Glenmark Pharmaceuticals Ltd.

EQUITY REPORT

May 6, 2013

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Glenmark Pharmaceuticals Ltd. (Glenmark), the global integrated pharma giant, has shown robust earnings growth in the past decade. The company has strong presence in therapeutic segments ~Dermatology, Respiratory, Oral Contraceptives (OC) and Oncology. It has also developed capabilities in New Chemical Entity (NCE) and New Biological entity (NBE) research successfully and has differentiated itself from the peers. It has presence across regulated markets including India, US, Latin America (LatAm) and other semi regulated markets.

Investor's Rationale

- Over the last few years, with the implementation of a conscious strategy of emphasizing on power brands and key therapeutic areas viz, Dematology, Respiratory and Oncology, Glenmark's specialty business in the domestic territory has turned highly lucrative with high margins and low capital intensity. We expect sales at its specialty business to grow at a CAGR of ~21% in India in the next 2 years led by launch of new products and market share gains for its existing products.

- Glenmark has separated itself from other generic companies by launching products in high margin segments like Dermatology and OC. The company has one of the largest dermatology portfolio in US (22 drug filings), of which 20 are authorized to be distributed in US. It is also the first Indian company to enter OC space with 10 drugs launched till date. The company has a portfolio of 83 generic products and 46 Abbreviated New Drug Applications (ANDA) pending for approval, of which 18 are Para-IV filings

- Glenmark has established strong R&D capabilities with 7 NCE and NBE in its pipeline. The company has done 7 out-licensing deals since 2004, generating ~USD215 mn as upfront and milestone payments till date. It has out-licensed GRC 15300 and GBR 500 to Sanofi Aventis; both the drugs if successfully commercialized have the potential to generate revenues in excess of USD1 bn for the company.

- With increasing shift towards regulated markets and newer geographies expansion, we have factored in a CAGR of 25.5% over FY12-14E for the API segment. API supplies for Crofelemer to Salix from FY14 would further boost the revenues. During 9MFY13, API segment's revenue grew 35% YoY to ₹3,037.8 mn, which reflects ~8.3% accountability towards the company's consolidated revenues.

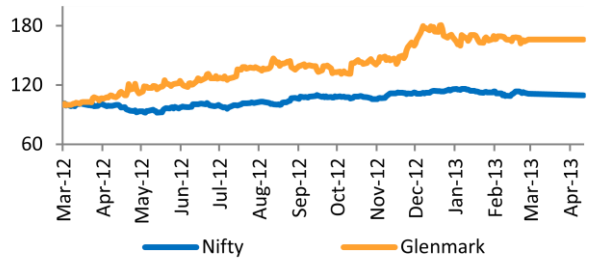
Market Data

Rating	**BUY**
CMP (₹)	500.0
Target (₹)	**595.0**
Potential Upside	~19.0%
Duration	Long Term
Face Value (₹)	1
52 week H/L (₹)	551/325
Adj. all time High (₹)	717
Decline from 52WH (%)	9.3
Rise from 52WL (%)	53.7
Beta	0.8
Mkt. Cap (₹ bn)	135.1
Enterprise Value (₹ bn)	146.0

Fiscal Year Ended

Y/E	FY11A	FY12A	FY13E	FY14E
Net Sales (₹bn)	29.5	40.2	49.2	58.9
EBIDTA (₹bn)	5.9	8.5	10.1	12.2
PAT (₹bn)	4.5	4.6	6.1	7.8
EPS (₹)	16.8	21.9	22.4	29.0
P/E (x)	29.8	22.8	22.3	17.2
P/BV (x)	6.5	5.6	4.3	3.5
EV/EBIDTA(x)	23.5	17.3	14.5	11.9
ROCE (%)	25.8	22.1	21.4	22.7
ROE (%)	22.0	24.4	19.2	20.1

One year Price Chart



Shareholding Pattern	Mar'13	Dec'12	Diff.
Promoters	48.31	48.32	(0.01)
FII	32.40	33.28	(0.88)
DII	8.12	6.73	1.39
Others	11.17	11.67	(0.50)

A ~₹135 bn Company, over 26 fold profitability growth in decade

Remarkably accelerated, over twenty-six fold growth in profit in a decade strengthens Glenmark's market position.

Glenmark, incorporated in 1977 is a research-driven, fully integrated pharmaceutical company of India. With leadership in the discovery of new molecules NCEs and NBEs, Glenmark stands among the few Indian pharmaceutical players targeting new drug discovery research. With presence in over 85 countries across the globe including India, US, Europe, Brazil, Russia/CIS, Africa and Asia, it focuses towards developing proprietary drugs as well as generic drugs across the categories of solid oral dose products, dermatological creams and ointments. Over the last decade, it has grown at a remarkable pace with fourteen fold growth in revenues and over twenty-six fold in profits, while strengthening its position as world class innovative company.

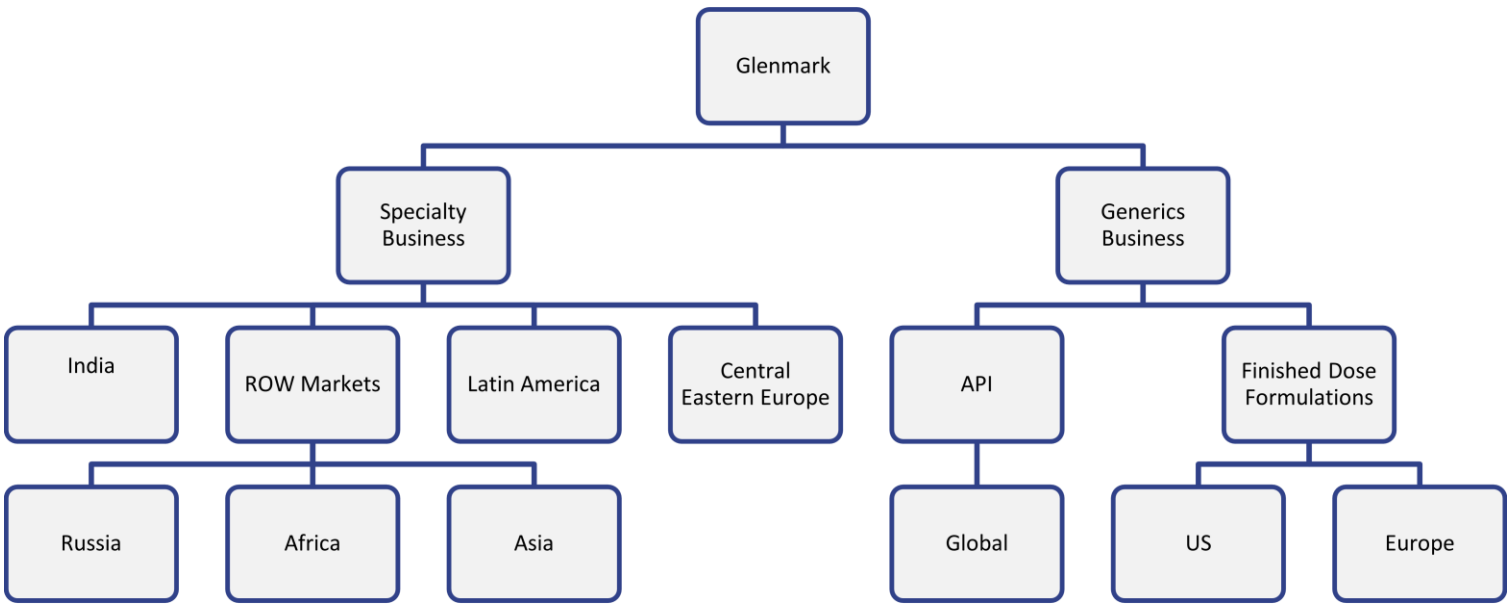
Business model

With two distinct business models for GPL and GGL, the company has strong presence across the pharmaceutical value chain.

The company has re-organized its business model into two separate business units - Specialty Business under the name of Glenmark Pharmaceuticals Ltd (GPL) and Generics Business under the head of Glenmark Generics Limited (GGL). Both GPL and GGL are growing as independent entities with distinct business models where in GPL is moving up the value chain with focus on branded generics and drug discovery activity while GGL is moving down the pharmaceutical value chain with focus on pure generics business and API.

A leading contributor to the specialties business, Glenmark's domestic formulations is highly profitable and generates strong free cash flows. The company's domestic business holds an important part in its revenue profile and is also crucial for supporting investments in NCE research and growth in overseas markets, helping GPL to extend its market share with steady volume growth and new product introductions. Going ahead, Glenmark expect its domestic sales to grow at strong pace in the coming three years while building expertise around therapeutic areas like dermatology, respiratory and oncology, across all operating regions.

Glenmark-Business Structure



Niche drug launches to drive the US business growth

Glenmark is the first Indian company to enter oral contraceptive (OC) space and has commercialized all the 10 OCs till date.

Glenmark's US business is the largest revenue generator for the company (contributed ~34% to the consolidated revenues in 9MFY13). The company has separated itself from other generic companies in US by launching products in the niche and high-entry barrier segments like dermatology, hormones, controlled substances and modified release categories.

Dermatology remains the largest sales contributor for the company in US market. The company has one of the largest dermatology portfolio in US with indigenously developed 22 drug filings, of which 20 are authorized to be distributed in US. Dermatology space provides significant entry barriers as clinical trials are essential to get ANDA approvals and in which Glenmark has significant expertise and thus we expect the segment to drive US business.

Glenmark is the first Indian company to enter OC space. It has commercialized all its approved OCs (10 OCs launched till date), with a gradual ramp-up expected in coming quarters. The company further intends to build an OC portfolio of 20-22 products.

Niche launches in US

Date	Product	Therapy	Brand	Innovator	Market size (USD mn)
Mar'12	Imiquimod Cream	Derma	Aldara	Medicis	244
Apr'12	Desogestrel and Ethinyl Estradiol	OC	Mircette	Teva	98
Apr'12	Norgestimate and Ethinyl Estradiol	OC	Ortho Cyclen	J&J	88
Jan'13	Mupirocin Calcium	Derma	Bactroban cream	GSK	57

The company also has first-to-file (FTF) opportunities in US that would contribute to one-time significant revenues. It has sole FTF rights in generics for 4 products namely Malarone, Cutivate, Locoid Lipocream and Zetia. Atovaquone/Proguanil, the generic of Malarone has already been launched in the US market in September 2011. The exclusivity for the drug continues throughout FY13 as patent for Malarone is going to expire in May 2014. Fluticasone Propionate lotion, the generic of Nycomed's Cutivate was also launched in March 2012 with 180-day exclusivity period.

Current portfolio of 83 generic products authorized for distribution in US market and has 46 ANDAs pending approval of which 18 are Para-IV filings.

Hydrocotisone Butyrate Cream, the generic of Locoid Lipocream to be launched in Dec 2013. The company is entitled to 180 days exclusivity while it will pay royalty to Triax and Astellas with respect to its cream. Ezetimibe, the generic of Merck-Schering Plough's Zetia will be launched in December 2016. This will be a huge opportunity for the company as Zetia's market size is USD1.3 bn (MAT April 2012). It has entered into an agreement with Par Pharmaceuticals, where the latter would market the drug in the US on a profit-sharing basis.

We believe US market would continue to drive growth for Glenmark (CAGR of 32% over the period FY12-FY14E) led by growing niche generic portfolio, FTF opportunities and increasing sales from recently launched products. The company's base business is also gaining momentum as now it has attained a sizeable scale which is self-sustainable. It currently has a portfolio of 83 generic products authorized for distribution in US market and has 46 ANDAs pending approval, of which 18 are Para-IV filings.

The company has implemented a conscious strategy of leveraging its strong brands in the key therapeutic areas viz, Dematology, Respiratory and Oncology.

Para IV opportunities with sole exclusivity

Product	Brand	Sales (MAT Apr 2012)	Launch Time
Ezetimibe	Zetia	USD 1.3 bn	Dec 2016
Hydrocotisone Butyrate Cream	Locoid Lipocream	USD 38 mn	Dec 2013
Fluticasone Lotion 0.005%	Cutivate	USD 39 mn	Launched in Mar 2012
Atovaquone & Proguanil HCl	Malarone	USD 64 mn	Launched Sep 2011

New product launches to augment growth for Specialty business

Specialty business contributes over 58% to the total revenues of the Glenmark's consolidated business with major thrust from the domestic formulations segment (accounts for around 43% of its specialties business). The business is growing remarkably in India spurt by the new product launches in the key therapeutic areas and the market share gain in the existing ones. Over the last few years, the company has implemented a conscious strategy of leveraging its strong brands in the key therapeutic areas viz, Dematology, Respiratory and Oncology. It has further strengthened its position by entering into a 10-year agreement with Immanence IDC in April 2011. The tie-up is for distributing the company's high-end dermatology products in 8 countries including India, Brazil, Mexico, South Africa, Egypt, Vietnam, Malaysia and Thailand. This resulted into a considerable increase in market share in the respective segments. We expect revenue from the specialty business to grow at a CAGR of ~21% in India in the next 2 years.

Glenmark's competitive advantage in specialty business across carried geographies

The company's Russian subsidiary is among the fastest growing operations in Russia. In the other CIS markets, Ukraine, Kazakhstan and Uzbekistan are continuing to show positive trends in secondary sales, driven primarily by the focus brands.

The LatAm and ROW businesses together contribute ~38% to the specialty segment revenues. Its main focus areas in the region are dermatology, oncology and respiratory. Glenmark's LatAm operation's performance was driven by strong growth from its Brazil and Venezuela subsidiaries. Brazilian subsidiary contributes over 70% to LatAm sales and grew by over 17% in 9MFY13. The company has built a strong product pipeline and continued to emphasis on enhancing field force productivity. It has also increased its presence in Mexican and Venezuelan markets and entered new markets like Peru and Ecuador. Glenmark's ROW business delivered a stellar performance across markets clocking growth of over 44% YoY in 9MFY13. The company's Russian subsidiary is among the fastest growing operations in Russia. In the other CIS markets, Ukraine, Kazakhstan and Uzbekistan are continuing to show positive trends in secondary sales, driven primarily by the focus brands. The Africa/Middle East region and Asia region continued the growth trajectory backed by strong product portfolio. We expect the momentum to continue in LatAm and ROW markets on back of new product launches (CAGR of 25.7% over the period FY12-14E).

Success of NBEs and NCEs to bolster the company's revenues

The company has struck 7 out-licensing deals since 2004, generating ~USD215 mn as upfront and milestone payments till date.

Glenmark has focused aggressively on drug discovery and research, which has resulted in a strong pipeline of novel molecules. The company has 2 NBEs and 5 NCEs molecules in clinical trials including the in-licensed molecule Crofelemer. It has actively followed the strategy of out-licensing its molecules in clinical development to large multinational pharmaceutical organizations. The strategy has been successful so far with 7 out-licensing deals struck by the company since 2004, generating ~ USD215 mn as upfront and milestone payments till date.

The company is also working with other pharma players in partnership to expand US presence. Its partner firm, Salix Pharmaceuticals (Salix) has been granted approval for Crofelemer by USFDA. This also enables Glenmark to proceed with filings in other markets, where it has got marketing rights. The company will benefit from API supplies to Salix, which may resume in FY14 and thereafter from commercialization of Crofelemer.

Glenmark's novel drugs in pipeline

Compound	Primary Indications	Status				
		Pre-Clinical	Phase I	Phase II	Phase III	Approved
Crofelemer (in-licensed from Napo Pharma)	Anti-diarrhea	→	→	→	→	→
GRC 4039 (Revamilast)	Asthma, COPD, RA	→	→	→	→	
GRC 15300 (out-licensed to Sanofi)	Osteoarthritic pain, Neuropathic pain	→	→	→		
GRC 17536	Neuropathic pain and respiratory disorder	→	→	→		
GBR 500 (out-licensed to Sanofi)	Crohn's Disease (CD), Multiple sclerosis, Inflammatory disorders	→	→	→		
mPGES-1 inhibitor	Inflammation (chronic pain)	→	→	→		
GBR 900	Chronic Pain	→	→			

Glenmark's R&D pipeline is progressing as per the schedule. The company is likely to start reporting the clinical data for various NCEs commencing with Asthma trial data for Revamilast in Q1FY14 and 3 other NCEs in H1FY14. This would be a key catalyst in FY14 as any favourable data can facilitate potential out-licensing deals. The company will discontinue development of Revamilast (GRC 4039) for Rheumatoid Arthritis (RA), since the data from Phase-IIb trials failed to meet the primary end-point.

Increasing its API focus towards regulated markets

Enhanced focus on the regulated markets which accounts for 65% of API revenues and expansion in new geographies would help to post a CAGR of 25.5% over FY12-14E for the segment.

Glenmark is one of the most vertically integrated global generic majors; a market leader on both fronts of the pharmaceutical business, APIs and Formulations. We expect the company to remain competitive in the generic business with focus on API development as few can be sourced at very low cost instead of manufacturing the same.

Currently, the company's 20% formulations use its own APIs. Its revenue from its API business during 9MFY13 recorded robust 35.3% YoY growth at ₹3,037.8 mn, which reflects ~8.3% accountability towards the company's consolidated revenues. API supplies for Crofelemer to Salix from FY14 will also boost the revenues. The strategy to shift its API business focus from semi-regulated to the regulated markets which fetch better margins is paying off. Enhanced focus on the regulated markets which accounts for 65% of API revenues and expansion in new geographies would help to post a CAGR of 25.5% over FY12-14E for the segment. The company has maintained its leadership position in Amiodarone for supplying to large generic companies in US and Europe and has further developed a sizable API pipeline for the future.

Favourable industry dynamics

IMS Health forecasts the global pharma market to grow at a ~5% CAGR over the next four years to reach a size of over USD 1 tn by 2015.

Global pharmaceutical market which stood at USD 880 bn (according to data from IMS Health) has grown at a 7% CAGR over the past six years. The generics market has been the key driver of growth (13.8% CAGR over the same period) on account of large-scale patent expiries and global demand for low-cost drugs. IMS Health forecasts the global pharma market to grow at a ~5% CAGR over the next four years to reach a size of over USD 1 tn by 2015. Generics segment is expected to grow at 12%-15% CAGR in the same period to be driven by continuing patent expiries in US and the faster growth in the emerging markets (including Brazil, Russia, India, Mexico and Turkey) and economy like Japan.

The Indian pharmaceutical market has grown at a 14% CAGR over the past 18 years and is expected to register double-digit growth in the near future owing to a rise in pharmaceutical outsourcing and rising investments by multinational companies. New product launches and improving effectiveness of field force additions would support the growth. The sustained performance of the chronic therapies dominates the market and outperformed acute therapies in terms of growth.

Significant opportunities in terms of cost competitiveness relating to the product development and manufacturing along with a large skilled talent pool has helped India emerge as a dominant player in the global generics space. Drug consumption per capita in India is still among the lowest globally. Even adjusting for India having the lowest prices in the world, the per capita consumption volumes are estimated to be 8-12x lower than in the US and Japan. Hence, there is tremendous room for growth for the Indian industry.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY11A	FY12A	FY13E	FY14E
Share Capital	270	271	271	271
Reserve and surplus	20,102	23,746	31,152	38,590
Net Worth	20,372	24,016	31,423	38,861
Minority Interest	267	250	250	250
Long term debt	6,171	13,125	13,394	12,574
Current liabilities	22,591	19,017	21,937	24,920
Other liabilities	101	926	926	926
Deferred Tax Liabilities	1,476	1,500	1,500	1,500
Total liabilities	**50,978**	**58,834**	**69,431**	**79,031**
Goodwill	606	609	609	609
Fixed Assets	21,518	24,248	26,857	28,369
Loans & Advances(LT)	128	151	184	229
Current Assets	25,988	29,472	37,425	45,470
Investments	181	181	181	181
Deferred Tax Assets	2,558	4,174	4,174	4,174
Total assets	**50,978**	**58,834**	**69,431**	**79,031**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY11A	FY12A	FY13E	FY14E
Net Revenue	**29,491**	**40,206**	**49,245**	**58,940**
Expenses	23,568	31,746	39,194	46,790
EBITDA	**5,923**	**8,460**	**10,051**	**12,150**
EBITDA margin (%)	*20.1*	*21.0*	*20.4*	*20.6*
Other Income	1,444	182	208	220
Depreciation	947	979	1,212	1,264
EBIT	**6,420**	**7,663**	**9,048**	**11,105**
Interest	1,605	1,466	1,549	1,429
Profit Before Tax	**4,815**	**6,198**	**7,498**	**9,677**
Tax	237	238	1,387	1,790
Profit After Tax before MI	**4,578**	**5,960**	**6,111**	**7,886**
Minority Interest	(46)	(40)	(40)	(40)
Adj Net Profit	**4,532**	**5,920**	**6,072**	**7,847**
Reported Net Profit	**4,532**	**4,603**	**6,072**	**7,847**
NPM (%)	*15.4*	*11.4*	*12.3*	*13.3*

Key Ratios (Consolidated)

Y/E	FY11A	FY12A	FY13E	FY14E
EBITDA Margin (%)	20.1	21.0	20.4	20.6
EBIT Margin (%)	21.8	19.1	18.4	18.8
NPM (%)	15.4	11.4	12.3	13.3
ROCE (%)	25.8	22.1	21.4	22.7
ROE (%)	22.0	24.4	19.2	20.1
EPS (₹)	16.8	21.9	22.4	29.0
P/E (x)	29.8	22.8	22.3	17.2
BVPS (₹)	76.3	89.7	117.1	144.6
P/BVPS (x)	6.5	5.6	4.3	3.5
EV/Operating Income (x)	18.9	16.9	14.2	11.6
EV/EBITDA (x)	23.5	17.3	14.5	11.9

Valuation and view

Glenmark has differentiated itself among Indian drug companies through its significant success in NCE research. Its partner firm, Salix Pharmaceuticals (Salix has been granted approval for Crofelemer by USFDA. The new product launches in India, ROW and LatAm markets would further provide impetus to the sales. Launch of Crofelemer by Salix, positive data on its NCE pipeline and any out-licensing deal would act as potential triggers, further.

At a current market price (CMP) of ₹500, the stock trades at 22.3x FY13E and of 17.2x FY14E, earnings. We recommend 'BUY' with a target price of ₹595, arrived at 20.5x FY14E EPS which implies potential upside of 19.0% to the CMP from long term (1 year) perspective.

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