

**BUY**  
 TP: Rs 560 | ▲ 25%

**GLENMARK LIFE SCIENCES**

| Pharmaceuticals

| 05 August 2022

**Margins improve despite revenue decline**

- Q1 revenue fell 7% YoY on a high base (+6.5% ex-Covid portfolio) with CDMO/API down 38%/7%; RM relief and PLI incentives boosted gross margin
- Client inventory rationalisation hit CDMO business; APIs contracted due to weak Covid-driven sales (+7% YoY ex-Covid products)
- We trim revenue estimates but keep margins intact, leading to ~15% cut in FY23/FY24 EPS; our TP reduces to Rs 560 (vs. Rs 620) – retain BUY

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**India, LATAM and ROW continue to drive API growth; Europe soft:** GLS’s overall Q1FY23 revenue fell 7% YoY to Rs 4.9bn (+6.5% ex-Covid portfolio) on a high base. Region-wise, growth was led by India, LATAM and ROW but Europe remained weak due to supply chain issues. The chronic portfolio formed ~73% of revenue. From a therapy perspective, cardiovascular, CNS, pain and diabetes were the major drivers. Growth was mainly volume-driven (ex-Covid portfolio), barring a few instances where price increases were passed on.

**CDMO share guided to hold at 8-9% of revenue:** CDMO revenue declined 38% YoY in Q1 to Rs 243mn (5% revenue share) due to the adverse impact of client API inventory rationalisation. Management expects the business to bounce back to 8-9% of the mix.

**RM relief and PLI incentives supported margins:** Gross margin for the quarter improved 115bps YoY and 200bps QoQ to 51.2% mainly driven by the booking of PLI scheme incentives, a better product mix and cost optimisation efforts. Though prices have fallen for a large number of solvents, some raw material prices remain elevated (especially ones dependent on lithium, sodium, phosphorus and iodine). Price erosion has flattened out in the US, but GLS continues to see demand challenges in sartans.

**Earnings call highlights:** (1) Revenue share for parent Glenmark Pharma was 35%. (2) Q1 capex was at Rs 410mn with a total of ~Rs 2bn planned for FY23. (3) Working capital days stood at 168 due to strategic buildup of inventory to mitigate supply chain issues. (4) Cash balance was Rs 4.8bn. (5) The API pipeline consists of 36 APIs. (6) GLS has submitted a list of 85 APIs under group-A for the PLI scheme. (7) Three new DMFs were filed in major markets with plans to file 8-10 more in FY23.

**Maintain BUY:** We trim our FY23/FY24 revenue estimates by ~14% each while keeping margin assumptions largely unchanged, which results in a 14%/15% EPS cut. Our two-stage DCF model thus yields a revised TP of Rs 560 (vs. Rs 620) at an implied FY24E P/E of 13x – ~20% discount to the peer group average. BUY.

**Key changes**

Target	Rating
▼	◀ ▶

Ticker/Price	GLS IN/Rs 449
Market cap	US\$ 694.6mn
Free float	17%
3M ADV	US\$ 0.3mn
52wk high/low	Rs 799/Rs 410
Promoter/FPI/DII	83%/8%/0%

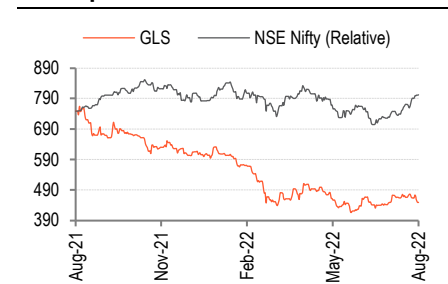
Source: NSE | Price as of 5 Aug 2022

**Key financials**

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	21,232	20,927	24,307
EBITDA (Rs mn)	6,160	6,148	7,305
Adj. net profit (Rs mn)	4,180	4,385	5,168
Adj. EPS (Rs)	34.1	35.8	42.2
Consensus EPS (Rs)	34.1	38.6	44.6
Adj. ROAE (%)	31.0	21.1	21.5
Adj. P/E (x)	13.2	12.6	10.7
EV/EBITDA (x)	10.5	9.4	7.0
Adj. EPS growth (%)	4.6	4.9	17.9

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

**Stock performance**



Source: NSE



**Fig 1 – Quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Net Sales	4,691	5,192	(9.7)	5,025	(6.6)
EBITDA	1,468	1,605	(8.5)	1,422	3.2
Depreciation	99	89	-	96	-
EBIT	1,369	1,515	(9.7)	1,327	3.2
Interest	1	206	-	1	-
Other Income	95	40	-	51	-
PBT	1,463	1,350	8.4	1,376	6.3
Less: Taxation	375	341	-	387	-
Less: Minority Interest	0	0	-	0	-
Recurring PAT	1,087	1,009	7.8	989	10.0
Exceptional items	0	0	-	0	-
Reported PAT	1,087	1,009	7.8	989	10.0
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>
Gross Margin	51.2	50.0	116	49.2	198
EBITDA Margin	31.3	30.9	39	28.3	299
Tax / PBT	25.6	25.2	-	28.1	-
NPM	23.2	19.4	375	19.7	350
EPS	8.9	9.4	-5%	8.1	10.0

Source: Company, BOBCAPS Research

**Fig 2 – Segmental performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Generic API	4,448	4,803	(7.4)	4,590	(3.1)
CDMO	243	389	(37.5)	435	(44.2)
<b>Net Sales</b>	<b>4,691</b>	<b>5,192</b>	<b>(9.7)</b>	<b>5,025</b>	<b>(6.6)</b>
OOI	208	57	266.5	116	79.3
<b>Revenues</b>	<b>4,899</b>	<b>5,249</b>	<b>(6.7)</b>	<b>5,141</b>	<b>(4.7)</b>

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 internal accruals are intended as a major source of funding, we believe the investment plan will be back-ended in nature while retaining the emphasis on profitable growth.

Factoring in the Q1FY23 performance, we trim FY23/FY24 revenue estimates by ~14% each while keeping margin assumptions largely unchanged. This results in a 14%/15% EPS cut for our forecast years. We now expect GLS to post a brisk 9%/11%/13% revenue/EBITDA/PAT CAGR over FY22-FY25.

The stock is trading at attractive valuations of 12.6x/10.7x P/E and 8.1x/6.6x EV/EBITDA on FY23E/FY24E. Post estimate revision, our two-stage DCF model yields a revised TP of Rs 560 (vs. Rs 620) at an implied FY24E P/E of 13x – ~20% discount to the peer group average (NLL, SLPA, ARTD & SOLARA). Maintain BUY.

**Fig 3 – Revised estimates**

(Rs bn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Sales	20.9	24.3	24.2	28.3	(13.7)	(14.0)
EBITDA	6.1	7.3	7.1	8.5	(13.9)	(13.8)
EBITDA margin (%)	29.3	30.0	29.4	29.9	(8bps)	9bps
EPS (Rs)	35.8	42.3	41.7	49.6	(14.1)	(14.7)

Source: BOBCAPS Research

**Fig 4 – Key assumptions**

Parameter	FY22A	FY23E	FY24E
Generic API	19.2	19.5	22.6
CDMO	1.7	1.1	1.4
OOI	0.4	0.3	0.4

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	<b>11.8</b>	
Cost of Debt (E)	9	As of FY21
Marginal Tax Rate (%) (F)	25	
Post-Tax Cost of Debt (%) (G) = E x (1-F)	<b>7</b>	
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-FY32E) (%)	6.6	3%

Source: BOBCAPS Research

Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY22-24E (%)	PE (Rs)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
Glenmark Lifesciences	GLS IN	BUY	560	7.0	12.6	10.7	21.1	21.5	12.5
Neuland*	NLL IN	NR	NA	15.3	17.2	13.1	9.5	11.3	-
Shilpa*	SLPA IN	NR	NA	10.9	37.2	27.9	5.2	6.5	-
Aarti*	ARTD IN	NR	NA	15.6	16.6	12.7	21.1	22.6	-
Solara*	SOLARA IN	NR	NA	17.6	45.9	12.2	2.0	7.1	-

Source: BOBCAPS Research | \*Bloomberg Consensus Estimates | NR – Not Rated

## 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	2.1	1,280	1,500	BUY
Alembic Pharma	ALPM IN	1.7	673	770	HOLD
Alkem Labs	ALKEM IN	4.7	3,113	3,400	BUY
Aurobindo Pharma	ARBP IN	4.2	569	680	BUY
Cipla	CIPLA IN	10.5	1,034	1,100	BUY
Divi's Labs	DIVI IN	13.1	3,912	4,250	HOLD
Dr Reddy's Labs	DRRD IN	8.7	4,157	4,450	HOLD
Eris Lifesciences	ERIS IN	1.2	695	970	BUY
Glenmark Life Sciences	GLS IN	0.7	449	560	BUY
Laurus Labs	LAURUS IN	3.7	545	645	BUY
Lupin	LPC IN	3.8	668	600	SELL
Sun Pharma	SUNP IN	27.7	916	1,100	BUY

Source: BOBCAPS Research, NSE | Price as of 5 Aug 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
<b>Total revenue</b>	<b>18,852</b>	<b>21,232</b>	<b>20,927</b>	<b>24,307</b>	<b>27,325</b>
EBITDA	5,911	6,160	6,148	7,305	8,349
Depreciation	334	386	478	558	606
EBIT	5,577	5,774	5,670	6,747	7,743
Net interest inc./(exp.)	(875)	(280)	(1)	0	0
Other inc./(exp.)	8	147	190	144	269
Exceptional items	0	0	0	0	0
EBT	4,709	5,642	5,860	6,891	8,012
Income taxes	1,194	1,462	1,474	1,723	2,003
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>4,180</b>	<b>4,385</b>	<b>5,168</b>	<b>6,009</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>3,516</b>	<b>4,180</b>	<b>4,385</b>	<b>5,168</b>	<b>6,009</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
Accounts payables	2,213	3,077	2,709	2,886	3,097
Other current liabilities	251	602	618	718	808
Provisions	199	144	142	166	186
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	18,970	22,040	25,657	29,864
Shareholders' fund	7,756	19,215	22,285	25,902	30,109
<b>Total liab. and equities</b>	<b>19,971</b>	<b>23,067</b>	<b>25,754</b>	<b>29,672</b>	<b>34,200</b>
Cash and cash eq.	1,156	3,490	4,523	6,316	8,747
Accounts receivables	6,195	6,735	6,320	7,214	8,112
Inventories	5,134	5,162	4,853	5,509	6,195
Other current assets	1,616	823	824	957	1,077
Investments	1	1	1	1	1
Net fixed assets	5,649	5,847	8,206	8,646	9,040
CWIP	141	917	917	917	917
Intangible assets	79	92	110	111	112
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>23,067</b>	<b>25,754</b>	<b>29,672</b>	<b>34,200</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22P	FY23E	FY24E	FY25E
<b>Cash flow from operations</b>	<b>3,691</b>	<b>6,230</b>	<b>5,233</b>	<b>4,343</b>	<b>5,233</b>
Capital expenditures	(571)	(1,451)	(2,000)	(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>(571)</b>	<b>(1,451)</b>	<b>(2,000)</b>	<b>(1,000)</b>	<b>(1,000)</b>
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	(2,577)	(1,316)	(1,550)	(1,803)
Other financing cash flows	(3)	9,710	(855)	0	0
<b>Cash flow from financing</b>	<b>(2,065)</b>	<b>(2,444)</b>	<b>(2,200)</b>	<b>(1,550)</b>	<b>(1,803)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>1,056</b>	<b>2,334</b>	<b>1,033</b>	<b>1,793</b>	<b>2,431</b>
<b>Closing cash &amp; cash eq.</b>	<b>1,156</b>	<b>3,490</b>	<b>4,523</b>	<b>6,316</b>	<b>8,747</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22P	FY23E	FY24E	FY25E
Reported EPS	31.9	34.1	35.8	42.2	49.0
Adjusted EPS	32.6	34.1	35.8	42.2	49.0
Dividend per share	0.0	21.0	10.7	12.7	14.7
Book value per share	63.3	156.8	181.9	211.4	245.7

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22P	FY23E	FY24E	FY25E
EV/Sales	3.5	3.0	2.7	2.1	1.8
EV/EBITDA	11.2	10.5	9.4	7.0	5.9
Adjusted P/E	13.8	13.2	12.6	10.7	9.2
P/BV	7.1	2.9	2.5	2.1	1.8

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22P	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	74.7	74.1	74.8	75.0	75.0
Interest burden (PBT/EBIT)	84.4	97.7	103.3	102.1	103.5
EBIT margin (EBIT/Revenue)	29.6	27.2	27.1	27.8	28.3
Asset turnover (Rev./Avg TA)	29.2	29.0	25.2	25.2	24.4
Leverage (Avg TA/Avg Equity)	2.7	1.4	1.0	1.0	1.0
<b>Adjusted ROAE</b>	<b>58.9</b>	<b>31.0</b>	<b>21.1</b>	<b>21.5</b>	<b>21.5</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22P	FY23E	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	22.6	12.6	(1.4)	16.1	12.4
EBITDA	25.2	4.2	(0.2)	18.8	14.3
Adjusted EPS	12.3	4.6	4.9	17.9	16.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	31.4	29.0	29.4	30.1	30.6
EBIT margin	29.6	27.2	27.1	27.8	28.3
Adjusted profit margin	18.6	19.7	21.0	21.3	22.0
Adjusted ROAE	58.9	31.0	21.1	21.5	21.5
ROCE	34.7	32.4	28.2	28.6	28.6
<b>Working capital days (days)</b>					
Receivables	121	118	112	110	110
Inventory	101	90	86	84	84
Payables	43	54	48	44	42
<b>Ratios (x)</b>					
Gross asset turnover	2.9	2.7	2.1	2.2	2.3
Current ratio	5.3	4.2	4.8	5.3	5.9
Net interest coverage ratio	6.4	20.7	6,553.7		
<b>Adjusted debt/equity</b>	<b>1.1</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.2)</b>	<b>(0.3)</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

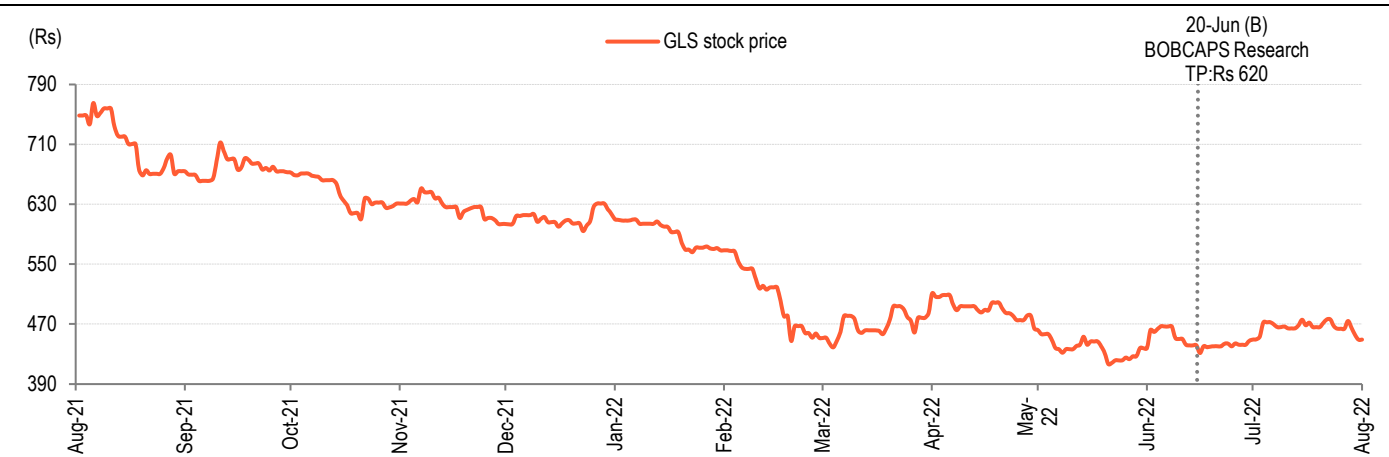
**HOLD** – Expected return from -6% to +15%

**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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