Update
SECTOR: PHARMACEUTICALS

GlaxoSmithKline Pharmaceuticals

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,939	GLXO IN
	REUTERS CODE
S&P CNX: 3,247	GLAX.BO

Equity Shares (m)	84.7
52-Week Range	1,551/710
1,6,12 Rel. Perf. (%)	-18/-15/-18
M.Cap. (Rs b)	93.7
M.Cap. (US$ b)	2.1

19 May 2006

Buy

Previous Recommendation: Buy Rs1,106

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
12/05A	14,704	3,063	36.2	18.7	30.6	10.7	34.9	54.3	5.9	20.2
12/06E	16,762	3,843	45.4	25.5	24.4	8.5	34.8	52.4	5.0	16.1
12/07E	17,151	3,935	46.5	2.4	23.8	7.0	29.3	44.1	4.7	15.7

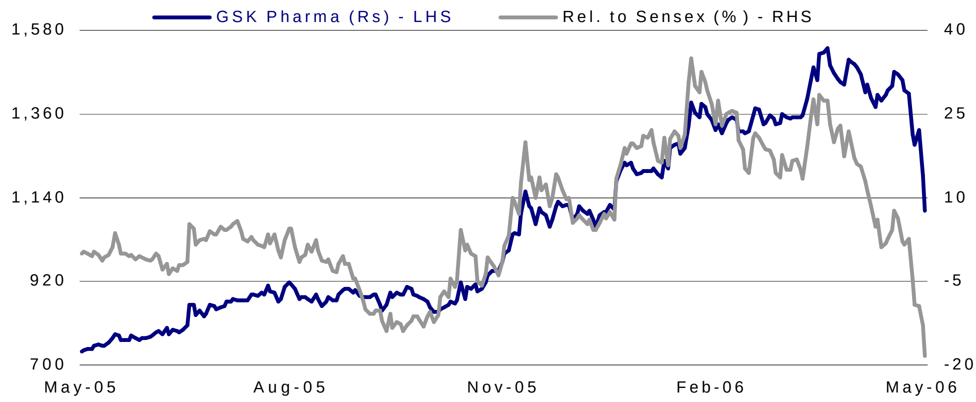
One of the best plays on IPR regime in India: GSK intends to launch 8 patented products in India in the CY07-09 period. We believe that the company deserves premium valuations due to the strong parentage (giving access to a large product pipeline), brand-building ability and its likely positioning in the post-patent era.

Planning to enter high-growth lifestyle segments: GSK Pharma intends to enter segments like CNS, CVS and Diabetology, which offer high growth potential. It expects to launch 3-5 new products annually for the next two years (including some in-licensed products). It has already launched new products in the anti-diabetic, anti-ulcer and oral contraceptive segments. The company has indicated that it is open to in-licensing good brands from other pharmaceutical companies to bridge the gaps in its proposed lifestyle portfolio. We expect these initiatives to aid margin expansion.

Strong commitment to India: We believe that GSK is strongly committed to its Indian operations, which is evident from the fact that 8 patented products are likely to be launched in the CY07-09 period. These launches will be through the listed arm. We believe that no other global pharmaceutical company is as committed to India as GSK.

Recent stock price decline an opportunity to buy: GSK is currently valued at 24.4x CY06E and 23.8x CY07E earnings. Our estimates for CY07E take into account the additional marketing and promotional expenditure linked to launch of patented products in CY08E. Our estimates also include the impact of the divestment of the animal healthcare unit (announced recently). We expect a one-time dividend from the proceeds of the divestment. We continue to be positive about GSK's long-term prospects. GSK's stock price has declined by more than 25% in the last one week. We believe that current valuations do not fully reflect the above positives and that the recent decline in stock price should be utilized as a buying opportunity. Our target price of Rs1,400 (30x CY07E earnings) implies a 26% upside.

STOCK PERFORMANCE (1 YEAR)



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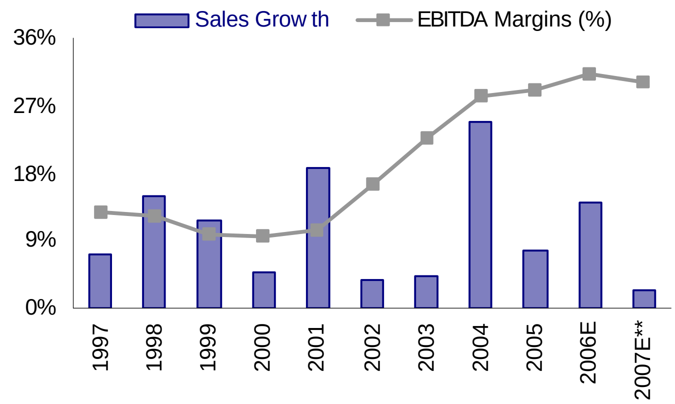
Aggressive initiatives for the Indian market

GSK has guided a top-line growth of 7-9% and bottom-line growth of about 10-15% for CY06E. GSK has clarified that it does not intend to set up new manufacturing facilities in excise-exempt zones. However, it is evaluating options to out-source manufacturing to units in such areas.

GSK is planning to enter the high-growth segments of CNS, CVS and Diabetology. It expects to launch 3-5 new products annually for the next two years (including some in-licensed products). It has already launched new products in the anti-diabetic, anti-ulcer and oral contraceptive segments. The company has indicated that it is open to in-licensing good brands from other pharmaceutical companies to bridge the gaps in its proposed life-style portfolio. In future it proposes to launch Vaccines (two in CY06E) and CNS products from the parent's pipeline. GSK has indicated launch of five new vaccines in the Indian market over the next 12-15 months. We believe that the company has one of the strongest pipelines of vaccines in the country.

TREND IN SALES GROWTH (%) AND EBITDA MARGINS (%)



*** - Takes into account divestment of animal healthcare unit and additional expenditure on promotion of patented products.*

Source: Company/Motilal Oswal Securities

Parent has a strong R&D pipeline

GSK Plc. is the 2nd largest pharmaceutical company in the world with a strong R&D pipeline. The company has about 117 new products in various stages of clinical trials. This should augur well for GSK's Indian operations, as the latter will have access to this R&D pipeline.

GSK PLC. – R&D PIPELINE

PHASE	NO. OF DRUGS
Pre-clinical	N.A.
Phase I	48
Phase II	46
Phase III	23
Total	**117**

Source: GSK Plc.

Planning to launch 8 patented products by CY09

GSK is planning to launch about 8-patented products in India in the CY07-09 period including 4 new vaccines. It expects patented products to contribute about 50% of its revenues by 2015. We expect the company to reach the US$1b revenue mark by 2015 compared to the current US$333m led mainly by launch of patented products and a 6% CAGR for its existing business. The time-line for launch of patented products is given below:

PRODUCT	THERAPEUTIC SEGMENT	LAUNCH YEAR
Rotarix	Rotavirus Vaccine	2007
Cervarix	Cervical cancer Vaccine	2007/08
Infanrix	Infant Vaccine	2007/08
Lapatinib	Cancer	2008
Allermist	Respiratory	2008
Alvimopan	Post-operative Ileus	2008
Pleuromutilin		2008
Streptorix	Pneumonia Vaccine	2009

Source: Company

In domestic market, we expect patented products to generate about US$1b in sales by 2010 and about US$3b by 2015. The top 4-5 MNC pharmaceutical companies in India are likely to account for about 50-70% of this opportunity.

Currently, Indian patients bear the entire cost of prescription medicines due to lack of a prescription insurance coverage. We believe that India will have such an insurance system in operation at least by 2015 thus further aiding the sales of patented products.

Patented products are unlikely to make any profits in the first year of launch due to the significant promotional and marketing expenses involved in the launch of a patented product. GSK has indicated that such products will start

PATENTED PRODUCTS – LONG-TERM UPSIDES (RS M)

	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15
No. of Patented Products Launched - Assumed	1	2	2	2	2	1	1	1
Total no. of Patented Products on Market	1	3	5	7	9	10	11	12
Product A	400	800	1,600	1,920	2,304	2,534	2,788	3,067
Product B	0	400	800	1,600	1,920	2,304	2,534	2,788
Product C	0	400	800	1,600	1,920	2,304	2,534	2,788
Product D	0	0	400	800	1,600	1,920	2,304	2,534
Product E	0	0	400	800	1,600	1,920	2,304	2,534
Product F	0	0	0	400	800	1,600	1,920	2,304
Product G	0	0	0	400	800	1,600	1,920	2,304
Product H	0	0	0	0	400	800	1,600	1,920
Product I	0	0	0	0	400	800	1,600	1,920
Product J	0	0	0	0	0	400	800	1,600
Product K	0	0	0	0	0	0	400	800
Product L	0	0	0	0	0	0	0	400
Total Sales	**400**	**1,600**	**4,000**	**7,520**	**11,744**	**16,182**	**20,705**	**24,959**
NPM (%) - Assumed	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*	*20.0*
Net Profit	**80**	**320**	**800**	**1,504**	**2,349**	**3,236**	**4,141**	**4,992**
Incremental EPS (Rs)	0.9	3.8	9.4	17.8	27.7	38.2	48.9	58.9
P/E for Patented Products (x)	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
Valuation for Patented Products (Rs/share)	38	151	378	710	1,109	1,528	1,956	2,357

Source: Motial Oswal Securities

contributing positively to the bottomline in the 2nd or 3rd year of launch.

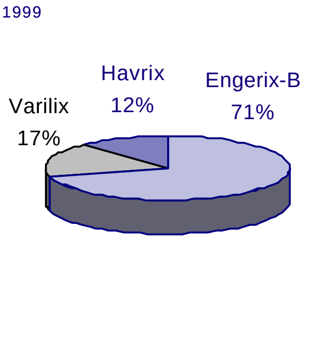
GSK has also indicated that it will have to share some profit margin on patented products with the parent and that it is likely to earn marketing margins on these products. The company will also have to undertake the front-ended investments in promoting patented products even before their launch. This is likely to temper down the bottom-line growth for CY07E. Our estimates already factor in the impact of these investments.

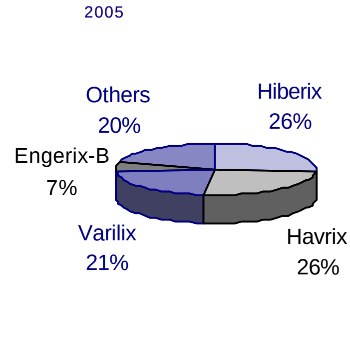
CY06-07 will witness change in product-mix

We expect GSK's product-mix to undergo a gradual change over the next two years, with increasing contribution of the life-style segment as the company is planning aggressive launches in this segment by leveraging the parent's product pipeline. It is also likely to resort to in-licensing arrangements for filling the gaps in its portfolio. It has already launched 3 products through the in-licensed route in CY05 and expects some more such launches in CY06E.

Strong Vaccine Portfolio

GSK has a strong presence in the Indian vaccine market. It faced intense competition for its leading hepatitis-B vaccine (Engerix B) some years back from aggressive Indian players. However, the company has successfully managed its vaccines portfolio by introducing new vaccines (involving complex technology) to emerge as the strongest player in the Indian vaccines market. GSK's new vaccine sales have grown by about 27% CAGR and constitute about 93% of total vaccine sales. GSK is planning to launch 4-patented vaccines in the Indian market in the CY07-09 period.



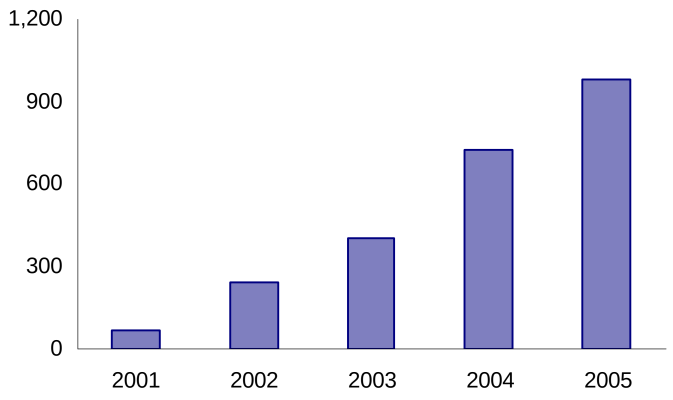


Source: Company

New launches have started contributing meaningfully to revenues

New introductions (launched post 2001) contributed about Rs1.0b to GSK's revenues for CY05 as compared to Rs65m in CY01. This growth has been led mainly by aggressive new launches as well as improvement in MR productivity due to a focused product portfolio. Of late, the company has become more aggressive in new launches and has also resorted to in-licensing to fill in the portfolio gaps.

NEW LAUNCHES – INCREASING CONTRIBUTION (RS M)



Source: Company

In-licensing to fill in portfolio gaps

GSK has resorted to various in-licensing arrangements to fill-in the gaps in its product portfolio (particularly in the life-style segment). It expects to leverage its large sales force to attract potential partners for in-licensing. The company has targeted those MNCs which do not have a strong presence in India. The table below indicates some of the recently concluded in-licensing deals:

IN-LICENSING ARRANGEMENTS

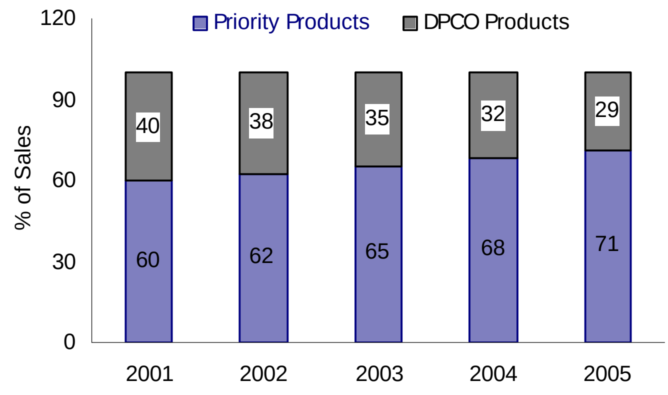
PRODUCT/SEGMENT	PARTNER
Oral Contraceptives	Organon
Parit (Rabeprazole)	Eisai
Ferronine	Albion
Carvedilol	Roche
CVS	Licensing deal yet to be signed
Diabetes	Licensing deal yet to be signed
Critical Care Anti-biotics	Licensing deal yet to be signed

Source: Company

DPCO coverage has been reducing over the past few years

GSK has been able to reduce its DPCO coverage from 40% to 29% in the last five years. It has achieved this by increasing sales of priority (non-DPCO) drugs as well as rationalizing its product portfolio (by divesting some DPCO drugs).

GSK – REDUCING DPCO COVERAGE



Source: Company

New Drug Policy will be a mixed bag

The New Drug Policy (proposed) has recommended the following proposals for the domestic pharmaceutical industry:

- Raise the limit of profitability and post-manufacturing expenses a drug maker can claim from a price controlled drug from 100% to 150% of its ex-factory cost. There would be no change in the norm in the case of imported medicines, which now enjoy a 50% maximum allowable post-manufacturing expenses (MAPE). Companies investing heavily in R&D and employing a particular number of scientists will be eligible for 200% MAPE.
- The government's Essential Drug's List (consisting of 354 drugs) will form the universe of drugs, which will attract some form of direct, or indirect price controls.
- Low cost drugs costing not more than Re1 per pill may be kept outside price control.
- The current DPCO coverage (consisting of 74 drugs) will be retained without any changes. Prices of these drugs are likely to be freezed for 12-month period post announcement of the final policy.

- The government will be devising a new formulae for computing prices of DPCO drugs and will do away with the current practice of fixing prices based on cost of manufacturing and market share.
- Some of the remaining drugs in the Essential Drug's List (excluding some life-saving drugs) will attract ceiling prices (an indirect form of price control).
- Detailed list of drugs under price control is not yet available.

Impact of proposed changes

The pharma industry has been complaining about uneconomical prices on price-controlled drugs (mandated by the DPCO) based on out-dated calculations of NPPA. In fact, some of the players are fighting litigations in various courts regarding drug pricing. Many players have discontinued manufacturing some of the DPCO products due to un-remunerative pricing (for example Doxycycline by Pfizer). We believe that the revised norms (for MAPE) may be a corrective measure by the regulatory authorities. We believe that the government will have to strike a balance between pragmatism on one hand and populist demands on the other. The change in norms of the DPCO (if implemented) may be the first step towards this. Our impact analysis indicates the following benefits to the Indian pharmaceutical industry, if the DPCO norms undergo a change:

- DPCO products enjoying strong brand-equity will gain at the expenses of their competitors, despite price controls, due to the increase in MAPE.
- Products falling outside the purview of price control (due to the Re1/pill norm) and having strong brand-equity will gain due to more pricing power.

If the above norms are implemented in the same form, we expect some of the key products, like Combiflam (Aventis), Becosules (Pfizer), Zinetac (GSK), Human Mixtard (Abbott/Novo), Asthalin (Cipla), Cifran (Ranbaxy) etc, to gain significantly from the proposed norms.

However, DPCO pricing should not be viewed in isolation as the government is in the process of formulating a comprehensive drug policy. Hence, any view on drug pricing should take into account all the aspects of the proposed new drug policy (as there may be a scenario wherein for a company, the prices of its DPCO drugs may be raised, but on the other hand, some of its drugs which were not under price control may attract the ceiling prices). Following are the key recommendations of the task force:

It is important to note that these are only recommendations, pending the announcement of the final new drug policy. These recommendations may or may not undergo a change in the final policy.

1QCY06 results were better than expectations

GSK Pharma's 1QCY06 results were higher than our estimates as sales and PAT growth beat our estimates. Key highlights:

- GSK Pharma reported a 54% YoY growth in net sales (to Rs4.25b) for 1QCY06, led by a 61% increase in pharmaceutical sales (to Rs3.8b) on low base of 1QCY05 (which was impacted due to VAT). Other businesses also recorded good growth of 19% YoY (to Rs532m).

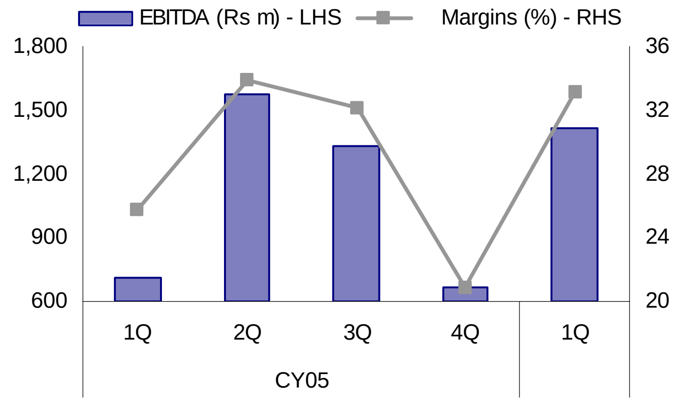
GSK PHARMA – BREAK UP OF SALES (RS M)

	1QCY06	1QCY05	GR. (%)	4QCY05	GR. (%)
Pharma	3,807	2,359	61.4	2,717	40.1
% of Sales	*87.7*	*84.1*		*80.9*	
Other Business	532	447	19.1	640	-16.9
% of Sales	*12.3*	*15.9*		*19.1*	
Total Sales	**4,339**	**2,806**	**54.6**	**3,357**	**29.2**

Source: Company

- EBITDA margins for 1QCY06 improved by 750bp to 33.2% mainly due to spread of fixed costs on higher sales, reflected in lower other expenditure (at 16.9% of sales v/s 20.6% in 1QCY05) and lower staff cost (at 8.7% of sales v/s 12.9% in 1QCY05). This translated into 99% higher EBITDA at Rs1.4b. Higher other income (up by 62% YoY) boosted recurring PAT to Rs1b, a growth of 89% YoY.

EBITDA MARGINS RECOVER



Source: Company/Motilal Oswal Securities

- The company has decided to sell its animal healthcare business (part of Other business) for a consideration of Rs2.1b to a leading European company.
- Post the results, we have revised our estimates upwards for CY06E by 7.8% to Rs45.4 to factor in better than expected 1QCY06 results. However, we have adjusted our estimates for CY07E for divestment of Animal health business, resulting in 1.8% downward revision in our estimates to Rs46.5.

Valuation and Outlook

We remain favorably inclined towards MNC Pharma stocks in the long-term. Leading Pharma MNCs are geared to gain from the opportunities arising in the stronger patent regime post 2005. We remain bullish on the long-term prospects of these companies. The potential upside from product patents would create ‘option value’ in these stocks over the longer term.

Strong commitment to India – We believe that GSK is strongly committed to its Indian operations, which is evident from the fact that 8-patented products are likely to be launched in the CY07-09 period. These launches will be through the listed arm. We believe that no other global pharmaceutical company is as committed to India as GSK.

GSK Pharma intends to undertake more clinical research work for its parent post 2005. The company has already started doing the groundwork for the same, and has already bagged 9 trials (most in Phase III and some in Phase IIb). These trials would however be conducted on a cost plus reasonable margin basis, and not contribute much to profitability. The intent here is to fast track the launch of a global product in India by conducting late stage clinical trials simultaneously in India.

We expect GSK to be a defensive bet given its track record of steady growth and high cash flow generation. This will be particularly relevant in a rising interest rate scenario as the company is virtually debt free.

GSK is valued at 24.4x CY06E and 23.8x CY07E earnings. Our estimates for CY07E take into account the additional marketing and promotional expenditure linked to launch of patented products in CY08E. Our estimates also include the impact of the divestment of the animal healthcare unit (announced recently). We expect a one-time dividend from the proceeds of the divestment. We continue to be positive about GSK’s long-term prospects. GSK’s stock price has declined by more than 25% in the last one week. We believe that current valuations do not fully reflect the above positives and that the recent decline in stock price should be utilized as a buying opportunity. Maintain **Buy**.

INCOME STATEMENT (RS MILLION)

Y/E DECEMBER	2003^	2004	2005	2006E	2007E
Exports	340	284	255	230	207
Net Domestic Sales	10,592	13,351	14,448	16,532	16,944
Net Sales	**10,932**	**13,635**	**14,704**	**16,762**	**17,151**
Change (%)	*4.4*	*24.7*	*7.8*	*14.0*	*2.3*
Total Expenditure	8,443	9,780	10,424	11,535	11,969
EBITDA	**2,489**	**3,855**	**4,280**	**5,227**	**5,182**
Change (%)	*43.0*	*54.9*	*11.0*	*22.1*	*-0.9*
Margin (%)	*22.8*	*28.3*	*29.1*	*31.2*	*30.2*
Depreciation	179	175	157	193	202
Int. and Finance Charges	26	25	0	18	15
Other Income - Rec.	563	528	656	771	961
PBT & EO Expense	**2,846**	**4,182**	**4,779**	**5,788**	**5,926**
Tax	1,027	1,522	1,716	1,945	1,991
Tax Rate (%)	*36.1*	*36.4*	*35.9*	*33.6*	*33.6*
Adj PAT	**1,819**	**2,660**	**3,063**	**3,843**	**3,935**
EO Expense (Net of Tax)	96	-670	-1,258	-1,324	0
Reported PAT	**1,722**	**3,331**	**4,321**	**5,167**	**3,935**
Change (%)	*41.6*	*46.3*	*15.1*	*25.5*	*2.4*
Margin (%)	*15.8*	*24.4*	*29.4*	*30.8*	*22.9*

BALANCE SHEET (RS MILLION)

Y/E DECEMBER	2003^	2004	2005	2006E	2007E
Equity Share Capital	745	873	847	847	847
Reserves	5,914	8,353	7,911	10,180	12,570
Capital Reserve	17	17	17	17	17
Net Worth	**6,675**	**9,243**	**8,775**	**11,044**	**13,433**
Loans	29	38	28	28	28
Capital Employed	**6,703**	**9,281**	**8,803**	**11,072**	**13,461**
Gross Block	2,567	2,526	2,626	2,826	3,026
Less: Accum. Deprn.	1,614	1,657	1,814	2,007	2,209
Net Fixed Assets	**953**	**870**	**813**	**820**	**818**
Capital WIP	41	45	40	40	40
Investments	4,091	7,768	6,729	8,978	11,456
Curr. Assets	**4,346**	**4,846**	**4,999**	**5,699**	**5,831**
Inventory	2,009	2,265	2,353	2,682	2,744
Account Receivables	671	761	809	922	943
Cash and Bank Balance	594	634	662	754	772
Others	1,072	1,187	1,176	1,341	1,372
Curr. Liability & Prov.	**3,028**	**4,697**	**4,117**	**4,693**	**4,802**
Account Payables	2,061	2,195	2,500	2,850	2,916
Other Liabilities					
Provisions	967	2,502	1,617	1,844	1,887
Net Current Assets	**1,318**	**149**	**882**	**1,006**	**1,029**
Deferred Tax Assets	300	449	339	229	119
Appl. of Funds	**6,703**	**9,281**	**8,803**	**11,072**	**13,461**

E: MOSt Estimates ^ - Standalone results

RATIOS

Y/E DECEMBER	2003^	2004	2005	2006E	2007E
Basic (Rs)					
EPS	**24.4**	**30.5**	**36.2**	**45.4**	**46.5**
Cash EPS	26.8	32.5	38.0	47.6	48.8
BV/Share	89.6	105.8	103.6	130.4	158.6
DPS	10.0	24.0	15.0	16.0	16.0
Payout (%)	46.2	89.1	88.3	40.2	39.3
Valuation (x)					
P/E		36.3	30.6	24.4	23.8
Cash P/E		34.1	29.1	23.2	22.6
P/BV		10.4	10.7	8.5	7.0
EV/Sales		6.3	5.9	5.0	4.7
EV/EBITDA		22.1	20.2	16.1	15.7
Dividend Yield (%)		2.2	1.4	1.4	1.4
Return Ratios (%)					
RoE	27.2	28.8	34.9	34.8	29.3
RoCE	42.8	45.3	54.3	52.4	44.1
Working Capital Ratios					
Asset Turnover (x)	1.6	1.5	1.7	1.5	1.3
Debtor (Days)	22	20	20	20	20
Inventory (Days)	67	61	58	58	58
Working Capital (Days)	24	-13	5	5	5
Leverage Ratio					
Debt/Equity	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT (RS MILLION)

Y/E DECEMBER	2003^	2004	2005	2006E	2007E
Op. Profit/(Loss) before Tax	2,434	3,855	4,280	5,227	5,182
Interest/Dividends Recd.	563	528	656	771	961
Direct Taxes Paid	-935	-1,670	-1,606	-1,835	-1,881
(Inc)/Dec in WC	-66	-321	-1,040	1,128	-6
CF from Operations	**1,996**	**2,391**	**2,290**	**5,292**	**4,256**
EO Expense	164	-670	-1,258	-1,324	0
CF from Op. incl EO Exp.	**1,832**	**3,062**	**3,548**	**6,616**	**4,256**
(inc)/dec in FA	76	36	-95	-200	-200
(Pur)/Sale of Investments	-2,119	-3,677	1,039	-2,249	-2,478
CF from Investments	**-2,043**	**-3,641**	**944**	**-2,449**	**-2,678**
Issue of Shares	0	1,606	-2,084	-29	0
(Inc)/Dec in Debt	9	10	-10	0	0
Interest Paid	-19	-25	0	-18	-15
Dividend Paid	-590	-840	-2,370	-2,704	-1,545
CF from Fin. Activity	**-600**	**751**	**-4,464**	**-2,751**	**-1,560**
Inc/Dec of Cash	**-811**	**171**	**28**	**1,416**	**17**
Add: Beginning Balance@	1,406	594	634	662	754
Closing Balance	**595**	**765**	**662**	**2,078**	**772**

@ CY04 Op cash is for merged entity and does not tally with closing cash of CY03 (Glaxo)

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Disclosure of Interest Statement	GlaxoSmithKline Pharmaceuticals
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.