MOTILAL OSWAL

GlaxoSmithKline Pharmaceuticals

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,253	GLXO IN
	REUTERS CODE
S&P CNX: 4,107	GLAX.BO

Equity Shares (m)	84.7
52-Week Range (Rs)	1,551/891
1,6,12 Rel. Perf. (%)	-1/-29/-54
M.Cap. (Rs b)	97.4
M.Cap. (US$ b)	2.2

20 February 2007

Buy

Previous Recommendation: Buy

Rs1,150

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
12/06E	15,384	3,617	42.7	18.1	26.9	8.2	30.3	46.3	5.6	18.2
12/07E	17,173	4,076	48.1	12.7	23.9	6.7	28.2	43.3	4.9	15.5
12/08E	19,577	4,742	56.0	16.3	20.5	5.6	27.1	41.5	4.2	13.0

GSK Pharma's 4QCY06 EBITDA margins were better than estimates while PAT was in-line with estimates. Key highlights:

- Net sales declined 1.8% (v/s estimate of 4% growth) while adjusted PAT improved by 22% (v/s estimate of 19%). Pharmaceutical sales grew by 13% while other sales were down 52%, partly because of divestment of the animal healthcare business w.e.f. 31 July 2006. The double-digit growth in pharmaceutical sales was partly boosted by the one-time impact of certain infectious diseases which led to higher sales of anti-infective, NSAIDS and GI drugs. The supply issues, which impacted 3Q performance, have been resolved.
- EBITDA margins expanded by 520bp to 26.1% (v/s estimate of 22.6%) mainly due to higher pharmaceutical sales, savings in RM cost (down 9.4% mainly due to shift to loan-licensing arrangement) and lower staff costs (down 12.3%). Margins have also expanded due to the divestment of the animal healthcare business which enjoyed lower margins compared to the company's pharmaceutical business.

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 eight 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. The company is evaluating a share buyback to deploy surplus cash and will be taking a decision on this in the near term. GSK is currently valued at 23.9x CY07E and 20.5x CY08E earnings adjusted for the divestment of the animal healthcare business. Maintain **Buy**.

QUARTERLY PERFORMANCE (Rs Million)

Y/E DECEMBER	CY05				CY06				CY05	CY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	**2,762**	**4,649**	**4,132**	**3,177**	**4,254**	**4,041**	**3,970**	**3,119**	**14,704**	**15,384**
YoY Change (%)	*-23.1*	*30.8*	*10.6*	*12.5*	*54.0*	*-13.1*	*-3.9*	*-1.8*	*6.9*	*4.6*
Total Expenditure	2,053	3,076	2,805	2,515	2,843	2,789	2,688	2,305	10,424	10,625
EBITDA	**710**	**1,573**	**1,328**	**663**	**1,411**	**1,252**	**1,283**	**814**	**4,280**	**4,760**
Margins (%)	*25.7*	*33.8*	*32.1*	*20.9*	*33.2*	*31.0*	*32.3*	*26.1*	*29.1*	*30.9*
Depreciation	37	38	38	44	38	39	41	41	157	159
Other Income	137	140	178	210	222	183	254	299	656	958
PBT before EO Expense	**810**	**1,675**	**1,467**	**828**	**1,596**	**1,396**	**1,496**	**1,072**	**4,779**	**5,560**
Tax	254	549	481	270	567	475	499	348	1,553	1,889
Deferred Tax	8	72	37	46	-6	10	6	43	164	53
Rate (%)	*32.4*	*37.1*	*35.3*	*38.1*	*35.2*	*34.8*	*33.8*	*36.4*	*35.9*	*34.9*
Adjusted PAT	**548**	**1,054**	**949**	**512**	**1,034**	**911**	**991**	**682**	**3,063**	**3,617**
YoY Change (%)	*-21.6*	*44.0*	*20.0*	*16.6*	*88.9*	*-13.6*	*4.4*	*33.0*	*15.1*	*18.1*
Margins (%)	*19.8*	*22.7*	*23.0*	*16.1*	*24.3*	*22.5*	*25.0*	*21.9*	*20.8*	*23.5*
Extra-Ord Expense	78	19	-2,144	89	22	0	-1,864	4	-1,958	-1,838
Reported PAT	**469**	**1,035**	**3,093**	**424**	**1,012**	**911**	**2,854**	**678**	**5,021**	**5,455**

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

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Supply constraints eased out

Net sales declined 1.8% (v/s estimate of 4% growth) while adjusted PAT improved by 22% (v/s estimate of 19%). Pharmaceutical sales grew by 13% while other sales were down 52%, partly because of divestment of the animal healthcare business w.e.f. 31 July 2006. The double-digit growth in pharmaceutical sales was partly boosted by the one-time impact of certain infectious diseases which led to higher sales of anti-infective, NSAIDS and GI drugs. The supply issues, which impacted 3Q performance, seem to have been resolved as the company has recorded 13% growth for its pharmaceutical division.

For CY06, Priority brands contributed 35% of pharmaceutical sales, Priority Focus category 35% and DPCO products contributed 30% of sales. Vaccines accounted for 7-8% of the portfolio which declined by 8% due to supply issues faced in 3Q.

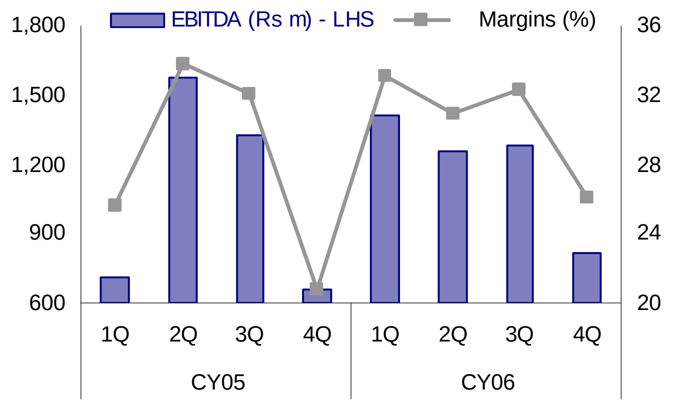
GSK PHARMA – BREAK UP OF SALES (RS M)

	4QCY06	4QCY05	GR. (%)	3QCY06	GR. (%)
Pharma	3,068	2,717	12.9	3,691	-16.9
% of Sales	*90.9*	*80.9*		*90.2*	
Other Business	305	640	-52.3	401	-23.8
% of Sales	*9.1*	*19.1*		*9.8*	
Total Sales	**3,373**	**3,357**	**0.5**	**4,092**	**-17.6**

Source: Company

EBITDA margins expanded by 520bp to 26.1% (v/s estimate of 22.6%) mainly due to higher pharmaceutical sales, savings in RM cost (down 9.4% mainly due to shift to loan-licensing arrangement) and lower staff costs (down 12.3%). Margins have also expanded due to the divestment of the animal healthcare business which enjoyed lower margins compared to the company's pharmaceutical business.

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 2006. Our estimates factor in this divestment which has also impacted the 4QCY06 top-line growth.

New launches have started contributing meaningfully to revenues

New introductions (launched in CY01 and onwards) contributed about Rs1.4b to GSK's revenues for CY06 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 proposed in CY07E include:

1. Carvedilol (CVS)
2. Arixtra (Low molecular weight heparin)
3. Tykerb (oncology – will enjoy patent protection in India)
4. A 2nd 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. The company's recent launches in the anti-diabetic category - Windia (Roziglitazone) and Windamet (Roziglitazone + Metformin) – have received good response from the market. 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 and CNS products from the parent's pipeline. 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 in the past, 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 US$1b revenue mark by 2015 compared to the current US$350m 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:

PATENTED PRODUCTS LAUNCH TIMELINE

PRODUCT	THERAPEUTIC SEGMENT	LAUNCH YEAR
Lapatinib	Cancer	2007/8
Allermist	Respiratory	2008
Alvimopan	Post-operative Ileus	2008
Pleuromutilin		2008
Rotarix	Rotavirus Vaccine	2008
Cervarix	Cervical cancer vaccine	2008
Streptorix	Pneumonia Vaccine	2009
Infanrix	Infant Vaccine	2008

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 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.

Evaluating share buyback to deploy surplus cash

GSK currently has about Rs12.5b of cash, of which Rs5b will be invested in capital gains bonds while dividend (Rs31/share) will entail cash outflow of Rs3.5b. Management is evaluating a share buyback to deploy the surplus cash and will be taking a decision on this in the near term.

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 CY07E.

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 on 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 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 is currently valued at 23.9x CY07E and 20.5x CY08E 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 July 2006 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 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 23.9x CY07E and 20.5x 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	23.9	15.9	22.5
	CY08E	20.5	14.0	19.5
P/BV (x)	CY07E	6.7	4.1	4.7
	CY08E	5.6	3.4	4.2
EV/Sales (x)	CY07E	4.9	2.5	3.1
	CY08E	4.2	2.1	2.8
EV/EBITDA (x)	CY07E	15.5	8.9	13.4
	CY08E	13.0	7.5	11.2

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	50.7	50.7	50.7
Domestic Inst	15.1	14.7	13.4
Foreign	14.4	14.0	15.1
Others	19.8	20.6	20.8

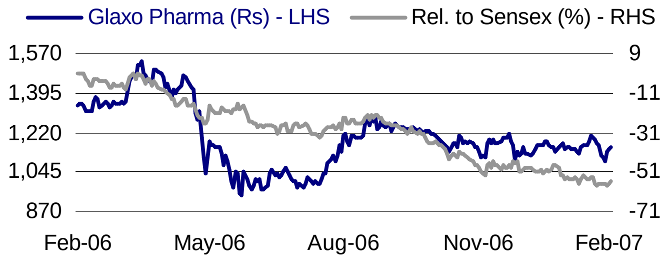
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	48.1	48.8	-1.4
CY08	56.0	-	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,150	1,392	21.0	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	14,973	16,803	18,944
Net Sales	**13,635**	**14,704**	**15,384**	**17,173**	**19,577**
Change (%)	*24.7*	*7.8*	*4.6*	*11.6*	*14.0*
Total Expenditure	9,804	10,417	10,625	11,743	13,301
EBITDA	**3,830**	**4,287**	**4,760**	**5,430**	**6,277**
Change (%)	*53.9*	*11.9*	*11.0*	*14.1*	*15.6*
Margin (%)	*28.1*	*29.2*	*30.9*	*31.6*	*32.1*
Depreciation	175	157	159	170	182
Int. and Finance Charges	25	24	0	15	0
Other Income - Rec.	552	673	958	1,026	1,200
PBT & EO Expense	**4,182**	**4,779**	**5,560**	**6,271**	**7,295**
Tax	1,522	1,716	1,942	2,195	2,553
Tax Rate (%)	*36.4*	*35.9*	*34.9*	*35.0*	*35.0*
Adj PAT	**2,661**	**3,063**	**3,617**	**4,076**	**4,742**
EO Expense (net of tax)	-670	-1,958	-1,838	0	0
Reported PAT	**3,331**	**5,021**	**5,455**	**4,076**	**4,742**
Change (%)	*46.3*	*15.1*	*18.1*	*12.7*	*16.3*
Margin (%)	*24.4*	*34.1*	*35.5*	*23.7*	*24.2*

BALANCE SHEET					(Rs Million)
Y/E DECEMBER	**2004**	**2005**	**2006E**	**2007E**	**2008E**
Equity Share Capital	873	847	847	847	847
Reserves	8,353	8,622	11,084	13,614	16,662
Capital Reserve	17	17	17	17	17
Net Worth	**9,243**	**9,486**	**11,947**	**14,478**	**17,526**
Loans	38	49	49	49	49
Capital Employed	**9,281**	**9,535**	**11,996**	**14,526**	**17,574**
Gross Block	2,526	2,531	2,731	2,931	3,131
Less: Accum. Deprn.	1,657	1,715	1,874	2,044	2,226
Net Fixed Assets	**870**	**816**	**857**	**887**	**905**
Capital WIP	45	154	40	40	40
Investments	7,768	9,131	9,931	12,355	15,277
Curr. Assets	**4,846**	**4,618**	**5,231**	**5,839**	**6,656**
Inventory	2,265	2,181	2,461	2,748	3,132
Account Receivables	761	674	846	945	1,077
Cash and Bank Balance	634	475	692	773	881
Others	1,187	1,288	1,231	1,374	1,566
Curr. Liability & Prov.	**4,697**	**5,481**	**4,308**	**4,808**	**5,482**
Account Payables	2,195	2,576	2,615	2,919	3,328
Provisions	2,502	2,906	1,692	1,889	2,153
Net Current Assets	**149**	**-863**	**923**	**1,030**	**1,175**
Deferred Tax Assets	449	298	244	213	177
Appl. of Funds	**9,281**	**9,535**	**11,996**	**14,526**	**17,574**

E: MOSt Estimates ^ - Standalone results

RATIOS					
Y/E DECEMBER	**2004**	**2005**	**2006E**	**2007E**	**2008E**
Basic (Rs)					
EPS	**30.5**	**36.2**	**42.7**	**48.1**	**56.0**
Cash EPS	32.5	38.0	44.6	50.1	58.1
BV/Share	105.8	112.0	141.0	170.9	206.9
DPS	24.0	28.0	31.0	16.0	16.0
Payout (%)	89.1	88.3	82.8	37.9	32.6
Valuation					
P/E		31.8	26.9	23.9	20.5
Cash P/E		30.2	25.8	22.9	19.8
P/BV		10.3	8.2	6.7	5.6
EV/Sales		6.0	5.6	4.9	4.2
EV/EBITDA		20.5	18.2	15.5	13.0
Dividend Yield (%)		2.4	2.7	1.4	1.4
Return Ratios (%)					
RoE	28.8	32.3	30.3	28.2	27.1
RoCE	45.3	50.4	46.3	43.3	41.5
Working Capital Ratios					
Asset Turnover (x)	15	15	13	12	11
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

CASH FLOW STATEMENT					(Rs Million)
Y/E DECEMBER	**2004**	**2005**	**2006E**	**2007E**	**2008E**
Oper. Profit/(Loss) before Ta	4,062	4,562	4,760	5,430	6,277
Interest/Dividends Recd.	353	351	958	1,026	1,200
Direct Taxes Paid	-1,403	-1,458	-1,889	-2,163	-2,517
(Inc)/Dec in WC	110	467	-1,859	1,422	-36
CF from Operations	**3,121**	**3,923**	**1,970**	**5,714**	**4,924**
EO expense	578	129	-1,838	0	0
CF from Operating incl	**2,544**	**3,793**	**3,808**	**5,714**	**4,924**
(inc)/dec in FA	969	1,955	-86	-200	-200
(Pur)/Sale of Investments	-2,642	-1,465	-801	-2,424	-2,922
CF from investments	**-1,673**	**490**	**-887**	**-2,624**	**-3,122**
Issue of Shares	0	-2,073	0	0	-149
(Inc)/Dec in Debt	10	10	0	0	0
Interest Paid	-17	-17	0	-15	0
Dividend Paid	-992	-2,361	-2,704	-2,994	-1,545
CF from Fin. Activity	**-1,000**	**-4,440**	**-2,704**	**-3,009**	**-1,694**
Inc/Dec of Cash	**-129**	**-157**	**217**	**81**	**108**
Add: Beginning Balance@	763	634	475	692	773
Closing Balance	**634**	**476**	**692**	**773**	**881**

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

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