glenmark
A new way for a new world

May 25, 2017

To,
Dy. General Manager
Department of Corporate Services,
BSE Ltd.,
P. J. Towers, Dalal Street,
Fort, Mumbai – 400 001.

Ref: Scrip Code: 532296

To,
The Manager – Listing,
National Stock Exchange of India Ltd.,
Plot No. C/1, G Block,
Bandra Kurla Complex,
Bandra (E), Mumbai – 400 051.

Ref: Scrip Name: GLENMARK

Dear Sirs,

Sub:- Clarification relating to S&P Global Rating

Glenmark would like to clarify that S&P Global Ratings has reaffirmed our credit rating as 'BB' as part of their annual review cycle. In addition, they have affirmed 'BB' issue rating on the senior unsecured notes issued last year. However, they have changed the outlook from 'Stable' to 'Negative', based on their internally defined criteria.

Kindly find enclosed rating research update issued by S&P Global for your reference.

Thanking You.

Yours faithfully,
For Glenmark Pharmaceuticals Ltd.

Harish Kuber
Company Secretary & Compliance Officer

Glenmark Pharmaceuticals Ltd.
Glenmark House, B D Sawant Marg, Andheri (E), Mumbai - 400 099, India
T: 91 22 4018 9999 F: 91 22 4018 9988 CIN No: L24299MH1977PLC019982 W: www.glenmarkpharma.com
Registered office: B/2, Mahalaxmi Chambers, 22 Bhulabhai Desai Road, Mumbai 400 026 E: complianceofficer@glenmarkpharma.com

S&P Global
Ratings

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Research Update:

Glenmark Pharmaceuticals Outlook Revised To Negative On Weaker Cash Flow, Delayed Deleveraging; 'BB' Ratings Affirmed

Primary Credit Analyst:
Vishal Kulkarni, CFA, Singapore (65) 6216-1047; vishal.kulkarni@spglobal.com

Secondary Contacts:
Abhishek Dangra, FRM, Singapore (65) 6216-1121; abhishek.dangra@spglobal.com
Shruti Zatakia, Singapore (65) 6216 1094; shruti.zatakia@spglobal.com

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Research Update:

Glenmark Pharmaceuticals Outlook Revised To Negative On Weaker Cash Flow, Delayed Deleveraging; 'BB' Ratings Affirmed

Overview

- Softer operating performance and constrained profitability for Glenmark will likely result in negative free operating cash flow. We expect a ratio of gross debt to EBITDA of about 2.8x in fiscal 2018 compared with our earlier expectation of below 2.0x.
- Glenmark generated negative free operating cash flow in fiscal 2017 against our expectation of positive free operating cash flow due to weaker profitability and continuing higher working capital investments than we had expected.
- We are revising the outlook to negative from stable, and affirming our 'BB' long-term corporate credit rating and issue rating on Glenmark.
- Our negative outlook reflects the slower-than-expected deleveraging and continuing negative free operating cash flow for Glenmark resulting in debt to EBITDA of between 2.5x-3x.

Rating Action

On May 25, 2017, S&P Global Ratings revised to negative from stable the outlook on its 'BB' long-term corporate credit rating on India-based generics pharmaceutical company Glenmark Pharmaceuticals Ltd. (Glenmark). At the same time, we affirmed the rating at 'BB'. We also affirmed our 'BB' issue rating on the company's senior unsecured notes.

Rationale

The negative outlook reflects the risk of delayed deleveraging for Glenmark, resulting in a ratio of debt to EBITDA of about 2.8x in fiscal 2018, against our previous expectation of below 2.0x. We estimate Glenmark will continue to register negative free operating cash flow on the back of relatively slower revenue growth with profitability constrained by natural price erosion, elevated research and development and capital expenditure (capex), and higher working investments. We still expect the company to maintain a ratio of debt to EBITDA of below 3x. However, lower revenue growth due to a weaker-than-expected rate of new approvals, continuing generic price compression, and negative working capital movement together could result in a ratio of debt to EBITDA of above 3x, resulting in a downgrade. A higher tax incidence for the company will also result in a significantly weaker ratio of funds from operations (FFO) to debt of about 20%-25%

Glenmark's revenues in fiscal 2017 were in line with our expectations though lower than management's expectations. A pricing pressure in the U.S., slowdown due to the impact of demonetization on the India business, and the devaluation of the pound sterling weighed on the company's EBITDA margin. Sales from its first large exclusivity opportunity from a generic Zetia, a cholesterol drug, were lower than estimates. As a result, EBITDA margin was nearly 300 basis points lower than our earlier expectation of about 22.7%. In addition, estimated continuing negative working capital movement of over Indian rupee (INR) 4 billion resulted in adjusted debt rising to INR49 billion in fiscal 2017 (from INR42 billion in fiscal 2016), compared with our previous expectation of a reduction in gross debt.

We expect slower revenue growth in fiscal 2018 from fiscal 2017 levels due to continuing generic price compression in U.S. markets, only partial contribution of generic Zetia exclusivity revenues, and significant dependence on new approvals in the U.S., which could constrain growth in the case of any delays. Further, the company's management now expects overall Zetia sales to be in the range of US$180 million to US$200 million, compared with US$200 million to US$250 million previously. Product approvals by the U.S. Food and Drug Administration (USFDA) slowed considerably in the second half of fiscal 2017 on the expectation that the USFDA would inspect some its plants. The inspections have since been completed and observations addressed. Although we understand from the company that product approvals are likely normalizing, timely approvals and supply chain readiness are essential for commercial success and revenue and cash flow growth. We now expect EBITDA margin to stabilize at about 19%-20%, with EBITDA of about INR20 billion in fiscal 2019, compared with our previous expectation of INR25 billion.

Glenmark's working capital cycle is longer than most of its peers and we expect it to remain elevated. This, coupled with continuing capex, is likely to limit significant improvement in financials--a departure from our previous expectations.

Our base case for the next three fiscal years assumes the following:

- One-time revenue of US$60 million from its generic Zetia product remaining exclusive till June 2018.
- U.S. revenues of about US$525 million-US$550 million over the next two years driven by new product launches, even as base business continues to face price compression of about 10% annually. This assumes that new product revenues replace one-time revenues from generic Zetia consistently for two years.
- Revenue growth from India of about 12%-20% driven by new product launches and reformulation strategies.
- Healthy revenue growth in Europe supported by new products.
- EBITDA margin at around 19%-20% levels, comparable to fiscal 2016 (excluding one-off sales).

- Capex of INR7 billion-INR8 billion annually.
- Working capital investment could be INR3 billion or higher.

Based on these assumptions, we arrive at the following credit measures over the next two to three years:

- Free operating cash flow to remain negative between INR1 billion-INR3 billion annually.
- Ratio of gross debt to EBITDA to remain at 2.5x-2.8x over the next two years.
- Ratio of FFO to debt to remain at 20%-22% during the period.

We believe a slower-than-expected pace of product approvals and revenue growth from future product launches has downside risk. In our base case, deleveraging is highly dependent on cash flows from future launches, which if weaker, can slow the expected improvement in financial ratios. Higher negative working capital movement, like in the past few years, could further pressure financials.

Nevertheless, the company's management expects an improved pace of product approvals after clearing observations for the Goa and Baddi plants. The company also expects higher double-digit revenue growth and stronger EBITDA margin of about 22% and reversal of working capital (negative movement in past few years), which together could result in a ratio of FFO to debt of about 25%.

Liquidity

We view Glenmark's liquidity as adequate. We expect the company's liquidity sources to exceed uses by at least 1.2x over the next 12 months, and net sources to remain positive even if EBITDA declines by 15%. The company maintains a sound relationship with banks and a fair standing in the local credit markets. We consider its financial management to be prudent as it has issued equity and addressed its refinancing needs on a timely basis.

Key sources:
- Cash balance of INR10.6 billion as of March 31, 2017.
- Cash FFO of INR8 billion-INR10 billion annually.

Key uses of cash:
- About INR7.4 billion in debt maturities in fiscal 2018.
- Negative working capital movement of INR4 billion-INR5 billion annually.
- Maintenance capex of INR2 billion-INR3 billion annually.
- Dividends of up to INR800 million annually.

Outlook

Our negative outlook reflects the potential for continuing negative free operating cash flows leading to slower-than-expected deleveraging over the next six to nine months. We expect liquidity to remain adequate over this period.

Downside scenario

We may lower the rating if revenue growth lags our expectation due to slower new product approvals or lower revenue from such products. We may also lower the rating if we see working capital needs, capex, acquisitions or shareholder remuneration divert cash flow away from the stated purpose of debt reduction such that the currently expected leverage profile seems unattainable. A debt-to-EBITDA ratio failing to improve significantly below 2.5x or a ratio of FFO to debt remaining below 25% would be a downgrade trigger.

Upside scenario

We may revise the outlook to stable if the company generates free operating cash flows and reduces debt such that its debt-to-EBITDA ratio is sustainably better than 2.5x and FFO to debt sustainably above 25%. A revision to stable would also be contingent on the company adhering to such a leverage profile and prudently managing working capital, growth investments, or shareholder returns.

Ratings Score Snapshot

Corporate Credit Rating: BB/Negative/--

Business risk: Weak
- Country risk: Low Risk
- Industry risk: Intermediate Risk
- Competitive position: Weak

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bb

Modifiers
- Diversification/Portfolio effect: Neutral/Undiversified (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Pharmaceutical Industry, April 8, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Glenmark Pharmaceuticals Ltd.		
Corporate Credit Rating	BB/Negative/--	BB/Stable/--

Ratings Affirmed

Glenmark Pharmaceuticals Ltd.		
Senior Unsecured	BB	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.