Sharekhan
by BNP PARIBAS

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Stock Update

Result Update

Gland Pharma Ltd

Weak Q1; long term levers intact

Pharmaceuticals	Sharekhan code: GLAND
Reco/View: Buy ↔	CMP: Rs. 2,473
	Price Target: Rs. 3,080 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated July 08, 2022				44.83
Severe Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

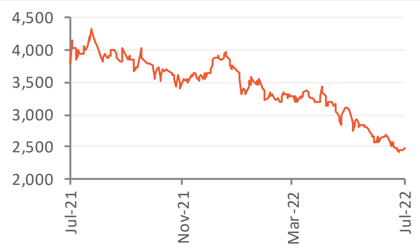
Company details

Market cap:	Rs. 40,724 cr
52-week high/low:	Rs. 4,350/2,421
NSE volume: (No of shares)	2.2 lakh
BSE code:	543245
NSE code:	GLAND
Free float: (No of shares)	6.9 cr

Shareholding (%)

Promoters	58.0
FII	11.5
DII	11.7
Others	18.84

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.9	-24.7	-32.0	-35.9
Relative to Sensex	-14.3	-21.8	-25.1	-40.8

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Gland Pharma (Gland) with a revised PT of Rs. 3,080.
- Gland reported a weak performance for Q1FY23 due to the impact of continued supply disruption, cost escalation and the managements decision to shut down two of its manufacturing lines for productivity improvement.
- While the near term challenges seem to be transient in nature, the long-term growth levers for Gland are intact.
- FY2023 is expected to witness moderation in the topline growth while in FY24E the topline growth is likely to bounce back. The OPM guidance is around 33% to 35%

Gland Pharma Limited (Gland) reported weak performance for Q1FY23 and the results reflected the impact of continued supply disruption, cost escalation and shutting down two of the manufacturing lines for productivity improvement. The results missed ours as well as streets estimates. The revenues declined 26% y-o-y while the PAT declined by 34.6% y-o-y. Due to continued supply disruptions and cost escalations, Gland has reported a business loss of Rs ~ 200 crore for the quarter which the management sees a challenge recovering. Consequently, the FY23 overall growth is expected to slow down while basis the long term growth levers being intact, FY24 could witness a strong double digit growth. In the short term, the management envisages certain challenges to stay while the long-term growth levers are intact.

Key positives

- Gross margins expanded by 280 bps y-o-y to 56.3%.

Key negatives

- The revenue declined by 26% y-o-y on the back of a 72% and 55% y-o-y decline in the India and RoW market sales respectively
- Operating margins contracted by 631 bps y-o-y to 31.5%.

Management Commentary

- Gland expects the revenue growth in the subsequent quarters to improve as the supply side challenges are likely to ease out. Overall gland sees topline growth moderation in FY23 and a strong double-digit growth in FY24. It has guided for 33% to 35% OPM's going ahead.
- For FY2023 the company intends to invest Rs. 300 crore as capex, which would be towards the expansion of Pashamylaram facility and vertical integration for API's.
- Gland has a strong product pipeline in the US with 316 ANDAs filled and of this 255 are approved ANDAs and 61 ANDAs awaiting approval. In total, the company has 1567 products registered across the globe.

Revision in estimates – Q1FY23 was a weak quarter for gland and the results are below estimates. Given the weak Q1 performance and the irrecoverable revenue loss, we have revised down our estimates by ~16% to 18% for FY23E –FY24E.

Our Call

Valuation – Long-term levers intact; retain Buy: Gland reported a weak performance for Q1FY23 and the results reflected the impact of continued supply disruption, cost escalation and shutting down two of its manufacturing lines for productivity improvement. Collectively these factors, resulted in a business loss of Rs 200 cr for Q1FY23 which the management sees as a challenge to recover in the subsequent quarters. However, Gland expects the supply chain issues to be easing out gradually. Overall while the challenges seem to be transient in nature, the long-term growth levers for Gland are intact. At the CMP, the stock trades at 33.8x/26.5x its FY2023E/FY2024E EPS. Over a span of 3 months, the stock price has corrected by ~25% due to said challenges which the management expects to ease out gradually and could support growth. We retain our Buy recommendation on the stock with a revised PT of Rs. 3,080.

Key Risks

1) Delay in key product approvals; 2) any adverse change in the regulatory landscape; and 3) adverse forex movements.

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E
Total Sales	3462.9	4400.7	4751.0	5762.1
Operating Profits	1437.0	1734.1	1745.3	2172.7
OPM (%)	37.6	34.3	33.2	34.5
Reported PAT	997.0	1211.7	1196.3	1524.2
EPS (Rs)	61.1	74.2	73.3	93.3
PER (x)	40.5	33.3	33.8	26.5
EV/Ebidta (x)	26.0	21.4	21.2	16.5
P/BV (x)	6.8	5.6	4.9	4.1
ROCE (%)	22.4	22.4	19.1	20.4
RONW (%)	16.9	16.9	14.4	15.6

Source: Company; Sharekhan estimates

Weak Q1; results miss estimates: Gland Pharma reported a weak set of results for Q1FY23 and the performance was impacted by supply side disruptions including a short supply of syringes as well as issues in API procurement. Also, the macro environment remained challenging across geographies. High base due to Covid-related opportunities in Q1fY22 too added to the decline. The results missed ours as well as streets estimates. The revenues at Rs 857 cr down 26% y-o-y and was lower than the estimates. The India sales at Rs 51 cr declined 77.5% y-o-y as B2B sales were impacted due to planned shutdown of Insulin line and a high base in Q1FY22 due to covid led opportunities. The RoW sales too declined by 55% y-o-y due to delay in input material supplies. The sales from the core markets for the quarter were almost flat y-o-y basis at Rs 705 cr. The overall revenues missed estimates. The operating margins at 31.5% (missed estimated 32%) contracted 630 bps y-o-y due to operating de-leverage playing out as revenues declined sharply by 26% y-o-y. The gross margins however expanded by 280 bps y-o-y to 56.3% attributable to the favourable mix. The EBITDA stood at Rs 270 cr decline of 38% y-o-y and missed estimates. Tracking the operating performance, the PAT stood at Rs 229 cr down by 34.6% y-o-y, and missed ours as well as streets estimates.

Q1FY2023 Concall Highlights

- **Weak Q1FY23 to moderate FY23 revenue growth; FY24 to witness a bounce back:** Gland's revenues for Q1FY23 at Rs 857 crore declined by 26% y-o-y, which is one of the sharpest decline reported by the company. Revenues across the geographies were impacted with India business exhibiting Sharp 77.5% y-o-y drop in revenues, attributable to shut down of an insulin line during the quarter as well as high base in Q1FY22 due to covid led opportunities. The shut down of the insulin line has resulted in around Rs 40-50 crore of business loss in Q1FY23 and the management expects the quarterly run rate to be around Rs 100 cr for the India business in the subsequent quarters. The RoW market sales too declined by 55% y-o-y to Rs 100 cr and the performance was impacted due to the short supplies of syringes as well as Supply Chain Issues. The US sales too were impacted reflecting a business loss of Rs 25 crore on account of the short supply of syringes. Overall for Q1FY23 Glands revenues reflected business loss of ~Rs 200 crore, which the management sees as a challenge to recover in the subsequent three quarters. However, the run rate is expected to improve and 2HFY23 is likely to witness an improvement with FY24 likely to stage a marked improvement. Hence basis the weak performance in Q1FY23 the topline growth for FY23 is expected to moderate to high single digits while revenue growth is expected to bounce back to string double digits in FY24.
- **RoW market revenue declined sharply in Q1; Gland sees high potential in China markets:** Gland's revenues from the RoW markets stood at Rs 100 cr down from Rs 222 cr in Q1FY22. The delay in input material supplies has significantly impacted the company's ability to procure new orders. MENA, LATAM and APAC are the company's key markets in the RoW markets and Gland has registered new products in these new geographies during the year. The share of revenues from the RoW markets for Q1FY23 stood at 11.7% as compared to 19.3% in Q1FY22. Further, Gland sees China as a market with strong potential; and Gland has filed for its product in China. The company is expecting two product approvals to flow in from the regulator in FY23 as the inspection has been waived off. Also Gland looks to file 5 products in FY23 and 6-7 products in FY24 in the China markets. The company has registered Ethacrynate Sodium, Ganciclovir, Foscarnet sodium and Labetalol Hydrochloride in new geographies in Q1FY23 and next set of molecules are being finalized for the China markets offering an addressable market size of $1 bn, which is quite substantial and points at a strong growth trajectory.
- **Core Markets:** Gland's core markets consist of the US, Europe, Australia, and Canada. Collectively, these core markets constitute around 82% of the overall revenue of the company for the quarter. Core markets declined by 6% y-o-y to Rs. 705 crore. The US accounts for 90% of the overall core markets sales and

revenues have declined by 4% y-o-y whilst growing 6% Q-o-qQ-o-q. In Q1FY23 Gland launched products such as Bortezomib, Pemetrexed, Pantoprazole and Cyanocobalamin in the US market and has also received 180 days CGT exclusivity Zinc Sulfate injection in the US market. Overall in Q1FY23 the company launched 14 product SKU's (7 molecules). Going ahead, growth in core markets is expected to be strong, driven by US business growth. For US markets, which is one of the key constituents of core markets, Gland has had a strong product pipeline in the US, which includes 59 pending approvals. As of June 2022, the company has a total of 316 ANDA;s filed in the US markets and of this has received approvals for 255 ANDA's and 61 are pending approvals. Collectively, a strong product launch pipeline bodes well and provides ample growth visibility.

- **India Markets:** Revenue from India business for the quarter at Rs 51 crore declined steeply by 72% y-o-y attributable to the shutdown of the insulin manufacturing line at Pashmylaram facility. The shit down was taken in order to increase productivity. Further in Q1FY22 drugs such as Enoxaparin and Remdesivir has higher demand due to Covid leading to a higher base. However, the shortfall in Insulin production is to be compensated by improved line productivity for the rest of the year.
- **R&D:** R&D expenses for the quarter stood at Rs. 41 crore, translating to around 4.8% of overall sales for the quarter. During the quarter, Gland has filed for six ANDAs and the as of June 2022 the company has a total of 316 ANDA filings in the US and total 1,567 product registrations globally.
- **Capex plans:** For FY2023 the company intends to invest Rs. 300 crores as Capex, which would be towards the expansion of Pashamylaram facility and vertical integration for the active pharmaceutical ingredients (APIs).
- **Outlook:** Gland expects the revenue growth in the subsequent quarters to improve as the supply issue of Syringes is likely to ease out thus enabling Gland to cater to a higher number of orders. Also, the company is focusing on creating an alternate vendor base which would ensure an uninterrupted supply of raw materials / API's. Overall though Q1FY23 was a weak quarter, the subsequent quarters are expected to witness improvement while FY24 could see a double- digit top-line growth. Further, the management has guided for the OPM's to be in the range of 33% to 35% going ahead.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-y %	Q4FY22	Q-o-qQ-o-q %
Total Income	856.9	1153.9	-25.7	1103.0	-22.3
Expenditure	587.0	717.6	-18.2	754.6	-22.2
Operating profit	269.9	436.3	-38.1	348.4	-22.5
Other income	74.4	61.8	20.3	65.2	14.0
EBIDTA	344.3	498.1	-30.9	413.6	-16.8
Interest	0.9	1.0	-9.8	2.0	-55.6
Depreciation	34.9	25.3	38.2	31.1	12.3
PBT	308.5	471.9	-34.6	380.5	-18.9
Tax	79.3	121.2	-34.5	94.6	-16.1
PAT	229.2	350.7	-34.6	286.0	-19.9
Margins			**BPS**		**BPS**
OPM (%)	31.5	37.8	-631.0	31.6	-8.8
Net profit margin (%)	26.7	30.4	-364.6	25.9	81.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Better growth prospects

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in the US generics market), improving product approvals, and plant resolutions by the USFDA coupled with strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules, biosimilars, and injectables) and the commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for Indian pharma companies.

■ Company Outlook – Well placed to harness growth opportunities

Gland is an established player globally in sterile injectables and is one of the fastest-growing generic injectable companies. Gland has an extensive and vertically integrated injectables manufacturing capabilities and has a consistent regulatory compliance track record, with no observations received from the USFDA. US markets constitute a lion's share of sales and, hence, a strong compliance track record augurs well. Improved demand traction and incremental capacities coming on stream provide ample growth visibility ahead. Further, the company follows a unique diversified B2B-led model across markets globally, which partially lowers compliance risk, thus paving way for faster growth. In domestic markets, Gland follows a B2C model. Gland has an extensive portfolio of complex products (which are well supported by internal R&D), awaiting to be commercialised across markets. Gland has an experienced management team and, over the years, has developed strong capabilities, which would enable the company to stage strong growth going ahead. Further, the company is looking to tap RoW markets, including China for growth and expects the share of RoW revenue to double to 40% over 3-4 years, primarily led by growth in China markets. The arrangement of manufacturing doses of Sputnik light vaccine would just take the company closer to its long-term strategy to enter the lucrative biosimilar CDMO space and Gland has been receiving initial interest for this which bodes well.

■ Valuation – Long-term levers intact; retain Buy

Gland reported a weak performance for Q1FY23 and the results reflected the impact of Continued supply disruption, cost escalation and the Company's decision to shut down two of its manufacturing lines for productivity improvement. Collectively these factors resulted in a business loss of Rs 200 cr for Q1FY23 which the management sees a challenge to recover in the subsequent quarters. However, Gland expects the supply chain issues to be easing out gradually as it has already started on building an alternate vendor base which could support the revenue growth. Overall while the challenges seem to be transient in nature, the long-term growth levers for Gland are intact. Also it is looking at China markets to be a material contributor to the growth of the company. Given the weak Q1 performance and the irrecoverable revenue loss, we have revised down our estimates by ~16% to 18% for FY23E –FY24E. At the CMP, the stock trades at 33.8x/26.5x its FY2023E/FY2024E EPS. Over a span of 3 months, the stock price has corrected by ~25% due to challenges such as the short supply of Syringes and supply chain issues, which the management expects to ease out and could support growth. The strong domain expertise and growth prospects and strong financials are key positives for Gland. We retain our Buy recommendation on the stock with a revised PT of Rs. 3,080.

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)			EV/EBIDTA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Gland Pharma	2,473.0	16.3	40,724.0	33.3	33.8	26.5	21.4	21.2	16.5	16.9	14.4	15.6
Cipla	982.0	80.6	79214.0	28.9	25.8	20.3	17.2	15.5	12.4	14.6	13.8	15.3
Dr Reddy's	4,457.0	16.6	74,186.0	33.9	21.7	19.1	13.9	11.4	9.6	11.4	16.4	16.4

Source: Company, Sharekhan estimates

About company

Gland was established in Hyderabad in 1978. The company is a vertically integrated company with capabilities, including internal research and development expertise, robust manufacturing capabilities, a stringent quality assurance system, extensive regulatory experience, and established marketing and distribution relationships. The company has 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. Predominantly, Gland has been focusing on the injectables space with negligible presence in orals. The company focuses on meeting diverse injectables needs with a stable supply of affordable and high-quality products. Gland follows a unique B2B business model and has a successful track record of operating this model across multiple geographies. Gland has a total of seven manufacturing plants with three of them being API plants. Of the balance, two are sterile injectables plant – one each for oncology and ophthalmology.

Investment theme

The injectables space inherently has high entry barriers, thus pointing towards relatively low competition. Gland has extensive and vertically integrated injectable manufacturing capabilities and has a consistent regulatory compliance track record, with no observations received from the USFDA. Improved demand traction and incremental capacities coming on stream provide ample growth visibility ahead. Further, the company follows a unique diversified B2B-led model across markets globally, which partially lowers compliance risk, thus paving the way for faster growth. In domestic markets, Gland follows a B2C model. Gland has an extensive portfolio of complex products, awaiting to be commercialised across markets. Gland has an experienced management team and, over the years, has developed strong capabilities, which would enable the company to stage strong growth going ahead. Moreover, the company is looking to build its presence in the European market through the inorganic route and is open to an acquisition in the complex API space. The recent arrangement to manufacture doses of the Sputnik vaccine would just take the company closer to its long-term strategy to enter the lucrative biosimilar space.

Key Risks

1) Delay in key product approvals; 2) any adverse change in the regulatory landscape; and 3) adverse forex movements.

Additional Data

Key management personnel

Mr Srinivas Sadu	Managing Director & Chief Executive Officer
Mr Ravi Mitra	Chief Financial Officer
KVGK Raju	Chief Technology Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Pvt Ltd	3.36
2	Republic of Singapore	2.66
3	EMPOWER DISCRETIONARY TR	2.63
4	Axis Asset Management Co Ltd/India	1.88
5	Capital Group Cos Inc/The	1.21
6	NILAY DISCRETIONARY TR	1.15
7	Motilal Oswal Asset Management Co	1.12
8	Ninety One UK Ltd	0.76
9	FIL Ltd	0.47
10	Nippon Life India Asset Management	0.44

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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