

GlaxoSmithKline India

Foundations for sustainable growth in place

- ▶ **Management confirms introduction of patented products on track; but we think these would be earnings-accretive only after 2009**
- ▶ **Lower earnings by 2% for 2006e and 10% for 2007e due to sale of non-core business and business development costs for new launches**
- ▶ **Raise fair value range to INR930-1030 following rollover to 2007e. Upgrade rating to Neutral from Underweight**

Product expansion strategy to come into play with only marginal benefits from restructuring activities going ahead

We believe that the benefits from restructuring exercise for GSK India may largely be over and may only contribute marginally to earnings growth going ahead. However we note several positives on the product development front.

- ▶ Only 29% of GSK's India's product portfolio is currently under price control as of 2005 as against c40% in 2001.
- ▶ 'Power brands' identified as key drivers early on have grown at rates much higher than industry.
- ▶ In-licensing of products from global pharma companies (at least 7 launches since 2003) has enabled GSK India to expand its therapeutic coverage from anti-infectives to the more profitable chronic therapies.
- ▶ GSK India's plans to launch patented products from 2008 onwards remain on track. We expect at least 4 launches of patented products with possibilities of 2 more launches. However, we expect that these products would take 2-3 years for break-even and would have only marginal impact on earnings until 2009

Jatin Kotian

Analyst

+91 22 22681638

jatinkotian@hsbc.co.in

Disclaimer & Disclosures.

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, that form part of it.

Stock data

Current price	Reuters	Bloomberg equity	Bloomberg debt	Valuation range
INR 944	GLAX. BO	GLXO IN	GSK	INR 930-1030

Price as at close of 14 June 2006
Source: HSBC

- ▶ Among MNC pharma companies in India, we believe GSK India is ahead in terms of clearly outlining its strategy for the Indian pharma market as well as delivery.

Forecasts

- ▶ We lower our revenue forecasts by 4% for 2006e and by 5% for 2007e. The decline in our forecasts mainly stem from the proposed disposal of the animal healthcare business which is effective from 2006.
- ▶ Our revised forecasts assume a decline in operating margins for 2006e and 2007e by 2% and 3% to 29.5% and 31% respectively.
- ▶ We also lower our EPS forecasts by 2% for 2006e and by 10% for 2007e. Our earnings estimate decline for 2006e is modest as the sale of veterinary business is effective by late 2006. However we believe that 2007e (EPS impact: cINR3) would see the full impact of the disposal.
- ▶ The proposed disposal of the veterinary business and the potential divestures of remaining non pharma business is a positive as the profitability for these businesses is well below that for the pharmaceutical business.

Change in forecasts

	2006e	2007e
Revenues	-4%	-5%
Operating margins	-6%	-9%
EPS	-2%	-10%

Source: HSBC

Valuations

Our previous notional target of INR830 was set at a target PE of 20x 2006e EPS. We now roll over the reference year to 2007e EPS and raise our target PE to 22x (in line with peers like Ranbaxy), given the imminent launch of patented drugs, our revised notional target price is INR980, with a fair value range of INR930-1,030. Given the significant correction in the share price recently, we also revise our rating from Underweight to Neutral.

Key risks to our rating

- ▶ We believe that greater clarity on extent of price controls for the patented products proposed to be launched by GSK India would be key risks to our current rating. In addition any increase in price controls for existing portfolio would be a negative.
- ▶ Further the impact of the price controls on existing products would also depend on whether the company could offset it by the reported move to allow companies to: **1)** charge a higher margin of 150% of cost of production (from 100% currently) and **2)** The National Pharmaceutical Pricing Authority (NPPA) accepting costing data furnished by companies which will cut lead time for price revision from the current minimum three years.
- ▶ Any delays in the proposed launch of patented products would be a significant negative.

Financials & valuation

Financial statements

Year to	12/2005a	12/2006e	12/2007e	12/2008e
Profit & loss summary (INRm)				
Revenue	14,853	15,945	17,103	18,610
EBITDA	4,280	4,711	5,189	5,608
Depreciation & amortisation	-157	-165	-173	-182
Operating profit/EBIT	4,123	4,546	5,016	5,425
Net interest	234	275	318	366
PBT	6,737	7,178	5,784	6,253
HSBC PBT	0	0	0	0
Taxation	-1,716	-1,798	-1,984	-1,951
Net profit	5,021	5,380	3,800	4,302
HSBC net profit	3,063	3,455	3,800	4,302

Cash flow summary (INRm)

Cash flow from operations	6,017	3,124	4,211	4,294
Capex	-212	69	-50	-45
Cash flow from investment	-1,574	-613	-919	-535
Dividends	-2,068	-2,311	-3,243	-3,709
Change in net debt	-1,194	-912	-900	-522
FCF equity	3,047	2,842	3,511	3,786

Balance sheet summary (INRm)

Intangible fixed assets	83	75	67	61
Tangible fixed assets	886	661	545	414
Current assets	13,272	14,328	15,391	16,204
Cash & others	9,130	9,993	10,893	11,415
Total assets	15,130	16,051	17,090	17,867
Operating liabilities	2,701	2,531	2,738	2,845
Gross debt	49	0	0	0
Net debt	-9,081	-9,993	-10,893	-11,415
Shareholders funds	9,486	12,537	13,076	13,651
Invested capital	2,411	2,539	2,371	2,419

Ratio, growth and per share analysis

Year to	12/2005a	12/2006e	12/2007e	12/2008e
Y-o-y % change				
Revenue	8.0	7.4	7.3	8.8
EBITDA	13.1	10.1	10.1	8.1
Operating profit	14.2	10.3	10.3	8.2
PBT	38.8	6.5	-19.4	8.1
HSBC EPS	16.9	14.5	10.0	13.2

Ratios (%)

Revenue/IC (x)	5.7	6.4	7.0	7.8
ROIC	117.6	137.7	134.2	155.8
ROE	32.7	31.4	29.7	32.2
ROA	34.4	34.5	22.9	24.6
EBITDA margin	28.8	29.5	30.3	30.1
Operating profit margin	27.8	28.5	29.3	29.2
EBITDA/net interest (x)				
Net debt/equity	-95.7	-79.7	-83.3	-83.6
Net debt/EBITDA (x)	-2.1	-2.1	-2.1	-2.0
CF from operations/net debt				

Per share data (INR)

EPS Rep (fully diluted)	168.00	180.02	127.15	0.00
HSBC EPS	35.61	40.79	44.87	50.79
DPS	24.26	27.50	38.50	44.00
NAV	110.28	148.01	154.38	161.17

Valuation data

Year to	12/2005a	12/2006e	12/2007e	12/2008e
EV/sales	4.8	4.4	4.1	3.7
EV/EBITDA	16.7	15.0	13.5	12.4
EV/IC	29.7	27.9	29.5	28.7
PE*	26.9	23.5	21.4	18.9
P/NAV	8.7	6.5	6.2	6.0
FCF yield (%)	3.8	3.5	4.3	4.7
Dividend yield (%)	2.5	2.9	4.0	4.6

Note: * = Based on HSBC EPS

Issuer information

Share price (INR)	958.95	Country	India
Reuters (Equity)	GLAX.BO	Bloomberg (Equity)	GLXO IN
		Bloomberg (Debt)	GSK
Market cap (INRm)	81,226	Enterprise value (INRm)	70,757
No of shares (m)	85	Free float (%)	50.9
Analyst	Jatin Kotian	Contact details	91 22 2268 1638

Note: price at close of 15 Jun 2006

Disclosure appendix

Stock ratings and basis for financial analysis

HSBC believes that institutional investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 2-year time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock (vs Global sector universe of companies under coverage by sector team)

- ▶ Overweight (Buy)
- ▶ Neutral (Hold)
- ▶ Underweight (Sell)

HSBC assigns ratings to its stocks in this sector on the following basis:

For companies covered on a sector basis, we apply a ratings structure which ranks the stocks according to their notional target price vs current market price and then categorises (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price is defined as the mid-point of the analysts' valuation for a stock.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

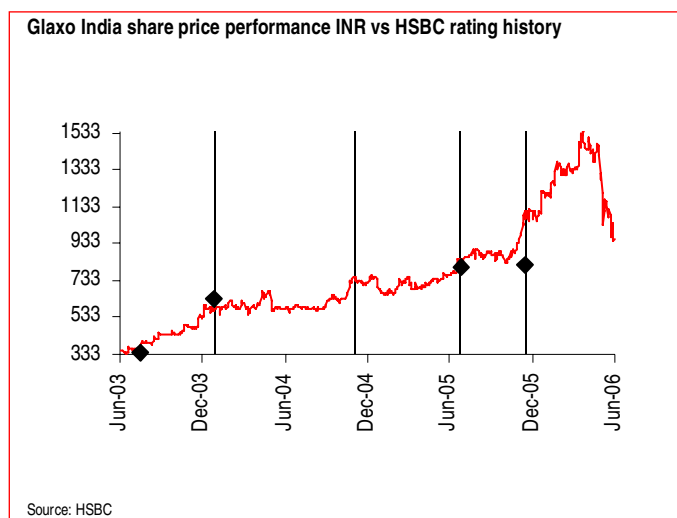
From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Rating distribution for long-term investment opportunities

As of Thursday, June 15, 2006, the distribution of all ratings published is as follows:

Overweight/Buy	43%	(37% of these provided with Investment Banking Services)
Neutral/Hold	40%	(37% of these provided with Investment Banking Services)
Underweight/Sell	17%	(31% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Rating & price target history

From	To	Date
Hold	Add	07 January 2004
Add	N/R	15 November 2004
N/R	Neutral	08 July 2005
Neutral	Underweight	29 November 2005
Target price	Value	Date
Price 1	341.43	28 July 2003
Price 2	634.08	07 January 2004
Price 3	N/A	15 November 2004
Price 4	806.56	08 July 2005
Price 5	821.41	29 November 2005

Source: HSBC

Issuer & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Disclosure
Glaxo India	GLAX.NS	958.95	3

Source: HSBC

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* HSBC legal entities listed on page 7

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Issuer of report

HSBC Securities and Capital Markets (India) Private Limited

Registered Office

52/60 Mahatma Gandhi Road

Fort, Mumbai 400 001, India

Telephone: +91 22 2267 4921

Fax: +91 22 2263 1983

Website: www.hsbcnet.com/research

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