

# GLAXOSMITHKLINE PHARMACEUTICALS

INR 1,167

*Steady quarter***BUY**

GlaxoSmithKline's (GSK) Q1CY07 results were in line with our expectations. While revenues for the quarter were at INR 4,203 mn, EBITDA and net profit (excluding extraordinary items) were at INR 1,450 mn and at INR 1,113 mn, respectively. The revenue and profitability for the current quarter is not strictly comparable with 1Q06, as the latter constituted revenues from the animal health business, which has been divested w.e.f. July 31, 2006.

GSK's pharmaceutical sales grew by 5.1% Y-o-Y, which was lower than expected. We believe this could be more of a quarterly aberration and going forward we are likely to see a sustainable double digit growth rate. The company maintained that it will launch three new products in CY07E, out of which, two will be on patented products.

The new launches in CY07E are expected to slightly pressurise margins. We believe that the company will grow at a much higher rate in CY08E, as some of the product launches in CY07E will have full year impact and three more products will be introduced in CY08E. We are not changing any of our CY07E or CY08E earnings. At CMP of INR 1,167, the stock currently trades at a P/E of 25.0x on our CY07E earnings. We retain our 'BUY' recommendation on the stock.

#### \* Domestic formulations: Double digit growth

GSK's pharmaceutical business reported 5.1% growth in Q1CY07. This was lower than our expectations. But we believe this could be more of a quarterly aberration and going forward we are likely to see a sustainable double digit growth rate.

GSK is planning to launch three products—Cervarix (vaccine), Carvedilol (cardiovascular), and Tykerb (oncology)—in 2007. It is pertinent to note that Tykerb and Cervarix are new launches globally as well. In CY08E, GSK intends to launch atleast three new patented products from its parent's existing late stage pipeline. These developments are expected to give a major boost to CY08E revenue growth rate, albeit at slightly lower margins.

For CY07E, the management has guided that the pharmaceutical division's growth rate will be in tandem with that of the industry, which we believe is likely to be in low double digits. We have assumed 12% growth in GSK's pharmaceutical business in CY07E and ~ 16% in CY08E.

#### Financials

Year to December	Q1CY07	Q1CY06	Growth (%)	Q4CY06	Growth (%)	CY07E	CY08E
Revenues (INR mn)	4,203	4,262	(1.4)	3,203	31.2	17,545	20,035
EBITDA (INR mn)	1,450	1,411	2.8	814	78.2	5,229	5,602
Adj. net profit (INR mn)	1,113	1,034	7.6	681	63.4	3,947	4,191
Adj. EPS (INR)	13.1	12.2	7.6	8.0	63.3	46.6	49.5
Adj. PE (x)						25.0	23.6
EV/EBITDA (x)						18	16



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#### Market Data

52-week range (INR) : 1,551 / 891  
Share in issue (mn) : 84.7  
M cap (INR bn/USD mn) : 101.7 / 2,487.5  
Avg. Daily Vol. BSE/NSE ('000) : 107.4

#### Share Holding Pattern (%)

Promoters : 50.7  
MFs, FIs & Banks : 15.2  
FIs : 14.9  
Others : 19.2

\* **New product introductions: Could give significant upside**

In CY08E, GSK's pharmaceutical business is likely to grow by 16% because of a significant shift in the product mix, driven by full year impact of three new launches in CY07E and three more in CY08E. Although the company may face some hurdles in grant of patent approvals for its new launches in the domestic market, we believe it will be favoured by the new patent regime. Margins on these launches may be lower due to increased promotional expenses towards them. But we believe GSK is best placed MNC as there is fair amount of certainty on sharing of upsides regarding the launch of on patent products via the listed entity.

\* **Valuations**

Despite a delay in the launch of new products, we believe GSK is one of the best MNC pharma companies to benefit from the new patent regime, given its well-established presence in the domestic market. However, uncertainty regarding the timeline for regulatory approvals is a concern. At CMP of INR 1,167, the stock currently trades at P/E of 25.0x on our CY07E. We maintain our **'BUY'** recommendation.

<b>Financial Snapshot</b>							<b>(INR mn)</b>		
<b>Year to December</b>	<b>Q1CY07</b>	<b>Q1CY06</b>	<b>Growth (%)</b>	<b>Q4CY06</b>	<b>Growth (%)</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>	
Total operating income	4,203	4,262	(1.4)	3,203	31.2	15,820	17,545	20,035	
Gross sales	4,580	4,569	0.2	3,489	31.3	17,100	18,866	21,543	
Less: Excise duty	377	308	22.5	286	31.7	1,281	1,321	1,508	
<i>Net sales</i>	4,203	4,262	(1.4)	3,203	31.2	15,820	17,545	20,035	
Total expenses	2,753	2,851	(3.4)	2,389	15.2	10,920	12,316	14,432	
Cost of goods sold	1,689	1,784	(5.3)	1,211	39.4	6,315	7,457	9,016	
Raw material cost (including adj. to stock)	1,689	1,784	(5.3)	1,211	39.4	6,315	7,457	9,016	
Gross profit	2,514	2,478	1.5	1,992	26.2	9,505	10,089	11,019	
Other expenses	1,064	1,066	(0.3)	1,178	(9.7)	4,605	4,859	5,417	
Salaries, wages, other payments	402	371	8.1	353	13.9	1,537	1,614	1,710	
Other expenses	662	695	(4.7)	741	(10.7)	3,068	3,246	3,706	
EBITDA	1,450	1,411	2.8	814	78.2	4,900	5,229	5,602	
Other income	272	222	22.4	299	(9.2)	964	877	882	
PBDIT	1,722	1,633	5.4	1,113	54.7	5,864	6,106	6,484	
Depreciation	37	38	(3.2)	41	(11.2)	157	162	172	
PBT	1,686	1,596	5.7	1,072	57.3	5,707	5,944	6,312	
Extraordinary items	-	22	(100.0)	(4)	(100.0)	(1,842)	-	-	
Tax (including deferred tax)	573	561	2.0	391	46.6	2,072	1,997	2,121	
PAT (exclusive of Ext. Items)	1,113	1,034	7.6	681	63.4	3,635	3,947	4,191	
Reported PAT	1,113	1,012	10.0	685	62.5	5,477	3,947		
Equity capital (FV INR 10)	847	847		847		847	847	847	
Dividend						1,355.2	1,355.2		
Dividend per share (INR)						16.0	16.0	16.0	
Number of shares	84.7	84.7	-	84.7	-	84.7	84.7	84.7	
EPS (INR)	13.1	12.0	10.0	8.0	64.2	64.7	46.6	49.48	
EPS (w/o extraordinary items)	13.1	12.2	7.6	8.0	63.3	42.9	46.6	49.48	
PE (x)						27.2	25.0	23.6	
EV/EBITDA (x)						19.6	17.9	16.3	
M. Cap/Revenues (x)						6.2	5.6	4.9	
<b>as % of net revenues</b>									
Total expenses	65.5	66.9		74.6		69.0	70.2	72.0	
Gross profit	59.8	58.1		62.2		60.1	57.5	55.0	
EBITDA	34.5	33.1		25.4		31.0	29.8	28.0	
Net profit	26.5	23.8		21.2		34.6	22.5	20.9	
Tax rate	34.0	35.2		36.4		33.6	33.6	33.6	

## Company Description

GSK has been a market leader in the Indian pharmaceuticals market for more than 25 years. It is currently ranked No. 2 as per market share, which is about 5%. GSK has a field force of about 1,800 medical representatives across six divisions. It is also a major player in the vaccines market. The company has plans to introduce on-patent products in India from end 2007 onwards. UK-based GSK plc. owns 51% share in GSK Pharma India.

## Investment Theme

We believe the company will have sustainable growth going forward on account of : (1) continuation of new product introductions; (2) introduction of on-patent products which will be ramped up in CY08E; and (3) revenues from export of Betamethazone from CY08E onwards.

## Key Risks

Regulatory issues for the launch of on-patent products.

Lower-than-expected margins as the listed entity will be responsible only for marketing the on-patent products.

Further cuts/reduction in prices of domestic formulations will hurt the company's growth prospects.

## Financial Statements

<b>Income statement</b>				(INR mn)
<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Income from operations	15,185	15,820	17,545	20,035
Gross sales	16,105	17,100	18,866	21,543
Less: Excise	919	1,281	1,321	1,508
Net sales	15,185	15,820	17,545	20,035
Total operating expenses	10,762	10,920	12,316	14,432
Materials cost	6,390	6,315	7,457	9,016
Employee cost	1,555	1,537	1,614	1,710
Other expenses	2,818	3,068	3,246	3,706
EBITDA	4,423	4,900	5,229	5,602
Other income	661	964	877	882
Depreciation and amortisation	200	157	162	172
Extraordinary items [expenses/(gain)]	(1,954)	(1,842)	-	-
Profit before tax	6,839	7,549	5,944	6,312
Provision for tax	1,767	2,072	1,997	2,121
PAT(post exceptionals & pre minority interests)	5,071	5,477	3,947	4,191
PAT ( inc. exceptionals)	5,071	5,477	3,947	4,191
Shares outstanding (mn)	84.7	84.7	84.7	84.7
Dividend per share (INR)	28.0	16.0	16.0	16.0
Dividend payout (%)	46.8	24.7	34.3	32.3

### Common size metrics- as % of net revenues

<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Material cost	42.1	39.9	42.5	45.0
Employee cost	10.2	9.7	9.2	8.5
Other expenses	18.6	19.4	18.5	18.5
Depreciation	1.3	1.0	0.9	0.9
EBITDA margins	29.1	31.0	29.8	28.0
Net profit margins	33.4	34.6	22.5	20.9

### Growth metrics (%)

<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Revenues	7.7	4.2	10.9	14.2
EBITDA	11.6	10.8	6.7	7.1
Net profit	50.2	8.0	(27.9)	6.2
EPS	54.8	8.0	(27.9)	6.2

### Cash flow statement

<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Cash flow from operations	5,173	5,634	4,109	4,363
Cash for working capital	832	(338)	(74)	(113)
Net operating cash flow	6,004	5,296	4,035	4,250
Net purchase of fixed assets	113	62	189	215
Net purchase of investments	2,876	2,292	-	-
Net cash flow from investing	(2,989)	(2,354)	(189)	(215)
Proceeds from equity capital	(4,767)	(1,542)	(1,545)	(1,545)
Net cash flow from financing	(4,767)	(1,542)	(1,545)	(1,545)
<b>Free cash flow</b>	<b>3,937</b>	<b>3,546</b>	<b>3,846</b>	<b>4,035</b>

**Balance sheet**

<b>As on 31st December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
Shareholders funds	9,532	13,463	15,865	18,511
Capital	847	847	847	847
Reserves & surplus	8,685	12,616	15,018	17,664
Borrowings	49	52	52	52
Unsecured loans	49	52	52	52
Deferred tax liability (net)	(299)	(400)	(400)	(400)
<b>Sources of funds</b>	<b>9,281</b>	<b>13,115</b>	<b>15,517</b>	<b>18,163</b>
Gross block	2,973	3,144	3,332	3,548
Depreciation	2,071	2,228	2,389	2,561
Net block	902	916	943	986
Capital work in progress	154	45	45	45
Investments	9,004	10,100	10,100	10,100
Inventories	2,223	1,401	1,655	2,001
Sundry debtors	674	329	388	469
Cash and bank balances	476	2,971	5,272	7,761
Loans and advances	1,108	949	1,053	1,202
Other current assets	204	316	351	401
Total current assets	4,686	5,967	8,718	11,834
Current liabilities	2,559	2,235	2,610	3,123
Provisions	2,906	1,678	1,679	1,680
Total current liabilities and provisions	5,465	3,913	4,289	4,802
Net current assets	(779)	2,054	4,429	7,032
<b>Uses of funds</b>	<b>9,281</b>	<b>13,115</b>	<b>15,517</b>	<b>18,163</b>
Book value per share (INR)	113	159	187	219

**Ratios**

<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
ROE (%)	53.2	40.7	24.9	22.6
ROCE (%)	73.7	57.6	38.3	34.8
Inventory days	129	105	75	74
Debtors days	17	12	7	8
Fixed assets T/o (x)	5.1	5.2	5.4	5.8

**Valuation parameters**

<b>Year to December</b>	<b>CY05</b>	<b>CY06</b>	<b>CY07E</b>	<b>CY08E</b>
EPS, inc. exceptionals (INR)	59.9	64.7	46.6	49.5
Y-o-Y growth (%)	54.8	8.0	(27.9)	6.2
CEPS (INR)	62.2	66.5	48.5	51.5
PE (x)	19.5	18.0	25.0	23.6
Price/BV(x)	10.4	7.3	6.2	5.3
EV/Sales (x)	6.5	6.1	5.3	4.5
EV/EBITDA (x)	22.2	19.6	17.9	16.3

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Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Shabnam Kapur - 2286 4394
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Balakumar V - (044) 4263 8283
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Sumeet Budhraj - 2286 4430	FMCG	Nikhil Garg - 2286 4282
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Swati Khemani - 2286 4266
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Neha Shahra - 2286 4276
Hitesh Zaveri - 2286 4424	Information Technology	Priya Ramchandran - 2286 4389
Parul Inamdar - 2286 4355	Information Technology	Anubhav Kanodia - 2286 4361
Priyank Singhal - 2286 4302	Media, Retail	Tushar Mahajan - 2286 4439
Prakash Kapadia - 4097 9843	Mid Caps	Harsh Biyani - 2286 4419
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Nirmal Ajmera - 2286 4258
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Ankit Doshi - 2286 4671
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*unless otherwise specified*

### RATING INTERPRETATION

<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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