

**HOLD**

TP: Rs 620 | ▼ 1%

**GLENMARK LIFE SCIENCES**

| Pharmaceuticals

| 21 October 2023

## Revenue in line but higher opex dampens margins

- Q2 revenue in line at Rs 6bn but EBITDA/PAT 3%/6% below our estimates due to higher opex and a product mix change
- 5Y agreement with Glenmark Pharma (GPL) to safeguard business interest after stake sale to Nirma group
- We largely retain our estimates and reiterate our DCF-based TP of Rs 620 and HOLD rating

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**Revenue growth led by generic APIs; CDMO disappoints:** GLS reported 17% YoY revenue growth in Q2FY24 to Rs 6bn led by a 20% increase in generic API sales that comprised robust business from GPL and steady external API income. Regulated markets, including the US, Europe, LATAM and India, continued to spearhead growth, with the CVS and CNS API portfolios faring well. CDMO business contracted 18% YoY due to a temporary blip in demand for one product. Management stated that it is in talks with several companies globally and expects to add 2-3 CDMO projects to its portfolio in the next 2-3 years.

**Seasonality, mix change and higher opex hurt margins QoQ:** Gross margin expanded 125bps YoY, but EBITDA margin was flat at 28.1% due to higher opex, specifically employee cost. Sequentially, gross/EBITDA margins contracted 300bps/530bps due to a change in product mix towards the low-margin generic business, as CDMO revenue contribution halved to 4% from 8% in the previous quarter. Seasonality also had a role to play. EBITDA/PAT thus declined 14%/12% QoQ to Rs 1.7bn/Rs 1.2bn in Q2, falling 3%/6% short of our estimates.

**Guidance intact; growth plans seen unaffected by management change:** Last month, detergent soap maker Nirma acquired a 75% stake in GLS for ~Rs 56.5bn. GLS's management reiterated that the change in ownership will not have any impact on growth plans and profitability. The company has a five-year agreement with GPL that will ensure business continuity but will lower dependence on the GPL in the long run as planned earlier. Management reiterated its mid-teens revenue growth and ~30% EBITDA margin guidance for FY24.

**Maintain HOLD:** GLS's shares are trading at 14.6x/12.7x FY24E/FY25E EPS. We leave our FY24/FY25 estimates largely unchanged and introduce FY26 forecasts. Our two-stage DCF model yields a TP of Rs 620, implying an FY25E P/E of 12.4x. Given the low upside potential, we maintain our HOLD rating on the stock.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	GLS IN/Rs 624
Market cap	US\$ 930.0mn
Free float	17%
3M ADV	US\$ 2.1mn
52wk high/low	Rs 675/Rs 370
Promoter/FPI/DII	83%/4%/1%

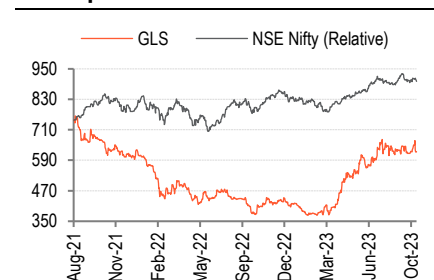
Source: NSE | Price as of 20 Oct 2023

## Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	21,613	24,497	27,480
EBITDA (Rs mn)	6,424	7,295	8,388
Adj. net profit (Rs mn)	4,691	5,235	6,036
Adj. EPS (Rs)	38.3	42.7	49.3
Consensus EPS (Rs)	38.3	47.7	51.5
Adj. ROAE (%)	22.0	22.1	21.9
Adj. P/E (x)	16.3	14.6	12.7
EV/EBITDA (x)	12.2	10.0	8.7
Adj. EPS growth (%)	12.0	11.6	15.3

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Revenue	5,954	5,094	16.9	5,785	2.9	11,739	9,993	17.5
EBITDA	1,671	1,437	16.3	1,932	(13.5)	3,603	2,905	24.0
Depreciation	131	99	-	126	-	257	198	-
EBIT	1,540	1,338	15.1	1,806	(14.7)	3,346	2,707	23.6
Interest	4	1	-	4	-	8	3	-
Other Income	54	100	-	19	-	72	195	-
PBT	1,590	1,437	10.6	1,821	(12.7)	3,410	2,899	17.6
Less: Taxation	402	367	-	466	-	867	742	-
Less: Minority Interest	0	0	-	0	-	0	0	-
Recurring PAT	1,188	1,070	11.0	1,355	(12.3)	2,543	2,157	17.9
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,188	1,070	11.0	1,355	(12.3)	2,543	2,157	17.9
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	54.1	52.9	124	57.1	(299)	55.6	53.1	253
EBITDA Margin	28.1	28.2	(15)	33.4	(533)	30.7	29.1	162
Tax / PBT	25.3	25.5	-	25.6	-	25.4	25.6	-
NPM	20.9	22.1	(118)	24.6	(370)	22.7	22.6	10.3
EPS	9.7	8.7	11.0	11.1	(12.3)	20.8	17.6	17.9

Source: Company, BOBCAPS Research

**Fig 2 – Revenue mix**

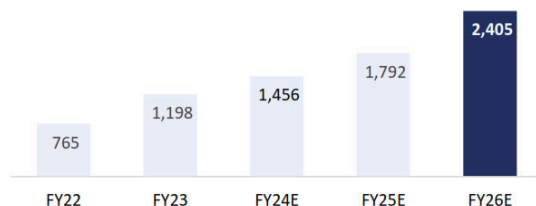
(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Generic API	5,428	4,534	19.7	5,042	7.7	10,470	8,982	16.6
CDMO	253	309	(18.1)	464	(45.5)	717	552	29.9
Net Sales	5,681	4,843	17.3	5,506	3.2	11,187	9,534	17.3
OOI	273	251	8.8	279	(2.2)	552	459	20.3
Revenues	5,954	5,094	16.9	5,785	2.9	11,739	9,993	17.5

Source: Company, BOBCAPS Research

**Fig 3 – 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

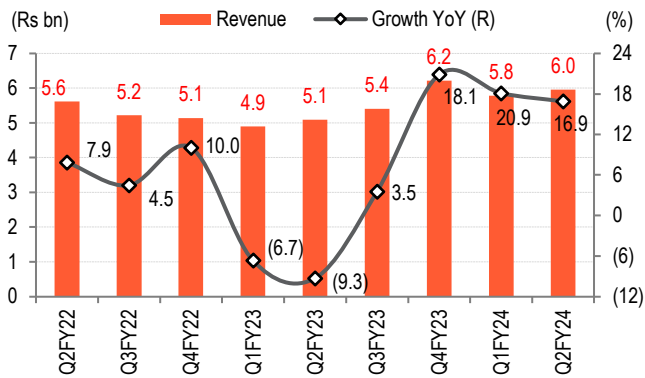
**Total Reactor Capacity Expansion Plan (KL)**



- ✓ 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

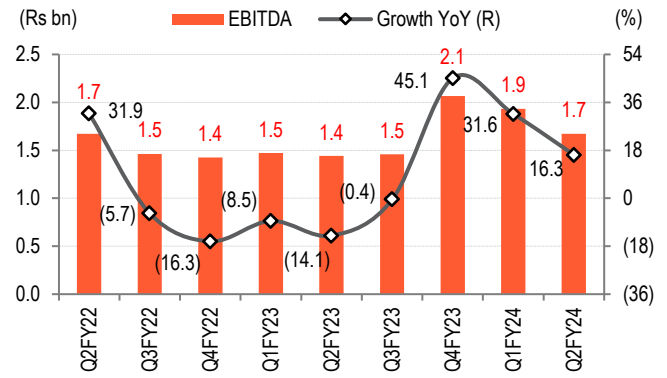
Source: Company, BOBCAPS Research

**Fig 4 – Revenue**



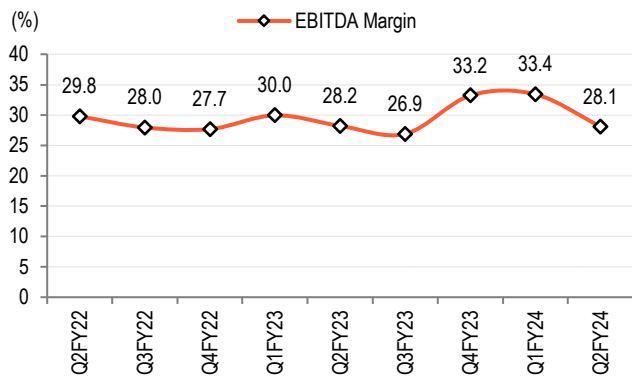
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA**



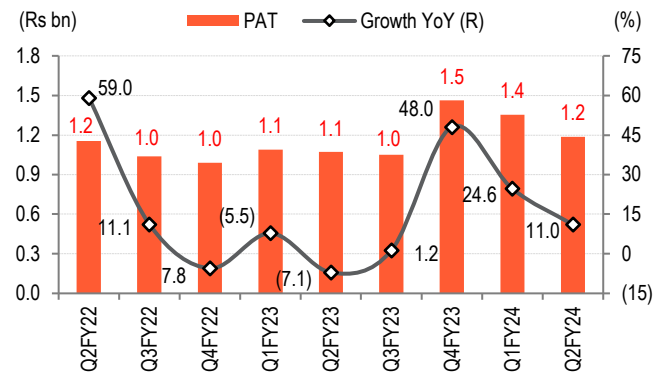
Source: Company, BOBCAPS Research

**Fig 6 – EBITDA margin**



Source: Company, BOBCAPS Research

**Fig 7 – PAT**



Source: Company, BOBCAPS Research

### Earnings call highlights

- **Revenue mix:** Revenue contribution from regulated markets was stable at 79.5% in Q2FY24. Chronic therapies contributed 68% of GLS’s revenue, with the CVS and CNS portfolios continuing to deliver strong growth.
- **Generic API:** Generic API revenue grew 20% YoY to Rs 5.4bn, propelled by robust GPL business and steady external API income, with strong growth in the regulated markets of the US, Europe LATAM and India.
  - GLS added three new products to the grid, of which one is a high-potent API (HP API) oncology molecule and two are synthetic small molecules.
  - The company’s high performance API portfolio now extends to 12 products with an addressable market of US\$ 21bn (Source: IQVIA, MAT Jun’23). Of these, 3 products are validated and 3 are in the advanced stage of development.
  - Per management, development of the new iron complex molecule added last quarter is progressing well. Filing has been completed for one iron complex molecule with two others in the advanced stage of development. These molecules have an addressable market of US\$ 1.8bn (Source: IQVIA, MAT Jun’23).

- **CDMO:** CDMO revenue at Rs 253mn declined 18% YoY due to temporarily low demand for one product. Management stated that it is in talks with several companies globally and expects to add 2-3 CDMO projects to its portfolio over the next 2-3 years.
- **Margin:** Sequential gross and EBITDA margin contraction of 300bps/530bps stemmed from a change in product mix towards the low-margin generic business, as CDMO revenue contribution halved QoQ to 4%. Seasonality and higher employee costs YoY and QoQ also dampened margins.
- **Working capital:** Management does not see an immediate change in working capital levels as it would like to maintain enough inventory to overcome any supply chain constraints in a challenging global geopolitical climate.
- **PLI benefit:** Production-linked incentive (PLI) benefits will cease once Nirma acquires the 75% stake in GLS but will not have a meaningful impact on earnings, per management.
- **Capex:** Capital expenditure for H1FY24 stood at Rs 627mn.
- **Cash generation:** During H1FY24, GLS recorded strong free cash flow of Rs 1.5bn, leading to cash & cash equivalents of Rs 4.4bn as on 30 Sep 2023. The company's balance sheet remains debt-free.

## Valuation methodology

GLS's shares are trading at 14.6x/12.7x FY24E/FY25E EPS. We leave our FY24/FY25 estimates largely unchanged and introduce FY26 forecasts. Our two-stage DCF model yields a TP of Rs 620, implying an FY25E P/E of 12.4x. Given the low upside potential, we maintain our HOLD rating on the stock.

**Fig 8 – Revised estimates**

(Rs bn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Sales	24.5	27.5	30.0	24.4	27.3	NA	0.5	0.5	-
EBITDA	7.3	8.4	9.7	7.3	8.3	NA	(0.3)	0.6	-
EBITDA margin (%)	29.8	30.5	32.3	30.0	30.5	NA	(25bps)	1bps	-
EPS (Rs)	42.7	49.3	55.0	43.3	49.1	NA	(1.3)	0.3	-

Source: BOBCAPS Research

**Fig 9 – Key assumptions**

Revenue (Rs bn)	FY23A	FY24E	FY25E	FY26E
Generic API	19.1	21.9	24.7	27.1
CDMO	1.4	1.5	1.6	1.7
Other Operating Revenue	1.1	1.1	1.1	1.2

Source: Company, BOBCAPS Research

**Fig 10 – DCF 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 (2023) (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 (FY23-FY33E) (%)	25	3

Source: BOBCAPS Research

## Key risks

Key upside risks to our estimates are:

- **CDMO resolution:** CDMO is a lumpy business and faster than anticipated ramp-up could take revenue above our estimates.
- **Higher volumes:** Increased volume offtake from formulation companies given ongoing drug shortages in the US represents an upside risk to our assumptions.

Key downside risks to our estimates are:

- **Regulatory lapses:** The US and the 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 derives more than half of its revenue from its top 5 customers, pointing to potential revenue concentration risk.
- **Raw material supply disruptions:** Periodic uncertainty regarding the supply chain out of China and other geographies due to various factors, including 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	2.7	1,754	1,860	BUY
Alembic Pharma	ALPM IN	1.9	798	615	HOLD
Alkem Labs	ALKEM IN	5.2	3,586	3,300	SELL
Aurobindo Pharma	ARBP IN	6.2	866	880	HOLD
Cipla	CIPLA IN	11.8	1,200	1,250	BUY
Divi's Labs	DIVI IN	11.5	3,554	3,200	HOLD
Dr Reddy's Labs	DRRD IN	11.3	5,569	4,900	HOLD
Eris Lifesciences	ERIS IN	1.4	871	955	BUY
Glenmark Life Sciences	GLS IN	0.9	624	620	HOLD
Laurus Labs	LAURUS IN	2.6	401	340	HOLD
Lupin	LPC IN	6.5	1,180	800	SELL
Sun Pharma	SUNP IN	33.3	1,142	1,160	HOLD

Source: BOBCAPS Research, NSE | Price as of 20 Oct 2023

## Glossary

Glossary of Abbreviations			
<b>API</b>	Active Pharmaceutical Ingredient	<b>cGMP</b>	Current Good Manufacturing Practices
<b>CDMO</b>	Contract Development and Manufacturing Operations	<b>LATAM</b>	Latin America
<b>CNS</b>	Central Nervous System	<b>PLI</b>	Production Linked Incentive
<b>CVS</b>	Cardiovascular		

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Total revenue</b>	<b>21,232</b>	<b>21,613</b>	<b>24,497</b>	<b>27,480</b>	<b>30,038</b>
EBITDA	6,160	6,424	7,295	8,388	9,694
Depreciation	379	401	536	603	994
EBIT	5,782	6,023	6,759	7,785	8,701
Net interest inc./(exp.)	(280)	(5)	(15)	0	0
Other inc./(exp.)	147	290	255	263	289
Exceptional items	0	0	0	0	0
EBT	5,649	6,307	7,000	8,048	8,989
Income taxes	1,462	1,616	1,765	2,012	2,247
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>4,187</b>	<b>4,691</b>	<b>5,235</b>	<b>6,036</b>	<b>6,742</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>4,187</b>	<b>4,691</b>	<b>5,235</b>	<b>6,036</b>	<b>6,742</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	3,077	3,966	3,204	3,607	3,953
Other current liabilities	602	901	702	790	289
Provisions	144	155	177	200	219
Debt funds	29	194	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	245	245	245	245	245
Reserves & surplus	20,613	21,561	25,226	29,451	34,171
Shareholders' fund	20,858	21,806	25,471	29,696	34,416
<b>Total liab. and equities</b>	<b>24,710</b>	<b>27,021</b>	<b>29,554</b>	<b>34,294</b>	<b>38,876</b>
Cash and cash eq.	5,121	2,474	4,349	6,700	9,570
Accounts receivables	6,735	8,068	8,010	9,018	9,882
Inventories	5,162	6,042	6,408	7,215	7,906
Other current assets	823	1,395	1,403	1,580	1,731
Investments	1	1	1	1	1
Net fixed assets	5,847	8,436	8,703	9,102	9,098
CWIP	970	616	616	616	616
Intangible assets	51	(10)	64	61	72
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>24,710</b>	<b>27,021</b>	<b>29,554</b>	<b>34,294</b>	<b>38,876</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Cash flow from operations</b>	<b>6,230</b>	<b>3,512</b>	<b>4,531</b>	<b>5,161</b>	<b>5,893</b>
Capital expenditures	(588)	(2,257)	(1,468)	(1,000)	(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>(588)</b>	<b>(2,257)</b>	<b>(1,468)</b>	<b>(1,000)</b>	<b>(1,000)</b>
Equities issued/Others	225	0	0	0	0
Debt raised/repaid	(9,522)	165	(194)	0	0
Interest expenses	(280)	(5)	(15)	0	0
Dividends paid	(2,579)	(1,407)	(1,571)	(1,811)	(2,023)
Other financing cash flows	10,480	(2,654)	591	0	0
<b>Cash flow from financing</b>	<b>(1,676)</b>	<b>(3,902)</b>	<b>(1,187)</b>	<b>(1,811)</b>	<b>(2,023)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>3,966</b>	<b>(2,647)</b>	<b>1,875</b>	<b>2,351</b>	<b>2,870</b>
<b>Closing cash &amp; cash eq.</b>	<b>5,121</b>	<b>2,474</b>	<b>4,349</b>	<b>6,700</b>	<b>9,570</b>

### Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	34.2	38.3	42.7	49.3	55.0
Adjusted EPS	34.2	38.3	42.7	49.3	55.0
Dividend per share	21.1	11.5	12.8	14.8	16.5
Book value per share	170.2	178.0	207.9	242.4	280.9

### Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	4.0	3.6	3.0	2.7	2.4
EV/EBITDA	13.9	12.2	10.0	8.7	7.3
Adjusted P/E	18.3	16.3	14.6	12.7	11.3
P/BV	3.7	3.5	3.0	2.6	2.2

### DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	74.1	74.4	74.8	75.0	75.0
Interest burden (PBT/EBIT)	97.7	104.7	103.6	103.4	103.3
EBIT margin (EBIT/Revenue)	27.2	27.9	27.6	28.3	29.0
Asset turnover (Rev./Avg TA)	27.8	25.2	25.8	24.9	23.4
Leverage (Avg TA/Avg Equity)	1.3	1.0	1.0	1.0	1.0
<b>Adjusted ROAE</b>	<b>29.3</b>	<b>22.0</b>	<b>22.1</b>	<b>21.9</b>	<b>21.0</b>

### Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>YoY growth (%)</b>					
Revenue	12.6	1.8	13.3	12.2	9.3
EBITDA	4.2	4.3	13.6	15.0	15.6
Adjusted EPS	4.8	12.0	11.6	15.3	11.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	29.0	29.7	29.8	30.5	32.3
EBIT margin	27.2	27.9	27.6	28.3	29.0
Adjusted profit margin	19.7	21.7	21.4	22.0	22.4
Adjusted ROAE	29.3	22.0	22.1	21.9	21.0
ROCE	31.0	29.4	29.6	29.2	28.0
<b>Working capital days (days)</b>					
Receivables	118	144	125	125	125
Inventory	90	108	100	100	100
Payables	54	71	50	50	50
<b>Ratios (x)</b>					
Gross asset turnover	3.0	2.3	2.3	2.3	2.3
Current ratio	4.7	3.6	4.9	5.3	6.5
Net interest coverage ratio	20.7	1,101.1	465.6		
<b>Adjusted debt/equity</b>	<b>(0.2)</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.3)</b>

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

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SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**

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**BUY** – Expected return >+15%

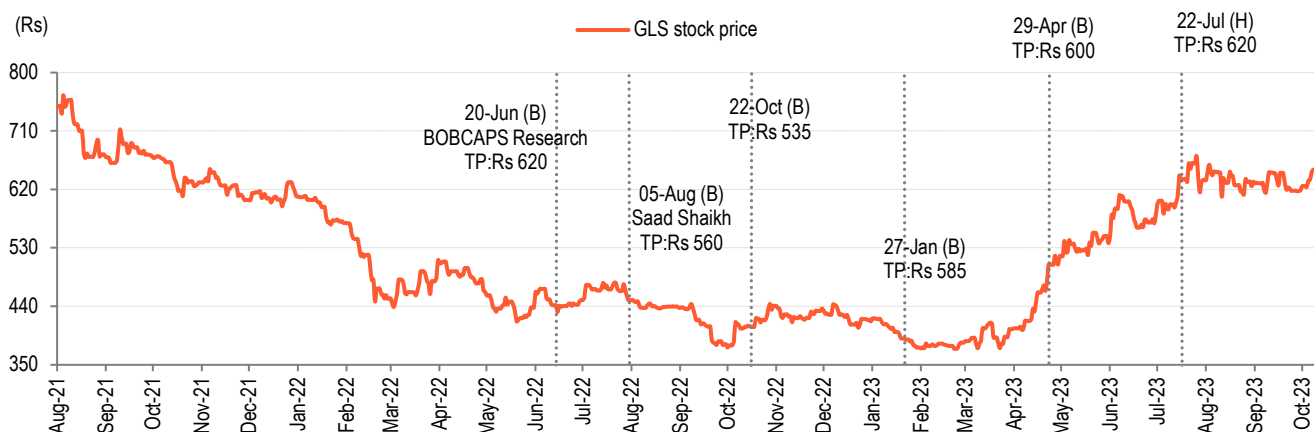
**HOLD** – Expected return from -6% to +15%

**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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