Sharekhan by BNP PARIBAS

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Gland Pharma Ltd

Cenexi acquisition a strategic buy; would widen footprint

Pharmaceuticals	Sharekhan code: GLAND

Reco/View: Buy	↔	CMP: Rs. 1,778	Price Target: Rs. 2,260	↔

↑ 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 44.83

Updated Oct 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 29,275 cr
52-week high/low:	Rs. 4,060/1,660
NSE volume: (No of shares)	4.3 lakh
BSE code:	543245
NSE code:	GLAND
Free float: (No of shares)	6.9 cr

Shareholding (%)

Promoters	57.9
FII	6.4
DII	21.9
Others	13.84

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-13.7	-21.4	-44.6	-49.5
Relative to Sensex	-24.2	-31.0	-54.3	-52.7

Sharekhan Research, Bloomberg

Summary

- Gland Pharma (Gland) is wholly acquiring French based Cenexi group for an enterprise value (EV) of Euro 230mn (valued at EV/Sales of 1.2x its CY22E expected sales); Cenexi operates in CDMO space with expertise in sterile business.
- The acquisition is in line with Gland's strategy of building a European manufacturing presence in sterile injectables. ~70% Cenexi's revenues come from sterile and injectable products.
- Though EBITDA margins of the acquired company is lower than Gland's, the operating efficiencies, focus on specialty projects and scale-up in the business will help Gland's EBIDTA margins to improve in long run.
- Acquisition will add value to Gland's business in the long run. Recent news regards to its parent Fosun Pharma Ltd.'s potential stake sale is a key monitorable. We have Buy rating on the stock with an unchanged PT of Rs. 2260.

Gland Pharma (Gland) has announced the acquisition of 100% of French company Cenexi Group through its wholly-owned subsidiary Gland Pharma International PTE, Singapore for an equity value of EUR 120 million or Rs. 10.14 billion and an Enterprise Value (EV) of EUR 230 Mn or INR 19.43 billion, by entering into a Put Option agreement with Cenexi. The deal is to boost up Gland Pharma's injectable focused Contract Development Manufacturing Organization (CDMO) business in Europe. Gland Pharma is one of the largest global generic injectables-focused companies in India. The given deal entails EV / EBITDA valuation multiple of 6.0x and EV / sales multiple of 1.2x on its CY22E numbers vs. 10.0x – 15.5x EV / EBITDA deal multiples seen in the recent past in the CDMO space. Hence, the deal appears cheaper for Gland Pharma, especially when there has been a 700 bps increase in EBITDA margins for Cenexi in H1CY22 vs. CY21. Acquisition will strengthen Gland's presence in the sterile injectables space.

- **Event – Acquisition of Cenexi:** Gland Pharma is acquiring 100% of France based Cenexi Group (founded in 2004, is an erstwhile Roche company and operates in CDMO space with expertise in sterile business, including for ampoules (small sealed vials), PFS and vials (glass syringes), and complex or niche formulations and / or dosage forms with a focus on high potent sterile and solids) through its wholly owned subsidiary Gland Pharma International PTE, Singapore for an equity value of EUR 120 million or Rs. 10.14 billion and an Enterprise Value (EV) of EUR 230 million euros or Rs. 19.43 billion, by entering into a Put Option agreement with Cenexi. The deal is expected to boost up Gland Pharma's injectable focused Contract Development Manufacturing Organization (CDMO) business in Europe.
- **To expand its CDMO offerings in Europe:** The acquisition is in line with Gland Pharma's strategic roadmap of building a European manufacturing presence in sterile injectables. Nearly 70% of Cenexi's revenue comes from sterile and injectable products. The same is expected to grow to contribute 82% of the revenue over the next four years. Cenexi has an expertise to process specific substances such as hormones, controlled substances and oncology products with four Food and Drug Administration (FDA) approved manufacturing sites spread across Europe. The deal is expected to bring Gland Pharma with an access to the know-how and development abilities in sterile forms including vials, pre-filled syringes, and other innovative technologies such as ophthalmic gel and needleless injectors fill and finish. Also, the deal will increase Gland Pharma's customer base in biologic space.
- **Deal valuation is relatively cheaper:** Cenexi posted revenue of EUR 184.1 Mn or Rs. 15.55 bn and EBITDA of EUR 23.1 million or Rs. 1.95 billion for CY21 and nearly EUR 100.1 million of revenue or Rs. 8.45 billion and EBITDA of EUR 19.1 million or Rs. 1.61 billion in H1CY22. The given deal entails EV / EBITDA valuation multiple of 6.0x and EV / sales multiple of 1.2x on its CY22E numbers vs. 10.0x – 15.5x EV / EBITDA deal multiples seen in the recent past in the CDMO space. Hence, the deal appears cheaper for Gland Pharma, especially when there has been a 700-bps increase in EBITDA margins for Cenexi in H1CY22 vs. CY21. The transaction would be funded by internal accruals by Gland Pharma.

Our Call

View – Maintain Buy with unchanged PT of Rs. 2260: The acquisition is in line with Gland Pharma's strategic objective to expand its CDMO offerings in Europe. Hence, we believe the new geographical expansion in Europe, acquisition of new customer base, especially in the biologics space, and the opportunity to work on high value projects should help Gland Pharma to improve its long term growth prospects. However, the recent news regarding its largest shareholder Fosun Pharma Ltd's potential stake sale in it is a key monitorable. The stock has corrected by 45% over the past six months and currently is trading at a reasonable valuation of 28x and 22x its FY2023E and FY2024E earnings, presenting attractive risk reward ratio for the stock. However, the stock performance will be subject to its consistent improvement in the business performance. We retain a Buy rating on the stock with an unchanged PT of Rs. 2260.

Key Risks

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

Valuation Rs cr

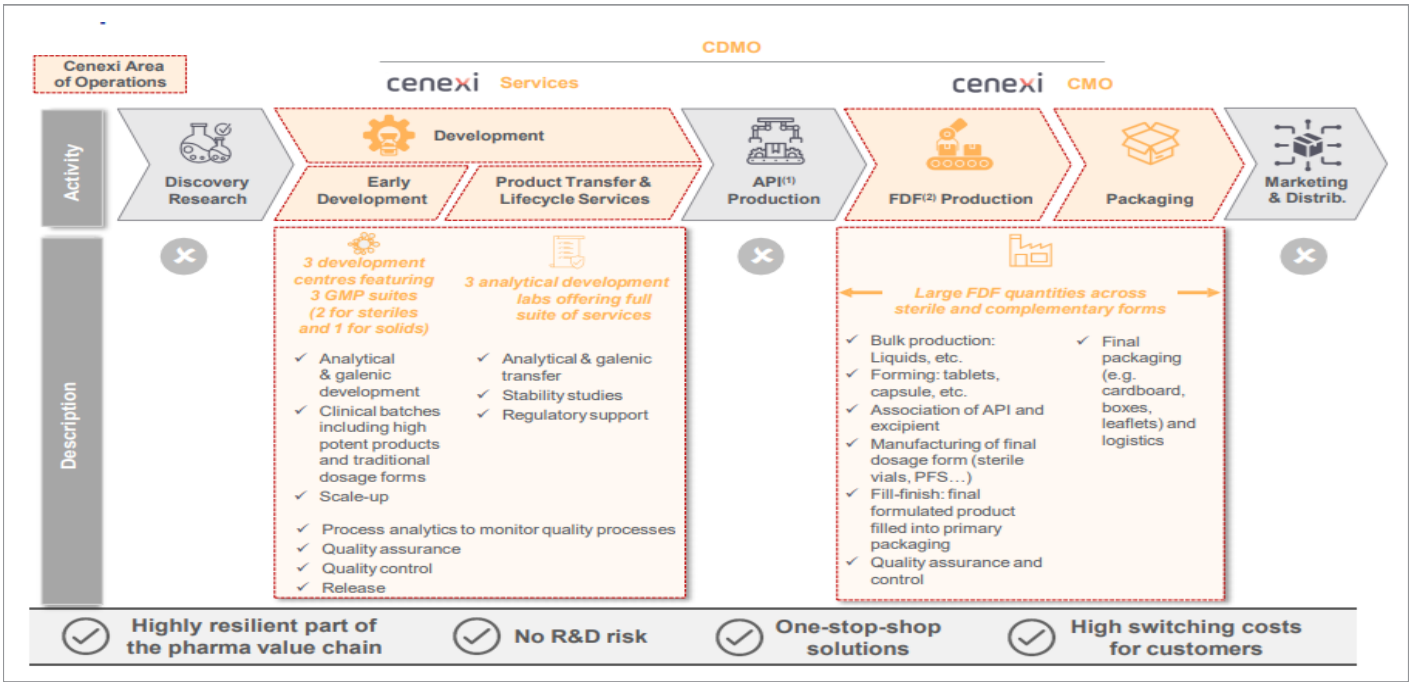
Particulars	FY21	FY22	FY23E	FY24E	FY25E
Total Sales	3462.9	4400.7	4312.7	5116.5	5869.3
OPM (%)	37.6	34.3	30.2	32.0	32.5
Reported PAT	997.0	1211.7	1040.5	1313.8	1525.3
EPS (Rs.)	61.1	74.2	63.7	80.5	93.4
PER (x)	29.1	24.0	27.9	22.1	19.0
EV/Ebidta (x)	18.1	14.9	16.5	12.9	10.8
P/BV (x)	4.9	4.1	3.6	3.1	2.7
ROCE (%)	22.4	22.4	16.9	18.3	18.4
RONW (%)	16.9	16.9	12.8	14.0	14.1

Source: Company; Sharekhan estimates

About Cenexi

Cenexi is engaged in Contract Development & Manufacturing Organisation (CDMO) of pharmaceutical products with expertise in sterile liquid and lyophilised fill finished drug, including capabilities on oncology and complex products. Around 70% of business is currently from sterile and injectable products which is expected to increase to 82% from injectables in next 4 years. It has experience in processing specific substances like hormones, suspensions and controlled substances. It has presence across four manufacturing sites in Europe which include three sites in France and one site in Belgium. It has an employee strength of 1,372 including 1,252 employees across four manufacturing sites and 120 employees for services. The company's revenues stood at around 185-195 million euros in the past three years with EBIDTA margins at around 12-13%. In H1CY2022, the company clocked revenues of 100 million euros with EBIDTA margins of around 19%. Around 56% of the company revenues are coming from European market.

Cenexi position in pharma value chain



Source: Company presentation

Acquisition in line with the strategy

The Cenexi acquisition is aimed at expanding Gland's CDMO offerings in the European market. It is in line with the company's strategic roadmap of building a European manufacturing presence in sterile injectables. It provides access to leading know-how and development capabilities in sterile forms including vials, pre-filled syringes and other innovative technologies such as ophthalmic gel and needleless injectors fill & finish. It will help us establish Glands presence into the branded CDMO space and the biologics space.

Synergistic benefits

- **Global scale:** Post acquisition, Gland will be one of the leading sterile focused CDMO globally with further ability to support investments in developing Cenexi's European platform.
- **Sustainable growth:** It will help in driving long term profitable growth by leveraging the combined manufacturing footprint and large sterile capacities. It can broaden offerings to enhance value addition for customers.
- **Development expertise:** Gland would support and leverage Cenexi's leading development capabilities in sterile forms, including for cytotoxics and biologics.
- **Best quality standards:** Acquisition can enhance operations by sharing best practices across quality, regulatory and operations.
- **Commercial synergies:** Gland and Cenexi can leverage their longstanding customer relationships to capture cross-selling opportunities and increase combined share of wallet.

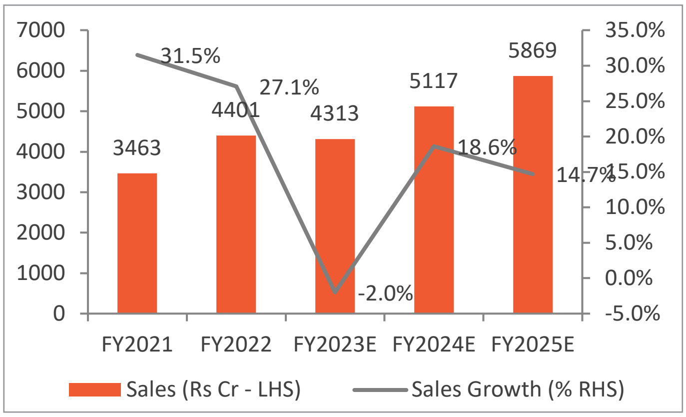
Gland will get access to blue-chip, global pharma and biotech customer base

Source: Company presentation

- **Deal valuation relatively cheaper:** Cenexi posted revenue of EUR 184.1 million or Rs. 15.55 billion and EBITDA of 23.1 million euros or Rs. 1.95 billion for CY21 and nearly EUR 100.1 million of revenue or Rs. 8.45 billion and EBITDA of 19.1 million euros or Rs. 1.61 billion in H1CY22. The given deal entails EV / EBITDA valuation multiple of 6.0x and EV / sales multiple of 1.2x on its CY22E numbers vs. 10.0-15.5x EV / EBITDA deal multiples seen in the recent past in the CDMO space. Hence, the deal appears cheaper for Gland Pharma, especially when there has been a 700-bps increase in EBITDA margins for Cenexi in H1CY22 vs. CY21. The transaction would be funded by internal accruals as Gland has around Rs. 3300 crore of cash on its books (as on 30th Sept, 2022).

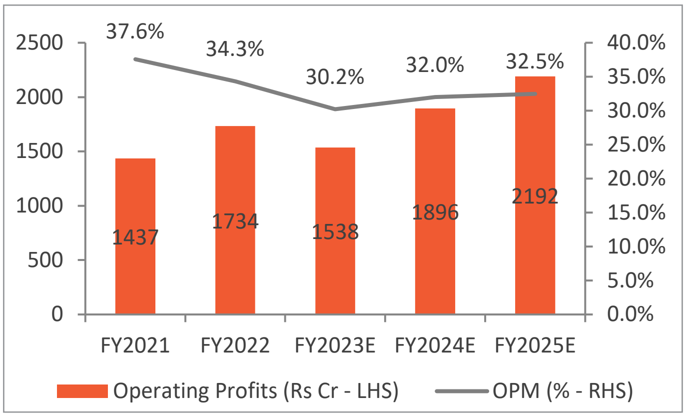
Financials in charts

Trend in revenues



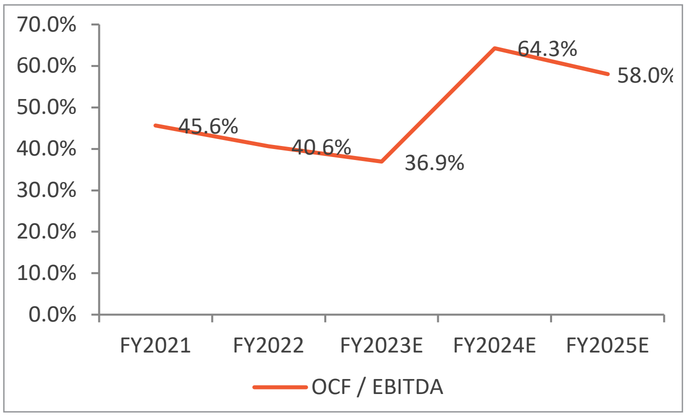
Source: Company, Sharekhan Research

Trend in EBIDTA margins



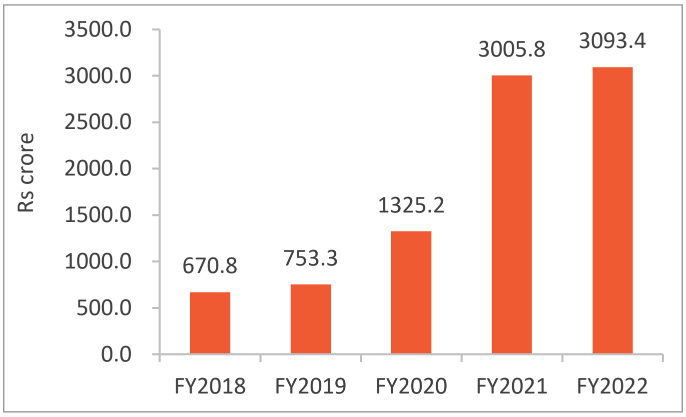
Source: Company, Sharekhan Research

OCF/EBIDTA



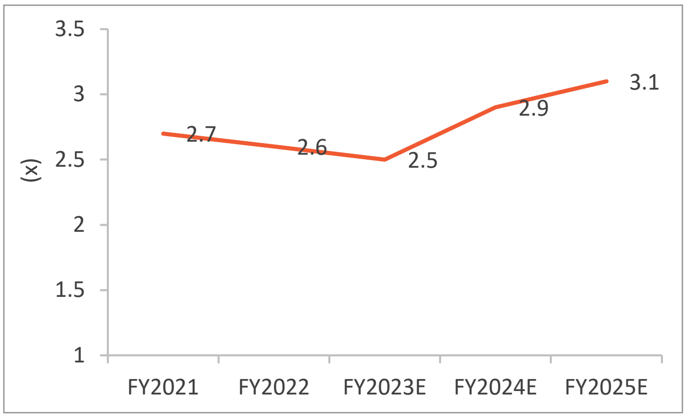
Source: Company, Sharekhan Research

Consistent increase in cash balance



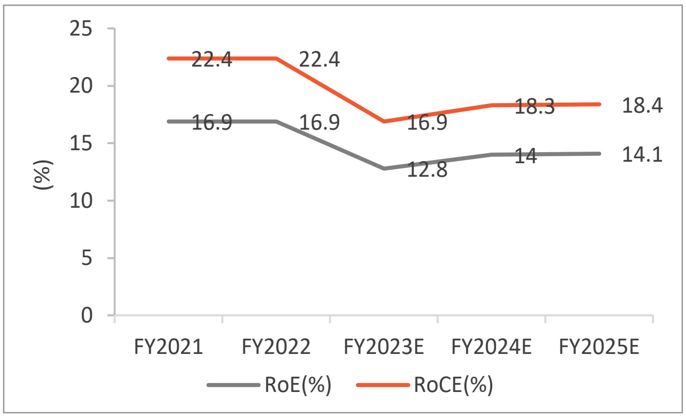
Source: Company, Sharekhan Research

Asset turnover remains stable



Source: Company, Sharekhan Research

Trend in return ratios



Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Better growth prospects

The Indian Pharma market (IPM) is growing with increased consumer spend and awareness. Additionally, Indian Pharma players with large market share in IPM and a strong pipeline of speciality products will help them gain market share in the US and thereby partially offset any impact of competitive pricing pressure in the US. 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 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 - Near-term outlook weak; medium-term prospects intact

For H1FY2023, Gland's revenue/PAT declined by 14.9% /27.9% y-o-y, respectively, while EBITDA margin contracted by 657 bps y-o-y to 29.8% owing to multiple headwinds which dragged the company's performance. Near term outlook of the company is weak owing to supply side constraints, cost inflation and overall weak macro-economic sentiments. Improved demand traction and incremental capacities coming on stream provide ample growth visibility ahead. Moreover, the company is looking to build its presence in Europe inorganically and is open to an acquisitions in the complex API space. The company is backing on its strong product pipeline and entry into newer markets to aid growth in the medium to near term. Margins are expected to improve aided by easing supply side challenges and lower freight costs. Revenue and PAT are expected to clock a CAGR of 10% and 8%, respectively over FY2022-25E.

Valuation - Maintain But with an unchanged PT of Rs. 2260

The acquisition is in line with Gland Pharma's strategic objective to expand its CDMO offerings in Europe. Hence, we believe the new geographical expansion in Europe, acquisition of new customer base, especially in the biologics space, and the opportunity to work on high value projects should help Gland Pharma to improve its long term growth prospects. However, the recent news regarding its largest shareholder Fosun Pharma Ltd's potential stake sale in it is a key monitorable. The stock has corrected by 45% over the past six months and currently is trading at the reasonable valuation of 28x and 22x its FY2023E and FY2024E earnings, presenting attractive risk reward ratio for the stock. However, the stock performance will be subject to its consistent improvement in the business performance. We retain a Buy rating on the stock with an unchanged PT of Rs. 2260.

Peer Comparison

Companies	CMP (Rs/ Share)	O/S Shares (Crs)	Mcap (Rs Cr)	P/E (x)			EV / EBITDA (x)			RoE (%)		
				FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Gland Pharma	1777.6	16.5	29,275.0	24.0	27.9	22.1	14.9	16.5	12.9	16.9	12.8	14.0
Cipla	1140.3	80.7	92,011.6	33.5	29.0	23.2	20.0	17.7	14.4	14.0	14.2	15.5
Dr Reddy's	4,486.0	16.6	74,665.4	34.2	20.7	16.9	17.0	13.5	11.4	11.4	17.3	18.5

Source: Company; Sharekhan Research

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. The company 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

Yiu Kwan Stanley Lau	Chairman
Srinivas Sadu	Managing Director & Chief Executive Officer
Ravi Shekhar Mitra	Chief Financial Officer
Sampath Kumar Pallerlamudi	Company Secretary & Compliance Officer

Source: BSE; Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Asset Management	3.98
2	Mirae Asset Global Investments	3.86
3	R P Advisory Services	2.61
4	Nicomac Machinery	2.05
5	Nicomac Machinery Pvt Ltd	1.93
6	Nippon Life India Asset Management	1.60
7	ICICI Prudential AMC	1.54
8	Sundaram AMC	1.29
9	R P Advisory	1.14
10	Republic of Singapore	1.05

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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