Health Care & Pharmaceuticals | India

Glenmark Pharmaceuticals GNP IN

BUY

NOMURA

NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

RESULTS FIRST LOOK

GNP reported robust rev growth across geographies in 2QFY12. Ex-licensing income rev was up 29% y-y and 12% higher than our expectations. However, a q-q sharp drop in EBITDA margins (-510bps) was a surprise and led to 8% slippage at the EBITDA level. The balance sheet recorded improvement as inventory and debtor days declined compared to Mar '11, and cash inflows from licensing income reduced net debt. We retain our Buy rating as the stock trades at 13x FY13F EPS adjusted for one-off and R&D valuations. We present key takeaways from the conference call.

Price target: 432.0 INR   Price (09 Nov 2011): 318.3 INR

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Growing across geographies

- **Earnings vs. our Forecast:** **IN LINE**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

Robust sales growth across markets

Glenmark reported strong growth across all markets, substantially ahead of expectations. Sales ex licensing income at INR9.37bn was up 29% y-y and 12% higher than our expectations.

Fig 1: Sales mix review: Robust sales growth

(INR mn)	Q2FY12	YoY(%)	Q2FY11A	QoQ(%)	Q1FY12A
Generics	**3,990**	**22%**	**3,274**	**19%**	**3,362**
US	3,001	34%	2,238	19%	2,512
Europe	185	38%	134	6%	175
Oncology	41	-64%	115	43%	29
API	763	-3%	787	18%	646
Specialty	**5,134**	**36%**	**3,777**	**25%**	**4,108**
India	2,539	20%	2,122	13%	2,254
RoW	1,479	82%	811	41%	1,047
Latin America	738	50%	493	25%	592
Europe	378	7%	351	76%	215
Other	**246**		**184**		
Out-licensing income	**1,185**		**-**		**1,112**
Net sales	**10,555**	**46%**	**7,236**	**23%**	**8,582**

Source: Company data, Nomura research

India sales growth was impressive at 20%, particularly when most players have recorded a material slowdown. The company expects growth to slowdown in the subsequent quarter to 15-18% from ~20% in 1HFY12. From FY13F onwards, the company expects to get back to a 20%+ growth rate.

The US witnessed the steepest sequential increase of ~US$10mn q-q. The growth was driven by market share gain in older products, ramp up in sales of products launched over the last one year and Malarone exclusivity during the quarter (sales booked for 2 weeks). As per the latest IMS data (week ended 28 Oct 2011) GNP has secured 64% market share. There is no authorized generic in the product. GNP has 43 ANDAs pending approval of which 6-12 may get approved in 2HFY12, as per management. The traction in the oral contraceptive (OC) portfolio has been encouraging. GNP has five OCs in the market, with a market share range of 25-50% for four earlier launched products. For the recently launched product, market share is currently at 10%.

On a low base, ROW markets have started to record strong growth. Management expects growth in excess of 30% in the region.

The decline in the Oncology business is primarily due to internal consumption of the API.

Gross margins under pressure; EBITDA margin ex licensing income improves y-y but drops sequentially

Fig 2: Income Statement review: Gross margins lower than expected

(INR mn)	Q2FY12	YoY (%)	Q2FY11	QoQ (%)	Q1FY12
Net sales (including other operating income)	**10,557**	**46%**	**7,241**	**22%**	**8,685**
Material cost	3,335	34%	2,486	45%	2,308
Staff cost	1,575	18%	1,332	17%	1,346
SG&A and other exp	2,541	26%	2,010	23%	2,062
EBITDA	**3,106**	120%	**1,413**	5%	**2,969**
Interest	291	-27%	400	-29%	408
Depreciation	247	8%	228	-6%	264
Other income	(931)	-703%	154	-855%	123
PBT	**1,637**	**74%**	**940**	**-32%**	**2,420**
Extraordinary Item	1,317		-		-
Tax	(238)	-405%	78	-175%	319
PAT	**559**	**-35%**	**862**	**-73%**	**2,101**
% of sales (ex licensing income)					
Material cost	35.6%	125bps	34.3%	510bps	30.5%
Staff cost	16.8%	(158)bps	18.4%	(97)bps	17.8%
Other Exp	27.1%	(65)bps	27.8%	(12)bps	27.2%
Tax rate	-73.5%	(8,174)bps	8.3%	(9,104)bps	17.6%
EBITDA (ex-licensing)	20.5%	98bps	19.5%	(401)bps	24.5%

Source: Company data, Nomura research

Material cost as percentage of sales increased 130bps y-y during the quarter. The rise is due to changes in product mix, increase in input costs and samples. Management expects gross margin to remain in this range or improve only marginally going forward.

Forex loss of INR850mn was booked in the quarter. This includes MTM losses on forex debt of INR1.28bn and translation gains of INR430mn on other balance sheet items. Foreign currency debt is at US$350mn, most of which is long term and the average cost of debt is ~6%. Re-pricing of the loans in 1HFY12 resulted in a significant drop in interest costs.

GNP has exercised the put option and paid US$28.8mn to Paul Capital Partners' to regain complete rights on the derma portfolio. Paul Capital invested US$10.5mn in 2005, and GNP shall no longer pay royalty on future sales. The royalty on sales could have been ~30% of sales, as per management.

Tax rate guidance at 13-14% for the year

R&D cost in 2QFY12 was INR600mn and 1HFY12 was bINR1bn. The company has guided for INR2.0-2.25bn for FY12 of which innovation spend is INR1.3-1.5bn. In 1HY12, the R&D costs increased almost 100% y-y.

For the full year, management expects an EBITDA margin at 21-22%.

Fig 3: Balance Sheet shows improvement

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	**0.94**	**0.85**

Source: Company data, Nomura research

Balance sheet improves

The half-yearly disclosures indicate that the balance sheet has improved over the last six months as net debt to equity declined to 0.85 from 0.94 at the start of the year. Working capital has recorded improvement. Strong cash flows from licensing income and Salix payment also contributed to the improvement in the balance sheet. GNP received US$15mn towards the Crofelemer facility during the quarter from Salix. Inventory days (calculated ex licensing income on trailing 12 month sales) are down to 91 from 103. Similarly receivable days are down to 131 from 144 at the start of the year. However, capex intensity remains high as gross block increased by INR1.96bn in 1HFY12 from FY11. The company expects debt levels to come down by INR1-2bn by end FY12F.

Valuation Methodology and Investment Risks: See below

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Mentioned companies

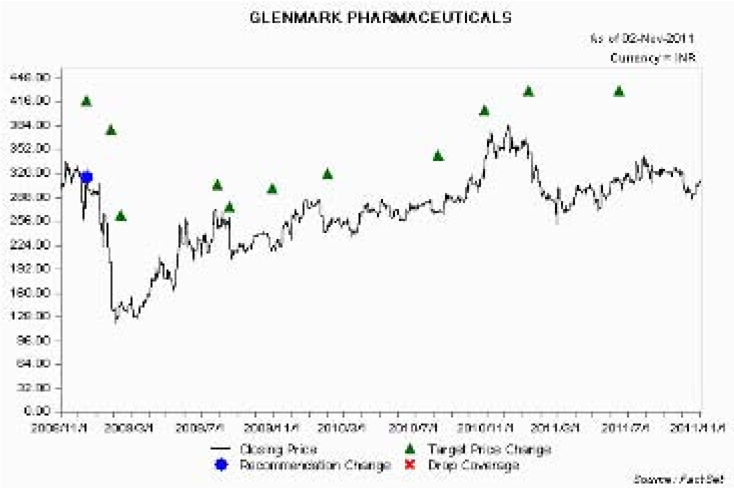
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Glenmark Pharmaceuticals	GNP IN	318.3 INR	09 Nov 2011	Buy	

Previous Rating

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

Glenmark Pharmaceuticals (GNP IN) **318.3 INR (09 Nov 2011)** Buy

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 We value GNP on a sum-of-the-parts basis to arrive at the PT of INR432/share. The parts are: 1) the core business; 2) R&D value; and 3) Zetia exclusivity upsides. We value the core business at 18x one-year forward earnings (FY13F) to arrive at a one-year forward price target. Over the recent past the stock has traded between 13-19x one-year forward earnings adjusted for the R&D and Zetia values. We expect the stock could trade at the higher end of the valuation range as visibility on growth improves. Assuming 18x one-year forward earnings, we value the core business at INR398/share.Glenmark has generated out-licensing income in all years FY05-FY12 — except in FY09. Average licensing income has been Rs1bn over the eight year period. With seven development assets in the pipeline, we believe Glenmark will be able to continue to book licensing income, although the quantum and timing cannot be predicted. For the purpose of valuation, we assume average licensing income of INR1bn and net profit impact of INR0.87bn. We value the licensing income stream at 6x average licensing income, contributing INR21/share to our price target.In the valuation of one-off product-specific opportunities, we include only Zetia. The other smaller FTFs are not valued separately, as they are not material. Also, in most such cases, competition may remain limited in the foreseeable future, in our view. We compute Zetia opportunity value at INR13/share.

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 on the two key advanced molecules in the innovation R&D pipeline; 3) a lower-than-expected revival in emerging market revenues; and 4) a significant delay in the approval of new products by the USFDA.

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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