

Date: 13 Jun, 2008

Every week ICICIdirect research team will select a stock based on fundamental and/or technical parameter, which is likely to return 20% over a 3-6 month perspective.

## Glenmark Pharmaceuticals Ltd. (GLEPHA)

Current Price: 673

Target Price: 807

Potential upside: 20%

Time Frame: 3-6 mths

Glenmark Pharma is one of the best plays in the Indian drug discovery landscape. The company plans to reorganise its business in two separate entities Glenmark Generics (GGL, new entity) which will look after the generics business in regulated markets and Glenmark Pharma (GPL) which will look after Specialty business - branded generics as well as NCE R&D. We believe the re-organisation and subsequent listing of GGL will be value accretive for Glenmark shareholders.

### Company Background

Glenmark Pharmaceuticals, incorporated in 1977, is engaged in research and development, manufacturing and marketing of branded formulations in India and abroad. It markets products in 70 countries across the globe including the regulated markets of Europe and USA.

### Investment Rationale

Re-organisation value accretive

Glenmark plans to re-organise the business in two separate entities the generics business in regulated markets (such as North America and EU, where generics are non-branded) under GGL and branded generics (India and unregulated markets) as well as NCE R&D in Specialty business under existing GPL. The re-organisation is aimed at increasing the focus on managing the two businesses, which has already attained the critical mass. Moreover, listing of GGL will unlock value for shareholders. The rationale behind keeping the NCE R&D with GPL (which houses the Indian and unregulated market branded generics business) is that the branded generics business will provide the steady cash flow and the field force for branded generics can be utilized for the new molecule in unregulated markets. We believe the re-organisation (effective April 1, 2008) and subsequent listing of GGL (planned in FY09) will be value accretive for shareholders.

### GGL bank on quality ANDA pipeline

Glenmark's US strategy is to have high margin and longer lifecycle products in the US markets. Nearly 1/5th of its US product portfolio is constituted of such products. However, going forward the company plans such products to form about 3/4th of its US portfolio. To have differentiated products, the company focuses on developing niche ANDA pipeline of products such as ANDAs in para IV, controlled release, dermatology, hormones, oncology and controlled substance, which give higher margin and longer life cycle compared with commodity generics. Currently, Glenmark has 30 ANDAs pending approval, with a good mix of commodity and niche generics. Glenmark has FTF (first-to-file) status on 6 ANDAs, including Zetia (ezetimibe), Strattera (atomoxetine), Tarka (Trandopril) and Crestor (Rosuvastatin) with innovator's market size of around US\$4bn, which the company plans to monetize aggressively. We believe this strategy will help the company in improving and sustaining margins in highly competitive US market.

### Preparing for future via GGL's IPO in Fy09

In order to prepare itself for new product (NCE) launch via its own distribution network, Glenmark Pharma plans to acquire a profitable specialty company in the US. The company is actively looking out for a potential target, which has at least 3-4 years of patent protection for its top-patented products. Such acquisition would help Glenmark establish a strong front-end distribution in the US, which could later be utilized for its own NCE marketing. For the acquisition, the company plans to utilise the business-transfer-considerations received from Glenmark Generics. As part of the business re-organisation, Glenmark plans to come out with an IPO of GGL in FY09, subject to Indian stock market conditions. The company plans to dilute 25-30% of GGL through fresh issue of shares. Of the total IPO-proceeds, around 70-80% would go to Glenmark Pharma (GPL) in the form of considerations for transfer of business. The rest is planned to be utilized for GGL's ambitious inorganic growth plans, wherein the company plans acquisition in the US and EU generics space.

Most successful in innovative research in Indian pharma space

Glenmark is the most successful company in drug discovery research in India. The company has a unique innovation strategy, wherein it follows four key mantras:

- i) focus on validated and known targets that have large target markets and significant level of interest from big innovator companies,
- ii) developing end-to-end understanding of science pertaining to each compound,
- iii) attracting and retaining a strong team of scientists,
- iv) strong understanding and commitment from top management

Following these tenets, Glenmark has developed a strong pipeline of 13 molecules, including five NBEs (new biological entities) and eight NCEs (new chemical entities). Out of these, three molecules are in clinical trials of phase II (b), one is in phase I and the others are either in preclinical or discovery stages. Four molecules in the discovery pipeline are first-in-class for launch. Glenmark has envisioned launching two proprietary drugs and building a late-stage pipeline by 2015.

### Two out-licensing deals may happen in FY09

The company may get into two more out-licensing deals in FY09, which may fetch US\$69mn to the company in FY09. Glenmark is the highest earner (so far US\$117mn) among its peers, from its innovative research in India. It started drug discovery research in FY01 and since then it has struck couple of out-licensing deals. In FY05, the company signed the first deal with Forest Labs in September 2004 and the second was in Q3FY07 with Merck for its Type II Diabetes compound (GRC 8200). The potential candidates for licensing deals are Oglemilast (for the EU), Melogliptin (GRC 8200, which has come back from Merck KGaA) and GRC 4039.

### Risks & Concerns

The company invests hugely into innovative research, which is highly risky and involves a long gestation period. Moreover, the company plans to invest in R&D for filing ANDAs under para IV, which may trigger litigation with the innovator company, involving substantial sum of money. Glenmark Pharma has out-licensed three molecules; the failure of molecule at the later phase will lead to a non-payment of the milestone payment. Variation in exchange rate of Rupee vis-à-vis Dollar may impact the top line and margins of the company.

### Financials

We believe the consolidated revenue of Glenmark Pharma to grow at a robust rate of 42% to Rs 3583 crore over FY07-10E on the back of growth flowing in from domestic and international avenues. Bottom line is expected to grow at a CAGR of 52% during this period to Rs 1088 crore. Over the past few years the company has entered various regulated and unregulated markets. The company entered the regulated market of US of late but has generated good revenue and has grown at a very robust rate over last few years. With its differentiated strategy for the US market, we expect the revenue growth to be robust. The company is now focusing on consolidating its position in the new geographies and also to follow the inorganic route to grow. As far as the EBIDTA margin is concerned, the company has been able to generate one of the highest EBIDTA margin in the US and we expect the company to earn similar EBIDTA going forward also.

### Key Financial Ratios

	2007/03	2006/03	2005/03	2004/03	2003/03
EPS	11.17	5.55	5.29	6.91	6.32
CEPS	13.12	7.02	6.56	8.75	8.35
Book Value	37.5	25.16	22.48	37.99	28.03
Dividend/Share	0.8	0.7	0.7	1.3	1.3
OPM	26.59	18.72	23.18	20.21	20.02
RONW	30.61	21.81	23.52	18.07	23.83
Debt/Equity	2.02	2.5	1.71	0.55	0.91
Ratio	3.94	5.3	5.04	2.5	2.41
Interest Cover	5.98	6.85	7.09	7.27	5.98

## Valuations

Glenmark has a very impressive strategy of generating revenue from the generics business and put it into the NCE research, which generates high revenue at impressive profit margins. We believe that the generics business would grow at a robust growth rate, whereby the company would be able to put more resources into discovery research. We believe that Glenmark has one of the best new drug R&D in India. Currently, the stock trades at 20.6x the FY09E EPS of Rs 32.68 and 15.40x the FY10E EPS of 43.73. We rate the scrip an Outperformer for the investment horizon of 6 months with a target price of Rs 807.



## Technical Outlook

This Pharma sector major was witnessing a range bound action for the past few weeks while its peers were rallying rentlessly on huge volumes. However placing this in context of the higher degree charts we find that this seems to be a consolidation near the highs.

Such formation on charts indicate that the stock is probably getting ready for a bigger move on higher side. With the recent rise the stock gave a decisive break above the resistance and made its way clear to a new high. Volumes are supportive and absence of divergence on oscillators indicate that that the stock has a big room to conquer. With the technical set up being interesting we advise buying into this one at current and on dips if any. Medium term target comes to 795 and then 850. support is placed around 665.

*ICICIdirect Research Desk*

ICICI Securities Limited,  
Mafatlal House,  
Ground Floor,  
163, H T Parekh Marg, Mumbai - 400 020  
[research@icicidirect.com](mailto:research@icicidirect.com)

DISCLAIMER: The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. "The author of the report does not hold any investment/open position in any of the companies mentioned in this report. ICICI Securities (I-Sec) may be holding a small number of shares/ an open position in the above referred companies as on the date of release of this report." This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. I-Sec and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. I-Sec may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject I-Sec and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.