Gland Pharma Ltd

Recommendation	SUBSCRIBE
Price Band	Rs 1490-1500
Bidding Date	9-11 Nov
Book Running Lead Manager	Kotak, Citi, Haitong, Normura
Registrar	Link In-time
Sector	Pharma

Minimum Retail Application – Details At Cut off Price	
Number of Shares	10
Application Money	15000
Discount to retail	NIL
Payment Mode	ASBA, UPI

Consolidated Financials (Rs Cr)	FY19	FY20
Total Income	2044	2633
EBITDA	707	955
PAT	452	773

Valuations*	Lower Band	Upper Band
Market Cap (Rs cr)	24329	24492
EPS	47.3	47.3
BV/share	223	223
P/BV	6.7	6.7
P/E	31.5	31.7

**diluted equity*

Post Issue Shareholding Pattern	
Promoters	58.4%
Public	41.6%

Offer structure for different categories	
QIB (Including Mutual Fund)	50%
Non-Institutional	15%
Retail	35%
Post Issue Equity Capital (Rs cr)	16.33
Issue Size (Rs cr)	6455-6480
Face Value (Rs)	1

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BACKGROUND

Company Overview

Gland Pharma Ltd (GPL) was established in Hyderabad, India in 1978 and is present in sterile injectables, oncology and ophthalmic, and focus on complex injectables, NCE-1s, First-to-File products and 505(b)(2) filings. **It has a consistent compliance track record with a range of regulatory regimes across the markets and has never got a warning letter from USFDA.** It has seven manufacturing facilities in India, comprising four finished formulations facilities and three API facilities. As of June 30, 2020, GPL along with its partners has 267 ANDA filings in the United States, of which 215 were approved and 52 were pending approval.

Objects of the Issue

The issue of Rs 6480 cr comprised of Rs 1250 cr fresh issue and Rs 5230 cr Offer for Sale. The company intends to incur capex from the fresh issue.

Investment Rationale

- **Extensive portfolio of complex products**
- **Vertically integrated injectables manufacturing capabilities with a consistent regulatory compliance track record**
- **Diversified B2B-led model across markets**
- **Healthy Financials –** (a) Robust Return Ratios (b) Strong profitability and healthy revenue growth (c) Healthy Balance Sheet

Valuation and Recommendation

Between FY18-20, Gland Pharma's revenues have grown at CAGR of 28% while Q1FY21's revenue grew by 31%. The company is engaged in complex products hence it has healthy profitability. Due to no debt and high cash, the company has strong PAT margins at 29.4% in FY20 which has improved from 19.8% in FY18.

We believe the company is able to maintain CAGR of 25% for medium term with strong profitability. Though, Q1FY21 margins looks on the higher side, we believe EBITDA margins in the range of 35-38% are sustainable.

The company intends to do capex with the IPO and cash on books, which can temporarily affect the return rations in near term however the long-term trajectory remains positive

The issue price commands P/E of 31.7x FY20 and 19.5x Q1FY21 annualized earnings at the upper price of band of Rs 1490-1500, which is at upper end of Industry. However, going forward the higher revenue growth, improving profitability would make it a better choice among peers. We recommend "Subscribe" on the issue for long term gains.

Financial Snapshot	FY18	FY19	FY20	Q1FY21
Revenues	1620	2044	2633	884
*%growth**		*26%*	*29%*	*31%*
EBIDTA	535	707	955	413
% margins	*33.0%*	*34.6%*	*36.3%*	*46.7%*
Adj. PAT	321	452	773	314
EV/EBIDTA @ Rs 1500			24.8	13.9
P/E @ Rs 1500			31.7	19.5
P/BV @ Rs 1500			8.6	6.2

Company Overview

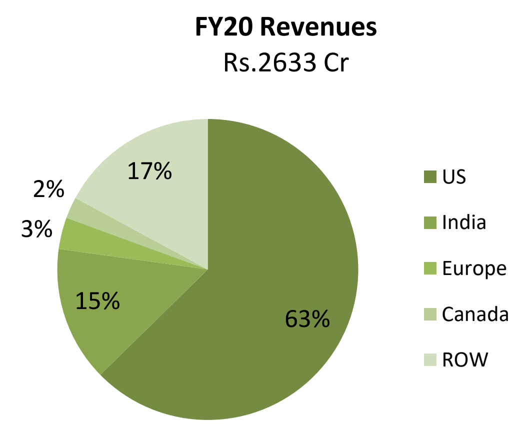
Gland Pharma Ltd (GPL) was established in Hyderabad, India in 1978 and have expanded from liquid parenteral to cover other elements of the injectables value chain, including contract development, own development, dossier preparation and filing, technology transfer and manufacturing across a range of delivery systems. It is present in sterile injectables, oncology and ophthalmic, and focus on complex injectables, NCE-1s, First-to-File products and 505(b)(2) filings. The company has an extensive track record in complex injectables development, manufacturing and marketing and regulatory processes.

It sells its products primarily under a business to business ("B2B") model in over 60 countries as of June 30, 2020 including the United States, Europe, Canada, Australia, India and the Rest of the world. **It has a consistent compliance track record with a range of regulatory regimes across these markets and has never got a warning letter from USFDA**.

It has seven manufacturing facilities in India, comprising four finished formulations facilities and three API facilities. API facilities are 100% captively consumed and provide the company the in-house manufacturing capabilities for critical products in addition to control costs and quality and mitigate supply chain related risks around its key products.

As of June 30, 2020, GPL along with its partners has 267 ANDA filings in the United States, of which 215 were approved and 52 were pending approval.

Geographical Revenue Breakup



Investment Rationale

Extensive portfolio of complex products

Gland Pharma is present in sterile injectables, oncology and ophthalmic, and focus on complex injectables, NCE-1s, First-to-File products and 505(b)(2) filings. Injectables manufacturers face high entry barriers such as high capital investments, operational costs, manufacturing complexities, stricter compliance requirement due to the sterile nature of products and high-quality standards, resulting in limited competition in the market. These factors ensure lesser competition in the injectables segment relative to other segments. Due to highly complex and stringent development and manufacturing process involved, injectables continue to remain a specialized area within the pharmaceutical industry. Hence, over the years there are less players in the injectables segment resulting into injectables forming major portion of drug shortages in the United States.

The company is expanding its development and manufacturing capabilities in complex injectables such as peptides, long-acting injectables, suspensions and hormonal products as well as new delivery systems such as pens and cartridges. As of June 30, 2020, the company along with its partners have 267 ANDA filings in the United States, of which 215 were approved and 52 were pending approval. The 267 ANDA filings comprise 191 ANDA filings for sterile injectables, 50 for oncology and 26 for ophthalmic related products

Vertically integrated injectables manufacturing capabilities with a consistent regulatory compliance track record

Gland Pharma has seven manufacturing facilities are situated in southern India including two sterile injectables facilities, one dedicated Penems facility, one oncology facility and three API facilities. API is 100% captive and 24 its ANDAs covering the key products are supported by in-house APIs. The vertical integration allows the company to achieve greater control over its manufacturing processes to meet required standards, increase operating efficiencies, accelerate product development, strengthen product quality control and improve supply chain efficiencies.

The manufacturing facilities have established a consistent record of regulatory compliance with the USFDA highlighting the strong quality standards maintained by the company.

Gland Pharma has had no warning letters from the USFDA (whether as a result of facility inspections or otherwise) since the inception of each facility, which is rare of rare.

Diversified B2B-led model across markets

GPL's primary business model is B2B (95-96% of revenues), covering IP-led, technology transfer and contract manufacturing models, complemented by a B2C model in its home market of India. Over the years the company has developed various B2B models like –

(a) B2B – IP led own filings
(b) B2B – IP led Partner filing
(c) B2B Tech Transfer
(d) B2B CMO

The various B2B business models enables the company to (i) grow market share in key markets such as the United States, Europe, Canada and Australia, particularly the United States, while reducing the marketing investments they need to make, (ii) leverage the reputation of the marketing partners in their home markets to build its own presence in these markets, (iii) build its reputation as a complex injectables manufacturer with a consistent compliance record attracting confidence from other potential marketing partners, and (iv) balance profitability and capacity utilization while continuing to deliver high manufacturing and quality standards to a broad range of customers.

There are various *Benefits of B2B over B2C* such as

a) Since the majority of injectable products are sold through hospital channels, early entry helps in building scale to defend pricing pressure due to increasing competition.
b) B2B players generally have long-term supply contracts ranging from three to five years with marketing partners, providing predictability of medium-term revenue
c) B2B players have a lower cost profile due to lack of higher SG&A expenses as compared to B2C players, which improves profitability

Healthy Financials

Robust Return Ratios

Due to the strong profitability and healthy balance sheet the company enjoys high ROE and ROCEs. It has huge cash balance on balance sheet (Rs 1325 cr as on 30th June'20) which we believe somewhat muted the ratios.

Particulars	**FY18**	**FY19**	**FY20**	**Q1FY21**
ROE	13.3%	15.8%	21.2%	31.6%
ROCE	20.9%	24.1%	27.4%	42.4%

Strong profitability and healthy revenue growth

The company is present in complex products i.e. Injectibles which has lower competition and higher profitability. In addition, cost below gross margins is largely fixed in nature hence provides operation leverage in case of higher revenue growth which is CAGR of 28% over FY18-20. Furthermore, the company is net debt free hence has no interest cost and have high other income which aids PAT margins

Margins (%)	**FY18**	**FY19**	**FY20**	**Q1FY21**
Gross Margins	59.2%	58.1%	58.1%	63.8%
EBITDA Margins	33.0%	34.6%	36.3%	46.7%
PAT Margins	19.8%	22.1%	29.4%	35.5%

Healthy Balance Sheet

Though the company has high working captial – which is intentional, it is net debt free and has robust cash generation, which provides sustainability to the overall business.

Risks and Concerns

1. **High working capital:** The company has high working capital cycle of 150+ days mainly led by high inventory days. The management maintains that this is intentional and almost all of the inventory is of raw materials. Being present in the injectables business, there are high chances of product shortages and the penalty on product shortages are higher than carrying cost of inventory. Also, the management assured that the risk of these high inventory lies with the customers hence they are broadly insulated from any major loss arising from high inventory levels. Hence, the inventory levels are likely to be remain at high levels. However, the company has otherwise high cash generation which gives confidence on the overall working and sustainability of the business operations.
2. **Promoter is a Chinese Company:** Pre-IPO 75% of the company's shares are held by Fosun Pharma which is a Chinese company. Considering, the ongoing global trade tensions and disruptions at home borders, this might affect the general emotions of the potential shareholders.

   Also, the company has group company – Gland Chemicals which is engaged in similar business of APIs and GPL does source materials from it, hence doing related party transactions which can create corporate governance issues if proper transfer pricing is not maintained.

Valuation and Recommendation

Between FY18-20, Gland Pharma's revenues have grown at CAGR of 28% while Q1FY21's revenue grew by 31%. The company is engaged in complex products hence it has healthy profitability. It had 36.3% EBITDA margins, which are steadily improving from 33% in FY18. For Q1FY21, the company reported 46.7% EBITDA margins as compared to 39% in Q1FY20. Due to no debt and high cash, the company has strong PAT margins at 29.4% in FY20 which has improved from 19.8% in FY18. For Q1FY21, the company enjoyed 35.5% PAT margins.

We believe the company is able to maintain CAGR of 25% for medium term with strong profitability. Though, Q1FY21 margins looks on the higher side, we believe EBITDA margins in the range of 35-38% are sustainable.

The company intends to do capex with the IPO and cash on books, which can temporarily affect the return rations in near term however the long-term trajectory remains positive

	Sales	Sales CAGR FY18-20	EBITDA CAGR FY18-20	D/E	Total Asset Turns	EBITDA Margins	ROE	PE	EV/EBITDA
Sun Pharma	32838	11%	12%	0.0	0.7	21.2%	9.8%	27.6	17.7
Cipla	17132	6%	7%	0.1	1.0	18.7%	9.5%	40.9	19.7
Divis Lab	5394	17%	20%	0.0	0.7	33.8%	18.8%	64.7	48.8
Gland Pharma	**2633**	**18%**	**21%**	**-0.4**	**1.1**	**36.3%**	**21.2%**	**31.7**	**24.8**

The issue price commands P/E of 31.7x FY20 and 19.5x Q1FY21 annualized earnings at the upper price of band of Rs 1490-1500, which is at upper end of Industry. However, going forward the higher revenue growth, improving profitability would make it a better choice among peers. **We recommend "Subscribe" on the issue for long term gains.**

FINANCIALS

P&L (Rs. Cr)	FY18	FY19	FY20	Q1FY21
Net Revenue	**1,620**	**2,044**	**2,633**	**884**
% Growth		*26%*	*29%*	*31%*
COGS	661	857	1,102	320
% of Revenues	*40.8%*	*41.9%*	*41.9%*	*36.2%*
Employee Cost	179	223	278	72
% of Revenues	*11.1%*	*10.9%*	*10.5%*	*8.2%*
Other expenses	245	258	298	79
% of Revenues	*15.1%*	*12.6%*	*11.3%*	*9.0%*
EBITDA	**535**	**707**	**955**	**413**
EBITDA Margin	***33.0%***	***34.6%***	***36.3%***	***46.7%***
Depreciation	78	82	95	24
Other Income	49	86	139	32
Interest	4	4	7	0
Share of PAT (Invst)				
Exceptional gain		(20)		
PBT	**501**	**686**	**993**	**420**
Tax	180	234	220	106
Tax rate	*36%*	*34%*	*22%*	*25%*
PAT	**321**	**452**	**773**	**314**
% Growth		***41%***	***71%***	***71%***
EPS (Post Issue)	**19.7**	**27.7**	**47.3**	**19.2**

Performance Ratios	FY18	FY19	FY20	Q1FY21
EBITDA Margin (%)	33.0%	34.6%	36.3%	46.7%
PAT Margin (%)	19.8%	22.1%	29.4%	35.5%
ROE (%)	13.3%	15.8%	21.2%	31.6%
ROCE (%)	20.9%	24.1%	27.4%	42.4%
Net D/E (x)	-0.3	-0.3	-0.4	-0.4

Turnover Ratios	FY16	FY17	FY20	Q1FY21
Debtors Days	106	89	82	69
Inventory Days	114	161	103	103
Creditor Days	65	79	34	49
Asset Turnover (x)	0.7	0.7	0.7	0.9

Valuation Ratios	FY18	FY19	FY20	Q1FY21
Price/Earnings (x)			31.7	19.5
EV/EBITDA (x)			24.8	13.9
Price/BV (x)			8.6	6.2
Mkt cap/Sales (x)			9.3	6.9
EV/Sales (x)			9.0	6.5

Source: Company Data, NBRR

Balance Sheet (Rs. Cr)	FY18	FY19	FY20	Q1FY21
Share Capital	15	15	15	15
Reserve & Surplus	2,395	2,847	3,631	3,948
Non Controlling Int	-	-	-	-
Networth	**2,410**	**2,862**	**3,646**	**3,963**
Total Loans	**5**	**5**	**4**	**4**
Deff Tax Liab	96	108	74	73
Other non-curr liab.	39	16	3	3
Trade payable	292	446	249	477
Other Current Liab	85	84	92	149
Total provisions	2	3	17	21
Total Current Liab.	**379**	**533**	**359**	**648**
Total Equity & Liab.	**2,929**	**3,524**	**4,086**	**4,691**
Fixed Assets & CWIP	1,043	1,053	1,157	1,206
Goodwill	-			
Investments	-	-	-	
Deff Tax Assets	20	19	1	2
Other non Curr. assets	135	94	75	57
Cash	671	780	1,325	1,529
Inventories	513	912	756	1,009
Debtors	475	506	602	674
Other Current assets	73	159	170	215
Total Assets	**2,929**	**3,524**	**4,086**	**4,691**

Cash Flow (Rs. Cr)	FY18	FY19	FY20	Q1FY21
EBITDA	535	707	955	413
Provisions & Others	17	56	70	17
Op. profit before WC	**553**	**763**	**1,025**	**429**
Change in WC	(193)	(354)	(80)	(104)
Less: Tax	(157)	(223)	(244)	(32)
CF from operations	**202**	**185**	**701**	**293**
Addition to assets	(85)	(135)	(171)	(55)
(Purchase)/Sale of invst.	(298)	(219)	(639)	(42)
Div/Int Received	24	40	43	17
CF from Investing	**(359)**	**(314)**	**(766)**	**(81)**
Loans	(1)	(2)	(1)	
Dividend Paid	-	-	-	
Interest paid	(4)	(4)	(7)	(0)
Equity	1	2	1	0
CF from Financing	**(4)**	**(3)**	**(7)**	**(0)**
Net Change in cash	**(160)**	**(132)**	**(72)**	**212**
Cash at beginning	533	373	236	169
Exchange difference	0	(4)	5	0
Cash at end	373	236	169	382

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