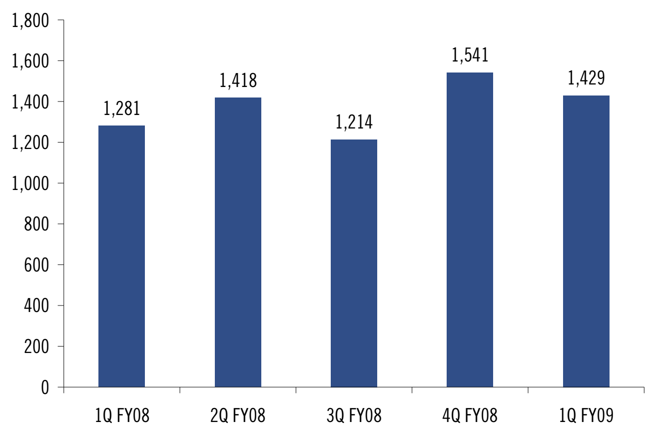

Source: Citi Investment Research

**CIR Comments**

- Lower revenues owing to measures taken by the company to correct inventory in the trade
- Expected to normalize over the full year given the strong trend in secondary sales (as reflected in the IMS growth rate of c40%)
- Filed for 5 new products; 31 product approvals received
- 3 new products launched in Russia
- Initiated operations in China & Australia

Source: Citi Investment Research

**Figure 7. India formulation sales (Rs m)**




Source: Citi Investment Research

**CIR Comments**

- Revenues up 12% YoY – slightly below the growth rates achieved by most of its peers – however, in-line with the annual guidance
- 12 new products launched in the quarter including 3 major launches in the dermatology space
- Glenmark has witnessed some slowdown in growth over the last two months but expects a recovery to c15% levels by the end of FY09

Source: Citi Investment Research

**Figure 8. Glenmark's R&D Pipeline**

| Compound | Target | Status | CIR Comments |
|---|---|---|---|
| GRC 3886 | PDE 4 | Phase II | In talks for a European licensing deal; commenced phase 2b trials for COPD & set to commence phase 2b trials for asthma |
| GRC 8200 | DPP IV | Phase II | In talks to out license the molecule; expected to enter phase III by second half of CY09 |
| GRC 6211 | TRPV 1 | Phase II | On course |
| GRC 4039 | PDE 4 | Phase I | Expected to enter Phase II in 3QFY09 |
| GRC 10693 | CB 2 | Phase I | Phase II initiation by end of FY09 |
| GRC 9332 | SCD 1 | Pre-Clinical | To file for Phase I by end of FY09 |
| GRC 17173 | TRPV 3 | Pre-Clinical | To file for Phase I in Nov '08 |
| **Acquired from Chromos** | | | |
| GBR 500 | MAb | IND preparation | Expected to approach the FDA with their IND filing in August |
| GBR 600 | MAb | Pre clinical | |
| **Inlicensed from Napo** | | | |
| Crofelemer | Chronic Diarrhoea | Phase III | |
| *One NCE and 3 NBEs in discovery stage; expected to enter clinics by FY10/11* | | | |

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 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 rating on Glenmark Pharmaceuticals. Our positive outlook on the stock is based on: a) The R&D pipeline has broadened, with the company expecting seven molecules to be in the clinic by end FY08; b) With two 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 achieved significant traction, especially in the US 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). Although there are potential risk triggers (especially related to Oglemilast) that could lead to partial erosion of the option value, we believe the risk-reward remains in favor of investors.

## Valuation

Our target price for Glenmark Pharmaceuticals of Rs770 is derived by 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 15% discount rate. We adjust for the higher-risk income streams by probability of success. Accordingly, we arrive at a value of Rs113/share for Oglemilast. We use a similar approach for GRC-8200 and GRC-6211, arriving at respective values of Rs32/share and Rs89/share. We value Glenmark's non-R&D business based on 20x forward earnings, which we use for front-line Indian pharma companies such as Ranbaxy and Cipla. We believe Glenmark deserves a P/E premium to other mid-tier companies, given the higher value addition in its business and its proven ability to leverage its assets. At 20x June '09E earnings, we arrive at a value of Rs537/share for the base business.

## Risks

We rate Glenmark Medium Risk, even though our quantitative model suggests Low Risk, as we believe the 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 execution is lacking; (2) growing competition, rapid price erosion and fragmented market share are risks that are inherent to the generics business; and (3) the failure of any molecule could lead to the R&D milestone payments being removed from our estimates.

# Appendix A-1

## Analyst Certification

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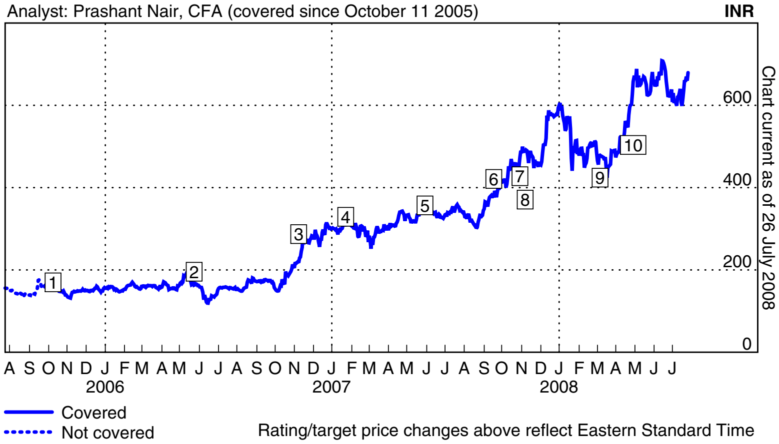
## IMPORTANT DISCLOSURES

### Glenmark Pharmaceuticals (GLEN.BO)

**Ratings and Target Price History - Fundamental Research**

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




| # | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1: | 10 Oct 05 | 3H | 152.50 | 162.75 |
| 2: | 24 May 06 | *1H | *227.50 | 163.05 |
| 3: | 8 Nov 06 | 1H | *317.50 | 217.60 |
| 4: | 23 Jan 07 | *1M | *379.50 | 310.40 |
| 5: | 30 May 07 | 1M | *427.00 | 336.58 |
| 6: | 18 Sep 07 | 1M | 427.00 | 380.55 |
| 7: | 30 Oct 07 | 1M | *575.00 | 474.20 |
| 8: | 7 Nov 07 | 1M | *632.00 | 486.45 |
| 9: | 6 Mar 08 | 1M | *592.00 | NA |
| 10: | 29 Apr 08 | 1M | *770.00 | 657.75 |

*Indicates change.

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| ***Data current as of 30 June 2008*** | **Buy** | **Hold** | **Sell** |
|---|---|---|---|
| Citi Investment Research Global Fundamental Coverage (3096) | 50% | 36% | 14% |
| *% of companies in each rating category that are investment banking clients* | 53% | 52% | 42% |

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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