

**HOLD**

TP: Rs 620 | ▼ 2%

**GLENMARK LIFE SCIENCES**

Pharmaceuticals

22 July 2023

## Another good quarter; cut to HOLD post rally

- Strong Q1 with EBITDA/PAT beat of 10%/6% despite slight miss on revenue
- Revenue/PAT up 18%/25% YoY accompanied by gross/EBITDA margin expansion of 385bps/345bps
- Limited upside potential following 26% rally in last 3 months; reduce from BUY to HOLD with a new TP of Rs 620 (vs. Rs 600)

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**Growth fuelled by improved demand environment:** GLS continued to deliver broad-based growth as the demand climate turned favourable, with revival in the US market as well as steady traction in Europe, emerging markets, and India. Q1FY24 revenue grew 18% YoY to Rs 5.8bn backed by a healthy performance in both generic API (+13% YoY) and CDMO (+91% YoY) businesses.

External as well GPL (parent Glenmark Pharma) business delivered strong growth of 18% YoY (-15% QoQ) and 19% YoY (-2% QoQ) respectively. The company saw volumes revive from GPL and expects further improvement, with the parent's contribution for the quarter at 34% (flat YoY, -300bps QoQ).

**Product mix improvement and easing RM cost aid margins:** Gross margin expanded 385bps YoY (+225bps QoQ) to 57% due to rationalisation of raw material and solvent cost (~200bps benefit) and an improved product mix. EBITDA margin also improved 345bps (+20bps QoQ) to 33.4% supported by better gross margins and tighter cost control.

**Capacity expansion on track; guidance reiterated:** Management reiterated its guidance of mid-teens' revenue growth with stable EBITDA margin of ~30% for FY24. The ongoing brownfield and greenfield expansion projects are progressing well and GLS envisages capex of Rs 1.5bn-2bn for FY24. Per management, a CDMO partner has received approval for an additional indication, which will drive up business.

**Downgrade to HOLD:** GLS's shares have rallied ~26% in last three months and are trading at 14.7x/12.9x FY24E/FY25E EPS. We slightly tweak FY24/FY25 estimates and hence our two-stage DCF model yields a revised TP of Rs 620 (vs. Rs 600), implying an FY25E P/E of 12.6x. Given the limited upside potential, we downgrade the stock to HOLD from BUY.

### Key changes

Target	Rating
▲	▼

Ticker/Price	GLS IN/Rs 636
Market cap	US\$ 947.9mn
Free float	17%
3M ADV	US\$ 1.5mn
52wk high/low	Rs 659/Rs 370
Promoter/FPI/DII	83%/3%/1%

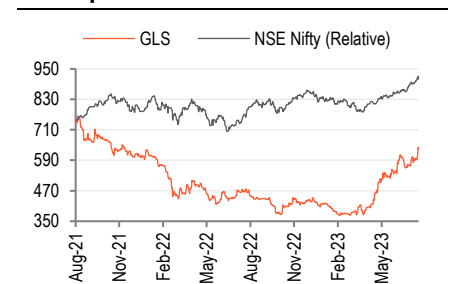
Source: NSE | Price as of 21 Jul 2023

### Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	21,613	24,365	27,334
EBITDA (Rs mn)	6,424	7,317	8,342
Adj. net profit (Rs mn)	4,671	5,303	6,019
Adj. EPS (Rs)	38.1	43.3	49.1
Consensus EPS (Rs)	38.1	43.2	50.1
Adj. ROAE (%)	21.9	22.4	21.8
Adj. P/E (x)	16.7	14.7	12.9
EV/EBITDA (x)	12.4	10.1	8.8
Adj. EPS growth (%)	11.5	13.5	13.5

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

### Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
<b>Revenues</b>	5,785	4,899	18.1	6,213	(6.9)
<b>EBITDA</b>	1,932	1,468	31.6	2,064	(6.4)
Depreciation	126	99	-	115	-
<b>EBIT</b>	1,806	1,369	31.9	1,949	(7.3)
Interest	4	1	-	1	-
Other Income	19	95	-	28	-
<b>PBT</b>	1,821	1,463	24.5	1,976	(7.9)
Less: Taxation	466	375	-	513	-
Less: Minority Interest	0	0	-	0	-
<b>Recurring PAT</b>	1,355	1,087	24.6	1,463	(7.4)
Exceptional items	0	0	-	0	-
<b>Reported PAT</b>	1,355	1,087	24.6	1,463	(7.4)
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>
Gross Margin	57.1	53.3	385	54.9	225
EBITDA Margin	33.4	30.0	344	33.2	18
Tax / PBT	25.6	25.6	-	25.9	-
NPM	24.6	23.2	143	24.9	(33)
EPS	11.1	8.9	24.6	11.9	(7.4)

Source: Company, BOBCAPS Research

**Fig 2 – Revenue Mix**

(Rs mn)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Generic API	5,042	4,448	13.4	5,299	(4.8)
CDMO	464	243	90.9	568	(18.3)
<b>Net Sales</b>	<b>5,506</b>	<b>4,691</b>	<b>17.4</b>	<b>5,867</b>	<b>(6.2)</b>
OOI	279	208	34.3	346	(19.4)
<b>Revenues</b>	<b>5,785</b>	<b>4,899</b>	<b>18.1</b>	<b>6,213</b>	<b>(6.9)</b>

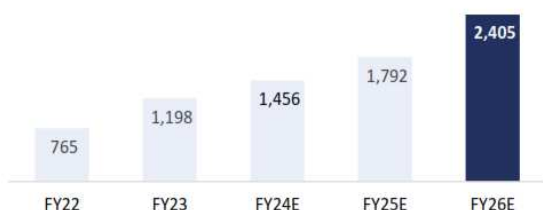
Source: Company, BOBCAPS Research

**Fig 3 – Future capacity expansion plan**

Expansion Type	Division	Location	Status & Planned Capacity	Operational Timelines
Brownfield	API / Intermediate	Ankleshwar	208 KL (Under Construction)	FY24
			Planned addition of 280KL-300KL	FY25-FY26
Brownfield	API	Dahej	Planned addition of 220KL-240KL	FY24-FY26
Greenfield	API	Solapur	CTE received for 1,000MT ~500 KL capacity will be operational by FY26	FY26

**Total Reactor Capacity Expansion Plan (KL)**

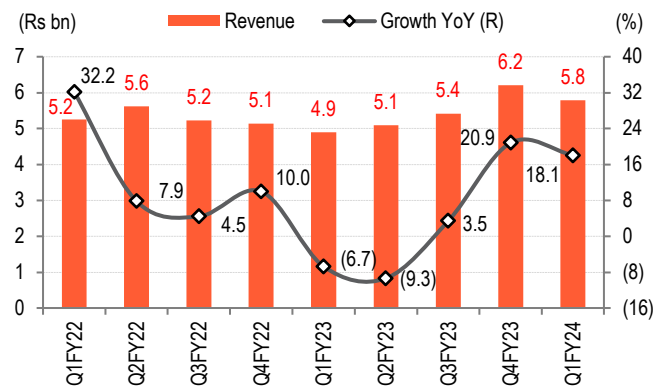
Capacity Progress by Year



- ✓ Backward Integration plant at Ankleshwar of 208KL is under construction.
- ✓ Engineering work started for construction at Solapur Plant of 200KL (Phase 1).
- ✓ Solapur's further capacity expansion will be calibrated as per the volume demand

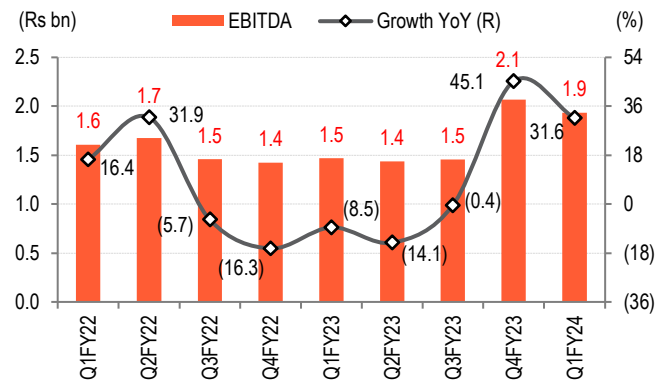
Source: Company, BOBCAPS Research

**Fig 4 – Revenue**



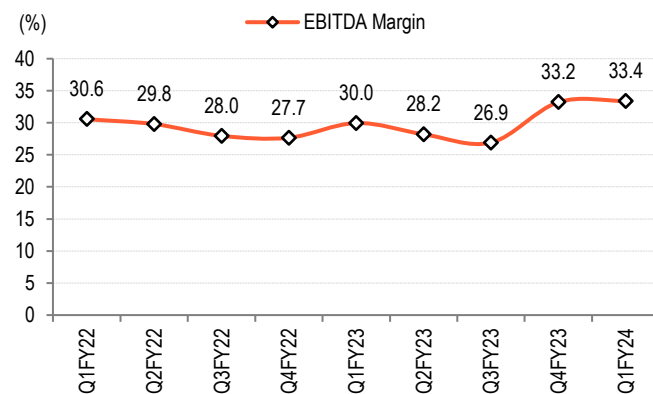
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA**



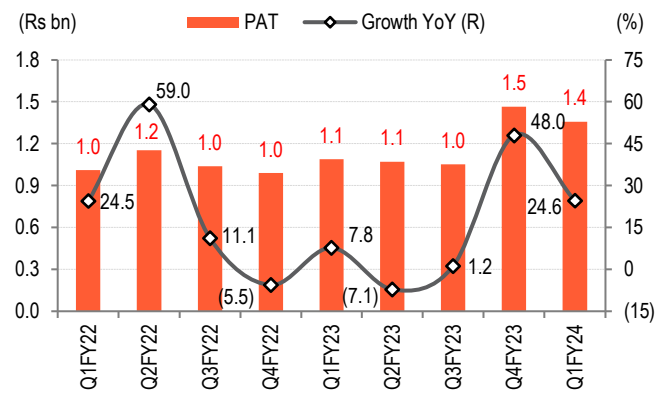
Source: Company, BOBCAPS Research

**Fig 6 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 7 – PAT**



Source: Company, BOBCAPS Research

### Earnings call takeaways

- **Generic API:** The launch of a new CNS product in Q1FY24 as well as momentum in the existing portfolio aided strong growth in CNS therapies.
- **CDMO:** GLS has three existing projects in the CDMO business, one of which has received approval for an additional indication. The fourth project remains delayed because of regulatory filings at the customer’s end.
- **Guidance:** Management expects mid-teens’ revenue growth with stable margins for FY24.
- **Capex:** FY24 capex is planned in the range of Rs 1.5bn-2bn (Rs 350mn spent in Q1).
- **Regulatory audits:** The company’s facilities are overdue for inspection by the USFDA. GLS indicated that it is ready for surprise inspections as well.
- **Progress on capacity expansion:** (1) Ankleshwar: The remaining 208kl intermediate block is under construction out of total manufacturing capacity of 400kl and is due to be operational in the second half of FY24. Additional brownfield capacity in the range of 280kl-300kl will become operational between FY25 and

FY26. (2) Dahej: Additional brownfield capacity of 220kl-240kl will commence between FY24 and FY26.

(3) Solapur: GLS has received environmental clearance and CTE (consent to establish) for the installation of 1,000MT of capacity at the planned greenfield site at Chincholi industrial area. Detailed engineering work has started for the construction of 200kl in phase 1, with total capacity of ~500kl to become operational by FY26. Further expansion will be calibrated as per demand.

- **R&D pipeline progress:** R&D expenditure at Rs 174mn in Q1 was 3% of sales. The company expects R&D spend to stay at ~3% for FY24 as well.
  - GLS has added a new complex molecule to the portfolio backed by customer interest, taking the addressable market for the basket of complex products to US\$ 676mn (Source: IQVIA, MAT Mar'23). The basket is seeded with 6+ customers. One molecule has been filed and the rest are under development.
  - One new iron complex molecule has been added to the existing grid of three molecules, each backed by customer interest. Filing has been completed for one, with two others in advanced stages of development. The total addressable market here is US\$ 1.8bn (Source: IQVIA, MAT Mar'23).
  - Two new high-potent oncology molecules were added to the current grid of nine products, with a total addressable market of ~US\$ 19bn (Source: IQVIA, MAT Mar'23) and 10+ customer tie-ups. Four products have been validated and five are under advanced stages of development.
- **Higher contribution from regulated markets:** Regulated market contribution in Q1FY24 was 78% (vs. 72% in Q1FY23). Chronic therapies contributed 66% of the Q1 revenue.

## Valuation methodology

GLS's shares have rallied ~26% in last three months and are trading at 14.7x/12.9x FY24E/FY25E EPS. We slightly tweak FY24/FY25 estimates and hence our two-stage DCF model yields a revised TP of Rs 620 (vs. Rs 600), implying an FY25E P/E of 12.6x. Given the limited upside potential, we downgrade the stock to HOLD from BUY.

**Fig 8 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Sales	24,365	27,334	24,417	27,349	(0.2)	(0.1)
EBITDA	7,317	8,342	7,093	8,346	3.2	(0.1)
EBITDA margin (%)	30.0	30.5	29.0	30.5	98bps	0bps
EPS (Rs)	43.3	49.1	42.4	49.2	2.1	(0.1)

Source: BOBCAPS Research

**Fig 9 – Key assumptions**

Revenue (Rs bn)	FY23A	FY24E	FY25E
Generic API	19.1	21.4	24.1
CDMO	1.4	1.9	2.1
Other Op. Revenue	1.1	1.1	1.1

Source: Company, BOBCAPS Research

**Fig 10 – Valuation summary**

Variables	Assumptions	Basis
Risk Free Rate (%) (A)	7.4	10Y Average GIND10Y Index
Equity Risk Premium (%) (B)	6.0	(Rm-Rf)
Beta (C)	0.7	5Y Average Beta of Nifty Pharma
Cost of Equity (%) (D) = A + B x C	<b>11.8</b>	
Cost of Debt (%) (E)	NA	Debt free
Marginal Tax Rate (%) (F)	25	
Post-Tax Cost of Debt (%) (G) = E x (1-F)	<b>0</b>	Debt free
Current Debt to Equity (2024) (H)	<b>0</b>	
WACC (%) (I) = (1 x D + H x G)/(1 + H)	<b>11.8</b>	
	<b>Stage 1</b>	<b>Stage 2 (Terminal)</b>
FCF CAGR (FY22-FY33E) (%)	20	3

Source: BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- **CDMO resolution:** Resolution of regulatory hurdles in the fourth CDMO project could take revenue above our estimates.
- **Higher volumes:** Increased volume offtake from formulation companies given ongoing drug shortages in the US would represent an upside risk to our assumptions.

Key downside risks to our estimates are:

- **Regulatory lapses:** The US and EU are key geographies for GLS's clientele, implying potential risk of lapses in maintaining the strict cGMP standards required by regulators in these markets. There have, however, been no regulatory lapses at the company's manufacturing plants to date.
- **Customer concentration:** GLS derived ~55% of revenue from its top-5 clients over FY19-FY21, implying revenue concentration risk.
- **Raw material supply disruptions:** Periodic uncertainty regarding the supply chain from China and other geographies due to various factors and geopolitical tensions poses risks to our assumptions of growth and raw material costs in the near-to-medium term.
- **Pricing pressure:** Pricing pressure from customers may affect gross margins, profitability, and the ability to increase prices.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ajanta Pharma	AJP IN	2.2	1,412	1,520	BUY
Alembic Pharma	ALPM IN	1.7	691	615	HOLD
Alkem Labs	ALKEM IN	5.4	3,701	3,000	SELL
Cipla	CIPLA IN	10.3	1,049	1,170	BUY
Divi's Labs	DIVI IN	11.9	3,688	3,200	HOLD
Dr Reddy's Labs	DRRD IN	10.7	5,288	4,900	HOLD
Eris Lifesciences	ERIS IN	1.2	745	800	BUY
Glenmark Life Sciences	GLS IN	0.9	636	620	HOLD
Laurus Labs	LAURUS IN	2.3	349	340	HOLD
Lupin	LPC IN	5.2	937	700	HOLD
Sun Pharma	SUNP IN	32.0	1,097	1,130	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Jul 2023

## Glossary

Glossary of Abbreviations			
<b>ANDA</b>	Abbreviated New Drug Application	<b>CNS</b>	Central Nervous System
<b>API</b>	Active Pharmaceutical Ingredient	<b>MR</b>	Medical Representative
<b>CDMO</b>	Contract Development and Manufacturing Operations	<b>NLEM</b>	National List of Essential Medicines
<b>CET</b>	Consent to Establish		

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Total revenue</b>	<b>18,852</b>	<b>21,232</b>	<b>21,613</b>	<b>24,365</b>	<b>27,334</b>
EBITDA	5,911	6,160	6,424	7,317	8,342
Depreciation	334	379	421	511	578
EBIT	5,577	5,782	6,003	6,806	7,764
Net interest inc./(exp.)	(875)	(280)	(5)	(6)	0
Other inc./(exp.)	8	147	290	285	262
Exceptional items	0	0	0	0	0
EBT	4,709	5,649	6,287	7,085	8,026
Income taxes	1,194	1,462	1,616	1,782	2,006
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>3,516</b>	<b>4,187</b>	<b>4,671</b>	<b>5,303</b>	<b>6,019</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>3,516</b>	<b>4,187</b>	<b>4,671</b>	<b>5,303</b>	<b>6,019</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	2,213	3,077	3,966	2,805	3,014
Other current liabilities	251	602	901	698	786
Provisions	199	144	155	177	199
Debt funds	9,551	29	194	0	0
Other liabilities	0	0	0	0	0
Equity capital	20	245	245	245	245
Reserves & surplus	7,737	20,613	21,561	25,274	29,487
Shareholders' fund	7,756	20,858	21,806	25,519	29,732
<b>Total liab. and equities</b>	<b>19,971</b>	<b>24,710</b>	<b>27,021</b>	<b>29,198</b>	<b>33,731</b>
Cash and cash eq.	1,156	5,121	3,094	6,894	9,331
Accounts receivables	6,195	6,735	8,068	7,012	7,895
Inventories	5,134	5,162	6,042	5,354	6,029
Other current assets	1,616	823	1,395	931	1,048
Investments	1	1	1	1	1
Net fixed assets	5,649	5,847	7,749	8,247	8,665
CWIP	141	970	616	616	616
Intangible assets	79	51	57	143	147
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>19,971</b>	<b>24,710</b>	<b>27,021</b>	<b>29,198</b>	<b>33,731</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Cash flow from operations</b>	<b>3,691</b>	<b>6,230</b>	<b>3,512</b>	<b>6,686</b>	<b>5,242</b>
Capital expenditures	(571)	(588)	(1,659)	(1,700)	(1,000)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(571)</b>	<b>(588)</b>	<b>(1,659)</b>	<b>(1,700)</b>	<b>(1,000)</b>
Equities issued/Others	0	225	0	0	0
Debt raised/repaid	(1,186)	(9,522)	165	(194)	0
Interest expenses	(875)	(280)	(5)	(6)	0
Dividends paid	0	(2,579)	(1,401)	(1,591)	(1,806)
Other financing cash flows	(3)	10,480	(2,638)	605	0
<b>Cash flow from financing</b>	<b>(2,065)</b>	<b>(1,676)</b>	<b>(3,879)</b>	<b>(1,186)</b>	<b>(1,806)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>1,056</b>	<b>3,966</b>	<b>(2,027)</b>	<b>3,800</b>	<b>2,436</b>
<b>Closing cash &amp; cash eq.</b>	<b>1,156</b>	<b>5,121</b>	<b>3,094</b>	<b>6,894</b>	<b>9,331</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	31.9	34.2	38.1	43.3	49.1
Adjusted EPS	32.6	34.2	38.1	43.3	49.1
Dividend per share	0.0	21.1	11.4	13.0	14.7
Book value per share	63.3	170.2	178.0	208.3	242.7

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	4.7	4.1	3.7	3.0	2.7
EV/EBITDA	15.1	14.2	12.4	10.1	8.8
Adjusted P/E	19.5	18.6	16.7	14.7	12.9
P/BV	10.0	3.7	3.6	3.1	2.6

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Tax burden (Net profit/PBT)	74.7	74.1	74.3	74.9	75.0
Interest burden (PBT/EBIT)	84.4	97.7	104.7	104.1	103.4
EBIT margin (EBIT/Revenue)	29.6	27.2	27.8	27.9	28.4
Asset turnover (Rev./Avg TA)	29.2	27.8	25.2	25.6	24.7
Leverage (Avg TA/Avg Equity)	2.7	1.3	1.0	1.0	1.0
<b>Adjusted ROAE</b>	<b>58.9</b>	<b>29.3</b>	<b>21.9</b>	<b>22.4</b>	<b>21.8</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	22.6	12.6	1.8	12.7	12.2
EBITDA	25.2	4.2	4.3	13.9	14.0
Adjusted EPS	12.3	4.8	11.5	13.5	13.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	31.4	29.0	29.7	30.0	30.5
EBIT margin	29.6	27.2	27.8	27.9	28.4
Adjusted profit margin	18.6	19.7	21.6	21.8	22.0
Adjusted ROAE	58.9	29.3	21.9	22.4	21.8
ROCE	34.7	31.0	29.3	29.8	29.1
<b>Working capital days (days)</b>					
Receivables	121	118	144	110	110
Inventory	101	90	108	84	84
Payables	43	54	71	44	42
<b>Ratios (x)</b>					
Gross asset turnover	2.9	3.0	2.5	2.3	2.4
Current ratio	5.3	4.7	3.7	5.5	6.1
Net interest coverage ratio	6.4	20.7	1,097.4	1,171.9	
<b>Adjusted debt/equity</b>	<b>1.1</b>	<b>(0.2)</b>	<b>(0.1)</b>	<b>(0.3)</b>	<b>(0.3)</b>

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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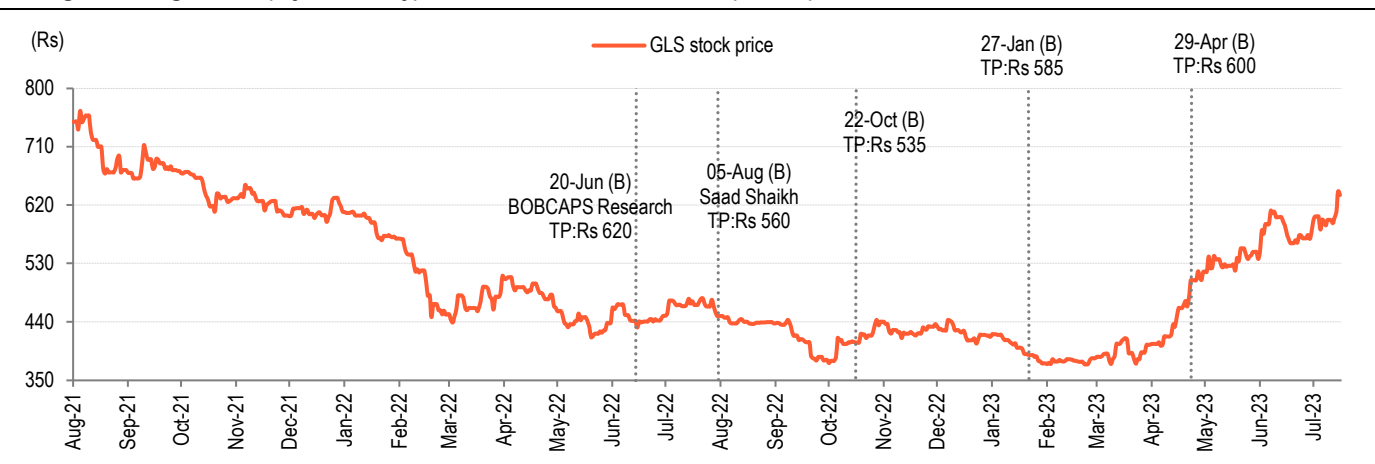
### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

- BUY** – Expected return >+15%
- HOLD** – Expected return from -6% to +15%
- SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): GLENMARK LIFE SCIENCES (GLS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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