

## India Update

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### Highlights

Sector/event	Impact
<b>FMCG:</b> <b>GlaxoSmithKline Consumer – Key Takeaways</b>	The key takeaways from our call with the management of GSK Consumer (GSKCH) are: i) robust sales growth expected in Q1CY07 despite a higher base ii) CY07 sales growth to be ahead of the 11.5% YoY growth in CY06 and iii) Q1CY07 profit margins to be subdued though GSKCH is confident of sustaining profit margins for the full year (CY07) despite inflationary pressures. We maintain BUY on the stock as at a trailing CY06 P/E of 16.5x and EV/E of 8.6x, the stock trades at one of the lowest valuation multiples in the i-SEC universe.

### News Snippets

#### Sectoral

- Rail freight increase of 6% as busy season surcharge is expected to squeeze the margins of cement companies. (The Economic Times)

#### Corporate

- Satyam has won a US\$200mn contract from the semiconductor manufacturer, Applied Materials, to be executed over the next five years. (The Economic Times)
- Tata Tea is planning to tie-up with some global retail chains to roll out a coffee chain to cash in on the drinking specialty tea and beverages segment. (The Economic Times)
- Schering Corporation and MSP Singapore Company have filed a patent challenge in the US against Glenmark Pharmaceuticals' cholesterol drug, Ezetimibe. (Business Line)
- Aban Offshore has bought the residual 1.99% stake in Sinvest ASA and would be delisting the stock from the Oslo stock exchange with effect from March 30. (Business Standard)
- ACC is investing Rs40bn for capacity expansion. (Business Line)
- Birlas are contemplating increasing their stake in Hindalco. At present, they own 37% stake in the company. (The Economic Times)

**Market data as on Mar 28, 2007**

INDICES		
		% chg (DoD)
BSE Sensex	12884	(1.83)
S&P CNX Nifty	3761	(4.59)
BSE 100	6495	(1.79)
BSE 200	1535	(1.74)
Instanex Skindia DR	2243	(1.74)
Mindex	5469	(3.27)

OVERSEAS MARKETS		
		% chg (DoD)
Dow Jones	12300	(0.78)
Nasdaq Comp.	2417	(0.83)
S&P 500	1417	(0.80)
Hang Seng	19554	(0.78)
Nikkei	17255	(0.64)

ADVANCES/DECLINES (BSE)			
Group	A	B1	B2
Advances	38	128	240
Declines	167	574	623
Unchanged	2	10	27

FII TURNOVER (BSE+NSE)* (Rs mn)			
Bought	Sold	Net	
21,847	21,042	805	

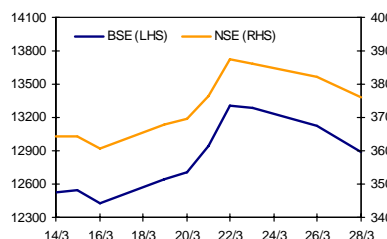
NEW HIGHS AND LOWS (BSE)			
Group	A	B1	B2
Highs	-	3	9
Lows	2	54	36

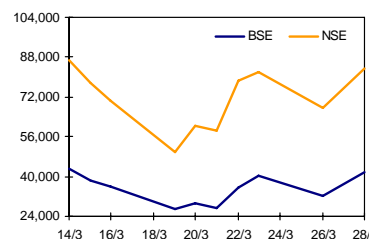
CURRENCY	
US\$1 =	Rs43.05

\* FII turnover (BSE + NSE) as on March 26, 2007

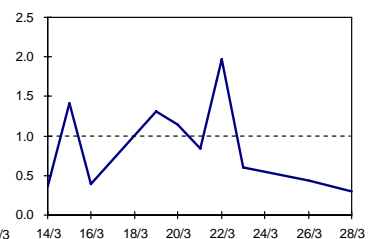
Market movement over last fortnight



Volumes in Rs mn (BSE and NSE)



Advances & Declines ratio (BSE)



## GlaxoSmithKline Consumer (Buy)

FMCG

## KEY TAKEAWAYS

## Sales growth to accelerate

Rs515

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The key takeaways from our call with the management of GSK Consumer (GSKCH) are: i) robust sales growth expected in Q1CY07 despite a higher base ii) CY07 sales growth to be ahead of the 11.5% YoY growth in CY06 and iii) Q1CY07 profit margins to be subdued though GSKCH is confident of sustaining profit margins for the full year (CY07) despite inflationary pressures. We maintain BUY on the stock as at a trailing CY06 P/E of 16.5x and EV/E of 8.6x, the stock trades at one of the lowest valuation multiples in the i-SEC universe.

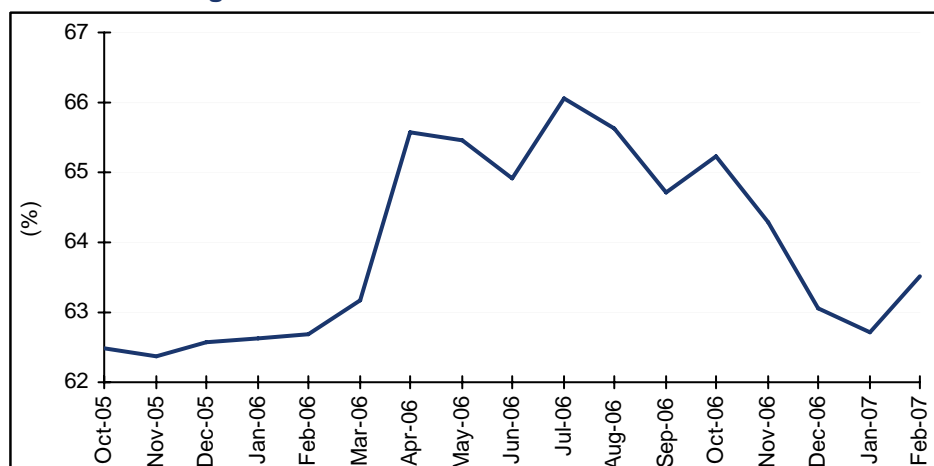
Table 1: Valuation summary

		Y/E	EPS	P/E	EV/E		
		Dec	(Rs)	(x)	(x)		
Price (28/3/07) (Rs)	515	2004	16.8	30.7	12.7	BSE Sensex	12884
52 Week Range	710/403	2005	25.7	20.0	10.2	Market Cap. (Rs bn)	21.7
Dividend CY07E (Rs/sh.)	12.0	2006	31.3	16.5	8.6	Market Cap. (US\$ mn)	489.4
Dividend yield (%)	2.3	2007E	39.0	13.2	6.8	Shares Out. (mn)	42.1
Face value (Rs)	10	2008E	46.1	11.2	5.5	Free float (%)	57.0

Source: Company data, i-SEC Research

**Robust sales growth but margin pressure likely in Q1CY07.** After a sharp deceleration in sales growth in Q4CY06, we expect GSKCH's sales growth to be back on track in Q1CY07 despite a high base (when net sales grew 24% YoY). This would be mainly due to aggressive promotions, re-launch of *Horlicks Lite* and restocking in Tamil Nadu post the VAT implementation. The company re-launched *Horlicks Lite* in February '07 at a higher price point and changed the brand's positioning to a sugar-free, cholesterol-free drink for the middle-aged from a drink for diabetics, thereby increasing the target segment. According to AC Nielsen, GSKCH's market share in beverages improved 83bps YoY to 63.5% in February '07. Further, while we expect sales growth to be robust in Q1CY07, margins would likely decline during the quarter due to a significant upsurge in commodity prices, especially milk powder and barley.

Chart 1: Beverages' market share witness YoY increase



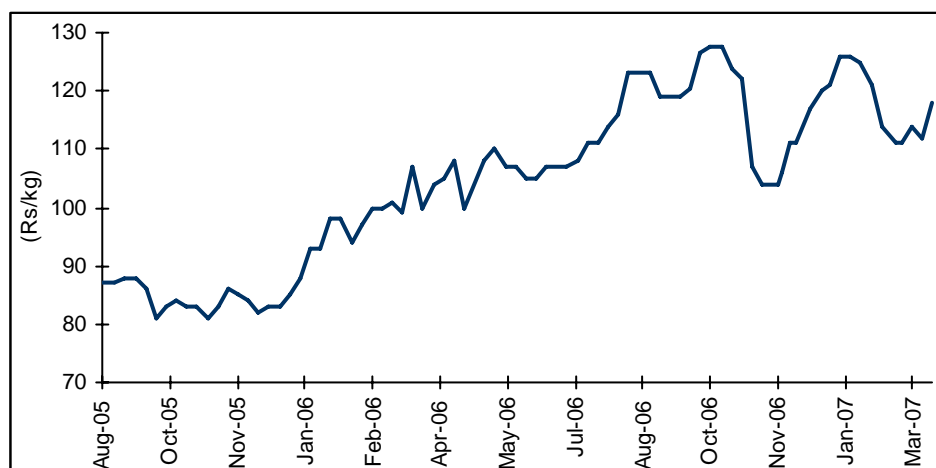
Source: ACNielsen

**Margins to improve Q2CY07 onwards.** Given the impressive beginning made by GSKCH this year, the company expects its CY07 gross sales growth to be ahead of the 11.5% YoY growth registered in CY06. After an expected decline in profit margins in Q1CY07, the company's margins would likely improve from Q2CY07 on account of the following factors:

- GSKCH is contemplating a hike in product prices from Q2CY07 to counter inflationary pressure.
- The decline in VAT on beverages in Kerala (which constitutes 8-8.5% of the company's sales) from 20% to 12.5%, effective April 1, '07, would lead to significant VAT savings, resulting in ~65bps increase in overall margins.
- GSKCH is contemplating a withdrawal of the 5% extra volumes on offer in Tamil Nadu as freebies (after the VAT implementation from January '07). This would result in significant cost reduction as Tamil Nadu contributes more than 20% to the company's sales.
- GSKCH intends to increase the share of production from excise-exempt locations.

On account of the above factors, a price hike of less than 5% would be able to offset the increase in input prices. Post the ban on milk powder exports (imposed on February 1, '07), the input price-related inflationary concern has reduced to some extent and the cost inflation would likely be ~15%. Notwithstanding this inflation, GSKCH is confident of maintaining its PBT-to-sales ratio as it enjoys strong pricing power. Further, a price hike of ~5% is unlikely to have any significant affect on volume growth.

**Chart 2: Milk powder prices stabilise after the ban on milk exports**



Source: Commodities India

**Foray in a new category expected by year end.** GSKCH has identified new categories (for expansion) as its long-term growth driver and would likely enter at least one new category by end-CY07. Besides, the company is actively scouting for acquisition targets to grow inorganically.

**Attractive valuations.** In light of the steep increase in input prices, GSKCH would not be able to significantly improve its margins. Consequently, there would be a small downside to our earnings estimates. Despite this, we maintain BUY on the stock as at a trailing CY06 P/E of 16.5x and EV/E of 8.6x, the stock trades at one of the lowest valuation multiples in the i-SEC universe. The continued robust performance with double-digit topline and bottomline growth as well as strong free cash flow generation leaves significant scope for re-rating of the stock.

## Comment

### PHARMA – Glenmark Pharmaceuticals (Buy)

*Company release:* Glenmark has filed para IV ANDA for generic US\$1.5bn drug *Zetia* (Ezetimibe).

*Impact:* Minor positive for Glenmark. The company had filed para IV ANDA for generic *Zetia* 10mg tablets on October 25, '06. As a normal practice, the innovator company, Schering Corporation filed a suit against Glenmark in the US District Court in New Jersey on March 22, '07.

Glenmark's management believes that it is the first and currently the only company to have filed an ANDA for the product, implying that if it wins the litigation, it would enjoy a 180-day exclusivity in the US generic market. Note that the product has three patents in the Orange Book of the US FDA, which are expiring in '13-22. Given the limited information and that the litigation would likely take 2-3 years to be resolved, we are not estimating the potential upside at the moment. However, this is a strategic move as it is the first time when it has filed an ANDA, which can win it potential 180-day exclusivity. Note that Glenmark's strategy for the US generics business has been impressive with expected US\$43mn sales in FY07E compared with less than US\$1mn in FY05. At present, the company has a strong pipeline of 38 ANDAs (including that of partners) awaiting approval from the US FDA. The company's FY08 guidance for the US generics business is US\$75mn.

With both drug discovery and generics engines scaling up fast, Glenmark offers the best twin play from India. Besides, the company could bag two new licensing deals for NCEs by end-FY08. We reiterate Glenmark as one of our top large-cap BUYs in the sector. The stock is currently trading at FY08E P/E of 17x on a consolidated basis.

## Recent reports/updates

Analyst	Company/Sector	Date
Rajesh Vora	Cadila Healthcare: Run to form	Mar 26
Amar Kedia	Balmer Lawrie: Stirring up	Mar 23
Anand Shah	Nestle: On an accelerated growth path	Mar 22
S. Ramesh	Netback margin monthly: Refining, the lone star shining	Mar 19
Rajesh Vora	Sun Pharma: The Sun SPARCles	Mar 16
Vikash Mantri	Jagran Prakashan (Unrated): Augmenting clout	Mar 15
Shilpa Gupta	Speedometer (Mar '07) – Balanced manoeuvre	Mar 14
Eq. Research Team	Union Budget Review 2007-08	Mar 1
S. Ramesh	Gujarat Gas Company: Higher gas costs hit margins	Feb 26
S. Ramesh	Netback margin monthly: Refining sweetens the pot	Feb 21
S. Ramesh	Oil&Gas sector update: Halcyon days ahead	Feb 15
Rajesh Vora	Dr. Reddy's Lab: Bolstering the base	Feb 9
Amar Kedia	Aviation Sector: Clear horizons	Feb 9
Anand Shah	Godrej Consumer: Outshining the rank	Feb 6
Poonam Nishal	Bharti Airtel: Ringing in success	Feb 5
Vinay Patel	Monetary policy review: Yet another surprise	Feb 1
Shekhar Singh	Mphasis: In the fray	Feb 1
S. Ramesh	Netback margin monthly: Exploding margins	Jan 24
Shekhar Singh	Satyam Computer: Tangy Flavor	Jan 19
S. Ramesh	Reliance Industries: Refined surprise	Jan 19
Shekhar Singh	Infotech Enterprises: Minor roadblock	Jan 17
Shekhar Singh	Wipro: Getting back on track	Jan 17
Vinay Patel	Market Strategy: Still packs a punch	Jan 16
Shekhar Singh	HCLT: Upbeat Mood	Jan 16
Shekhar Singh	TCS: Robust Performance	Jan 16

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