Risk-reward favourable

Expect discount to front-line peers to narrow

November 30, 2011

Rating Remains	**Buy**
Target price Reduced from 432	INR 414
Closing price November 29, 2011	INR 317
Potential upside	+30.6%

Action: Reaffirm Buy; TP adjusted to INR414

We see the sales pick-up across its key markets as positive for GNP. Furthermore, FY12 has turned out to be the best year in terms of out-licensing revenue. Working capital cycle has improved and net debt-to-equity declined to 0.85x in Sep 2011 from 0.94x in FY11. There are still investor concerns on expense capitalisation, on a higher-than-expected rise in net block in 1HFY12. However, management indicated that forex translation adjustments contributed to the rise and that there are no capitalised expenses. Adjusting for one-time upside and R&D value, the stock currently trades at 13.5x 1-year fwd EPS of INR20.8. We assess the risk-reward as favourable.

Catalysts

Consistent improvement in cashflows and balance sheet; market share gains in key products in the US.

Valuation

GNP currently trades at a discount to front-line peers primarily on concerns of higher receivables and expense capitalisation. We expect some improvement on both these counts and expect the discount to narrow. We value the core business at INR 384/share i.e., 16x one-year fwd core earnings. We maintain our 20% discount to front-line generic peers. R&D value is retained at INR 21/share. We estimate one-off value at INR 10/share, down from INR13/share to account for USD20mn as potential Tarka liability.

31 Mar	FY11		FY12F		FY13F		FY14F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	29,536	37,108	39,429	41,153	42,856		49,456
Reported net profit (mn)	4,578	6,653	5,242	5,963	5,979		6,991
Normalised net profit (mn)	4,578	6,653	6,559	5,963	5,979		6,991
Normalised EPS	16.94	24.66	24.27	22.10	22.12		25.87
Norm. EPS growth (%)	41.1	45.3	43.3	-10.4	-8.8		16.9
Norm. P/E (x)	18.7	N/A	13.1	N/A	14.3	N/A	12.3
EV/EBITDA (x)	17.6	10.5	9.9	11.1	10.9		9.5
Price/book (x)	4.2	N/A	3.4	N/A	2.7	N/A	2.2
Dividend yield (%)	0.1	N/A	0.1	N/A	0.1	N/A	0.1
ROE (%)	20.8	28.1	22.9	20.0	21.0		20.1
Net debt/equity (%)	93.9	58.3	70.6	40.3	58.0		45.6

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

Glenmark's presence across markets — the US, India and emerging markets — makes it a play on growth opportunities across geographies. In addition, there could be potential upside from the innovation R&D pipeline.

Nomura vs consensus

Our price target is 13% ahead of consensus, as we expect a greater re-rating of the shares as a result of the ramp-up in US sales and improvements in the balance sheet

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

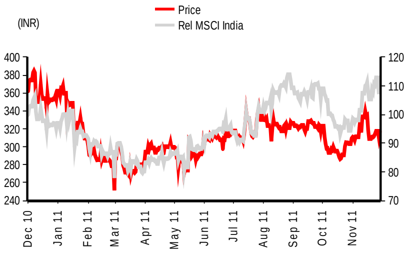
Key data on Glenmark Pharmaceuticals

Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**25,496**	**29,536**	**39,429**	**42,856**	**49,456**
Cost of goods sold	-10,193	-9,918	-12,527	-14,532	-16,795
Gross profit	**15,303**	**19,618**	**26,902**	**28,324**	**32,660**
SG&A	-9,824	-14,596	-17,560	-20,172	-23,332
Employee share expense					
Operating profit	**5,479**	**5,022**	**9,342**	**8,152**	**9,329**
EBITDA	**6,685**	**5,968**	**10,491**	**9,499**	**10,873**
Depreciation	-1,206	-947	-1,149	-1,347	-1,544
Amortisation					
EBIT	5,479	5,022	9,342	8,152	9,329
Net interest expense	-1,640	-1,566	-1,300	-1,200	-1,200
Associates & JCEs					
Other income	0	1,359	-807	0	0
Earnings before tax	**3,839**	**4,816**	**7,235**	**6,952**	**8,129**
Income tax	-529	-237	-676	-973	-1,138
Net profit after tax	**3,310**	**4,578**	**6,559**	**5,979**	**6,991**
Minority interests	-66	0	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	**3,245**	**4,578**	**6,559**	**5,979**	**6,991**
Extraordinary items	0	0	-1,317	0	0
Reported NPAT	**3,245**	**4,578**	**5,242**	**5,979**	**6,991**
Dividends	-126	-126	-126	-126	-126
Transfer to reserves	**3,119**	**4,452**	**5,116**	**5,852**	**6,864**
Valuation and ratio analysis					
FD normalised P/E (x)	26.4	18.7	13.1	14.3	12.3
FD normalised P/E at price target (x)	34.5	24.4	17.1	18.7	16.0
Reported P/E (x)	26.4	18.7	16.3	14.3	12.3
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1
Price/cashflow (x)	11.0	5.1	4.8	6.5	5.6
Price/book (x)	3.6	4.2	3.4	2.7	2.2
EV/EBITDA (x)	15.5	17.6	9.9	10.9	9.5
EV/EBIT (x)	18.9	20.9	11.1	12.7	11.1
Gross margin (%)	60.0	66.4	68.2	66.1	66.0
EBITDA margin (%)	26.2	20.2	26.6	22.2	22.0
EBIT margin (%)	21.5	17.0	23.7	19.0	18.9
Net margin (%)	12.7	15.5	13.3	14.0	14.1
Effective tax rate (%)	13.8	4.9	9.3	14.0	14.0
Dividend payout (%)	3.9	2.8	2.4	2.1	1.8
Capex to sales (%)	15.5	13.6	12.7	11.7	10.1
Capex to depreciation (x)	3.3	4.2	4.4	3.7	3.2
ROE (%)	16.4	20.8	22.9	21.0	20.1
ROA (pretax %)	12.4	10.7	18.8	14.4	14.5
Growth (%)					
Revenue	18.8	15.8	33.5	8.7	15.4
EBITDA	37.9	-10.7	75.8	-9.5	14.5
EBIT	43.4	-8.4	86.0	-12.7	14.4
Normalised EPS	5.0	41.1	43.3	-8.8	16.9
Normalised FDEPS	5.1	41.1	43.3	-8.8	16.9
Per share					
Reported EPS (INR)	12.01	16.94	19.40	22.12	25.87
Norm EPS (INR)	12.01	16.94	24.27	22.12	25.87
Fully diluted norm EPS (INR)	12.01	16.94	24.27	22.12	25.87
Book value per share (INR)	87.28	75.38	94.31	115.96	141.36
DPS (INR)	0.47	0.47	0.47	0.47	0.47

Source: Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	4.5	-3.2	-10.2
Absolute (USD)	-2.1	-14.3	-20.8
Relative to index	15.2	-1.2	8.9
Market cap (USDmn)	1,647.1		
Estimated free float (%)	0.5		
52-week range (INR)	389.9/241.1		
3-mth avg daily turnover (USDmn)	4.01		
Major shareholders (%)			
Promoter	48.4		

Source: Thomson Reuters, Nomura research

Notes

GNP currently trades at 14x FY13F earnings – at a significant discount to front-line peers

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	6,685	5,968	10,491	9,499	10,873
Change in working capital	-2,441	1,671	-119	-2,402	-2,654
Other operating cashflow	3,524	9,303	7,572	6,123	7,081
Cashflow from operations	**7,768**	**16,942**	**17,945**	**13,219**	**15,299**
Capital expenditure	-3,958	-4,012	-5,000	-5,000	-5,000
Free cashflow	**3,810**	**12,930**	**12,945**	**8,219**	**10,299**
Reduction in investments	0	-100	0	0	0
Net acquisitions					
Reduction in other LT assets					0
Addition in other LT liabilities					0
Adjustments	-4,155	-7,429	-10,372	-7,096	-8,219
Cashflow after investing acts	**-345**	**5,401**	**2,572**	**1,123**	**2,081**
Cash dividends	-84	-126	-126	-126	-126
Equity issue	4,143	41	0	0	0
Debt issue	1,003	-10,926	0	0	0
Convertible debt issue					
Others	-4,362	6,526	-1,300	-1,200	-1,200
Cashflow from financial acts	**700**	**-4,485**	**-1,426**	**-1,326**	**-1,326**
Net cashflow	**355**	**916**	**1,146**	**-203**	**754**
Beginning cash	715	1,070	1,986	3,132	2,929
Ending cash	1,070	1,986	3,132	2,929	3,684
Ending net debt	17,624	19,130	17,984	18,187	17,433

Source: Nomura estimates

Notes

We expect capex of INR5bn per annum from FY12F to FY14F

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	1,070	1,986	3,132	2,929	3,684
Marketable securities	0	0	0	0	0
Accounts receivable	10,783	11,308	12,627	14,673	16,933
Inventories	7,085	8,070	9,092	10,565	12,192
Other current assets	5,273	4,651	5,007	5,264	5,547
Total current assets	**24,211**	**26,016**	**29,858**	**33,431**	**38,356**
LT investments	181	281	281	281	281
Fixed assets	23,881	22,123	25,974	29,627	33,083
Goodwill					
Other intangible assets					
Other LT assets					
Total assets	**48,273**	**48,420**	**56,113**	**63,339**	**71,721**
Short-term debt					
Accounts payable	3,793	6,574	8,477	9,850	11,367
Other current liabilities	1,393	1,172	1,847	1,847	1,847
Total current liabilities	**5,186**	**7,746**	**10,323**	**11,697**	**13,214**
Long-term debt	18,694	21,116	21,116	21,116	21,116
Convertible debt					
Other LT liabilities	710	-1,081	-1,081	-1,081	-1,081
Total liabilities	**24,590**	**27,781**	**30,358**	**31,732**	**33,249**
Minority interest	130	267	267	267	267
Preferred stock	0	0	0	0	0
Common stock	270	270	270	270	270
Retained earnings	14,206	13,399	18,515	24,367	31,231
Proposed dividends					
Other equity and reserves	9,077	6,703	6,703	6,703	6,703
Total shareholders' equity	**23,552**	**20,372**	**25,488**	**31,340**	**38,205**
Total equity & liabilities	**48,273**	**48,420**	**56,113**	**63,339**	**71,721**
Liquidity (x)					
Current ratio	4.67	3.36	2.89	2.86	2.90
Interest cover	3.3	3.2	7.2	6.8	7.8
Leverage					
Net debt/EBITDA (x)	2.64	3.21	1.71	1.91	1.60
Net debt/equity (%)	74.8	93.9	70.6	58.0	45.6
Activity (days)					
Days receivable	145.6	136.5	111.1	116.3	116.6
Days inventory	239.7	278.9	250.7	246.9	247.3
Days payable	129.4	190.8	219.9	230.2	230.6
Cash cycle	255.8	224.6	141.9	133.0	133.4

Source: Nomura estimates

Notes

We expect net debt to improve, led by strong cash flows. Management guides for an improvement in working capital

Raising our revenue estimates by 4-6%; EBITDA estimates up 8-10%

On the back of robust 1HFY12 revenue, we are raising our revenue estimates for FY12/FY13F by 4-6%. Higher revenue from branded generics outside India and its US generics business are the key drivers for raising our estimates. We factor in USD55mn of licensing income into our FY12F estimates. However, we have not factored in any additional licensing income for FY13/FY14F at this stage.

Fig. 1: Changes to our estimates (INRmn)

(in INR mn)	Current estimates		Previous estimates		Change (%)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Domestic formulations	9,997	11,697	10,347	12,047	-3%	-3%
Latin America	2,869	3,500	2,369	2,819	21%	24%
RoW	6,070	7,070	5,070	5,770	20%	23%
Europe branded generics	1,628	1,790	1,678	1,828	-3%	-2%
Specialty (ex-R&D)	**20,563**	**24,057**	**19,464**	**22,464**	6%	7%
US	11,778	13,658	10,242	12,717	15%	7%
Argentina	151	151	451	501	-67%	-70%
Europe	744	944	714	884	4%	7%
API	3,137	3,537	3,937	4,537	-20%	-22%
Generics	**15,809**	**18,289**	**15,344**	**18,639**	3%	-2%
Outlicensing and others	3,047	500	2,250	-	35%	
Total Sales	**39,419**	**42,846**	**37,058**	**41,103**	6%	4%
Core EBITDA	**10,491**	**9,499**	**9,551**	**8,793**	**10%**	**8%**
Margins (%)	26.6%	22.2%	25.8%	21.4%		
PBT	5,918	6,952	7,579	6,934	-22%	0.3%
PAT	5,242	5,979	6,653	5,963	-21%	0.3%

Source: Nomura estimates

Higher revenue and increased licensing income result in an 8-10% increase in our EBITDA estimates for FY12F and FY13F

Higher revenue and higher licensing income result in an 8-10% increase in our EBITDA estimates for FY12F and FY13F. Ex-licensing income, we project EBITDA margin of 21.5%.for FY12F, in line with management's guidance of 21-22%. Higher forex losses, payment to Paul Capital and lower other income result in a drop in our PAT estimates for FY12F. Our FY13F profit estimates remain largely unchanged.

Working capital improves

The half-yearly disclosures indicate an improvement in the balance sheet over the past six months, with net debt-to-equity having declined to 0.85x in Sep 2011 from 0.94 in March 2011. The company expects debt levels to decline by INR1-2bn by end-FY12F.

Working capital improved in Sep 2011 from the FY11 levels

Working capital has also improved. Strong cash flows from licensing income and Salix payment also contributed to the improvement in the balance sheet. Inventory days (calculated as ex-licensing income on trailing 12-month sales) was down to 91 days in Sep 2011 from 103 days in FY11. Similarly, receivable days are down to 131 days from 144 days over the same period.

Fig. 2: Improvement in balance sheet (INR mn)

Balance Sheet (INR mn)	Mar-11	Sep-11
Shareholders Fund		
Capital	270	270
Reserve and Surplus	20,102	21,696
Minority Interest	267	278
Loan Funds	21,116	21,036
Deferred Tax Liability	1,476	1,498
Total	**43,232**	**44,779**
Fixed Assets	22,123	23,582
Investments	181	181
Deferred tax assets	2,558	2,844
Current Assets		
Inventories	8,070	8,037
Sundry Debtors	11,308	11,567
Cash and Bank Balance	1,986	2,334
Loans and Advances	4,751	4,695
Less: Current Liability and Provisions		
Liabilities	7,560	8,215
Provisions	185	245
Total	**43,232**	**44,779**
Inventory days	**103**	**91**
Debtor days	**144**	**131**
Net Debt:Equity	**0.94x**	**0.85x**

Source: Company data, Nomura research

No further capitalisation of expenses, as per management

Capitalisation of R&D expenditure has been a key concern for investors. In FY11, while transitioning to IFRS, the company had taken a write-off of INR5.9bn primarily related to capitalised R&D and intangibles. On our assessment, almost 75% of the capitalised R&D and ~25% of brand intangibles were written off.

As per management, it expects no further capitalisation of R&D spend

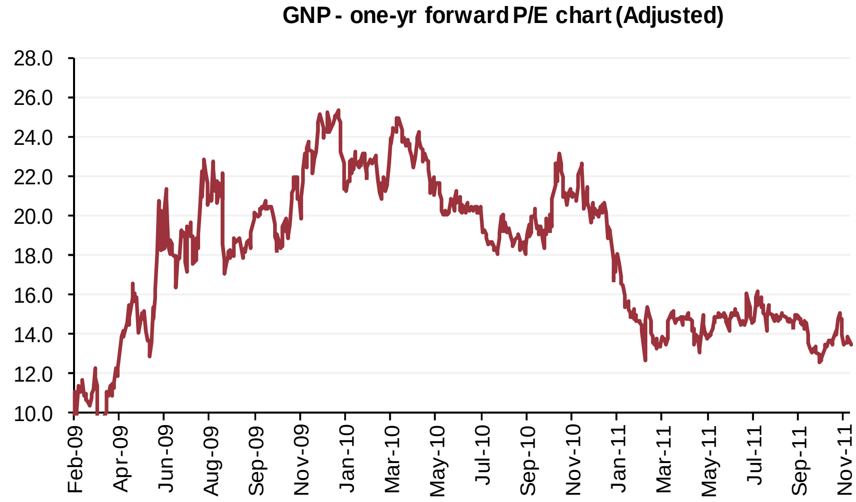
As per management, it expects no further capitalisation of R&D spend. The increase in gross block over Apr-Sept 2011, indicates a capex spend of INR1.96bn in 1HFY12. As per management, ~INR450mn of the increase is on account of forex translation. The remaining is primarily related to capex.

Reaffirm Buy; TP adjusted to INR 414 from INR432

Reaffirm Buy; TP adjusted to INR414

We value the core business at INR 384/share i.e., 16x one-year fwd core earnings. We maintain our 20% discount to front-line generic peers. R&D value is retained at INR 21/share. We estimate one-off value at INR 10/share, down from INR13/share to account for USD20mn as potential Tarka liability.

Fig. 3: Glenmark – one-year fwd adjusted P/E chart



Note: The market price is adjusted of INR 10/sh for value of one offs and INR 21/sh for innovation R&D. Earnings are adjusted for one off income/expenses, licensing income and forex gain/loss.

Source: Company data, Bloomberg, Nomura estimates

Valuation methodology and risks

We adjust our TP to INR414 (from INR432). Our valuation methodology remains unchanged. We continue to value Glenmark's core business at 20% discount to the frontline peers (currently 16x vs. previous 18x). The valuation of innovation R&D is unchanged and the one offs value now include USD 20mn Tarka liability.

Risks to our price target include: 1) further deterioration in the working capital cycle of the company; 2) negative developments in the innovation R&D pipeline; 3) lower-than-expected growth in emerging market revenue, and; 4) significant delays in the approval of new products by the USFDA.

Global economics: What if things get worse before they get better?

As the news coming out of Europe suggests that downside risks to our baseline economic forecasts have not dissipated, our global economics team have run a scenario analysis to see what would happen in the event of a market meltdown or unforeseen shocks or policy errors.

The bear case assumes:

- US GDP averages -1% in 2012 and Euro area GDP averages -3% in 2012 before both recover to 2% growth in 2013.
- CRB commodity price index falls 15% in 2012, but rebounds by 15% in 2013.

What if things get much worse than this? After all, we know that in 2009, US GDP fell 3.5% and Euro area GDP fell 4.2%. Although our global economics team does not see such a situation as plausible at the moment, they have run the numbers to see the hypothetical impact of such an extreme macro environment on Asian economies to provide some perspective. This extreme scenario assumes:

- US GDP averages -4% in 2012 and Euro GDP averages -6.5% before both recover to 1% growth in 2013.
- CRB commodity price index falls 40% in 2012, and does not rebound in 2013.

The global bear case does not look too bad for much of Asia and in fact is marginally better than the base case for China and India in 2013 because we would expect a V-shape rebound for the region after initial shock, thanks to the likely decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies. We would also expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia. In the extreme case, however, even these strengths will be tested.

Fig. 4: Real GDP growth forecasts: baseline and downside scenarios

(% y-y)	2012F			2013F		
	Base case	**Bear case**	**Extreme case**	**Base case**	**Bear case**	**Extreme case**
Australia	4.6	3.5	1.0	3.1	2.4	2.2
China	8.6	8.0	7.2	8.4	8.6	8.1
Hong Kong	4.5	1.0	-4.5	4.2	4.5	5.5
India	7.9	7.2	6.6	8.1	8.4	8.8
Indonesia	7.0	5.5	4.0	7.0	5.6	5.2
Malaysia	5.1	2.5	-3.2	5.0	3.5	3.2
New Zealand	3.5	3.0	2.0	3.6	3.4	3.2
Philippines	5.7	4.0	1.0	6.5	4.5	4.0
Singapore	5.3	-0.5	-2.5	5.5	3.8	3.6
South Korea	5.0	-2.0	-5.0	4.0	4.0	5.0
Taiwan	4.7	1.0	-4.0	5.2	5.0	5.5
Thailand	4.7	2.6	-2.8	4.8	3.3	3.0
Asia ex Japan, Aus, NZ	7.6	6.2	4.7	7.4	7.5	7.4

Source: CEIC and Nomura Global Economics

What does this mean for Glenmark?

Earnings of Indian pharmaceutical companies including Glenmark are not very sensitive to a global slowdown, in our view. Growth in the near-term is largely driven by the US generics market which is linked to patent expiries and product approvals. Growth in India and other emerging markets will be impacted, but not materially, on our assessment due to high under-penetration and the non-discretionary nature of the business.

Fig. 5: Earnings and target price sensitivity for Glenmark

(INR)	Base case	Bear case	Downside %	Extreme case	Downside %
Year 1 EPS	19.4	19.4	0%	19.4	0%
Year 2 EPS	22.1	22.1	0%	22.1	0%
12-m target price	414	414	0%	414	0%

Note: Base case represents our current forecasts and TP

Source: Nomura estimates

Appendix A-1

Analyst Certification

We, Saion Mukherjee and Aditya Khemka, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

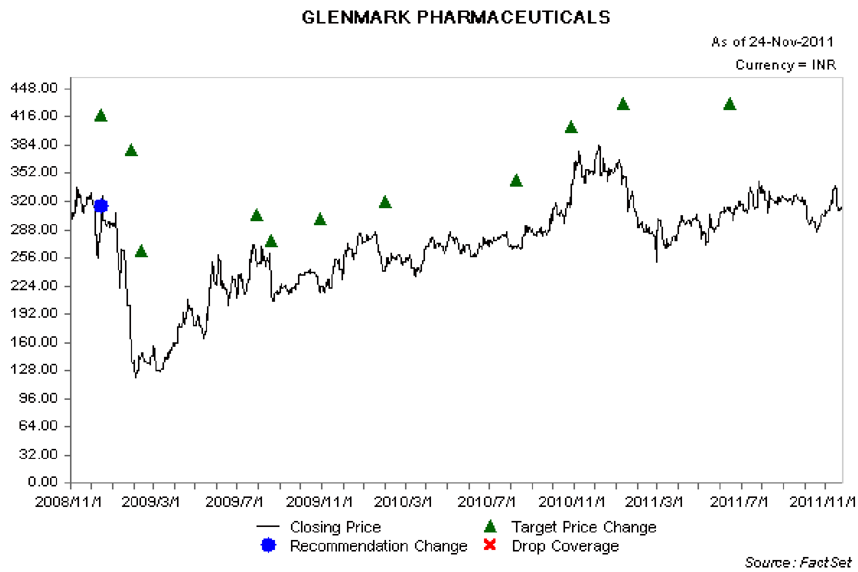
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Glenmark Pharmaceuticals	GNP IN	INR 317	29-Nov-2011	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Glenmark Pharmaceuticals	Not Rated	16-Dec-2008

Glenmark Pharmaceuticals (GNP IN) **INR 317 (29-Nov-2011)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
16-Jun-2011		432.00	309.95
11-Jan-2011		431.00	349.55
28-Oct-2010		405.00	316.40
10-Aug-2010		344.00	268.10
01-Feb-2010		320.00	246.95
30-Oct-2009		300.00	224.15
19-Aug-2009		276.00	223.20
29-Jul-2009		305.00	246.95
13-Feb-2009		265.00	147.85
28-Jan-2009		379.00	141.15
16-Dec-2008		418.00	315.70
16-Dec-2008	Buy		315.70

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP is INR414. We value the core business at INR 384/share i.e., 16x one-year fwd core earnings. We maintain our 20% discount to front-line generic peers. R&D value is retained at INR 21/share. We estimate one-off value at INR 10/share, down from INR13/share to account for USD20mn as potential Tarka liability.

Risks that may impede the achievement of the target price Risks to our price target include: 1) further deterioration in the working capital cycle of the company; 2) negative developments in the innovation R&D pipeline; 3) lower-than-expected growth in emerging market revenuem, and; 4) significant delays in the approval of new products by the USFDA.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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STOCKS

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

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