

GLENMARK PHARMACEUTICALS

PHARMACEUTICALS

Q4 miss led by Zetia; execution of guidance critical

Glenmark's (GNP) Q4 PAT was below estimates due to significant miss in US sales (USD 150 mn vs. estimated USD 193 mn). The sales miss was led by lower gZetia sales (~USD 50 mn vs. est. ~USD 80 mn) and ~15% price erosion in US base business. Management expects gZetia sales to improve in Q1FY18 as 2.5 months exclusivity still remains, and expects 12-15% revenue growth in FY18. We note some improvement in B/S as 1) net debt marginally declined despite Rs 3.2bn write-off related to Venezuela & 2) net worth accretion of Rs 6.7bn inFY17

On weak Q4, miss in guidance and increasing sector headwinds, we cut FY18/19E EPS by ~10% each and TP to Rs900 (17x FY19E EPS; vs. Rs 1,120 earlier at 19x). We maintain BUY rating given GNP's strong R&D pipeline in US, steady India and improving EM# business. NCE[^] licensing income critical to improve B/S & C/F, in our view.

BUY

Target Price: Rs 900

CMP : Rs 760
Potential Upside : 18%

MARKET DATA

No. of Shares : 282mn
Free Float : 53%
Market Cap : Rs255bn
52-week High / Low : Rs993 / Rs729
Avg. Daily vol. (6mth) : 5,57,190 shares
Bloomberg Code : GNP IB Equity
Promoters Holding : 47%
FII / DII : 35% / 6%

- ♦ **Miss in sales led by gZetia; pricing pressure:** Overall sales grew 7% YoY, but declined 3% QoQ to Rs 24.5 bn, 16% below consensus, primarily led by US (-19%QoQ). US sales (~41% of revenue) at USD 150 mn declined 18%QoQ in USD terms led by slower-than-expected ramp-up in gZetia and ~15% price erosion in base business. As per management, miss in gZetia is due to timing difference in booking sales – expected market share didn't improve as expected, and GNP had pushed significant inventory and booked sales in Q3. However, it expects gZetia sales to improve in Q1FY18 with sales to be marginally lower than USD 200mn (vs. earlier guidance of USD 200mn-250mn). We note it would have booked USD 120mn in H2FY17 and likely to book another USD 36mn in Q1FY18.
- ♦ **Margin further hit by one offs:** Gross/EBITDA margin down ~800 bps/~1,200 bps QoQ on lower gZetia sales & lower number of approvals (2 in H2'17 vs. 9 in H1'17). Op. margin was also hit by forex loss of Rs~740 mn (total Rs 1.39bn); adjusting for forex loss, margin stood at 21% vs. reported 18% – still ~900 bps lower QoQ mainly on higher R&D (~14.8% of Q4 sales vs. 10.9% in Q3). Interest expense was higher due to FY end adjustment of FCCB options. Lower tax (deferred tax on lower gZetia sales, MAT credit) led to adj. PAT of Rs 4 bn, 33% below estimate

Financial summary (Consolidated)

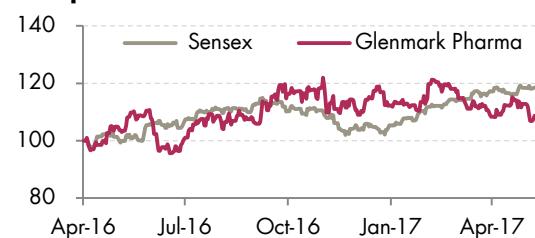
Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	76,496	91,857	96,485	1,09,809
Adj PAT (Rs mn)	7,021	11,757	12,330	14,974
Con. EPS* (Rs)	-	-	52.7	53.2
EPS (Rs)	24.8	41.6	43.6	53.0
Change YOY (%)	(16.2)	67.4	4.9	21.4
P/E (x)	36.4	21.7	20.7	17.1
RoE (%)	19.3	25.5	22.4	22.1
RoCE (%)	15.2	19.3	18.1	19.8
EV/E (x)	20.0	14.3	13.7	11.4
DPS (Rs)	2.0	2.0	2.8	2.8

Source: *Consensus broker estimates, Company, Axis Capital

EM: Emerging market ^NCE: New chemical entity

Key drivers

Growth (%)	FY17E	FY18E	FY19E
core US (USD)	430	492	592
India	9	12	13
Core EBITDA margin (%)	18.4	20.6	22.6
core EPS (Rs/ sh)	26	40	53
core-EPS (%)	(23)	52	32

Price performance


(...continued from page 1)

- ♦ **FY18 guidance remains upbeat:** Guidance of 12-15% YoY revenue growth on reported basis in FY18. Management expects US business to grow in FY18 on the high gZetia base in FY17 aided by limited competition niche dermatology products awaiting approval. GNP expects 10 to 15 new launches in the US in FY18. It expects to deliver ~23% EBITDA margin in FY18 (vs. ~22% in FY17) as it expects improvement in business across segments
- ♦ **Net debt stagnant due to Venezuela related write-off:** Net debt marginally declined QoQ to Rs 36.67 bn. We note GNP has written off receivables/ cash from its Venezuela subsidiary of Rs 2.36 bn in its standalone P&L and ~Rs 3.25 bn in consolidated balance sheet – netted vs. equity. Ex-Venezuela write-off (Rs 3.25 bn), net debt would have reduced to Rs 33.5 bn. GNP expects debt reduction below FY17 levels by end FY18
- ♦ **Other key highlights:** (1) **USFDA inspections** – Baddi facility did not receive any observation, but Goa facility received Form 483 with 4 observations; has responded to USFDA and awaiting approvals, (2) **R&D:** Guidance for 11-12% of sales for FY18 (vs. 11.8% in FY17); it has 65 pending ANDAs (of which 25 are Para IVs) with USFDA. Filed 9 in Q4, (3) **Tax:** Guided for ~25% tax rate in FY18 (vs. 23% tax in FY17), (4) **FY17 operating cash flow** at ~Rs. 12 bn and **cash tax** was high at Rs 7 bn (vs. effective tax of Rs 3.4 bn), (5) **Net working capital** days stand at 107 days vs. 114 days in H1FY17. Receivable days at 98 days vs. 115 days in H1FY17, inventory days at 87 days vs. 80 days in H1FY17. Payable days at 107 days vs. 114 days in H1FY17, (6) **FY17 capex** of Rs 7 bn, (7) **Negative free cash flow** of Rs 2.25 bn in FY17, (8) **Foreign Currency Translation Reserve (FCTR):** Venezuela related write-off of Rs 3.25 bn. Other EM's subsidiaries had net positive impact of Rs 1.46 bn. Net FCTR loss in FY17 was Rs 1.79 bn and (9) **Net worth:** Net addition of Rs 6.7 bn

Exhibit 1: US revenue declined sequentially due to slower ramp-up in gZetia

(Rs mn)	% of Q4 Sales	Q4'16	Q3'17	Q4'17	YoY (%)	QoQ (%)
US (USD mn)		97	183	150	54	(18)
US	41%	6,520	12,308	10,004	53	(19)
India	23%	5,398	5,169	5,769	7	12
Rest of the World (ROW)	12%	2,980	2,511	2,889	(3)	15
Europe	9%	2,705	1,957	2,298	(15)	17
Latin America	5%	2,416	947	1,340	(45)	41
API	8%	2,229	1,921	1,997	(10)	4
Consolidated Revenue		23,067	25,350	24,572	7	(3)

Source: Company

Exhibit 2: EBITDA margin declined sequentially on lower gZetia sales, higher R&D expense

(Rs mn)	Q4'16	Q3'17	Q4'17	YoY (%)	QoQ (%)
Net sales	23,067	25,350	24,572	7	(3)
Net sales	23,067	21,321	21,192	(8)	(1)
Gross margin	67.7	76.4	68.4	63 bps	-799 bps
Staff	3,482	4,017	3,847	11	(4)
% to sales	15.1	18.8	18.2	306 bps	-68 bps
Other expenses	6,661	4,933	4,880	(27)	(1)
% to sales	28.9	19.5	19.9	-902 bps	40 bps
R&D expense**	2,450	2,760	3,637	48	32
% to sales	10.6	10.9	14.8	418 bps	391 bps
EBITDA	3,035	7,650	4,438	46	(42)
EBITDA margin	13.2	30.2	18.1	491 bps	-1212 bps
Depreciation/Amortisation	584	625	689	18	10
Interest charge	475	617	697	47	13
Other income	117	146	(513)	(539)	(452)
PBT	2,092	6,553	2,540	21	(61)
Tax	604	1,794	(107)	(118)	(106)
Tax rate (%)	28.9	27.4	(4.2)	-3311 bps	-3160 bps
Reported PAT	1,488	4,759	1,838	23	(61)
Adjusted PAT*	1,488	4,759	3,997	169	(16)

Source: Company, As per IND-AS** Adjusted for Impairment loss (Rs 809mn), forex loss (Rs 1.35bn)

Exhibit 3: Guided for gross debt decline in FY18 below Mar'17 levels

(Rs mn)	Mar'16	Jun'16	Sept'16	Dec'16	Mar'17
Gross Debt	39,880	42,680	57,070	54,950	47,235
Cash	8,620	8,950	20,290	17,450	10,564
Net Debt	31,260	33,730	36,780	37,500	36,672

Source: Company

Conference call highlights
FY18 guidance

- ♦ **Revenue:** Expects 12-15% YoY growth on reported basis (despite high base of gZetia in FY17). Expects growth in US business on the high gZetia base in FY17
- ♦ **Margin:** Expects FY18 EBITDA margin of ~23% (22% in FY17), as it expects improvement in business across segments
- ♦ **R&D spends:** ~11-12% of sales for FY18 (vs. 11.8% in FY17)
- ♦ **Debt:** Expects net debt to decline in FY18 below FY17 levels
- ♦ **Tax rate:** ~25% tax rate in FY18

US business (USD 150 mn +54% YoY/-18% QoQ)

- ♦ ~15% price erosion within the base business in Q4. Additionally, the company received only 1 approval in H2FY17 vs. 10 approvals in H1FY17
- ♦ **gZetia** – Current run-rate marginally below lower end of initial guidance of USD 200-250mn within the 6 month exclusivity period
- ♦ Expects US business to grow YoY in FY18, on the high gZetia base in FY17, aided by limited competition niche dermatology products awaiting approval
- ♦ Expects 10 to 15 launches in US in FY18
- ♦ **Goa Form 483** – GNP has received indication from USFDA; currently, awaiting approvals from the Goa facility

India formulations (Rs 5,769 mn, +7% YoY/ +12% QoQ)

- ♦ India growth was muted at 7% YoY owing to demonetization and destocking at the distributor end
- ♦ Management expects growth to rebound in FY18

RoW (Rs 2,889 mn, -3% YoY/15% QoQ)

- ♦ Russia: Recorded growth of 33% YoY YTD March 2017. Launched a nasal spray in Russia in Q4
- ♦ Asia and Africa business recorded below average performance. Launched 3 new products in Q4 in the region. The subsidiaries of South Africa and Kenya recorded good secondary sales growth in Q4

EU (Rs 2,289 mn, -15% YoY)

- ♦ Growth hit by depreciation of the GBP
- ♦ Mixed performance – Western European region recorded good growth in constant currency in Q4, while the Eastern European region recorded a decline in sales
- ♦ Growth in Western Europe was aided by the good performance of the UK and the German subsidiaries. In the fourth quarter, there were few product launches in the UK, Germany, Spain, and Poland
- ♦ Glenmark launched nearly 25 products across markets and in-licensed over 35 products in FY17
- ♦ Management expects good growth in FY18

LatAm (Rs. 1,340 mn, -45% YoY/41% QoQ)

- ♦ Sales affected by high base of Venezuela in Q4'16
- ♦ Mexico subsidiary recorded good sales growth; Brazil subsidiary's performance was average

R&D (Rs 3,080 mn, 14.8% of Q4'17 sales; 11.8% in FY17)

- ♦ Filed 9 ANDAs in Q4FY17 (vs. 11 in 9M'17) and got 1 approval (17 approvals in FY17: 11 FA + 6 TA); GNP plans to file 3 ANDA's in Q1'18.
- ♦ Filed 20 ANDA in FY17. Out of these, 9 were dermatological products, 3 were hormonal products, 1 was Oncology injectable and 7 applications were oral solids out of which majority were complex or niche products
- ♦ GNP has 65 pending ANDA (of which 25 are Para IVs)
- ♦ GSP 301: Plans to meet with the FDA to discuss the 505(b)(2) New Drug Application (NDA) filing strategy in the second half of CY 2017.

B/S and C/F highlights

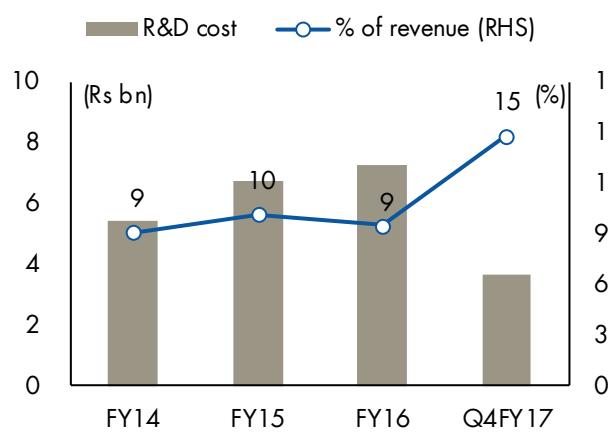
- ♦ Gross debt at Rs 47.23 bn while net debt marginally declined QoQ at Rs 36.67 bn. Expects net debt to decline in FY18 vs. FY17 levels
- ♦ Net working capital days stand at 107 days vs. 114 days in H1FY17. Receivable days stood at 98 days vs. 115 days in H1FY17, inventory days at 87 days vs. 80 days in H1FY17. Payable days at 107 days vs. 114 days in H1FY17
- ♦ Operating cash flow for FY17 was ~Rs 12 bn. Cash tax of Rs 7bn in FY17 (vs. effective tax of Rs 3.4bn). Negative FCF for FY17 of Rs 2-2.5bn
- ♦ Venezuela related write-off at Rs 3.25 bn. Ex Venezuela write-off, net debt would have stood at Rs 33.42bn vs. reported net debt of Rs 36.67bn

- ♦ Forex loss of Rs 1.39bn in Q4; Rs 650 mn was reversed in other income, as there was a forex gain in 9MFY17 and the remaining in other expenses
- ♦ Foreign Currency Translation Reserve (FCTR): Venezuela related write-off at Rs 3.25bn. Other EM's resulted in gains of Rs 1.46bn. Net FCTR loss in FY17 was Rs 1.79bn
- ♦ Net worth: FY17 net addition of Rs 6.7bn
- ♦ Interest cost of Rs. 697 mn has a cash component of Rs. 460 mn vs. cash component of Rs 490mn in Dec'16
- ♦ Other expenses increased due to R&D and higher selling and distribution costs

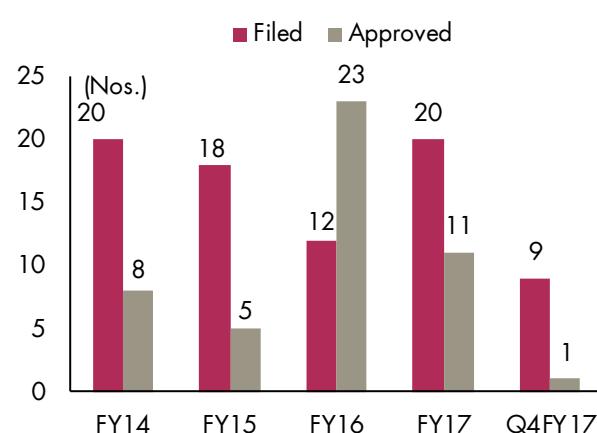
Exhibit 4: Market share in key products improving

Generic name	Brand name	mkt size (USD mn)	#No. of players	Market share (%)						
				Mar'16	Jun'16	Sep'16	Dec'16	Jan'17	Feb'17	Mar'17
Ezetimibe*	Zetia	2,300	2	-	-	-	20%	46%	48%	48%
Rosuvastatin Calcium	Crestor	6,780	>10	-	-	-	10%	11%	10%	7%
Calcipotriene cream	Dovonex	93	3	15%	19%	24%	26%	27%	31%	36%
Nystatin-Triam cream	Mycalog - II	145	3	-	-	-	3%	5%	5%	8%
Nystatin-Triam Ointment	Kenalog	38	4	-	-	-	2%	4%	6%	7%
Diclofenac Sodium Gel	Solaraze	297	4	-	-	-	10%	10%	9%	9%
Trandolapril + Verampil Hcl	Tarka	24	2	46%	45%	41%	44%	44%	49%	47%
Raloxifene Hcl	Evista	337	7	-	2%	6%	10%	10%	10%	10%
Mupirocin ointment	Bactroban	55	6	21%	27%	27%	27%	28%	27%	28%
Mupirocin cream	Bactroban	55	2	87%	98%	99%	99%	99%	99%	99%

Source: Bloomberg

Exhibit 5: R&D expense significantly higher in Q4


Source: Company

Exhibit 6: To file 3 ANDAs in Q1'18


Source: Company

Exhibit 7: Increasing focus on niche segments

Pending ANDA	Jun-13	Apr-14	Dec-14	Mar-15	Dec-15	Jun-16	Sep-16
Immediate Release	12	29	31	31	28	31	31
Hormones	5	13	14	11	8	5	6
Dermatology	5	8	10	15	12	15	11
Others*	5	7	6	6	6	5	5
Injectables	3	7	13	13	8	7	8
Total	53	64	74	76	62	63	61
Para IVs	23	29	39	33	26	22	23

Source: Company *Note: Others include Modified release, Controlled substance, immunosuppressants

Exhibit 8: Key complex generic products in pipeline

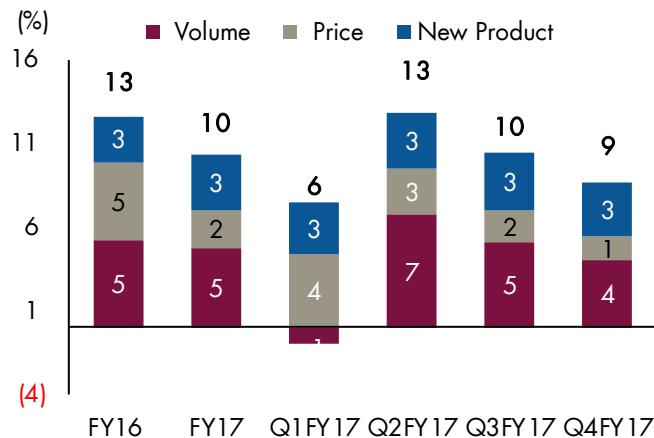
Product	Market Size (USD bn)	Source	Filing Status			
			Filed	CY17	CY18	CY19
gWelchol	0.6	In-House	✓			
gRenagel	2.1	In-House	✓			
gVagifem	0.4	In-House		✓		
gConcerta	1.8	In-License			✓	
gAbraxane	0.7	In-License				✓
gSuboxone	1.6	In-License				✓
gNuvaring	0.8	In-License				✓
GSP 101 (Gx Inhaler)	~4.5	In-House			✓	
GSP 103 (Gx Inhaler)	~1.0	In-House			✓	
GSP 104 (Gx Inhaler)	~0.8	In-House				✓

Source: Company

Exhibit 9: Expects to file 9 NDA/BLA in next decade across NME and specialty portfolio

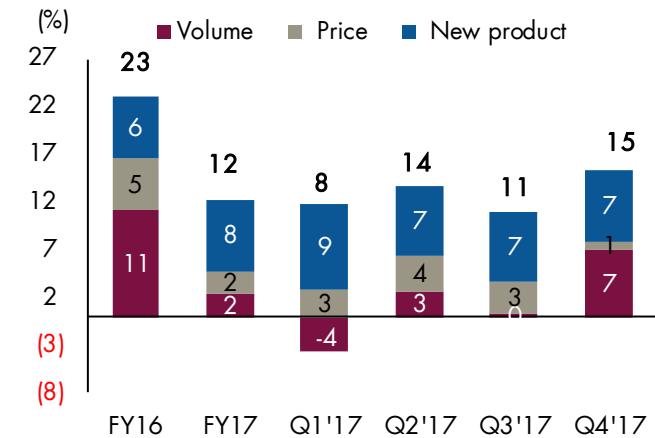
Therapy Area	Molecule	Status	Filing Timelines (NDA/BLA)				
			2019	2020	2021	2022	2023+
Respiratory	GSP 301	Phase 3		✓			
	GSP 304	Phase 2		✓			
	GBR 310	Pre Clinical			✓		
	GRC 388XX	Pre Clinical					✓
Dermatology	GBR 830	Phase 2				✓	
	GBR 1302	Phase 1				✓	
Oncology	GBR 1342	Pre Clinical					✓
	GBR 1372	Pre Clinical					✓
	GBR 8383	Pre Clinical					✓

Source: Company

Exhibit 10: IPM posted lower volume growth in Q4


Source: AIOCD

IPM = India Pharma market

Exhibit 11: GNP growth led by new launches/ volume pickup in Q4


Source: AIOCD

Exhibit 12: Strong growth seen in Respiratory and Anti-Infective segments in Q4

YoY growth	% of sales	FY16	FY17	Q1'17	Q2'17	Q3'17	Q4'17
Derma	28%	25%	13%	17%	9%	11%	12%
Cardiac	22%	23%	8%	8%	3%	13%	9%
Respiratory	16%	23%	19%	4%	40%	7%	19%
Anti-Infectives	14%	15%	13%	-3%	23%	9%	24%
Anti-Diabetic	7%	26%	-16%	-7%	-26%	-23%	-6%
Gastro Intestinal	3%	24%	56%	8%	59%	85%	68%
Vitamin/ Min / Nut	2%	16%	2%	36%	-10%	-2%	-9%
Pain / Analgesics	2%	7%	-2%	7%	-6%	-3%	-10%
Gynaecological	3%	13%	30%	15%	31%	49%	30%
Ophthal/Otolologicals	1%	23%	2%	-8%	15%	-6%	6%
Total (Rs bn)	27	23%	12%	8%	14%	11%	15%

Source: AIOCD

Financial summary (Consolidated)
Profit & loss (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	76,496	91,857	96,485	1,09,809
Other operating income	-	-	-	-
Total operating income	76,496	91,857	96,485	1,09,809
Cost of goods sold	(23,026)	(26,143)	(27,498)	(31,032)
Gross profit	53,470	65,714	68,987	78,777
<i>Gross margin (%)</i>	<i>69.9</i>	<i>71.5</i>	<i>71.5</i>	<i>71.7</i>
Total operating expenses	(39,142)	(45,347)	(47,929)	(53,954)
EBITDA	14,328	20,367	21,058	24,823
<i>EBITDA margin (%)</i>	<i>18.7</i>	<i>22.2</i>	<i>21.8</i>	<i>22.6</i>
Depreciation	(2,691)	(3,168)	(3,192)	(3,625)
EBIT	11,636	17,199	17,866	21,198
Net interest	(1,789)	(2,373)	(1,809)	(1,624)
Other income	200	373	383	392
Profit before tax	10,047	15,199	16,440	19,966
Total taxation	(3,026)	(3,442)	(4,110)	(4,991)
<i>Tax rate (%)</i>	<i>30.1</i>	<i>22.6</i>	<i>25.0</i>	<i>25.0</i>
Profit after tax	7,021	11,757	12,330	14,974
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	7,021	11,757	12,330	14,974
<i>Adj. PAT margin (%)</i>	<i>9.2</i>	<i>12.8</i>	<i>12.8</i>	<i>13.6</i>
Net non-recurring items	-	-	-	-
Reported net profit	7,021	11,757	12,330	14,974

Balance sheet (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	282	282	282	282
Reserves & surplus	42,420	49,112	60,489	74,511
Net worth	42,702	49,394	60,771	74,793
Borrowing	40,244	47,662	42,781	38,405
Other non-current liabilities	1,356	572	572	572
Total liabilities	84,299	97,624	1,04,120	1,13,766
Gross fixed assets	51,460	55,764	62,764	69,764
Less: Depreciation	(11,810)	(14,978)	(18,170)	(21,795)
Net fixed assets	39,650	40,787	44,595	47,969
Add: Capital WIP	-	-	-	-
Total fixed assets	39,650	40,787	44,595	47,969
Total Investment	172	157	157	157
Inventory	15,678	21,390	22,469	24,068
Debtors	24,926	24,043	25,113	27,076
Cash & bank	8,571	10,564	9,028	10,665
Loans & advances	10,289	13,265	14,539	16,547
Current liabilities	24,061	24,496	25,668	28,599
Net current assets	35,404	44,766	45,481	49,756
Other non-current assets	9,073	11,914	13,887	15,884
Total assets	84,299	97,624	1,04,120	1,13,766

Source: Company, Axis Capital

Cash flow (Rsmn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	10,047	15,199	16,440	19,966
Depreciation & Amortisation	2,691	3,168	3,192	3,625
<i>Chg in working capital</i>	<i>(6,077)</i>	<i>(6,174)</i>	<i>(3,146)</i>	<i>(2,116)</i>
Cash flow from operations	3,448	8,113	11,829	15,719
<i>Capital expenditure</i>	<i>(8,903)</i>	<i>(7,000)</i>	<i>(7,000)</i>	<i>(7,000)</i>
Cash flow from investing	(8,802)	(7,000)	(7,000)	(7,000)
<i>Equity raised/ (repaid)</i>	<i>18,944</i>	-	-	-
<i>Debt raised/ (repaid)</i>	<i>110</i>	<i>7,418</i>	<i>(4,881)</i>	<i>(4,376)</i>
Dividend paid	(679)	(681)	(953)	(953)
Cash flow from financing	16,575	4,364	(7,643)	(6,952)
Net chg in cash	11,222	5,478	(2,814)	1,767

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	24.8	41.6	43.6	53.0
CEPS (Rs)	34.4	52.8	54.9	65.8
DPS (Rs)	2.0	2.0	2.8	2.8
Dividend payout ratio (%)	8.0	4.8	6.4	5.3
GROWTH				
Net sales (%)	15.1	20.1	5.0	13.8
EBITDA (%)	16.9	42.2	3.4	17.9
Adj net profit (%)	(12.6)	67.4	4.9	21.4
FDEPS (%)	(16.2)	67.4	4.9	21.4
PERFORMANCE				
RoE (%)	19.3	25.5	22.4	22.1
RoCE (%)	15.2	19.3	18.1	19.8
EFFICIENCY				
Asset turnover (x)	1.1	1.1	1.1	1.1
Sales/ total assets (x)	0.7	0.8	0.8	0.8
Working capital/ sales (x)	0.3	0.3	0.4	0.3
Receivable days	118.9	95.5	95.0	90.0
Inventory days	92.0	109.2	108.7	103.4
Payable days	113.9	97.2	94.8	93.1
FINANCIAL STABILITY				
Total debt/ equity (x)	1.1	1.0	0.8	0.6
Net debt/ equity (x)	0.9	0.8	0.6	0.4
Current ratio (x)	2.5	2.8	2.8	2.7
Interest cover (x)	6.5	7.2	9.9	13.1
VALUATION				
PE (x)	36.4	21.7	20.7	17.1
EV/ EBITDA (x)	20.0	14.3	13.7	11.4
EV/ Net sales (x)	3.7	3.2	3.0	2.6
PB (x)	6.0	5.2	4.2	3.4
Dividend yield (%)	0.2	0.2	0.3	0.3
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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