

RESULTS FIRST LOOK

Glaxo's 3QCY11 results disappointed. Revenue grew 4.4% y-y vs. our expectation of 9.7%. As per management, anti infective business experienced lower growth due to high base. Gross margins declined 266bps y-y. We believe the pressure could be due to higher input costs and an adverse product mix. Core EBITDA margins declined to 29.8% primarily due to higher other expenses. Based on both our own and AIOCD estimates, Glaxo could face an adverse impact of INR 1500-1600mn (~20% of FY12E EBITDA) under the new proposed pharma pricing policy. We expect the stock to be under pressure.

Price target: 2292.0 INR

Price (04 Nov 2011): 2113.5 INR

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Disappointing quarter

- Earnings vs. our Forecast: **BELOW**

Likely Impact:

- Earnings Estimates: **NO CHANGE**
- Dividend Estimates: **NO CHANGE**
- Price Target: **NO CHANGE**
- Long-term View: **CONFIRMED**

- Revenues grew only 4.4% y-y vs our expectation of 9.7%. Management said that, while Vaccines, Dermatology, Oncology, Cardiovascular & Metabolic segments registered strong double digit growth, anti-infective business growth was slow due to high base.
- We believe that the launch of branded generics could have exerted some margin pressure. AIOCD data suggests that the anti infective space has been intensely competitive with a high number of names and high bonus rates.
- Gross margins declined 266bps y-y, led by higher material costs and 337bps below our estimate.
- Core EBITDA margins fell below 30% for the first time in the past three years. Core EBITDA margin came in 622bps below our estimates, primarily owing to higher than expected other expenditure and employee costs. We believe the employee costs were high because of the recent ramp-up in field force.
- Core EBITDA declined 15% y-y due to cost pressures.
- Net profit missed our estimates by 16% and declined 8% y-y.
- We believe that the 3QCY11 results are disappointing. We had highlighted that Glaxo has high exposure to the new proposed pharma pricing policy. As per both our own and AIOCD estimates, Glaxo could face an adverse impact of INR 1500-1600mn if the proposed policy is passed.
- We would expect the stock to be under pressure on the back of these results.

(in INR mn)	3Q'11	3Q'10	YoY (%)	2Q'11	QoQ (%)	3Q'11E	Vs. Nom.
Net sales	6,076	5,820	4.4%	5,615	8%	6,383	-5%
Other operating income	71	73	-3%	123	-43%	80	-12%
Total operating income	6,146	5,893	4%	5,739	7%	6,463	-5%
Material costs	2,420	2,163	12%	2,046	18%	2,327	4%
Employee costs	661	572	16%	776	-15%	711	-7%
Other expenditure	1,235	998	24%	924	34%	1,099	12%
Total expenses	4,316	3,733	16%	3,746	15%	4,137	4%
Core EBITDA	1,830	2,160	-15%	1,993	-8%	2,327	-21%
<i>Margins (%)</i>	29.8%	36.6%		34.7%		36.0%	-17.3%
Interest, treasury, and other income	371	194	91%	256	45%	306	21%
Depreciation	49	41	20%	49	-1%	50	-2%

PBT	2,152	2,374	-9%	2,242	-4%	2,597	-17%
Tax expense	692	792	-13%	725	-5%	857	-19%
Net profits before exceptional items	1,460	1,583	-8%	1,517	-4%	1,740	-16%
Exceptional items (net of tax)	(1)	(4)		(41)	(1)	-	
Net profit	1,459	1,578		1,475		1,740	-16%
	3Q'11	3Q'10	YoY (%)	2Q'11	QoQ (%)	3Q'11E	Vs. Nom.
As % of total operating income							
Material costs	39.4%	36.7%	266bps	35.6%	373bps	36.0%	337bps
Employee costs	10.8%	9.7%	104bps	13.5%	-277bps	11.0%	-25bps
Other expenditure	20.1%	16.9%	316bps	16.1%	399bps	17.0%	310bps
Core EBITDA	29.8%	36.6%	-687bps	34.7%	-495bps	36.0%	-622bps
Tax rate (%)	32.2%	33.3%	-118bps	32.3%	-19bps	33.0%	-84bps

Source: Company data, Nomura estimates

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://go.nomuranow.com/research/globalresearchportal>) rather than the date of this email.

Results First Look is the analyst's preliminary interpretation of the results announcement. Our recommendation and earnings estimates are not being changed in this report. Any formal changes to our recommendation or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed in this report.

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Issuer Specific Regulatory Disclosures

Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
GlaxoSmithKline Pharmaceuticals	GLXO IN	2113.5 INR	04 Nov 2011	Neutral	

Previous Rating

Issuer name	Previous Rating	Date of change
GlaxoSmithKline Pharmaceuticals	Buy	19 May 2010

GlaxoSmithKline Pharmaceuticals (GLXO IN)

2113.5 INR (04 Nov 2011) Neutral

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
07-Sep-2011		2292.00	2128.10
22-Feb-2011		2479.00	2236.50
19-May-2010		2132.00	2070.20
19-May-2010	Neutral		2070.20
22-Feb-2010		1936.00	1681.75
22-Feb-2010	Buy		1681.75
01-Oct-2009		1566.00	1561.25
01-Oct-2009	Neutral		1561.25
28-Jul-2009		1540.00	1351.15
20-Mar-2009		1320.00	1075.20
20-Mar-2009	Buy		1075.20

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Glaxo at 25x one year fwd earnings which is at the lower end of the trading band (25x-30x one yr fwd earnings) for the stock. The multiple accounts for a) slower than anticipated growth and b) less likelihood of a meaningful acquisition in the near term. Our 12 month target price is INR 2,292.

Risks that may impede the achievement of the target price Key downside risk: We believe there is increased noise on price control, though uncertainty remains. Extension of price control particularly to key products like Augmentin is a key risk. In addition increased competition in Vaccines though unlikely over next two years, remains a medium term challenge. Key upside risks: value-accretive acquisitions, greater-than-anticipated success of new launches.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

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