

GlaxoSmithKline Pharmaceuticals

Milind Bhargale

+91 22 67069907

Milind.bhargale@investsmartindia.com

Shareholding (%)

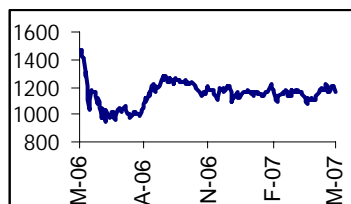
Foreign Promoters	50.7
FII's	14.0
FI's/Banks /MF	14.6
Others	20.7

Share price performance

52-week high/low (Rs)	1489/882		
	-1m	-3m	-12m
Abs (%)	5.4	0.5	-20.5
Rel* (%)	-0.7	3.1	-30.8

*to Nifty

Stock chart



Quarterly results disappoint; downgrade to 'Hold'

GlaxoSmithKline Pharmaceuticals Ltd's (GSK) Q1CY07 results were below our expectations. Net revenue for quarter was Rs4.2bn, one percent decline YoY. Due to divestment of relatively low margin animal health business, change in the product-mix and rising efficiency levels, GSK's EBITDA margin expanded by 130bps to 34.4%. Net profit increased by 10% YoY to Rs1.1bn, nudged by 22.4% increase in other income. The quarterly numbers are not pertinent, because GSK divested the animal health business in August 2006. Domestic pharma net sales have grown at about 10% YoY, which is in line with the industry growth rate, but significantly below growth achieved by other leading Indian companies in the same space.

At the CMP (Rs1,171), GSK trades at 24.1x CY07E EPS of Rs48.6 and 21.3x CY08E EPS of Rs54.9. There is limited room for upsides from the current level, given the rich valuation and 13.4% CAGR growth in earnings over CY06-08E. We downgrade the stock from 'Buy' to 'Hold' with a price target of Rs1,265 (26x CY07E and 23x CY08E).

- ▲ GSK's pharmaceutical sales grew by 5.1% YoY, which was lower than expected. We believe this could be more of a quarterly aberration and going forward we are likely to see a sustainable double digit growth rate.
- ▲ The company's operating margin improved by 130bps - from 33.1% to 34.4% - mainly due to decline in material cost and other expenses. GSK's material cost declined by 150bps - from 41.9% to 40.4% - due to change in product-mix, after hiving-off the AHC division.
- ▲ GSK is planning to launch three products - Cervarix (vaccine), Carvedilol (cardiovascular) and Tykerb (oncology) - in 2008E. New launches in CY08E are expected to slightly pressurise margins. We believe that the company will grow at a much higher rate in CY09E, as some of the product launches will have full year impact and three more products will be introduced.
- ▲ There is strong 19% YoY growth in other income to Rs171mn on account of revenue from clinical trials. This part of the business has been growing steadily over the last few quarters and we expect it to continue this steady pace of growth with Glaxo Plc emphasising on leveraging India's outsourcing advantages.

Hold

Rs1171

May 8, 2007

Market cap

Rs bn 99

US\$ mn 2,419

Avg 3m daily volume

66,955

Avg 3m daily value

USD mn 2

Shares outstanding (mn)

85

Reuters

GLAX.BO/GLAXO.NS

Bloomberg

GLXO IN

Sensex

13,675

Nifty

4,077

GlaxoSmithKline Pharmaceuticals

- ▲ GSK has registered 10% growth in its domestic pharma sales, which is lower than the growth rate achieved by other leading companies, giving an indication of the challenges of driving growth in a mature product market.
- ▲ We believe that the pace of EBITDA improvement is likely to slowdown with an escalation in inflationary pressures. Given this, we believe that further acceleration in GSK's profitability will largely depend on its ability to successfully launch patented drugs and vaccines, and to drive topline growth.
- ▲ We believe that GSK is the best placed MNC in India to leverage on the rich pipeline of vaccines / patented drugs in the new product patent regime. But there is limited room for upsides from the current level, given the rich valuation and 13.4% CAGR growth in earnings over CY06-08E. We downgrade the stock from 'Buy' to 'Hold' with a price target of Rs1,265 (26x CY07E and 23x CY08E).

Table 1. Quarterly result table

	Q1CY07	Q4CY06	QoQ (%)	Q1CY06	YoY (%)
Net Sales	4214.6	3202.7	31.6	4261.6	(1.1)
Expenditure	2764.2	2388.7	15.7	2850.5	(3.0)
EBITDA	1450.4	814.0	78.2	1411.1	2.8
Depreciation	36.5	41.1	(11.2)	37.7	(3.2)
Other Income	272.0	299.4	(9.2)	222.3	22.4
PBT	1685.9	1072.3	57.2	1595.7	5.7
Tax	572.7	390.7	46.6	561.4	2.0
PAT	1113.2	681.6	63.3	1034.3	7.6
Extraordinary Items	0.0	3.7		22.0	
Net Profit	1113.2	677.9	64.2	1012.3	10.0
Equity Capital	847.0	847.0		847.0	
EPS	13.1	8.0		12.0	
Key Ratios%					
EBITDA Margin	34.4	25.4		33.1	
Tax / PBT	34.0	36.4		35.2	
Other Income / Sales	6.5	9.3		5.2	
PAT Margin	26.4	21.3		24.3	

Source: IISL research, company

GlaxoSmithKline Pharmaceuticals

Financials

Profit & Loss

In Rs million	CY05	CY06	CY07E	CY08E
Net sales	14,853.0	15,529.2	16,680.5	18,667.6
YoY (%)	8.0	4.6	7.4	11.9
Total expenses	10,566.2	10,769.6	11,452.2	12,775.6
Inc/dec in stock	(80.5)	(132.5)	(18.4)	(225.4)
Raw material cost	6,345.1	6,370.7	6,581.5	7,365.6
Staff cost	1,554.7	1,655.8	1,796.5	2,012.1
Power and fuel cost	166.0	176.7	191.0	213.7
Other manufacturing expenses	441.3	471.1	508.4	568.9
Selling Expenses	793.4	771.7	834.0	1014.5
Other expenses	1,346.2	1,456.1	1,559.3	1,826.2
EBIDTA	4,286.9	4,759.6	5,228.2	5,891.9
YoY (%)	11.9	11.0	9.8	12.7
EBIDTA (%)	28.9	30.6	31.3	31.6
Other income	656.4	958.4	1,179.4	1,329.4
PBIDT	4,943.2	5,718.0	6,407.6	7,221.3
Interest	6.9	0.0	0.0	0.0
Gross profit	4,936.3	5,718.0	6,407.6	7,221.3
Depreciation	157.3	158.5	165.0	170.4
PBT and extra ordinary	4,779.0	5,559.5	6,242.7	7,050.9
Extra ordinary items	1,958.0	1,837.9	0.0	0.0
PBT	6,737.0	7,397.4	6,242.7	7,050.9
(-) Tax	1,716.2	1,942.3	2,122.5	2,397.3
Tax/ PBT	25.5	26.3	34.0	34.0
PAT	5,020.7	5,455.2	4,120.2	4,653.6
Adjusted net profit	3,062.8	3,617.3	4,120.2	4,653.6
YoY (%)	15.1	18.1	13.9	12.9

Key Ratios

	CY05	CY06	CY07E	CY08E
EPS (Rs)	36.2	42.7	48.6	54.9
CEPS (Rs)	63.1	66.9	51.3	57.8
Book value (Rs)	112.0	144.5	161.2	184.2
Dividend per share (Rs)	31.9	31.9	31.9	31.9
Debt-equity (x)	0.0	0.0	0.0	0.0
ROCE	43.3	37.5	37.0	36.6
ROE*	32.3	29.6	30.2	29.8
Valuations				
PE (x)	32.4	27.4	24.1	21.3
Cash PE (x)	18.6	17.5	22.8	20.3
Price/book value (x)	10.5	8.1	7.3	6.4
Dividend yield	2.7	2.7	2.7	2.7
Market cap/sales	6.7	6.4	5.9	5.3
EV/sales (x)	6.6	6.4	5.9	5.3
EV/EBDITA (x)	23.0	20.7	18.9	16.7

* Excluding extraordinary items

Balance Sheet

In Rs million	CY05	CY06	CY07E	CY08E
Equity capital	847.0	847.0	847.0	847.0
Preference capital	0.0	0.0	0.0	0.0
Reserves	8,639.0	11,389.9	12,805.7	14,755.0
Net worth	9,486.1	12,236.9	13,652.7	15,602.0
Total borrowings	48.5	48.5	48.5	48.6
Deferred tax	(297.6)	(244.3)	(181.9)	(111.4)
Total liabilities	9,237.0	12,041.1	13,519.4	15,539.2
Gross block	2,531.1	2,731.1	2,931.1	3,131.1
Less: Acc. depreciation	1,715.4	1,873.9	2,038.8	2,209.3
Net block	815.7	857.2	892.2	921.8
CWIP	153.7	100.0	100.0	100.0
Investments	9,130.6	11,709.2	13,064.9	14,692.2
Current assets	4,618.0	4,855.7	4,943.3	5,306.3
Inventories	2,181.3	2,300.9	2,330.6	2,601.2
Debtors	673.9	717.2	775.1	867.5
Cash	475.3	550.0	550.0	550.0
Loans and advances	1,287.6	1,287.6	1,287.6	1,287.6
Current liabilities	2,575.5	2,575.5	2,575.5	2,575.5
Provisions	2,905.5	2,905.5	2,905.5	2,905.5
Net current assets	(863.0)	(625.3)	(537.8)	(174.7)
Miscellaneous expenses	0.0	0.0	0.0	0.0
Total assets	9,237.0	12,041.1	13,519.4	15,539.2

Cash Flow

In Rs million	CY05	CY06	CY07E	CY08E
Net profit	5,020.7	5,455.2	4,120.2	4,653.6
Depn and w/o	157.3	158.5	165.0	170.4
Deferred tax	163.5	53.3	62.4	70.5
Change in working cap	853.8	(163.0)	(87.6)	(363.0)
Other income	(656.4)	(958.4)	(1,179.4)	(1,329.4)
Operating cash flow	5,539.0	4,545.6	3,080.6	3,202.1
Other income	656.4	958.4	1,179.4	1,329.4
Capex	(211.9)	(146.3)	(200.0)	(200.0)
Investments	(1,362.3)	(2,578.7)	(1,355.7)	(1,627.3)
Investing cash flow	(917.9)	(1,766.5)	(376.3)	(497.9)
Dividend	(2,704.3)	(2,704.3)	(2,704.3)	(2,704.3)
Fresh equity	(2,046.8)	0.0	0.0	0.0
Debt	10.1	(0.0)	0.0	0.0
Financing cash flow	(4,741.0)	(2,704.3)	(2,704.3)	(2,704.3)
Others	(38.7)	0.0	0.0	0.0
Net change in cash	(158.6)	74.7	0.0	(0.0)
Opening cash	633.8	475.3	550.0	550.0
Closing cash	475.3	550.0	550.0	550.0

Disclaimer Clause

This report has been prepared by the Research Department of IL&FS Investsmart Securities Limited (IISL). The information and opinions contained herein have been compiled or arrived at based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This report has been produced independently of the company, and forward looking statements, opinions and expectations contained herein are entirely those of IISL and given as part of its normal research activity and not as a Manager or Underwriter or any Offering or as an agent of the Company or any other person. Accordingly, if the Company should at any time commence an Offering of securities, any decision to invest in any such Offer or invitation to subscribe for or acquire securities of the Company must be based wholly on the information contained in the Final Prospectus issued or to be issued by the Company in connection with any such Offer or invitation and not on the contents hereof. This document is for information purpose only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. IISL, its directors, analysts or employees do not take any responsibility financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of the shares and bonds, changes in the currency rates, diminution in the NAVs reduction in the dividend or income, etc

IISL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject IISL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently send or has reached any individual in such country, especially, USA the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purpose without prior written approval of IISL.

Foreign currency denominated securities, if any, wherever mentioned are subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.