

Company

26 July 2010 | 8 pages

Glaxosmithkline Pharmaceutical (GLAX.BO)

 Equity
 Target price change

Sell: 2Q Subdued on Vaccine Supply Issues, Lower Other Income

- Aberration** — We believe GSK Pharma's subdued net income growth in 2Q is a one-off, driven by temporary supply constraints and timing effects on other income. The business appears on solid ground and 1H results (sales up 13%; recurring net income up 17%) is a fairer representation of sustainable growth rates. We however continue to find valuations stretched & maintain our Sell (3L) rating, even as we raise our TP to Rs1,880 as we roll forward to 25xSept 11E EPS.
- Subdued 2Q** — Sales (+9% YoY) and recurring PAT (+6% YoY) were below expectations. Sales growth was affected by temporary supply constraints in vaccines (situation is getting back to normal now) and subdued exports. Indian pharma sales grew 12% YoY. Despite margin expansion (+137bps YoY), growth in recurring PAT was subdued due to lower income on idle funds (-46% YoY).
- Other Income Dip - Timing Effect?** — GSK's other income has been quite erratic across quarters of late, leading us to believe that the dip is a timing issue. The entire Rs180m other income in CY09 was booked in 2QCY09. In CY10, GSK booked a similar amount in 1Q, while it is back to nil in 2Q. We thus believe that 1H (rec. PAT +17%) is a better reflection of sustainable growth rates.
- Remains Expensive** — While we are positive on GSK's long-term prospects in India, the stock appears expensive at 27xCY11E EPS. Despite a pick-up in revenue growth over the last two quarters and growing visibility on differentiated (patented / inlicensed / vaccines) launches, we believe most positives are priced in at current levels. Maintain Sell.

Sell/Low Risk	3L
Price (26 Jul 10)	Rs2,083.25
Target price	Rs1,880.00
	<i>from Rs1,820.00</i>
Expected share price return	-9.8%
Expected dividend yield	1.6%
Expected total return	-8.1%
Market Cap	Rs176,458M
	US\$3,761M

Price Performance (RIC: GLAX.BO, BB: GLXO IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	4,484	52.93	13.0	39.4	11.5	30.9	1.9
2009A	5,049	59.61	12.6	34.9	10.0	30.6	1.4
2010E	5,756	67.96	14.0	30.7	8.8	30.6	1.6
2011E	6,558	77.42	13.9	26.9	7.7	30.6	1.9
2012E	7,416	87.56	13.1	23.8	6.8	30.4	2.1

Source: Powered by dataCentral

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	39.4	34.9	30.7	26.9	23.8
EV/EBITDA adjusted (x)	26.9	23.5	20.2	17.4	15.0
P/BV (x)	11.5	10.0	8.8	7.7	6.8
Dividend yield (%)	1.9	1.4	1.6	1.9	2.1
Per Share Data (Rs)					
EPS adjusted	52.93	59.61	67.96	77.42	87.56
EPS reported	68.07	60.48	67.96	77.42	87.56
BVPS	181.94	207.68	236.57	269.47	306.68
DPS	40.00	30.00	33.98	38.71	43.78
Profit & Loss (RsM)					
Net sales	17,144	19,366	22,107	24,997	28,242
Operating expenses	-11,325	-12,780	-14,468	-16,224	-18,229
EBIT	5,820	6,586	7,640	8,773	10,013
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	979	999	1,082	1,163	1,224
Pre-tax profit	6,799	7,585	8,722	9,936	11,237
Tax	-2,315	-2,536	-2,965	-3,378	-3,821
Extraord./Min.Int./Pref.div.	1,282	74	0	0	0
Reported net income	5,766	5,123	5,756	6,558	7,416
Adjusted earnings	4,484	5,049	5,756	6,558	7,416
Adjusted EBITDA	5,983	6,749	7,803	8,937	10,177
Growth Rates (%)					
Sales	4.6	13.0	14.2	13.1	13.0
EBIT adjusted	8.2	13.2	16.0	14.8	14.1
EBITDA adjusted	8.0	12.8	15.6	14.5	13.9
EPS adjusted	13.0	12.6	14.0	13.9	13.1
Cash Flow (RsM)					
Operating cash flow	4,614	4,495	3,522	5,728	6,523
Depreciation/amortization	163	164	164	164	164
Net working capital	-333	222	-1,316	169	166
Investing cash flow	6,889	5,545	-16,691	-3,600	-3,400
Capital expenditure	-236	-298	-600	-600	-400
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-3,550	-3,914	-3,310	-3,771	-4,264
Borrowings	-1	-2	0	0	0
Dividends paid	-3,549	-3,912	-3,310	-3,771	-4,264
Change in cash	7,952	6,126	-16,479	-1,643	-1,142
Balance Sheet (RsM)					
Total assets	22,728	24,642	26,941	30,573	34,649
Cash & cash equivalent	16,584	18,635	19,329	21,850	24,932
Accounts receivable	579	537	701	793	896
Net fixed assets	1,004	1,142	1,578	2,014	2,251
Total liabilities	7,318	7,050	6,904	7,748	8,672
Accounts payable	2,716	3,167	3,140	3,523	3,954
Total Debt	56	54	54	54	54
Shareholders' funds	15,411	17,591	20,038	22,825	25,977
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	34.9	34.9	35.3	35.8	36.0
ROE adjusted	30.9	30.6	30.6	30.6	30.4
ROIC adjusted	na	na	na	nm	nm
Net debt to equity	-107.2	-105.6	-96.2	-95.5	-95.8
Total debt to capital	0.4	0.3	0.3	0.2	0.2

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2QCY10 Results Snapshot

Figure 1. GSK Pharma – 2QCY10 Earnings Summary (Rs m, %)

YE Dec 31	2QCY09	2QCY10	% Ch YoY	1QCY09	% Ch QoQ	CIRA Comments
Gross Sales	4,672	5,086	8.9	5,521	-7.9	Conclusion: Supply issues in vaccines & lower other income led to a subdued 2Q. 1H likely provides a better representation of sustainable growth rates – Sales & recurring net income up 13% & 17% respectively YoY
Excise Duty	(105)	(105)	0.4	(110)	-4.8	
Excise rate (%)	2.2	2.1	-17 bps	2.0	7 bps	
Net Sales	4,568	4,981	9.1	5,411	-7.9	
Other Operating Income	45	96	111.0	54	76.1	
Total Operating Income	4,613	5,077	10.1	5,465	-7.1	
Material Cost	1,692	1,741	2.9	2,035	-14.4	Pharma sales grew 12% YoY despite supply constraints on the vaccines biz. Overall growth was lower at 9% due to subdued exports
% of Sales	37.1	35.0	-209 bps	37.6	-265 bps	
Staff Cost	529	634	19.8	553	14.5	EBIDTA margins improved 137bps, despite higher staff cost, on improving product mix
% of Sales	11.6	12.7	114 bps	10.2	250 bps	
Other Expenses	842	912	8.4	908	0.5	Field force expansion drives higher staff cost
% of Sales	18.4	18.3	-11 bps	16.8	154 bps	
Recovery of expenses	(124)	(123)	-1.4	(86)	42.5	
Total expenses	2,939	3,165	7.7	3,410	-7.2	
EBITDA	1,674	1,913	14.2	2,056	-7.0	
EBITDA Margin (%)	36.3	37.7	137 bps	37.6	6 bps	
Interest Income	194	202	4.3	203	-0.6	Other income is back to nil in 2Q after coming in at Rs180m in 1QCY10 & Rs180m in 2QCY09. We believe this is a timing issue – even in CY10, total other income for the year was Rs180m, which was booked entirely in 2Q.
Depreciation	(40)	(41)	2.3	(38)	7.7	
Other income	180	0	-100.0	180	-100.0	
PBT	2,009	2,074	3.3	2,402	-13.6	
Tax	(692)	(678)	-2.0	(790)	-14.1	
Tax rate (%)	34.5	32.7	-176 bps	32.9	-19 bps	
PAT Before Extraordinaries	1,317	1,396	6.0	1,612	-13.4	
Extraordinary Items	(73)	(106)	45	0	n.a.	
PAT after extra ordinaries	1,244	1,290	3.7	1,612	-20.0	

Source: Company Reports and CIRA Estimates

Glaxosmithkline Pharmaceutical

Company description

SKB Pharmaceutical (India) was merged with Glaxo India in 2001 to become Glaxosmithkline Pharmaceutical following the merger of their parents in 2000. Post-merger, GSK Pharmaceutical is the largest pharmaceutical company in India. The company sells branded formulations in almost all product categories, mainly anti-infective, pain management and vitamins. The company has successfully carried out a restructuring exercise and has evolved a strategy to grow profits ahead of sales and remains among the market leaders.

Investment strategy

We rate GSK Pharma as Sell/Low Risk (3L). While we rate GSK as a good play on the stronger IPR regime in India, we expect any upside to be gradual over a number of years. In the interim, with an EPS CAGR of 14% (CY09-12E) and no near-term catalysts, we see limited upside over the next 12-18 months. Thus, while the stock could remain defensive with limited downside, it lacks near-term upside. GSK expects only seven patented/vaccine launches (including Tykerb) over CY08-10. With none of these likely to clock sales in excess of Rs400m by the third year, we expect a lag before any material step up in growth rate and profitability. Risks exist in the form of patent challenges, compulsory licensing, and possible government intervention in pricing.

Valuation

Our target price of Rs1,880 for GSK Pharma is based on 25x Sept 2011E earnings. Given its steady earnings growth, we believe P/E is best suited to value GSK Pharma. GSK has traded at 15-60x in the past 7-8 years, with a median of c.23x over the last five years. Over the past year, GSK has launched its first patented product and announced plans to launch few more over the next two years. While we expect greater clarity on the implementation of the IPR regime over the next few years, we believe that the upside on this front for most companies is likely to be limited in the near- to medium-term. As such, we believe that 25x is a suitable fair-value multiple.

Risks

We rate GSK Pharma as Low Risk in view of the company's profitable and growing business base in India. This is consistent with our quantitative risk-rating system. Key upside risks that could impede the stock from achieving our target price include: a) Faster than expected patented product launches - we expect five launches over the next two years; b) Pick up in the Indian market growth rate given GSK operates entirely in this market and is among the Top 3 companies in the segment; and c) Any accretive acquisitions, given the sizeable cash balance (c.US\$300m+) on its books.

Appendix A-1

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Glaxosmithkline Pharmaceutical (GLAX.BO)

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Analyst: Prashant Nair, CFA

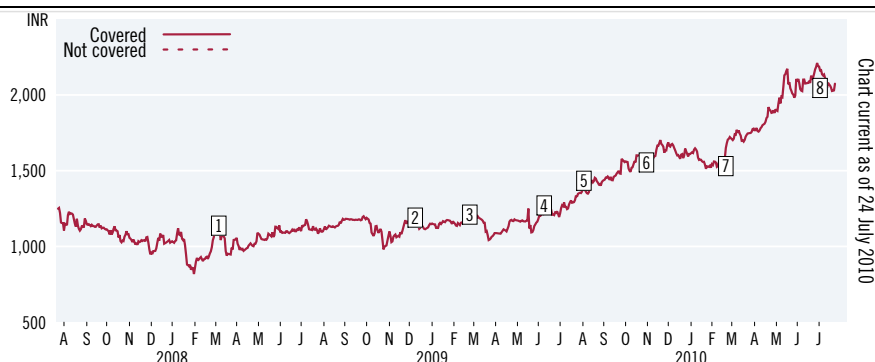


Chart current as of 24 July 2010

	Date	Rating	Target Price	Closing Price
1	6-Mar-08	3L	*1,100.00	1,124.00
2	9-Dec-08	*1L	*1,300.00	1,149.75
3	24-Feb-09	1L	*1,336.00	1,181.25

	Date	Rating	Target Price	Closing Price
4	9-Jun-09	1L	*1,372.00	1,248.85
5	4-Aug-09	*3L	*1,360.00	1,387.15
6	30-Oct-09	3L	*1,400.00	1,578.30

	Date	Rating	Target Price	Closing Price
7	19-Feb-10	3L	*1,550.00	1,649.65
8	2-Jul-10	3L	*1,820.00	2,162.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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