

BUY

TP: Rs 585 | ▲ 50%

GLENMARK LIFE SCIENCES

| Pharmaceuticals

| 27 January 2023

Sequential recovery in API business

- Q3 revenue up 6% QoQ to Rs 5.4bn supported by sequential recovery in API business to parent and PLI benefits
- EBITDA margin down 130bps QoQ to 26.9% on a higher share of acute therapies in the mix
- FY23-FY24 EPS raised 3-7% to bake in the 9M print; retain BUY with a revised TP of Rs 585 (vs. Rs 535)

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Sequential recovery in API business: GLS's Q3FY23 revenue grew 6% QoQ (+3.5% YoY) to Rs 5.4bn on the back of sequential recovery (+19%) in generic API business from parent Glenmark Pharma (GPL), further aided by 2% QoQ growth in external business. Higher other operating revenue due to production-linked incentive (PLI) scheme benefits further supported growth.

CDMO remains sluggish: The contract development and manufacturing (CDMO) business remained weak in Q3, declining 10% QoQ (-31% YoY) as one project continue to be stalled due to regulatory delays at the customer's end. Management expects a strong pickup from Q4FY23. CDMO business has declined by over 20% YoY in each of the last four quarters.

Sequential margin contraction due to higher acute mix: GLS's product mix changed significantly from last quarter as the acute segment grew 46% QoQ (+20% YoY), taking its share in API business to ~39% from 29% in Q2. This change in mix resulted in gross/EBITDA margin contraction of 190bps/130bps QoQ. On a YoY basis, gross margin remained stable, but EBITDA margin fell 100bps owing to a rise in operating expenses.

Brownfield expansion nears completion: GLS has completed the 240kl brownfield expansion for generic API products at Dahej (Gujarat) as well as the oncology expansion. The 400kl intermediate manufacturing block at the Ankleshwar plant is expected to be completed in Q4FY23, with the first module due for commissioning in that quarter. This additional capacity, with gradual ramp-up will lend a fillip to growth as company is running at 85-90% utilization levels.

Maintain BUY: The stock is trading at attractive valuations of 9.7x/8.3x FY24E/ FY25E P/E and 5.9x/4.7x EV/EBITDA. We raise our FY23-FY24 earnings estimates by 3-7% to factor in the 9MFY23 performance. Our two-stage DCF model thus yields a revised TP of Rs 585 (vs. Rs 535), implying an FY24E P/E of 14.6x – ~20% discount to the peer group average (Neuland Labs, Shilpa Medicare, Aarti Drugs and Solara Active Pharma). Maintain BUY.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	GLS IN/Rs 389
Market cap	US\$ 584.3mn
Free float	17%
3M ADV	US\$ 0.4mn
52wk high/low	Rs 581/Rs 370
Promoter/FPI/DII	83%/8%/1%

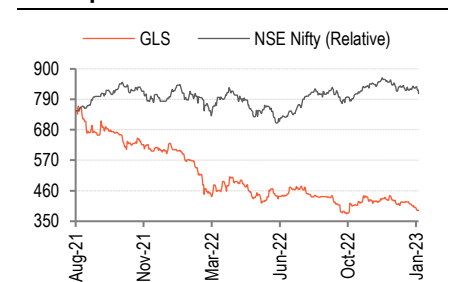
Source: NSE | Price as of 27 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	21,232	20,850	23,061
EBITDA (Rs mn)	6,160	5,909	6,729
Adj. net profit (Rs mn)	4,187	4,319	4,920
Adj. EPS (Rs)	34.2	35.2	40.2
Consensus EPS (Rs)	34.2	33.4	38.5
Adj. ROAE (%)	31.0	20.8	20.5
Adj. P/E (x)	11.4	11.0	9.7
EV/EBITDA (x)	9.3	8.4	6.4
Adj. EPS growth (%)	4.8	3.2	13.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
Revenue	5,407	5,225	3.5	5,094	6.2	15,400	16,092	(4.3)
EBITDA	1,455	1,461	(0.4)	1,437	1.2	4,360	4,739	(8.0)
Depreciation	108	97	-	99	-	306	283	-
EBIT	1,347	1,363	(1.2)	1,338	0.7	4,054	4,455	(9.0)
Interest	2	1	-	1	-	4	278	-
Other Income	66	35	-	100	-	261	96	-
PBT	1,411	1,398	1.0	1,437	(1.8)	4,311	4,273	0.9
Less: Taxation	361	361	-	367	-	1,104	1,075	-
Less: Minority Interest	0	0	-	0	-	0	0	-
Recurring PAT	1,050	1,037	1.2	1,070	(1.9)	3,207	3,198	0.3
Exceptional items	0	0	-	0	-	0	0	-
Reported PAT	1,050	1,037	1.2	1,070	(1.9)	3,207	3,198	0.3
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	51.0	50.8	24	52.9	(187)	52.4	51.0	131
EBITDA Margin	26.9	28.0	(106)	28.2	(132)	28.3	29.4	(114)
Tax / PBT	25.6	25.8	-	25.5	-	25.6	25.2	-
NPM	20.7	20.3	42	22.1	(141)	21.9	20.2	177
EPS	8.6	8.5	1.2	8.7	(1.9)	26.2	26.1	0.3

Source: Company, BOBCAPS Research

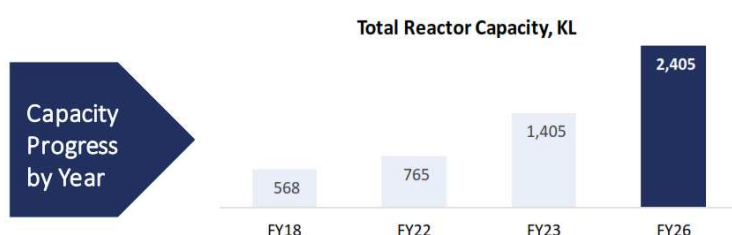
Fig 2 – Segmental performance

(Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
Generic API	4,799	4,715	1.8	4,534	5.8	13,781	14,565	(5.4)
CDMO	279	406	(31.1)	309	(9.6)	832	1,285	(35.3)
Net Sales	5,078	5,120	(0.8)	4,843	4.9	14,612	15,850	(7.8)
OOI	329	105	214.2	251	31.1	788	242	225.7
Revenues	5,407	5,225	3.5	5,094	6.2	15,400	16,092	(4.3)

Source: Company, BOBCAPS Research

Fig 3 – Future capacity expansion plan

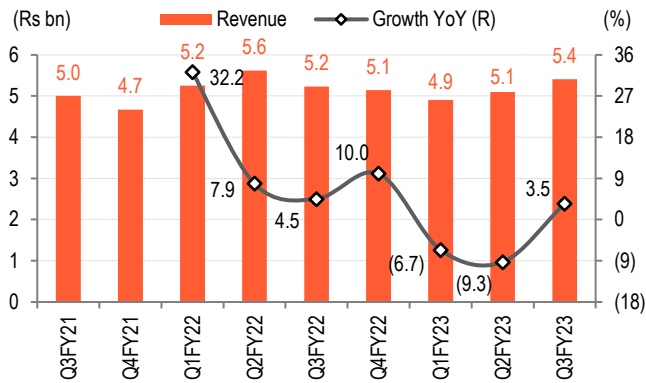
Expansion Type	Division	Location	Current Capacity	Status & Planned Capacity	Operational Timelines
Brownfield	API	Dahej	381.9 KL	240 KL capacity added in Nov 2022	-
Brownfield	Intermediate	Ankleshwar	550.2 KL	Under Construction 400 KL	Q4 FY23
Brownfield	Oncology	Dahej	-	Completed	-
Greenfield	API	Solapur	-	EC Received for 1,000 KL	FY24 - FY26



- ✓ API capacity expansion of 240 KL and Oncology facility at Dahej has been completed
- ✓ Backward Integration plant at Ankleshwar is under construction

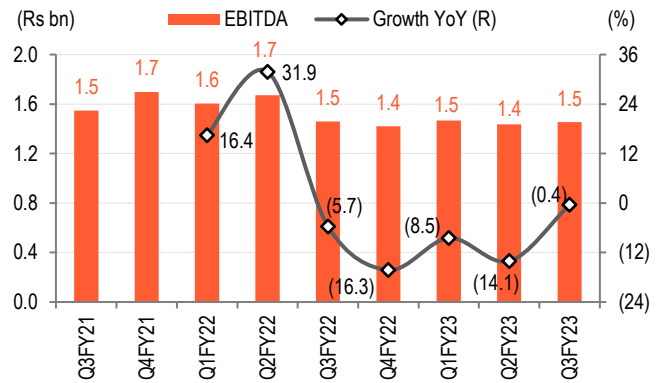
Source: Company, BOBCAPS Research

Fig 4 – Revenue



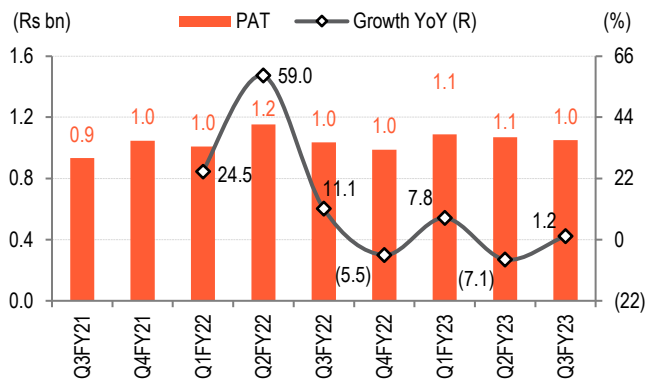
Source: Company, BOBCAPS Research

Fig 5 – EBITDA



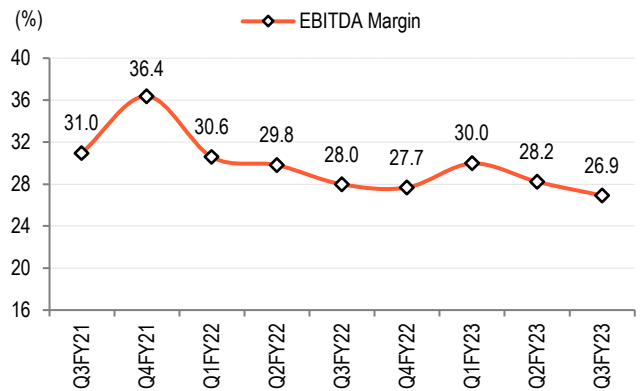
Source: Company, BOBCAPS Research

Fig 6 – PAT



Source: Company, BOBCAPS Research

Fig 7 – EBITDA Margin



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. The company is investing Rs 6bn-6.5bn toward manufacturing capacities over FY20-FY25 to meet demand from the expanding API portfolio and CDMO clientele, with a majority of the brownfield expansion now near completion, which will lend a fillip to growth.

The stock is trading at attractive valuations of 9.7x/8.3x FY24E/FY25E P/E and 5.9x/4.7x EV/EBITDA. We raise our FY23/FY24 earnings estimates by 7%/3% to factor in the 9MFY23 performance. Our two-stage DCF model thus yields a revised TP of Rs 585 (vs. Rs 535), implying an FY24E P/E of 14.6x – ~20% discount to the peer group average (Neuland Laboratories, Shilpa Medicare, Aarti Drugs and Solara Active Pharma). Maintain BUY.

Fig 8 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	20.9	23.1	25.8	20.0	22.4	25.2	4.1	2.9	2.6
EBITDA	5.9	6.7	7.9	5.6	6.7	7.7	6.2	(0.1)	2.8
EBITDA margin (%)	28.3	29.2	30.6	27.8	30.1	30.6	58bps	(87bps)	8bps
EPS (Rs)	35.2	40.2	46.6	32.8	38.9	45.2	7.3	3.2	3.1

Source: BOBCAPS Research

Fig 9 – Key assumptions

Revenue (Rs bn)	FY22	FY23E	FY24E	FY25E
Generic API	19.2	18.7	20.6	23.1
CDMO	1.7	1.1	1.4	1.6
Other Operating Income	0.4	1.0	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	11.9	
Cost of Debt (%) (E)	0	As of FY22
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)	11.9	
	Stage 1	Stage 2 (Terminal)
FCF CAGR (FY22-FY32E) (%)	4.8	3%

Source: BOBCAPS Research

Key risks

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 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	1,184	1,470	HOLD
Alembic Pharma	ALPM IN	1.3	539	615	HOLD
Alkem Labs	ALKEM IN	4.4	3,001	2,700	SELL
Aurobindo Pharma	ARBP IN	3.0	416	635	BUY
Cipla	CIPLA IN	10.4	1,047	1,250	BUY
Divi's Labs	DIVI IN	11.0	3,387	3,450	HOLD
Dr Reddy's Labs	DRRD IN	8.8	4,314	4,700	HOLD
Eris Lifesciences	ERIS IN	1.0	629	810	BUY
Glenmark Life Sciences	GLS IN	0.6	389	585	BUY
Laurus Labs	LAURUS IN	2.2	342	540	HOLD
Lupin	LPC IN	4.1	742	700	HOLD
Sun Pharma	SUNP IN	30.7	1,043	1,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 27 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	18,852	21,232	20,850	23,061	25,829
EBITDA	5,911	6,160	5,909	6,729	7,912
Depreciation	334	379	424	498	546
EBIT	5,577	5,782	5,486	6,231	7,366
Net interest inc./(exp.)	(875)	(280)	(6)	0	0
Other inc./(exp.)	8	147	324	330	247
Exceptional items	0	0	0	0	0
EBT	4,709	5,649	5,803	6,560	7,613
Income taxes	1,194	1,462	1,484	1,640	1,903
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	3,516	4,187	4,319	4,920	5,710
Adjustments	0	0	0	0	0
Adjusted net profit	3,516	4,187	4,319	4,920	5,710

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	2,213	3,077	2,604	2,650	2,844
Other current liabilities	251	602	594	659	741
Provisions	199	144	137	152	171
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	21,998	25,442	29,439
Shareholders' fund	7,756	19,220	22,243	25,688	29,684
Total liab. and equities	19,971	23,072	25,579	29,149	33,440
Cash and cash eq.	1,156	4,366	4,525	7,868	10,145
Accounts receivables	6,195	6,735	6,077	6,624	7,448
Inventories	5,134	5,162	5,968	5,059	5,687
Other current assets	1,616	823	792	879	988
Investments	1	1	1	1	1
Net fixed assets	5,649	4,964	7,172	7,668	8,118
CWIP	141	917	917	917	917
Intangible assets	79	104	126	132	137
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	19,971	23,072	25,579	29,149	33,440

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	3,691	6,230	4,144	5,819	4,990
Capital expenditures	(571)	(588)	(1,759)	(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)	(1,759)	(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)	(6)	0	0
Dividends paid	0	(2,579)	(1,296)	(1,476)	(1,713)
Other financing cash flows	(3)	9,725	(896)	0	0
Cash flow from financing	(2,065)	(2,431)	(2,226)	(1,476)	(1,713)
Chg in cash & cash eq.	1,056	3,210	158	3,343	2,277
Closing cash & cash eq.	1,156	4,366	4,525	7,868	10,145

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	31.9	34.2	35.2	40.2	46.6
Adjusted EPS	32.6	34.2	35.2	40.2	46.6
Dividend per share	0.0	21.1	10.6	12.0	14.0
Book value per share	63.3	156.9	181.5	209.7	242.3

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	3.1	2.7	2.4	1.9	1.6
EV/EBITDA	10.0	9.3	8.4	6.4	5.2
Adjusted P/E	11.9	11.4	11.0	9.7	8.3
P/BV	6.1	2.5	2.1	1.9	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	74.7	74.1	74.4	75.0	75.0
Interest burden (PBT/EBIT)	84.4	97.7	105.8	105.3	103.4
EBIT margin (EBIT/Revenue)	29.6	27.2	26.3	27.0	28.5
Asset turnover (Rev./Avg TA)	29.2	29.0	25.1	24.1	23.3
Leverage (Avg TA/Avg Equity)	2.7	1.4	1.0	1.0	1.0
Adjusted ROAE	58.9	31.0	20.8	20.5	20.6

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	22.6	12.6	(1.8)	10.6	12.0
EBITDA	25.2	4.2	(4.1)	13.9	17.6
Adjusted EPS	12.3	4.8	3.2	13.9	16.0
Profitability & Return ratios (%)					
EBITDA margin	31.4	29.0	28.3	29.2	30.6
EBIT margin	29.6	27.2	26.3	27.0	28.5
Adjusted profit margin	18.6	19.7	20.7	21.3	22.1
Adjusted ROAE	58.9	31.0	20.8	20.5	20.6
ROCE	34.7	32.4	28.0	27.4	27.5
Working capital days (days)					
Receivables	121	118	112	110	110
Inventory	101	90	110	84	84
Payables	43	54	48	44	42
Ratios (x)					
Gross asset turnover	2.9	3.0	2.4	2.3	2.4
Current ratio	5.3	4.5	5.2	5.9	6.5
Net interest coverage ratio	6.4	20.7	935.3		
Adjusted debt/equity	1.1	(0.2)	(0.2)	(0.3)	(0.3)

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%

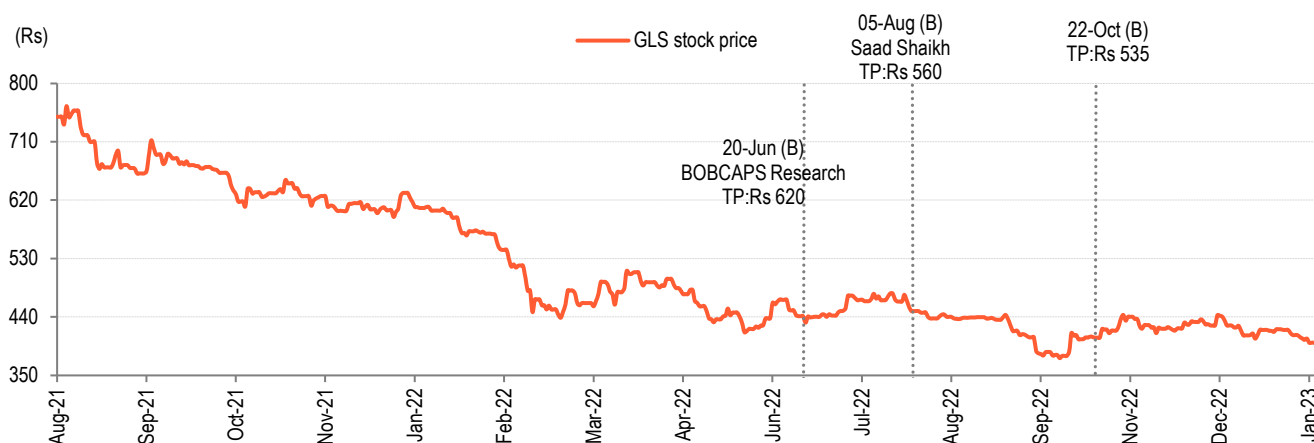
HOLD – Expected return from -6% to +15%

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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