

BUY

TP: Rs 535 | ▲ 31%

GLENMARK LIFE SCIENCES

| Pharmaceuticals

| 22 October 2022

Slowdown in parent-led business weakens revenue

- Q2 revenue fell 9% YoY led by a 10% decline in API business owing to lower sales to parent Glenmark Pharma (-33% YoY)
- Tepid Covid portfolio contribution and the geopolitical-led slowdown in Europe exacerbated topline pressure
- We cut FY23/FY24 EBITDA 9%/8%, translating to a revised TP of Rs 535 (vs. Rs 560); maintain BUY

Saad Shaikh

research@bobcaps.in

Generic API decline weighs on topline: GLS reported a 9% YoY drop in Q2FY23 revenue to Rs 4.8bn on account of a 33% YoY (-19% QoQ) decline in API business from parent Glenmark Pharma (GPL: to 26% total revenue share vs. 41%/34% in Q2FY22/ Q1FY23). The decline was exacerbated by weak Covid portfolio contribution. Generic API declined 10% YoY (+2% QoQ) in Q2 and CDMO dropped 37% while recovering sequentially (+27% QoQ) as the impact of inventory rationalisation ebbed. Excluding Covid-led sales in the base quarter, the company reported a 4% YoY decline in overall revenue.

Strong India business; US reminded muted: Geography-wise, LATAM, Japan and India business (ex-GPL) continued the strong growth momentum in generic API and Europe picked up, whereas US business witnessed muted demand.

Healthy growth in business ex-GPL: External business (ex-GPL) was the key driver for the quarter, growing 13% YoY and 16% QoQ. This was backed by healthy growth in regulated markets (75% revenue share) and a strong rise in CDMO business.

Update on capex: GLS completed API capex at its Dahej (Gujarat) plant and has commenced commercial production from Q3FY23. This has added 240KL of capacity to the generic API segment from Q3FY23, increasing the total capacity by 30%. Also, brownfield expansion at Dahej for the oncology plant has been completed and product trials/exhibit batches have already begun for some of the products.

Maintain BUY: Anticipating higher costs related to commissioning of the new facility at Dahej and given the H1FY23 revenue/EBITDA decline of 11% YoY each, we cut our FY23/FY24 EBITDA estimates by 8-10%. Our two-stage DCF model thus yields a revised TP of Rs 535 (vs. Rs 560), an implied FY24E P/E of 14x – ~20% discount to the peer group average. We continue to like GLS for its strong market position in key APIs and focus on product value over volumes, which translates to a superior margin profile. Maintain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	GLS IN/Rs 408
Market cap	US\$ 604.7mn
Free float	17%
3M ADV	US\$ 0.7mn
52wk high/low	Rs 667/Rs 370
Promoter/FPI/DII	83%/8%/1%

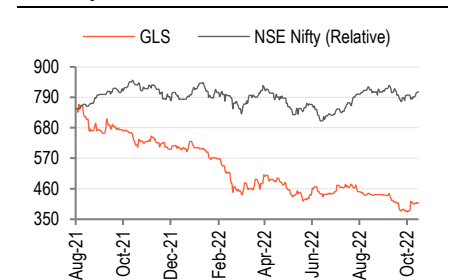
Source: NSE | Price as of 21 Oct 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	21,232	20,034	22,404
EBITDA (Rs mn)	6,160	5,562	6,733
Adj. net profit (Rs mn)	4,187	4,024	4,767
Adj. EPS (Rs)	34.2	32.8	38.9
Consensus EPS (Rs)	34.2	38.3	43.8
Adj. ROAE (%)	31.0	19.5	20.1
Adj. P/E (x)	11.9	12.4	10.5
EV/EBITDA (x)	9.7	9.4	6.7
Adj. EPS growth (%)	4.8	(3.9)	18.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **Regulated markets:** Regulated markets contributed 75% of total revenue in Q2FY23 and grew at 7% QoQ.
- **Emerging markets:** Emerging markets remained stable YoY (ex-Covid portfolio).
- **Raw material prices:** Input prices are currently stable. Solvents are softening and had a positive impact QoQ. Transportation cost (majorly airfreight) does not have much impact as GLS is a low-volume player, though this cost is higher than pre-Covid levels.
- **Margin guidance:** Management is confident of achieving EBITDA margin of 30% in FY23.
- **Other operating income:** GLS saw a jump in other operating income on account of production-linked incentives (PLI).
- **DMF filing:** The company indicated that it is on track to file 8-10 DMFs per year.
- **Capacity utilisation:** Current utilisation is at 95% and management expects the new capacity to be at 50-60% levels by FY23-end or latest within 12 months.
- **Greenfield expansion:** The Solapur site has received permission, but the company is going about the expansion in a measured manner so as not to overbuild capacities. The Sholapur facility will initially drive the ROW markets besides serving as a backward integration play.
- **Capex:** GLS spent Rs 1bn on capex in H1FY23 and expects to incur a similar number in H2.
- **Working capital:** In Q2, working capital days stood at 173 (vs 153 in FY22) given management's strategic decision to hold higher inventory in order to ride out the global uncertainty.

Fig 1 – Quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	4,843	5,537	(12.5)	4,691	3.2	9,534	10,729	(11.1)
Other Op. Income	251	81	-	208	-	459	137	-
Total Income	5,094	5,618	(9.3)	4,899	4.0	9,993	10,867	-
EBITDA	1,437	1,673	(14.1)	1,468	(2.1)	2,905	3,278	(11.4)
Depreciation	99	97	-	99	-	198	186	-
EBIT	1,338	1,577	(15.1)	1,369	(2.3)	2,707	3,092	(12.5)
Interest	1	72	-	1	-	3	278	-
Other Income	100	21	-	95	-	195	61	-
PBT	1,437	1,525	(5.8)	1,463	(1.8)	2,899	2,875	0.9
Less: Taxation	367	373	-	375	-	742	714	-
Less: Minority Interest	0	0	-	0	-	0	0	-
Recurring PAT	1,070	1,152	(7.1)	1,087	(1.6)	2,157	2,161	(0.2)
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,070	1,152	(7.1)	1,087	(1.6)	2,157	2,161	(0.2)
Key Ratios (%)			bps		bps			bps
Gross Margin	50.4	51.0	(57)	51.2	(76)	50.8	50.5	27.3
EBITDA Margin	29.7	30.2	(54)	31.3	(161)	30.5	30.6	(7.9)
Tax / PBT	25.5	24.5	-	25.6	-	25.6	24.8	-
NPM	22.1	20.8	128	23.2	(109)	22.6	20.1	248.4
EPS	8.7	9.4	(7)	8.9	(1.6)	17.6	17.6	(0.2)

Source: Company, BOBCAPS Research

Fig 2 – Segmental performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Generic API	4,534	5,047	(10.2)	4,448	1.9	8,982	9,850	(8.8)
CDMO	309	490	(37.0)	243	27.2	552	879	(37.2)
Net Sales	4,843	5,537	(12.5)	4,691	3.2	9,534	10,729	-
OOI	251	81	211.8	208	20.8	459	137	234.4
Revenues	5,094	5,618	(9.3)	4,899	4.0	9,993	10,867	(8.0)

Source: Company, BOBCAPS Research

Valuation methodology

We like GLS for its strong market position in key APIs and focus on product value over volumes which translates to a superior margin profile. Management has guided for investments of Rs 6bn-6.5bn toward manufacturing capacities to meet demand from the expanding API portfolio and CDMO clientele over FY20-FY25. Given that Rs 3.2bn of this capex drive has been implemented over FY20-FY22 and that internal accruals are intended as a major source of funding, we believe the investment plan will be backended in nature while retaining the emphasis on profitable growth.

The stock is trading at attractive valuations of 12.5x/10.5x P/E and 8.1x/6.3x EV/EBITDA on FY23E/FY24E. Anticipating higher costs related to commissioning of the new facility at Dahej and given the H1FY23 revenue/EBITDA decline of 11% YoY each, we cut our FY23/FY24 EBITDA estimates by 9%/8%. Our two-stage DCF model thus yields a revised TP of Rs 535 (vs. Rs 560), an implied FY24E P/E of 14x – ~20% discount to the peer group average (NLL, SLPA, ARTD & SOLARA). Maintain BUY.

Fig 3 – Revised estimates

(Rs bn)	New			Old		Change (%)	
	FY22A	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Sales	21.2	20.0	22.4	20.9	24.3	(4)	(7.8)
EBITDA	6.2	5.6	6.7	6.1	7.3	(9.3)	(7.6)
EBITDA margin (%)	29.0	27.8	30.1	29.3	30.0	(155)	5
EPS (Rs)	34.2	32.8	38.9	36.0	42.4	(8.7)	(8.2)

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY22A	FY23E	FY24E
Generic API	19.2	18.4	20.2
CDMO	1.7	1.3	1.8
OOI	0.4	0.3	0.3

Source: Company, BOBCAPS Research

Fig 5 – Valuation summary

Variables	Assumptions	Basis
Risk Free Rate (%) (A)	7.4	10Y Average GIND10Y Index
Equity Risk Premium (%) (B)	6.1	(Rm-Rf)
Beta (C)	0.72	5Y Average Beta of Nifty Pharma
Cost of Equity (%) (D) = A + B x C	11.8	
Cost of Debt (E)	9	As of FY21
Marginal Tax Rate (%) (F)	25	
Post-Tax Cost of Debt (%) (G) = E x (1-F)	7	
Current Debt to Equity (2024) (H)	0	
WACC (I) = (1 x D + H x G)/(1 + H)	11.8	
	Stage 1	Stage 2 (Terminal)
FCF CAGR (FY22-FY32E) (%)	3.9	3

Source: BOBCAPS Research

Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY22-24E (%)	PE (Rs)		ROE (%)		Implied FY24 P/E (x)
					FY23E	FY24E	FY23E	FY24E	
Glenmark Lifesciences	GLS IN	BUY	535	4.5	12.4	10.5	19.5	20.1	13.7
Neuland*	NLL IN	NR	NA	15.3	23.5	17.9	9.5	11.3	-
Shilpa*	SLPA IN	NR	NA	6.51	29.7	22.9	5.1	6.3	-
Aarti*	ARTD IN	NR	NA	15.6	18	13.6	20.5	22.4	-
Solara*	SOLARA IN	NR	NA	14.1	NA	23.5	-0.9	4.2	-

Source: BOBCAPS Research | * Bloomberg Consensus Estimates

Key risks

Key downside risks to our estimates are:

- **Regulatory lapses:** The US and EU are key geographies for GLS's clientele, implying the 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 56% 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 local pandemic-linked lockdowns 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	1.9	1,232	1,500	BUY
Alembic Pharma	ALPM IN	1.3	543	770	HOLD
Alkem Labs	ALKEM IN	4.5	3,096	3,220	HOLD
Aurobindo Pharma	ARBP IN	3.7	524	695	BUY
Divi's Labs	DIVI IN	11.5	3,571	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.7	4,331	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	731	970	BUY
Glenmark Life Sciences	GLS IN	0.6	408	535	BUY
Laurus Labs	LAURUS IN	3.2	486	645	BUY
Lupin	LPC IN	3.7	679	600	SELL
Sun Pharma	SUNP IN	28.3	978	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Oct 2022

Glossary

API	Active Pharmaceutical Ingredient	DMF	Drug Master File
CDMO	Contract Development and Manufacturing Organization	OOI	Other Operating Income

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	18,852	21,232	20,034	22,404	25,182
EBITDA	5,911	6,160	5,562	6,733	7,694
Depreciation	334	379	429	509	557
EBIT	5,577	5,782	5,133	6,224	7,137
Net interest inc./(exp.)	(875)	(280)	(1)	0	0
Other inc./(exp.)	8	147	256	132	248
Exceptional items	0	0	0	0	0
EBT	4,709	5,649	5,388	6,356	7,385
Income taxes	1,194	1,462	1,364	1,589	1,846
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	3,516	4,187	4,024	4,767	5,539
Adjustments	0	0	0	0	0
Adjusted net profit	3,516	4,187	4,024	4,767	5,539

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	2,213	3,077	2,595	2,660	2,854
Other current liabilities	251	602	592	662	744
Provisions	199	144	136	153	172
Debt funds	9,551	29	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	20	245	245	245	245
Reserves & surplus	7,737	18,975	21,792	25,129	29,006
Shareholders' fund	7,756	19,220	22,037	25,374	29,251
Total liab. and equities	19,971	23,072	25,359	28,848	33,021
Cash and cash eq.	1,156	4,366	5,457	7,336	9,499
Accounts receivables	6,195	6,735	6,054	6,650	7,475
Inventories	5,134	5,162	4,648	5,078	5,709
Other current assets	1,616	823	789	883	992
Investments	1	1	1	1	1
Net fixed assets	5,649	4,964	7,363	7,849	8,288
CWIP	141	917	917	917	917
Intangible assets	79	104	130	136	140
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	19,971	23,072	25,359	28,848	33,021

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	3,691	6,230	5,182	4,309	4,825
Capital expenditures	(571)	(588)	(1,959)	(1,000)	(1,000)
Change in investments	0	0	0	0	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(571)	(588)	(1,959)	(1,000)	(1,000)
Equities issued/Others	0	225	0	0	0
Debt raised/repaid	(1,186)	(9,522)	(29)	0	0
Interest expenses	(875)	(280)	(1)	0	0
Dividends paid	0	(2,579)	(1,207)	(1,430)	(1,662)
Other financing cash flows	(3)	9,725	(896)	0	0
Cash flow from financing	(2,065)	(2,431)	(2,132)	(1,430)	(1,662)
Chg in cash & cash eq.	1,056	3,210	1,090	1,879	2,164
Closing cash & cash eq.	1,156	4,366	5,457	7,336	9,499

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	31.9	34.2	32.8	38.9	45.2
Adjusted EPS	32.6	34.2	32.8	38.9	45.2
Dividend per share	0.0	21.1	9.9	11.7	13.6
Book value per share	63.3	156.9	179.9	207.1	238.7

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	3.2	2.8	2.6	2.0	1.7
EV/EBITDA	10.4	9.7	9.4	6.7	5.7
Adjusted P/E	12.5	11.9	12.4	10.5	9.0
P/BV	6.4	2.6	2.3	2.0	1.7

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	74.7	74.1	74.7	75.0	75.0
Interest burden (PBT/EBIT)	84.4	97.7	105.0	102.1	103.5
EBIT margin (EBIT/Revenue)	29.6	27.2	25.6	27.8	28.3
Asset turnover (Rev./Avg TA)	29.2	29.0	24.3	23.6	23.0
Leverage (Avg TA/Avg Equity)	2.7	1.4	1.0	1.0	1.0
Adjusted ROAE	58.9	31.0	19.5	20.1	20.3

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	22.6	12.6	(5.6)	11.8	12.4
EBITDA	25.2	4.2	(9.7)	21.1	14.3
Adjusted EPS	12.3	4.8	(3.9)	18.5	16.2
Profitability & Return ratios (%)					
EBITDA margin	31.4	29.0	27.8	30.1	30.6
EBIT margin	29.6	27.2	25.6	27.8	28.3
Adjusted profit margin	18.6	19.7	20.1	21.3	22.0
Adjusted ROAE	58.9	31.0	19.5	20.1	20.3
ROCE	34.7	32.4	26.1	26.8	27.0
Working capital days (days)					
Receivables	121	118	112	110	110
Inventory	101	90	86	84	84
Payables	43	54	48	44	42
Ratios (x)					
Gross asset turnover	2.9	3.0	2.2	2.2	2.3
Current ratio	5.3	4.5	5.1	5.7	6.3
Net interest coverage ratio	6.4	20.7	5,932.3		
Adjusted debt/equity	1.1	(0.2)	(0.2)	(0.3)	(0.3)

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

Disclaimer

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

BUY – Expected return >+15%

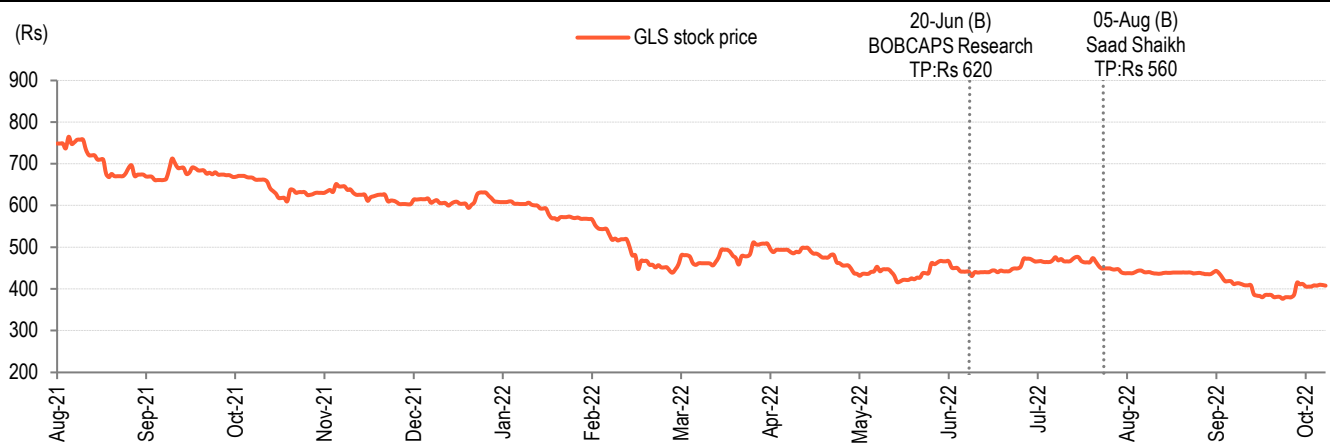
HOLD – Expected return from -6% to +15%

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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