

Stock Update

Weak Q4FY2019, Debt reduction remains a concern; Maintain Hold

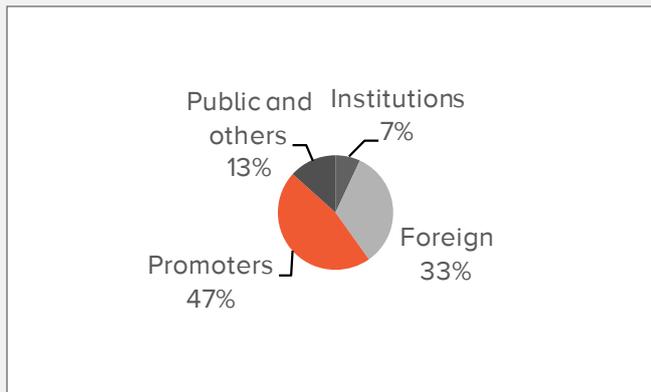
Glenmark Pharmaceuticals

Reco: Hold | CMP: Rs555

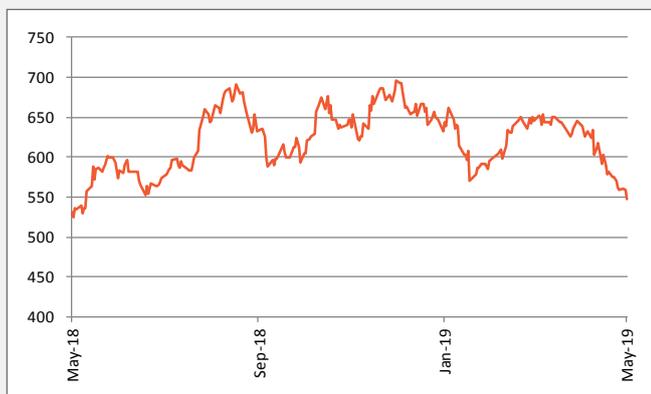
Company details

Price target:	Rs595
Market cap:	Rs15,662
52-week high/low:	Rs712/484
NSE volume: (No of shares)	7.2 lakh
BSE code:	532296
NSE code:	GLENMARK
Sharekhan code:	GLENMARK
Free float: (No of shares)	15.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-15.9	-8.7	-14.5	2.7
Relative to Sensex	-17.0	-17.3	-22.0	-10.3

Key points

- Q4FY2019 performance below expectations:** During the quarter, Glenmark Pharmaceuticals (Glenmark) reported sales growth of 12.4% y-o-y to Rs. 2,563.5 crore (in line with estimates). Operating profit grew by 11.3% y-o-y to Rs. 363.8 crore (16% below estimates). OPM declined by 14 BPS y-o-y to 14.2% (266 BPS lower than our estimate of 16.9%). The decline in operating profit was mainly due to high other expenses. Adjusted profit for the quarter grew by 22% y-o-y to Rs. 161.4 crore (33% below estimates). Weak performance was on account of modest growth of 10% each in India and U.S. businesses (U.S. business witnessed high pricing pressure, 10%+ for overall portfolio).
- Debt continues to remain a concern despite stable business outlook:** For FY2020, management has guided for overall 10-15% sales growth. Management is confident of double-digit growth in the domestic as well as other key markets on account of new launches as well as key approvals. In the U.S., the company expects competition to increase in its key product Mupirocin (from Q4FY2020 or Q1FY2021). However, the company is confident of 100-200 BPS improvement in its operating margin from FY2020 on account of operational efficiencies, lower staff and R&D costs (FY2019 OPM stood at 16.1%). The company does not have any pending regulatory issues on key its facility - Goa (Goa plant has received EIR recently). Glenmark expects to reduce debt (Gross Debt: Rs. 4,448 crore and Net Debt: Rs. 3,425 crore) going forward by taking cost initiatives and working capital rationalisation. However, we feel reducing the debt significantly (in the next two years), without an out-licensing deal/asset monetising, is an uphill task.
- Decent revenue guidance for FY2020, margins to see 100-200 BPS expansion:** 1) Target revenue growth of 10-15%; 2) staff cost and R&D expenditure will be lower in FY2020 compared to FY2019 (one of the key reasons for margin expansion); 3) conclude at least one partnership on innovative/specialty assets; 4) bring in a minority investor in to Glenmark Life Sciences Ltd.; and 5) divest other non-core global assets.
- Maintain Hold with lowered PT of Rs. 595:** Glenmark is expected to deliver sales and profit CAGR of 16% and 30%, respectively, over FY2019-FY2021E. We have maintained our earnings estimate for FY2020 and reduced it by 8.5% for FY2021 (on account of increased competition in the U.S. for key products). Lack of

avenues for significant debt reduction in books over the next two years and overall concerns on U.S. business keep us skeptical on the stock's performance. Hence, we maintain our Hold recommendation on the stock with lowered price target (PT) of Rs. 595.

- ◆ **Key Risks:** Delay/failure of new launches, delay in approvals and forex risks. An out-licensing deal or a strategic partner's investment in R&D subsidiary poses upside risk to our estimates.

Particulars	Rs cr				
	Q4FY2019	Q4FY2018	YoY %	Q3FY2019	QoQ %
Net sales	2563.5	2279.8	12.4	2555.0	0.3
Expenditure	2199.6	1953.0	12.6	2120.4	3.7
Operating profit	363.8	326.8	11.3	434.7	-16.3
Other income	39.1	4.6	-958.0	21.0	86.2
EBIDTA	402.9	331.4	21.6	455.7	-11.6
Interest	81.9	74.4	10.1	88.5	-7.5
Depreciation	81.0	73.5	10.1	83.1	-2.6
PBT	240.0	183.5	30.8	284.0	-15.5
Tax	78.6	51.4	53.1	37.7	108.7
Adj.PAT (Bfr Excp.Item)	161.4	132.1	22.2	246.3	-34.5
Exceptional Item	0.0	19.6		-130.0	
Net Reported Profit	161.4	151.7	6.4	116.3	38.7
Adj EPS (Rs.)	5.7	4.7	22.2	8.7	-34.5
			BPS		BPS
OPM (%)	14.2	14.3	-14	17.0	-282
EBIDTA margin (%)	15.7	14.5	118	17.8	-212
Adj. Net profit margin (%)	6.3	5.8	50	9.6	-335
Tax Rate (%)	32.8	28.0	477	13.3	1950

Source: Sharekhan Research

Key Conference Call Highlights:

- ◆ **Business re-organisation:** Glenmark has decided to re-organise its business into three entities by spinning-off its innovation business in a new company in the U.S. APIs will be under 100% subsidiary, Glenmark Life Sciences (GLS); and generics, OTC and speciality business will stay with the listed entity, Glenmark Pharmaceutical Ltd. (GPL). New R&D subsidiary will consist of Glenmark's current pipeline of eight innovation assets (NBEs/NCEs) - five clinical and three pre-clinical - along with innovation related R&D centres, manufacturing infra and technology. 400 employees will get transferred. The process of setting up the company and transfer is likely to get completed in the next 6-9 months. Going forward, management anticipates that the innovation business may become significantly self-sustaining post its value-unlocking process. Management plans to raise capital in the U.S. over 12-18 months to fund innovation in R&D. This, in turn, will sharply reduce the burden on Glenmark to fund growth of the innovation business. However, for the near term, till any sort of value-unlocking process takes place, we anticipate no change in the consolidated company's financials.
- ◆ **U.S. Business:** Management has indicated that pricing pressure in the U.S. business impacted performance as pricing erosion for its portfolio remained 10%+. Glenmark plans to launch 12-15 products per year in the next two years. Management expects Ryaltris (GSP – 301) launch in FY2020/FY2021 to be one of the key growth drivers for the U.S. business. The product will be a branded product in the U.S.; and it is still undecided that whether the company will partner with some players or will launch on its own in the markets in which it is already present.
- ◆ **India Business:** Domestic business has been one of the key growth drivers for the overall business. Management expects FY2020-FY2021 to see double-digit growth for the domestic market as it expects some big-ticket approvals, especially in the diabetes segment, and remains very optimistic on the growth outlook.
- ◆ The company's strategy of focusing on niche therapies of respiratory, dermatology and oncology should drive growth in emerging markets in the coming years.
- ◆ **Debt reduction continues to remain a challenge:** Gross debt at Rs. 4,448 crore and net debt at Rs. 3,425 crore was reported at the

end of Q4FY2019. The company continues to struggle to generate meaningful cash at current levels of operational profits. Given the current cash flow trends, we believe Glenmark will find it difficult to achieve material reduction in its net debt levels over the next two years. Meaningful

debt reduction can be achieved if the company is able to generate cash flows through some corporate actions and/or from any large out-licensing deals.

Geography-wise sales break up

Revenue Break Up	Rs cr				
	Q4FY2019	Q4FY2018	YOY %	Q3FY2019	QoQ %
India	667.8	608.7	9.71	667.5	0.04
U.S.	769.6	699.6	10.01	855.7	-10.06
ROW	385.3	298.5	29.06	340.1	13.28
Europe	318.4	319.0	-0.17	321.7	-1.04
Latin America	120.4	127.6	-5.65	101.4	18.71
API	248.8	204.9	21.44	239.2	3.98
Total Core Revenue	2510.3	2258.2	11.16	2525.7	-0.61
Out Licencing income	53.2	21.6	146.20	29.3	81.59
Total Revenue	2563.5	2279.8	12.44	2555.0	0.33

Source: Sharekhan Research, Company

Valuation

Particulars	Rs cr			
	FY2018	FY2019	FY2020E	FY2021E
Total Sales	9103	9865	11239	13337
OPM (%)	17.7	16.1	17.2	17.9
Adj. Net profit	804	759	987	1290
Adj. EPS (Rs.)	28.5	26.9	35.0	45.7
PER (x)	19.5	20.6	15.9	12.1
EV/Ebitda (x)	12.0	12.4	8.9	7.1
P/BV (x)	3.0	2.8	2.4	2.0
Mcap/sales	1.7	1.6	1.4	1.2
ROCE (%)	13.8	14.0	16.1	18.4
RONW (%)	15.6	13.5	15.1	16.7

Source: Sharekhan Research

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