



GlaxoSmithKline Pharmaceuticals

STOCK INFO. BLOOMBERG
BSE SENSEX: 13,033 GLXO IN
REUTERS CODE
S&P CNX: 3,767 GLAX.BO

1 November 2006

Buy

Rs1,168

Previous Recommendation:

Equity Shares (m) 84.7
52-Week Range (Rs) 1,551/827
1,6,12 Rel. Perf. (%) -4/-24/-4
M.Cap. (Rs b) 99.0
M.Cap. (US\$ b) 2.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
12/05A	14,704	3,063	36.2	18.7	32.3	10.4	32.3	50.4	6.1	20.9
12/06E	15,563	3,549	41.9	15.9	27.9	7.4	26.6	41.0	5.7	18.9
12/07E	17,388	4,016	47.4	13.2	24.6	6.3	25.4	39.1	5.0	15.9

GSK Pharma's 3QCY06 results were lower than our estimates mainly because of supply constraints faced by the company. Key highlights:

- Net sales declined 3.9% while adjusted PAT improved by only 4.4%. Pharmaceutical sales grew by only 2.5% impacted by supply constraints, while other sales were down 41%, due to divestment of the animal healthcare business. Pharma sales were impacted due to supply constraints for vaccines and some other products resulting as well as discontinuation of some un-remunerative products. These factors together have adversely impacted the top-line growth and the management indicated that it has lost about 3-4% of sales.
- EBITDA margins were flat at 32.3% mainly due to lower vaccine sales as these are high-margin products. GSK booked an extra-ordinary income of Rs1.86b (post-tax) on account of this divestment and provision for pricing of a formulation.
- We have revised our CY06 earnings estimates downwards by 5% to factor-in the supply constraints, but our CY07E estimates remain unchanged.

We continue to be positive about GSK's long-term prospects. It is one of the best plays on IPR regime in India with plans to launch 8 patented products by CY09E. 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. Management has guided that GSK is likely to outperform the average industry growth in the long-term (post 2008) as patented products start contributing meaningfully to the overall sales. It has also indicated that EBITDA margins will improve by 1-1.5% for CY07E. GSK is currently valued at 27.9x CY06E and 24.6x CY07E earnings adjusted for the divestment of the animal healthcare business. Maintain **Buy**.

QUARTERLY PERFORMANCE

Y/E DECEMBER	CY05				CY06				(Rs Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE	CY05	CY06E
Net Sales	2,762	4,649	4,132	3,177	4,254	4,041	3,970	3,298	14,704	15,563
YoY Change (%)	-23.1	30.8	10.6	12.5	54.0	-13.1	-3.9	3.8	6.9	5.8
Total Expenditure	2,053	3,076	2,805	2,515	2,843	2,789	2,688	2,552	10,424	10,872
EBITDA	710	1,573	1,328	663	1,411	1,252	1,283	746	4,280	4,691
Margins (%)	25.7	33.8	32.1	20.9	33.2	31.0	32.3	22.6	29.1	30.1
Depreciation	37	38	38	44	38	39	41	40	157	158
Other Income	137	140	178	210	222	183	254	286	656	945
PBT before EO expense	810	1,675	1,467	828	1,596	1,396	1,496	973	4,779	5,460
Tax	254	549	481	270	567	475	499	343	1,553	1,884
Deferred Tax	8	72	37	46	-6	10	6	17	164	27
Rate (%)	32.4	37.1	35.3	38.1	35.2	34.8	33.8	36.9	35.9	35.0
Adjusted PAT	548	1,054	949	512	1,034	911	991	613	3,063	3,549
YoY Change (%)	-21.6	44.0	20.0	16.6	88.9	-13.6	4.4	19.7	15.1	15.9
Margins (%)	19.8	22.7	23.0	16.1	24.3	22.5	25.0	18.6	20.8	22.8
Extra-Ord Expense	78	19	-2,144	89	22	0	-1,864	0	-1,958	-1,842
Reported PAT	469	1,035	3,093	424	1,012	911	2,854	613	5,021	5,391

E: MOST Estimates; * Quarterly results don't add up due to recasting

Sales impacted by supply constraints and divestments

Net sales for 3Q declined 3.9% (vs estimate of 8% growth) while adjusted PAT improved by only 4.4% (vs estimate of 12%). Pharmaceutical sales grew by only 2.5% impacted by supply constraints, while other sales were down 41%, partly because of divestment of the animal healthcare business wef 31-Jul. The parent company could not supply adequate quantities of vaccines to its Indian subsidiary. Also GSK faced supply constraints from one of its Indian suppliers.

Government mandated price reductions forced the company to discontinue certain products. These factors together have adversely impacted the top-line growth and the management indicated that it has lost about 3-4% of sales. Management also indicated that most of the supply constraints are likely to be eased out shortly, implying that even 4Q performance could be muted. It expects its pharmaceutical portfolio to grow by 10-11% for CY06E (it has grown by 9.3% YTD).

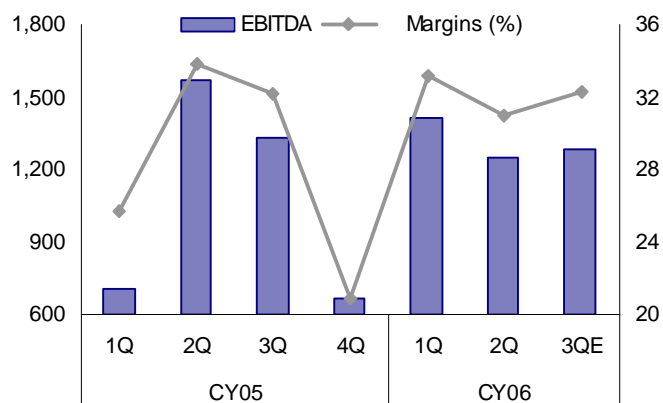
GSK PHARMA - BREAK UP OF SALES

	3QCY06	3QCY05	GR. (%)	2QCY06	GR. (%)
Pharma	3,691	3,601	2.5	3,594	2.7
% of sales	90.2	84.0		86.2	
Other business	401	686	-41.6	575	-30.4
% of sales	9.8	16.0		13.8	
Total Sales	4,092	4,287	-4.5	4,170	-1.9

Source: Company

EBITDA margins were flat at 32.3% (vs estimate of 32.7%) mainly due to lower vaccine sales as these are high-margin products. The company has booked an extra-ordinary income of Rs1.86b (post-tax) on account of this divestment and provision for pricing of a formulation. The company has indicated that adjusted PBT (excl. extra-ordinary income and adjusted for divestments) has grown by 16% YTD.

TREND IN EBITDA MARGINS



Source: Company/ Motilal Oswal Securities

Divestment of Animal Healthcare business

The company has sold its animal healthcare business (part of Other business) for consideration of Rs2.1b to a European company, w.e.f 31/July/06. Our estimates factor in this divestment which has also impacted the 3QCY06 performance.

New launches have started contributing meaningfully to revenues

New introductions (launched in CY01 and onwards) 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. The management expects these products to contribute around Rs1.29b in sales for CY06E.

Aggressive initiatives for the Indian market

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. It plans to launch

Carvedilol (in-licensed from Roche) in CY07. In future it proposes to launch Vaccines 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.

Betamethasone supplies to commence from CY07E

Betamethasone supplies to the parent are expected to commence in CY07E and management has guided Rs300m sales from Betamethasone exports in CY08E. This will be a test case for future outsourcing assignments by the parent. However, we believe that the margins on these opportunities may not be very high as the parent will be sourcing the products from GSK on a cost plus basis.

Planning to launch 8 patented products by CY09

GSK is planning to launch about 8 patented products 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 \$1.0b revenue mark by 2015 compared to the current \$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
Lapatinib	Cancer	2009
Allermist	Respiratory	2008
Alvimopan	Post-operative Ileus	2008
Pleuromutilin		2008
Rotarix	Rotavirus Vaccine	2007
Cervarix	Cervical cancer vaccine	2007/08
Streptorix	Pneumonia Vaccine	2009
Infanrix	Infant Vaccine	2007/08

Source: Company

In domestic market, we expect patented products to generate about \$1.0b in sales by 2010 and about \$3.0b 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 may not make any significant 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 contributing positively to the bottom-line 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. Our estimates already factor-in the impact of these investments.

CY07-08 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. The improvement in product mix would help in reducing exposure to products under DPCO to around 26% by end of CY06E.

New drug policy still remains uncertain

The government is yet to finalize the new pharmaceutical policy. While it had proposed bringing the Essential Drug's List (consisting of 354 drugs) under price control, the industry has stiffly opposed it. This has prompted the government to appoint a committee consisting of members, both from the government and the industry to find an alternative to make drugs more affordable to the masses without drastically hurting the industry's pricing flexibility.

This committee is yet to give its final recommendations to the government. While the contents of this proposed policy still remain uncertain, any attempt to bring in a significant number of drugs under government mandated price controls is likely to hurt the industry and all its players including GSK.

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. The potential upside from product patents would create 'option value' in these stocks over the longer term.

GSK Pharma intends to take on 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.

GSK is currently valued at 27.9x CY06E and 24.5x CY07E earnings. Our estimates for CY07E take into account the additional marketing and promotional expenditure linked to launch of patented products in CY08E and divestment of Animal Healthcare business from 31/Jul/06 onwards. We continue to be positive about GSK's long-term prospects. It is one of the best plays on IPR regime in India. 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. Maintain **Buy**.

GlaxoSmithKline Pharmaceuticals: an investment profile

Company description

GSK Pharma (50% subsidiary of GSK Plc) is the second largest formulations company in India, with a strong presence in segments like dermatology, respiratory and vaccines. The company has completed an aggressive restructuring process over the last couple of years – both in terms of product rationalization as well as cost cutting efforts. Its parent has one of the richest product and R&D pipelines among Pharma companies worldwide.

Key investment arguments

- ✍ Excellent branded portfolio with strong presence in dermatology, respiratory and vaccines; increased focus on high margin-high growth “power brands” has improved product mix
- ✍ Parent’s strong pipeline holds good upside potential post IPR implementation, with no conflict issues involved with any other subsidiary
- ✍ Plans to launch 8 patented products in India by 2009

Key investment risks

- ✍ Delay / ineffective implementation of product patents in India could suppress longer term growth potential
- ✍ Any widening of the price control net could hit profitability

Recent developments

- ✍ Divested its animal healthcare business (part of Other business) for consideration of Rs2.1b

Valuation and view

- ✍ Premium valuations of 27.9x CY06E and 24.6x CY07E earnings are deserved in view of GSK's strong brand equity, aggressive management and strong earnings visibility
- ✍ Reiterate **Buy** with price target of Rs1,392

Sector view

- ✍ The domestic market is expected to witness steady growth, with gradual increase in the low penetration levels - companies with strong brands and marketing muscle to benefit.
- ✍ IPR regime unlikely to lead to any major change in the near term; MNCs and large Indian players to gain over the longer term.

Among MNCs, we are bullish on companies whose domestic portfolio is well aligned with its parent and where risk of conflict with 100% subsidiaries is limited.

COMPARATIVE VALUATIONS

		GSK	AVENTIS	PFIZER
P/E(x)	FY07E	27.9	20.2	22.6
	FY08E	24.6	18.4	25.6
P/BV(x)	FY07E	7.4	5.7	5.9
	FY08E	6.3	4.7	5.3
EV/Sales(x)	FY07E	5.7	3.4	3.3
	FY08E	5.0	3.0	3.6
EV/EBITDA(x)	FY07E	18.9	12.1	14.2
	FY08E	15.9	10.6	15.5

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	50.7	50.7	50.7
Domestic Inst	14.7	15.0	14.0
Foreign	14.0	13.4	14.1
Others	20.6	21.0	21.3

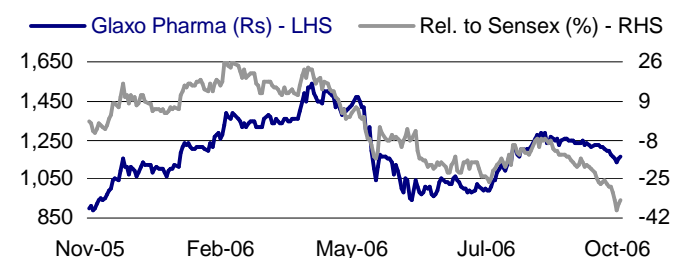
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	41.9	42.3	-1.0
CY07	47.4	48.5	-2.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,168	1,392	19.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Exports	382	457	411	370	633
Net Domestic Sales	13,253	14,247	15,152	17,018	19,189
Net Sales	13,635	14,704	15,563	17,388	19,822
Change (%)	24.7	7.8	5.8	11.7	14.0
Total Expenditure	9,804	10,417	10,872	11,977	13,563
EBITDA	3,830	4,287	4,691	5,411	6,260
Change (%)	53.9	11.9	9.4	15.4	15.7
Margin (%)	28.1	29.2	30.1	31.1	31.6
Depreciation	175	157	158	170	182
Int. and Finance Charges	25	24	18	15	0
Other Income - Rec.	552	673	945	952	1115
PBT & EO Expense	4,182	4,779	5,460	6,178	7,193
Tax	1,522	1,716	1,911	2,162	2,517
Tax Rate (%)	36.4	35.9	35.0	35.0	35.0
Adj PAT	2,661	3,063	3,549	4,016	4,675
EO Expense (net of tax)	-670	-1,958	-3,187	0	0
Reported PAT	3,331	5,021	6,736	4,016	4,675
Change (%)	46.3	15.1	15.9	13.2	16.4
Margin (%)	24.4	34.1	43.3	23.1	23.6

E: M OSt Estimates ^ - Standalone results

BALANCE SHEET (Rs Million)					
Y/E DECEMBER	2004	2005	2006E	2007E	2007E
Equity Share Capital	873	847	847	847	847
Reserves	8,353	8,622	12,461	14,932	17,913
Capital Reserve	17	17	17	17	17
Net Worth	9,243	9,486	13,325	15,795	18,777
Loans	38	49	49	49	49
Capital Employed	9,281	9,535	13,373	15,844	18,825
Gross Block	2,526	2,531	2,731	2,931	3,131
Less: Accum. Deprn.	1,657	1,715	1,873	2,043	2,225
Net Fixed Assets	870	816	858	888	906
Capital WIP	45	154	40	40	40
Investments	7,768	9,131	9,660	12,116	14,872
Curr. Assets	4,846	4,618	5,292	5,912	6,740
Inventory	2,265	2,181	2,490	2,782	3,172
Account Receivables	761	674	856	956	1,090
Cash and Bank Balance	634	475	700	782	892
Others	1,187	1,288	1,245	1,391	1,586
Curr. Liability & Prov.	4,697	5,481	4,358	4,869	5,550
Account Payables	2,195	2,576	2,646	2,956	3,370
Other Liabilities					
Provisions	2,502	2,906	1,712	1,913	2,180
Net Current Assets	149	-863	934	1,043	1,189
Deferred Tax Assets	449	298	270	239	203
Appl. of Funds	9,281	9,535	11,762	14,327	17,211

E: M OSt Estimates ^ - Standalone results

RATIOS					
Y/E DECEMBER	2004	2005	2006E	2007E	2008E
Basic (Rs) EPS	30.5	36.2	41.9	47.4	55.2
Cash EPS	32.5	38.0	43.8	49.4	57.3
BV/Share	105.8	112.0	157.3	186.5	221.7
DPS	24.0	28.0	30.0	16.0	16.0
Payout (%)	89.1	88.3	816	38.5	33.1
Valuation					
P/E	38.3	32.3	27.9	24.6	21.2
Cash P/E	36.0	30.7	26.7	23.6	20.4
P/BV	11.0	10.4	7.4	6.3	5.3
EV/Sales	6.6	6.1	5.7	5.0	4.2
EV/EBITDA	23.6	20.9	18.9	15.9	13.3
Dividend Yield (%)	2.1	2.4	2.6	14	14
Return Ratios (%)					
RoE	28.8	32.3	26.6	25.4	24.9
RoCE	45.3	50.4	41.0	39.1	38.2

Working Capital Ratios

Asset Turnover (x)	15	15	13	12	12
Debtor (Days)	20	17	20	20	20
Inventory (Days)	61	54	58	58	58
Working Capital (Days)	-13	-33	5	5	5

Leverage Ratio

Debt/Equity	0.0	0.0	0.0	0.0	0.0
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E: M OSt Estimates ^ - Standalone results

CASH FLOW STATEMENT (Rs Million)					
Y/E DECEMBER	2004	2005	2006E	2007E	2007E
Oper. Profit/(Loss) before Tax	4,062	4,562	4,691	5,411	6,260
Interest/Dividends Recd.	353	351	945	952	1,115
Direct Taxes Paid	-1,403	-1,458	-1,884	-2,131	-2,482
(Inc)/Dec in WC	110	467	-1,765	1,325	-37
CF from Operations	3,121	3,923	1,987	5,556	4,857
EO expense	578	129	-3,187	0	0
CF from Operating incl	2,544	3,793	5,174	5,556	4,857
(inc)/dec in FA	969	1,955	-86	-200	-200
(Pur)/Sale of Investments	-2,642	-1,465	-530	-2,456	-2,756
CF from investments	-1,673	490	-616	-2,656	-2,956
Issue of Shares	0	-2,073	0	0	-149
(Inc)/Dec in Debt	10	10	0	0	0
Interest Paid	-17	-17	-18	-15	0
Dividend Paid	-992	-2,361	-2,704	-2,897	-1,545
CF from Fin. Activity	-1,000	-4,440	-2,722	-2,912	-1,694
Inc/Dec of Cash	-129	-157	1,836	-12	206
Add: Beginning Balance@	763	634	475	700	782
Closing Balance	634	476	2,311	689	989

E: M OSt Estimates ^ - Standalone results

N O T E S

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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
4. Investment Banking relationship with company covered	No

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