



## GlaxoSmithKline Pharmaceuticals

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,978	GLXO IN
	REUTERS CODE
S&P CNX: 5,906	GLAX.BO

29 October 2007

Buy

Previous Recommendation: Buy

Rs1,101

Equity Shares (m)	84.7
52-Week Range (Rs)	1,340/1,000
1,6,12 Rel. Perf. (%)	-16/-50/-56
M.Cap. (Rs b)	93.2
M.Cap. (US\$ b)	2.4

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
12/06E	15,384	3,617	42.7	18.1	25.8	7.8	30.3	46.4	5.3	17.1
12/07E	15,359	3,721	43.9	2.9	25.0	6.0	24.0	37.3	5.1	16.8
12/08E	16,895	4,058	47.9	9.0	23.0	5.2	22.7	34.8	4.5	14.8

GSK Pharma's 3QCY07 results were above estimates. Key highlights:

- Net sales improved by 5.6% to Rs4.2b, primarily driven by 9.3% growth in pharmaceuticals business (albeit on a low base). Non-pharmaceutical sales declined by 18% mainly due to the proposed divestment of the fine chemical business.
- EBITDA margins improved by 30bp to 32.6% driven by 160bp improvement in pharmaceutical business margins to 37.4%.
- Higher other income at Rs339m (up 33%) on account of higher treasury income boosted PAT growth by 10% to Rs1.1b. During the quarter, company booked profit of Rs1.4b on account on divestment of fine chemical business, translating into reported PAT of Rs2.49b.
- We have revised our EPS estimates upwards by 2.5% for CY07E (to Rs43.9) and 2.5% for CY08E (to Rs47.9) to factor in for higher than expected other income.

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 3 patented products and 4 vaccines 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. Although, GSK's top-line growth has been disappointing in the past, we believe that it is likely to outperform the average industry growth in the long-term (post 2008) as patented products start contributing meaningfully to the overall sales. GSK is currently valued at 25x CY07E and 23x CY08E earnings. Maintain **Buy**.

### QUARTERLY PERFORMANCE

(Rs Million)

Y/E DECEMBER	CY06				CY07				CY06	CY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Net Sales</b>	<b>4,254</b>	<b>4,041</b>	<b>3,970</b>	<b>3,119</b>	<b>4,203</b>	<b>3,915</b>	<b>4,193</b>	<b>3,048</b>	<b>15,384</b>	<b>15,359</b>
YoY Change (%)	54.0	-13.1	-3.9	-1.8	-1.2	-3.1	5.6	-2.3	4.6	-0.2
Total Expenditure	2,843	2,789	2,688	2,305	2,753	2,692	2,826	2,389	10,617	10,660
<b>EBITDA</b>	<b>1,411</b>	<b>1,252</b>	<b>1,283</b>	<b>814</b>	<b>1,450</b>	<b>1,223</b>	<b>1,366</b>	<b>659</b>	<b>4,767</b>	<b>4,699</b>
Margins (%)	33.2	31.0	32.3	26.1	34.5	31.2	32.6	21.6	31.0	30.6
Depreciation	38	39	41	41	37	37	38	40	159	152
Other Income	222	183	254	299	272	312	339	344	965	1,267
<b>PBT before EO Expense</b>	<b>1,596</b>	<b>1,396</b>	<b>1,496</b>	<b>1,072</b>	<b>1,686</b>	<b>1,498</b>	<b>1,667</b>	<b>963</b>	<b>5,560</b>	<b>5,814</b>
Tax	567	475	499	348	563	502	555	347	1,889	2,030
Deferred Tax	-6	10	6	43	10	32	22	0	53	63
Rate (%)	35.2	34.8	33.8	36.4	34.0	35.6	34.6	36.1	34.9	36.0
<b>Adjusted PAT</b>	<b>1,034</b>	<b>911</b>	<b>991</b>	<b>682</b>	<b>1,113</b>	<b>964</b>	<b>1,091</b>	<b>616</b>	<b>3,617</b>	<b>3,721</b>
YoY Change (%)	88.9	-13.6	4.4	33.0	7.6	5.9	10.1	-9.7	18.1	2.9
Margins (%)	24.3	22.5	25.0	21.9	26.5	24.6	26.0	20.2	23.5	24.2
Extra-Ord Expense	22	0	-1,864	4	0	0	-1,399	0	-1,838	-1,399
<b>Reported PAT</b>	<b>1,012</b>	<b>911</b>	<b>2,854</b>	<b>678</b>	<b>1,113</b>	<b>964</b>	<b>2,490</b>	<b>616</b>	<b>5,455</b>	<b>5,120</b>

E: MOSSt Estimates

**Low base effect drives pharmaceutical growth**

Net sales improved by 5.6% to Rs4.2b, primarily driven by 9.3% growth in pharmaceuticals business (albeit on a low base). GSK's performance in 3QCY06 was impacted due to supply constraints, particularly in case of vaccines. Non-pharmaceutical sales declined by 18% mainly due to the proposed divestment of the fine chemical business.

GSK PHARMA – BREAK UP OF SALES

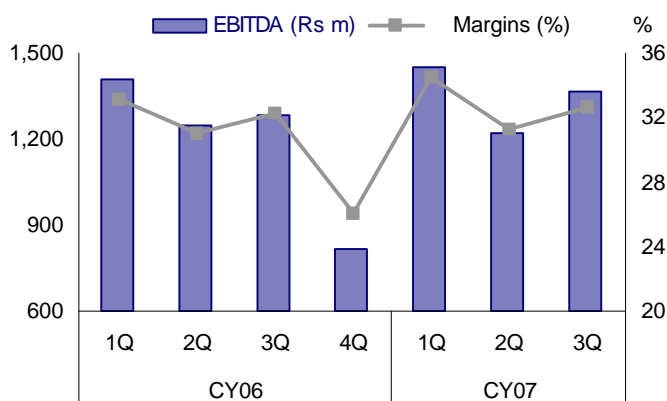
	3QCY07	3QCY06	GR. (%)	2QCY07	GR. (%)
Pharma	4,036	3,691	9.3	3,781	6.7
% of Sales	92.5	90.2		91.9	
Other Business	329	401	-17.9	334	-1.7
% of Sales	7.5	9.8		8.1	
<b>Total Gross Sales</b>	<b>4,365</b>	<b>4,092</b>	<b>6.7</b>	<b>4,115</b>	<b>6.1</b>

Source: Company

**Business mix improvement drives margin expansion**

EBITDA margins expanded by 30bp to 32.6% mainly due to improvement in pharmaceutical business PBIT margins by 160bp to 37.4%. The other business PBIT margins declined by 850bp to 15.3%. Focus products (which attract higher margins) recorded 11% growth for the quarter while DPCO products recorded flat growth.

TREND IN EBITDA MARGINS



Source: Company/Motilal Oswal Securities

Higher other income (up 33%) on account of higher treasury income, boosted PAT growth to 10% at Rs1.1b, despite the proposed divestment of fine chemicals business.

**New launches have started contributing meaningfully to revenues**

New introductions (launched in CY01 and onwards) are expected to contribute about Rs1.7b to GSK's revenues for CY07 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.

New launches expected in CY07E include:

1. Carvedilol (CVS) – launched in 3QCY07
2. Arixtra (Low molecular weight heparin) – launched in 2QCY07
3. A 2<sup>nd</sup> generation anti-infective

**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. Although, the company's recent launches in the anti-diabetic category - Windia (Roziglitazone) and Windamet (Roziglitazone + Metformin) – have received good response from the market, future growth is likely to slow down due to the global concerns over these products. 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 has recently launched Carvedilol which was in-licensed from Roche. In future it proposes to launch Vaccines and CNS products from the parent's pipeline. We believe that the company has one of the strongest pipelines of vaccines in the country. The company plans to launch four in-licensed products, of which, one will enjoy patent protection (likely to be launched in 2HCY08).

**Planning to launch 3 patented products & 4 vaccines by CY09**

GSK is planning to launch about 3 patented products and 4 vaccines in the CY08-09 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\$383m 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	2008
Allermist	Respiratory	2008/09
Pleuromutilin	Topical Anti-biotic	2008/09
Rotarix	Rotavirus Vaccine	2008
Cervarix	Cervical cancer vaccine	2009
Streptorix	Pneumonia Vaccine	2009
Infanrix	Infant Vaccine	2008

Source: Company

In domestic market, we expect patented products to generate 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 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.

Management indicated that patented products can command much higher revenues as compared to the historic trend of

Rs30-50m sales for non-patented product launch in the first year of launch. We believe that Cervarix (cervical cancer vaccine) holds good long-term potential but may not generate very high sales in the initial period as it will involve selling a new concept to the patients. Also, since GSK does not have any presence in the Indian oncology market, it will take some time for the company to establish itself in this segment.

Management has indicated that it has completed the trials for Cervarix and the filing for this product is expected in CY08E. A potential launch is expected in CY09E. In addition to this one of the in-licensed products (details not disclosed) is also likely to enjoy patent protection.

### **Full impact of Betamethasone supplies to reflect from CY08E**

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.

### **Evaluating share buyback to deploy surplus cash**

We expect GSK to end CY07E with cash surplus of about Rs17b generated through a combination of cash from operations and from divestment of non-pharmaceutical business. Management is evaluating various options like share buyback and/or one-time dividend to deploy the surplus cash and will be taking a decision on this in the near term.

### **CY08-09 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 CY08E.

### **New drug policy still remains uncertain**

We believe that the biggest risk to our positive stance on GSK could be the implementation of the new pharmaceutical policy in the current form. The new policy proposes to significantly increase the span of control by bringing in additional 354 drugs under price control. This could severely impact the profitability of GSK's domestic business. Industry has taken strong objection to the proposed policy and we believe that the policy is unlikely to be implemented in the current form. Given the strong opposition from the industry, the government has formed a Group of Ministers (GoM), which would give final recommendations to the government regarding the new pharmaceutical policy. However, the uncertainty related to this will remain till the government finally notifies the new pharmaceutical policy.

### **Valuation and outlook**

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 3 patented products and 4 vaccines 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. Although, GSK's top-line growth has been disappointing in the past, we believe that it is likely to outperform the average industry growth in the long-term (post 2008) as patented products start contributing meaningfully to the overall sales. We have revised our EPS estimates upwards by 2.5% for CY07E (to Rs43.9) and 2.5% for CY08E (to Rs47.9) to factor in for higher than expected other income. GSK is currently valued at 25x CY07E and 23x CY08E earnings. Maintain **Buy** with price target of Rs1,392.

## GlaxoSmithKline Pharmaceuticals: an investment profile

### Company description

GSK Pharma (50% subsidiary of GSK Plc) is the 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 three patented products and four vaccines in India by 2009.

### Key investment risks

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

### Recent developments

- ✍ The parent is likely to stop further development of Alvimopan (useful for post operative Ileus) due to adverse side-effects.

### Valuation and view

- ✍ Premium valuations of 25x CY07E and 23x CY08E 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 12-13% 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)	CY07E	25.0	15.1	14.9
	CY08E	23.0	12.2	16.7
P/BV (x)	CY07E	6.0	3.6	2.8
	CY08E	5.2	3.0	2.5
EV/Sales (x)	CY07E	5.1	2.1	2.1
	CY08E	4.5	1.8	2.2
EV/EBITDA (x)	CY07E	16.8	9.6	8.2
	CY08E	14.8	7.0	9.4

#### SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	50.7	50.7	50.7
Domestic Inst	15.3	15.2	14.7
Foreign	15.8	15.7	14.0
Others	18.2	18.4	20.6

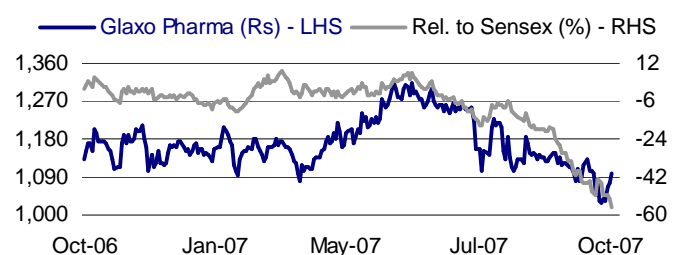
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	43.9	55.4	-20.7
CY08	47.9	59.6	-19.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,101	1,392	26.5	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Exports	382	457	570	513	762
Net Domestic Sales	13,253	14,247	14,814	14,845	16,132
<b>Net Sales</b>	<b>13,635</b>	<b>14,704</b>	<b>15,384</b>	<b>15,359</b>	<b>16,895</b>
Change (%)	24.7	7.8	4.6	-0.2	10.0
Total Expenditure	9,804	10,417	10,617	10,660	11,705
<b>EBITDA</b>	<b>3,830</b>	<b>4,287</b>	<b>4,767</b>	<b>4,699</b>	<b>5,189</b>
Change (%)	53.9	11.9	11.2	-1.4	10.4
Margin (%)	28.1	29.2	31.0	30.6	30.7
Depreciation	175	157	159	152	156
Int. and Finance Charges	25	24	13	0	0
Other Income - Rec.	552	673	965	1,267	1,210
<b>PBT &amp; EO Expense</b>	<b>4,182</b>	<b>4,779</b>	<b>5,560</b>	<b>5,814</b>	<b>6,243</b>
Tax	1,522	1,716	1,942	2,093	2,185
Tax Rate (%)	36.4	35.9	34.9	36.0	35.0
<b>Adj PAT</b>	<b>2,661</b>	<b>3,063</b>	<b>3,617</b>	<b>3,721</b>	<b>4,058</b>
EO Expense (net of tax)	-670	-1,958	-1,838	-1,400	0
<b>Reported PAT</b>	<b>3,331</b>	<b>5,021</b>	<b>5,455</b>	<b>5,121</b>	<b>4,058</b>
Change (%)	46.3	15.1	18.1	2.9	9.0
Margin (%)	24.4	34.1	35.5	33.3	24.0

BALANCE SHEET					
(Rs Million)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Equity Share Capital	873	847	847	847	847
Reserves	8,353	8,622	11,084	14,659	17,023
Capital Reserve	17	17	17	17	17
<b>Net Worth</b>	<b>9,243</b>	<b>9,486</b>	<b>11,947</b>	<b>15,523</b>	<b>17,887</b>
Loans	38	49	55	55	55
<b>Capital Employed</b>	<b>9,281</b>	<b>9,535</b>	<b>12,003</b>	<b>15,578</b>	<b>17,942</b>
Gross Block	2,526	2,531	2,536	2,736	2,936
Less: Accum. Deprn.	1,657	1,715	1,678	1,830	1,986
<b>Net Fixed Assets</b>	<b>870</b>	<b>816</b>	<b>858</b>	<b>906</b>	<b>950</b>
Capital WIP	45	154	87	40	40
Investments	7,768	9,131	11,394	13,493	15,752
<b>Curr. Assets</b>	<b>4,846</b>	<b>4,618</b>	<b>5,076</b>	<b>5,222</b>	<b>5,744</b>
Inventory	2,265	2,181	2,410	2,457	2,703
Account Receivables	761	674	604	845	929
Cash and Bank Balance	634	475	350	691	760
Others	1,187	1,288	1,712	1,229	1,352
<b>Curr. Liability &amp; Prov.</b>	<b>4,697</b>	<b>5,481</b>	<b>5,659</b>	<b>4,300</b>	<b>4,730</b>
Account Payables	2,195	2,576	2,477	2,611	2,872
Provisions	2,502	2,906	3,182	1,689	1,858
<b>Net Current Assets</b>	<b>149</b>	<b>-863</b>	<b>-582</b>	<b>922</b>	<b>1,014</b>
Deferred Tax Assets	449	298	246	217	186
<b>Appl. of Funds</b>	<b>9,281</b>	<b>9,535</b>	<b>12,003</b>	<b>15,578</b>	<b>17,942</b>

E: M OSt Estimates ^ - Standalone results

RATIOS					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
<b>Basic (Rs) EPS</b>	<b>30.5</b>	<b>36.2</b>	<b>42.7</b>	<b>43.9</b>	<b>47.9</b>
Cash EPS	32.5	38.0	44.6	45.7	49.7
BV/Share	105.8	112.0	141.0	183.3	211.2
DPS	24.0	28.0	31.0	16.0	16.0
Payout (%)	89.1	88.3	82.8	41.5	38.1
<b>Valuation</b>					
P/E		30.4	25.8	25.0	23.0
Cash P/E		28.9	24.7	24.1	22.1
P/BV		9.8	7.8	6.0	5.2
EV/Sales		5.7	5.3	5.1	4.5
EV/EBITDA		19.5	17.1	16.8	14.8
Dividend Yield (%)		2.5	2.8	1.5	1.5
<b>Return Ratios (%)</b>					
RoE	28.8	32.3	30.3	24.0	22.7
RoCE	45.3	50.4	46.4	37.3	34.8
<b>Working Capital Ratios</b>					
Asset Turnover (x)	15	15	13	10	0.9
Debtor (Days)	20	17	14	20	20
Inventory (Days)	61	54	57	58	58
Working Capital (Days)	-13	-33	-22	5	5
<b>Leverage Ratio</b>					
Debt/Equity	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Oper. Profit/(Loss) bef. Tax	4,062	4,562	5,187	4,699	5,189
Interest/Dividends Recd.	353	351	374	1,267	1,210
Direct Taxes Paid	-1,403	-1,458	-2,241	-2,064	-2,154
(Inc)/Dec in WC	110	467	-420	286	-23
<b>CF from Operations</b>	<b>3,121</b>	<b>3,923</b>	<b>2,899</b>	<b>4,188</b>	<b>4,222</b>
EO expense	578	129	21	-1,400	0
<b>CF frm Op. incl EO exp.</b>	<b>2,544</b>	<b>3,793</b>	<b>2,879</b>	<b>5,588</b>	<b>4,222</b>
(inc)/dec in FA	969	1,955	1,918	-153	-200
(Pur)/Sale of Investments	-2,642	-1,465	-2,232	-2,099	-2,259
<b>CF from investments</b>	<b>-1,673</b>	<b>490</b>	<b>-314</b>	<b>-2,253</b>	<b>-2,459</b>
Issue of Shares	0	-2,073	0	0	-149
(Inc)/Dec in Debt	10	10	7	0	0
Interest Paid	-17	-17	-7	0	0
Dividend Paid	-992	-2,361	-2,691	-2,994	-1,545
<b>CF from Fin. Activity</b>	<b>-1,000</b>	<b>-4,440</b>	<b>-2,691</b>	<b>-2,994</b>	<b>-1,694</b>
<b>Inc/Dec of Cash</b>	<b>-129</b>	<b>-157</b>	<b>-127</b>	<b>341</b>	<b>69</b>
Add: Beginning Balance@	763	634	476	350	691
<b>Closing Balance</b>	<b>634</b>	<b>476</b>	<b>350</b>	<b>691</b>	<b>760</b>

E: M OSt Estimates ^ - Standalone results

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

**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	Yes
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.