

GlaxoSmithKline Pharmaceuticals

BSE SENSEX	S&P CNX	CMP: INR2,088	TP: INR2,272	Buy						
18,429	5,607									
Bloomberg Equity Shares (m)	GLXO IN 84.7									
52-Week Range (INR)	2,475/1,830									
1,6,12 Rel. Perf. (%)	-4/-11/-5									
M.Cap. (INR b)	176.9									
M.Cap. (USD b)	3.6									
Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/Sales	EV/EBITDA
12/09A	18,708	5,049	59.6	12.6	-	-	28.7	43.0	-	-
12/10A	21,116	5,814	68.6	15.2	-	-	30.1	44.8	-	-
12/11A	23,380	6,314	74.5	8.6	28.0	9.2	32.9	47.9	6.6	20.9
12/12E	26,742	7,402	87.4	17.2	23.9	8.5	35.7	52.9	5.8	17.0

- GlaxoSmithKline Pharmaceuticals (GLXO) posted net sales of INR5.66b (v/s our estimate of INR5.43b) for 4QCY12, up 15.4% YoY. EBITDA grew 15.8% YoY to INR1.71b (v/s our estimate of INR1.62b) while adjusted PAT increased 20.5% YoY to INR1.47b (v/s our estimate of INR1.3b).
- While overall revenue growth was 15.4% YoY, revenue from the core pharmaceuticals business grew by an impressive 18.2% YoY. Topline growth was led by revival in the Mass Market business and Anti-infectives segments. Vaccines and Specialty segments including Oncology, Dermatology, Cardiovascular and Metabolics reported robust double-digit growth, driven by new product launches.
- EBITDA grew 15.8% YoY to INR1.71b; EBITDA margin remained flat YoY at 30.1% (v/s our estimate of 29.8%). EBITDA was higher than estimated, primarily led by better than estimated topline growth.
- Adjusted PAT increased by 20.5% YoY to INR1.47b (v/s our estimate of INR1.3b), led by higher than estimated other income and lower effective tax rate. GLXO has declared INR45/share as dividend.

We believe GLXO is one of the best plays on the IPR regime in India, with aggressive plans to launch new products in the high-growth lifestyle segments. These launches should bring in long-term benefits. While we expect double-digit topline growth to sustain over the next few years, the growth trajectory should improve further post CY13, as new launches start contributing meaningfully. This growth is likely to be funded through miniscule capex and negative net working capital. GLXO deserves premium valuations due to strong parentage (giving access to large product pipeline), brand-building ability and likely positioning in the post-patent era. It is one of the very few companies, with the ability to achieve reasonable growth without any major capital requirement, leading to high RoCE of over 45%. We expect GLXO to record an EPS of INR87.4 (up 17.2%) in CY12. The stock currently trades at 23.9x CY12E EPS. Maintain **Buy**, with a target price of INR2,272 (26x CY12E EPS).

Y/E December	(INR Million)								CY10	CY11
	CY10				CY11					
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	5,411	4,979	5,820	4,906	6,029	5,615	6,076	5,660	21,116	23,380
YoY Change (%)	18.4	8.9	13.7	10.4	11.4	12.8	4.4	15.4	12.9	10.7
Total Expenditure	3,410	3,163	3,733	3,433	3,920	3,746	4,316	3,954	13,739	15,935
EBITDA	2,001	1,817	2,087	1,473	2,109	1,870	1,760	1,706	7,378	7,445
Margins (%)	37.0	36.5	35.9	30.0	35.0	33.3	29.0	30.1	34.9	31.8
Depreciation	38	41	41	57	44	49	49	62	176	204
Interest	0	0	0	6	0	0	0	0	6	0
Other Income	438	298	328	413	580	421	441	532	1,477	1,975
PBT before EO Expense	2,402	2,074	2,374	1,823	2,645	2,242	2,152	2,177	8,673	9,216
Tax	790	678	792	600	782	725	692	703	2,859	2,902
Rate (%)	32.9	32.7	33.3	32.9	29.6	32.3	32.2	32.3	33.0	31.5
Adjusted PAT	1,612	1,396	1,583	1,223	1,863	1,517	1,460	1,474	5,814	6,314
YoY Change (%)	3.7	-19.6	-3.7	-7.4	15.6	8.6	-7.7	20.5	15.2	8.6
Margins (%)	29.8	28.0	27.2	24.9	30.9	27.0	24.0	26.0	27.5	27.0
Extra-Ord Expense	0	106	4	66	1,859	41	1	106	177	2,008
Reported PAT	1,612	1,290	1,578	1,157	5	1,475	1,459	1,367	5,637	4,306

E: MOSL Estimates

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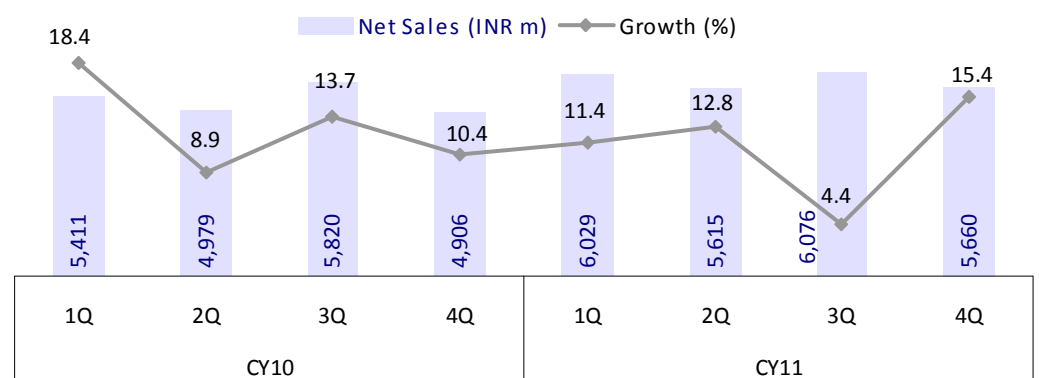
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Topline growth driven by revival in Mass Market and Anti-infectives segment

Net sales grew by 15.4% YoY to INR5.66b (v/s est of INR5.43b), EBITDA grew by 15.8% YoY to INR1.71b (v/s est of INR1.62b) while Adj PAT increased by 20.5% YoY to INR1.47b (v/s est INR1.3b).

While the overall revenue growth was at 15.4% YoY, revenue from core pharmaceutical business grew by impressive 18.2% YoY. Topline growth was led by revival in the Mass Market business and Anti-infectives segments. Vaccines and Specialty segment including Oncology, Dermatology, Cardiovascular and Metabolics reported robust double digit growth on the back of new product launches.

Revenue trend

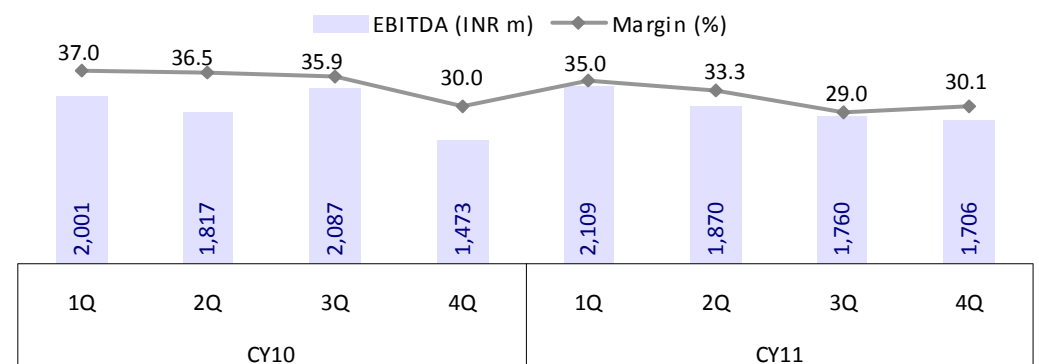


Source: Company/MOSL

EBITDA increased by 15.8%, above estimates

EBITDA increased by 15.8% YoY to INR1.71b while EBITDA margin remained flat YoY at 30.1% (v/s est 29.8%). EBITDA was above estimates primarily led by better than estimated topline growth. Adj PAT increased by 20.5% YoY to INR1.47b (v/s est INR1.3b) led by higher than estimated other income and lower effective tax rate. The company has declared INR45/share as dividend.

EBITDA and margin trend



Source: Company/MOSL

Topline to grow in double digits; EBITDA margins to sustain at 33-35%

We expect GSK to sustain double-digit topline growth over the next two years led by focus on Priority Products, expanding therapeutic and geographic coverage, and

incremental contribution from new launches. We believe the company will be able to sustain EBITDA margin at ~35% despite the gradual increase in field force strength (200-300 per year). Planned investments in field force expansion for the year continued during the quarter. GSK's strong brand-equity with doctors enables it to sustain premium pricing for many of its brands resulting in high profitability. The main products launched in the last few quarters include Synflorix (vaccine against invasive pneumococcal disease), Mycamine (injectable anti-fungal, in-licensed from Astellas), Parit-D (in the GI segment – in-licensed from Esai), Modvate 3 & Modvate AF creams (both in the dermatology segments), branded generics for Atorvastatin and Rosuvastatin (both in the CVS segment), Revolcade and Votirent from GSK's pipeline in Oncology and Haematology, one in dermatology and one in branded generic segment.

Aggressive new launches

GSK is strongly committed to Indian operations, which is evident from the fact that many new products have been launched in CY08-10 period. This includes four vaccines including the latest Cervarix (cervical cancer vaccine for women) and Tykerb (anti-cancer). We believe that Cervarix, Rotarix (Rotavirus vaccine) and Eltrombopag (platelet aggregator) hold good long-term potential. It has attained the leadership position in the cervical cancer vaccine market despite launching Cervarix post Merck's launch of Gardasil. GSK has recently dropped prices of this vaccine (not quantified). In line with its strategy, GSK is gradually ramping up its presence in the high-growth lifestyle segments through a combination of launching product's from the parent's pipeline, in-licensing from other MNCs and launch of branded generics. Despite having a negligible contribution from the life-style segments, GSK currently enjoys one of the highest profitability in the industry (EBITDA margins of 35%).

Draft New Pharma Pricing Policy, if implemented in its current form, likely to impact earnings

The government has released the draft of the National Pharmaceuticals Pricing Policy, 2011 (NPPP). The proposed policy significantly increased the span of price control. All the 348 drugs, which are currently a part of the National List of Essential Medicines (NLEM) will be subjected to price control. Currently, only 74 drugs are under price control. Price control will be implemented on formulations of these drugs as compared to the current practice of controlling bulk drug price. Further, price control will also apply to combination drugs and to all the dosage strengths of the drugs.

If the policy is implemented in its current form, as per AIOCD analysis, GLXO's sales will impacted by INR1.51b (6% of revenue). This translates into 13.5% impact on earnings.

Upgrading earnings estimates by 3%

Based on 4QCY11 result and guidance given by the management, we have increased revenue estimates for CY12 by 1%. Consequently, we have increased earnings estimates for CY12 by 2.8%. Our estimates do not take into account the impact of NPPP.

Valuation and view

We believe GSK is one of the best plays on IPR regime in India with aggressive plans to launch new products in the high-growth life-style segments. These launches are expected to bring in long-term benefits. We believe GSK is likely to sustain double-digit topline growth over the next few years. We believe that this growth trajectory will improve further post CY13, as new launches start contributing meaningfully to topline. Given the high profitability of operations, we expect this growth to lead to sustainable double-digit earnings growth and RoE of ~30%. This growth is likely to be funded through miniscule capex and negative net working capital.

GSK deserves premium valuations due to strong parentage (giving access to large product pipeline), brand-building ability and likely positioning in post patent era. It is one of the very few companies with ability to drive reasonable growth without any major capital requirement leading to high RoCE of over 45%. Based on our revised estimates, we expect GSK to record CY12E EPS of INR87.4 (up 17.2%). The stock is currently valued at 23.9x CY12E. Maintain **Buy** with a target price of INR2,272 (26x CY12E).

GlaxoSmithKline Pharmaceuticals: an investment profile

Company description

GSK Pharma (50% subsidiary of GSK Plc) is the 4th largest formulations company and second largest pharma MNC in India, with a strong presence in segments like dermatology, respiratory and vaccines. 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.
- GSK is strongly committed to its Indian operations, which is evident from the fact that 9 patented (or low-competition) products have launched in the CY08-10 period.

Key investment risks

- Biggest risk to GSK Pharma 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 Pharma’s business.

- Possible pre-grant and post-grant patent challenges by domestic generic companies could hamper the plans and prospects of launch of patented product by GSK Pharma in India.

Recent developments

- Launch of Votrient, indicated for the treatment of advanced renal cell carcinoma and Revolade for the treatment of reduced platelet count.

Valuation and view

- We believe GSK is one of the best plays on IPR regime in India. Parent is fully committed to the listed entity, which is evident from the fact that it is proposing to launch most of the patented products through the listed entity
- The stock is currently valued at 23.9x CY12E earnings. We maintain **Buy**.

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 Pharma	Aventis
P/E (x)	CY11A	28.0	28.4
	CY12E	23.9	26.1
P/BV (x)	CY11A	9.2	4.7
	CY12E	8.5	4.2
EV/Sales (x)	CY11A	6.6	4.1
	CY12E	5.8	3.2
EV/EBITDA (x)	CY11A	20.9	29.9
	CY12E	17.0	21.7

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	50.7	50.7	50.7
Domestic Inst	15.6	15.5	16.2
Foreign	17.3	17.4	16.3
Others	16.4	16.5	16.9

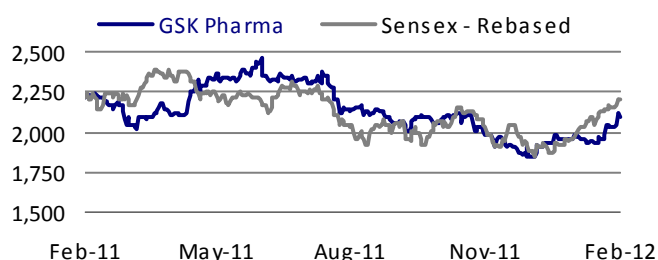
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
CY11	74.5	71.0	4.9
CY12	87.4	84.4	3.6

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
2,088	2,272	8.8	Buy

Stock performance (1 year)



Financials and Valuations

Income Statement		(INR Million)			
Y/E December	2009	2010	2011	2012E	
Net Sales	18,708	21,116	23,380	26,742	
Change (%)	12.7	12.9	10.7	14.4	
Materials Consumed	6,922	7,770	9,085	9,894	
Personnel Expenses	2,094	2,409	2,784	3,201	
Other Expenses	3,146	3,560	4,066	4,554	
Total Expenditure	12,162	13,739	15,935	17,650	
EBITDA	6,546	7,378	7,445	9,092	
Change (%)	13.3	12.7	0.9	22.1	
Margin (%)	35.0	34.9	31.8	34.0	
Depreciation	164	176	204	222	
Int. and Finance Charge	4	6	0	0	
Other Income - Rec.	1,206	1,477	1,975	2,084	
PBT & EO Expense	7,585	8,673	9,216	10,954	
Tax	2,536	2,859	2,902	3,552	
Tax Rate (%)	33.4	33.0	31.5	32.4	
Adj PAT	5,049	5,814	6,314	7,402	
EO Expense (net of tax)	-74	177	-2,008	0	
Reported PAT	5,123	5,637	4,306	7,402	
Change (%)	12.6	15.2	8.6	17.2	
Margin (%)	27.4	26.7	18.4	27.7	

Balance Sheet		(INR Million)			
Y/E December	2009	2010	2011	2012E	
Equity Share Capital	847	847	847	847	
Reserves	16,728	18,445	18,336	19,862	
Capital Reserve	17	17	17	17	
Net Worth	17,591	19,308	19,199	20,726	
Loans	54	52	49	0	
Capital Employed	17,646	19,360	19,248	20,726	
Gross Block	2,892	3,184	3,331	3,731	
Less: Accum. Deprn.	1,964	2,095	2,299	2,521	
Net Fixed Assets	928	1,089	1,032	1,209	
Capital WIP	214	87	214	214	
Investments	1,909	1,604	1,598	21,309	
Curr. Assets	21,144	24,483	26,959	9,948	
Inventory	2,530	2,815	3,301	4,279	
Account Receivables	537	470	853	1,070	
Cash and Bank Balance	16,726	19,481	19,864	1,337	
Others	1,351	1,717	2,940	3,262	
Curr. Liability & Prov.	6,996	8,468	11,168	12,569	
Account Payables	3,167	3,567	3,545	4,011	
Other Liabilities					
Provisions	3,830	4,900	7,623	8,557	
Net Current Assets	14,148	16,016	15,790	-2,621	
Deferred Tax Assets	447	564	615	615	
Appl. of Funds	17,646	19,360	19,248	20,726	

E: MOSL Estimates ^ - Standalone results

Ratios					
Y/E December	2009	2010	2011	2012E	
Basic (INR)					
EPS	59.6	68.6	74.5	87.4	
Cash EPS	61.5	70.7	76.9	90.0	
BV/Share	207.7	228.0	226.7	244.7	
DPS	30.0	40.0	50.0	60.0	
Payout (%)	58.9	66.5	76.5	78.3	
Valuation					
P/E			28.0	23.9	
Cash P/E			27.1	23.2	
P/BV			9.2	8.5	
EV/Sales			6.6	5.8	
EV/EBITDA			20.9	17.0	
Dividend Yield (%)			2.4	2.9	
Return Ratios (%)					
RoE	28.7	30.1	32.9	35.7	
RoCE	43.0	44.8	47.9	52.9	
Working Capital Ratios					
Fixed Asset Turnover (x)	20.4	20.9	22.0	23.9	
Debtor (Days)	10	8	13	15	
Inventory (Days)	49	49	52	58	
Working Capital (Days)	-50	-60	-64	-54	
Leverage Ratio					
Debt/Equity	0.0	0.0	0.0	0.0	

Cash Flow Statement		(INR Million)			
Y/E December	2009	2010	2011	2012E	
Oper. Profit/(Loss) bef.	6,546	7,378	5,438	9,092	
Interest/Dividends Rec	1,206	1,477	1,975	2,084	
Direct Taxes Paid	-2,687	-2,976	-2,953	-3,552	
(Inc)/Dec in WC	1,153	-3	-357	-1,082	
CF from Operations	6,218	5,876	4,102	6,542	
EO expense	-74	177	-2,008	0	
CF from Op. incl EO exp.	6,292	5,699	6,110	6,542	
(inc)/dec in FA	-184	-166	-273	-400	
(Pur)/Sale of Investme	5,535	216	6	-19,813	
CF from investments	5,350	50	-267	-20,213	
Change in Net Worth	0	0	-1,593	21	
Inc/(Dec) in Debt	-2	-3	-3	-49	
Interest Paid	-4	-6	0	0	
Dividend Paid	-3,976	-2,985	-3,863	-4,829	
CF from Fin. Activity	-3,982	-2,994	-5,459	-4,857	
Inc/Dec of Cash	7,660	2,755	383	-18,527	
Add: Beginning Balanc	9,065	16,726	19,481	19,864	
Closing Balance	16,726	19,481	19,864	1,336	

E: MOSL Estimates ^ - Standalone results

N O T E S

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GlaxoSmithKline Pharmaceuticals

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2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No
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