

Equities

6 November 2011 | 9 pages

Glaxosmithkline Pharmaceutical (GLAX.BO)

Big Miss – Pressure on Valuations?

- Company Update
- Target Price Change
- Estimate Change

- **Big miss** — 3Q PAT was well below (c19%) our expectations, primarily on lower topline growth due to the industry wide slowdown in anti-infectives. We believe this is a temporary phase and growth should get back to normal from 4Q. However, we revise CY11-13 EPS estimates by 2-6% & TP to Rs2,200 (roll over to Dec'12E EPS). Upside remains limited in view of high valuations that may now come under pressure due to this disappointment & the proposed widening of the price control net. Stay Neutral.
- **Topline growth slows** — After recording healthy growth (+12%) in 1HCY11, 3Q witnessed a slowdown (+4% YoY vs. Citi Est of +13%), as Pharma (biz excl exports) grew by 7% YoY. This low growth was despite four new launches last quarter (including two patented drugs – *Votrient* & *Revolade* & a *Stiefel* derma product) & aggressive sales force expansion. While oncology, derma, CVS & metabolic registered double-digit growth, mass market & anti-infectives disappointed due to a weak season & high base.
- **PAT well below expectations** — Higher RM/sales (inferior product mix – increasing branded generics contribution) & higher SG&A (sales force expansion related) added to topline woes and led to a significant drop in EBITDA margin (c30%, -587bps YoY, -495bps QoQ) – lowest in the last ten quarters. PAT declined (-8% YoY) despite higher interest income & lower tax rate and was c19% below our expectations.
- **Revising estimates & TP** — We lower our topline and EPS est. for CY11/CY12/CY13 by 4%/4%/4% & 6%/2%/3% respectively. Over the longer term, we expect GLAX to grow faster than the market on new launches & aggressive sales force expansion – forecast topline & PAT CAGRs of 14% & 16% respectively over CY11E-13E. We roll forward to Dec'12E EPS and arrive at a TP to Rs2,200/sh (Rs2,170/sh earlier).
- **Potential Catalysts** — a) Higher than expected product launches - especially from the patented basket & vaccines; b) Inorganic/dividend initiatives to utilize cash on books (cRs21bn) on its books; c) Vaccine launches: Synflorix, Infarix-Hexa; d) New branded generics launches; e) implications of the recently proposed DPCO 2011 provisions – likely negative

Neutral	2
Price (04 Nov 11)	Rs2,109.55
Target price	Rs2,200.00
	<i>from Rs2,170.00</i>
Expected share price return	4.3%
Expected dividend yield	1.9%
Expected total return	6.2%
Market Cap	Rs178,685M
	US\$3,647M

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)	(%)	(%)
2009A	5,049	59.61	12.6	35.4	10.2	30.6	1.4
2010A	5,814	68.64	15.1	30.7	9.3	31.5	1.9
2011E	6,245	73.73	7.4	28.6	8.2	30.3	1.8
2012E	7,447	87.92	19.2	24.0	7.1	31.8	2.1
2013E	8,491	100.25	14.0	21.0	6.1	31.4	2.1

Source: Powered by dataCentral

Prashant Nair, CFA

 +91-22-6631-9855
 prashant.nair@citi.com

Anshuman Gupta

 +91-22-6631-9873
 anshuman.gupta@citi.com

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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	35.4	30.7	28.6	24.0	21.0
EV/EBITDA adjusted (x)	23.9	20.6	20.5	16.5	14.1
P/BV (x)	10.2	9.3	8.2	7.1	6.1
Dividend yield (%)	1.4	1.9	1.8	2.1	2.1
Per Share Data (Rs)					
EPS adjusted	59.61	68.64	73.73	87.92	100.25
EPS reported	60.48	66.55	73.73	87.92	100.25
BVPS	207.68	227.95	258.27	295.33	343.70
DPS	30.00	40.00	37.75	44.22	45.11
Profit & Loss (RsM)					
Net sales	19,366	21,870	24,143	27,553	31,327
Operating expenses	-12,780	-14,344	-16,631	-18,251	-20,712
EBIT	6,586	7,526	7,512	9,302	10,615
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	999	1,147	1,540	1,813	2,059
Pre-tax profit	7,585	8,673	9,051	11,115	12,674
Tax	-2,536	-2,859	-2,806	-3,668	-4,182
Extraord./Min.Int./Pref.div.	74	-177	0	0	0
Reported net income	5,123	5,637	6,245	7,447	8,491
Adjusted earnings	5,049	5,814	6,245	7,447	8,491
Adjusted EBITDA	6,749	7,702	7,688	9,478	10,791
Growth Rates (%)					
Sales	13.0	12.9	10.4	14.1	13.7
EBIT adjusted	13.2	14.3	-0.2	23.8	14.1
EBITDA adjusted	12.8	14.1	-0.2	23.3	13.9
EPS adjusted	12.6	15.1	7.4	19.2	14.0
Cash Flow (RsM)					
Operating cash flow	4,495	4,697	2,846	6,091	6,308
Depreciation/amortization	164	176	176	176	176
Net working capital	222	111	-2,036	281	-301
Investing cash flow	5,545	-133	-19,996	-3,400	-2,900
Capital expenditure	-298	-206	-600	-400	-400
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-3,914	-2,934	-3,677	-4,308	-4,394
Borrowings	-2	-3	0	0	0
Dividends paid	-3,912	-2,932	-3,677	-4,308	-4,394
Change in cash	6,126	1,630	-20,828	-1,617	-986
Balance Sheet (RsM)					
Total assets	24,642	27,827	29,432	33,662	38,356
Cash & cash equivalent	18,635	21,084	21,193	24,389	27,961
Accounts receivable	537	470	767	878	1,000
Net fixed assets	1,142	1,177	1,600	1,824	2,048
Total liabilities	7,050	8,519	7,556	8,647	9,244
Accounts payable	3,167	3,567	3,427	3,887	4,398
Total Debt	54	52	52	52	52
Shareholders' funds	17,591	19,308	21,876	25,015	29,113
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	34.9	35.2	31.8	34.4	34.4
ROE adjusted	30.6	31.5	30.3	31.8	31.4
ROIC adjusted	na	na	na	nm	nm
Net debt to equity	-105.6	-108.9	-96.6	-97.3	-95.9
Total debt to capital	0.3	0.3	0.2	0.2	0.2

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3QCY11 Results Snapshot

Figure 1. GSK Pharma – 2QCY11 Earnings Summary (Rs m, %)

YE Dec 31	2QCY10	2QCY11	% Ch YoY	1QCY11	% Ch QoQ	CIRA Comments
Gross Sales	5,939	6,227	4.9	5,747	8.4	Recurring PAT c19% below expectations; Topline lower by c8%.
Excise Duty	(119)	(152)	27.4	(131)	15.4	
Excise rate (%)	2.0	2.4	43 bps	2.3	15 bps	
Net Sales	5,820	6,076	4.4	5,615	8.2	Topline growth muted as Core Pharma biz grew only by 7%
Other Operating Income	73	71	-3.2	123	-42.6	
Total Operating Income	5,893	6,146	4.3	5,739	7.1	Oncology, Dermatologicals, CVS and Metabolic grew in double digit; Mass market & Anti-Infectives growth muted EBITDA margins significantly lower on higher costs - higher RM/Sales & higher SG&A (field force related expenses) Increase in interest income due to higher cash balance – other income consistently rising in the current high interest rate scenario Recurring PAT well below expectations in line with slower growth and increasing expenses
Material Cost	2,163	2,420	11.9	2,046	18.3	
% of Sales	37.2	39.8	266 bps	36.4	340 bps	
Staff Cost	572	661	15.5	776	-14.8	
% of Sales	9.8	10.9	105 bps	13.8	-294 bps	
Other Expenses	1,078	1,340	24.3	1,012	32.4	
% of Sales	18.5	22.0	353 bps	18.0	403 bps	
Recovery of expenses	(80)	(104)	30.7	(88)	18.9	
Total expenses	3,733	4,316	15.6	3,746	15.2	
EBITDA	2,160	1,830	-15.2	1,993	-8.2	
EBITDA Margin (%)	36.6	29.8	-687 bps	34.7	-495 bps	
Interest Income	256	371	45.0	298	24.3	
Depreciation	(41)	(49)	19.5	(49)	-0.6	
Other income	0	0		0		
PBT	2,374	2,152	-9.4	2,242	-4.0	
Tax	(792)	(692)	-12.6	(725)	-4.6	
Tax rate (%)	33.3	32.2	-118 bps	32.3	-19 bps	
PAT Before EO Items	1,583	1,460	-7.7	1,517	-3.7	
Extraordinary Items	0	-1		(41)		
PAT after extra ordinaries	1,583	1,459	-7.8	1,475	-1.1	

Source: Citi Investment Research and Analysis, Company

Figure 2. EPS Revision

	CY11E	CY12E	CY13E
New	73.7	87.9	100.3
Old	78.2	89.5	102.9
% Change	-6%	-2%	-3%

Source: Citi Investment Research and Analysis estimates

Glaxosmithkline Pharmaceutical

Company description

GSK Pharmaceutical is one of the largest pharmaceutical companies in India and operates in the branded formulations space across a wide range of therapeutic areas such as anti-infectives, dermatology, gynecology, diabetes, oncology, cardiovascular and respiratory as well as vaccines. GSK has consistently featured among the top-5 companies in the highly fragmented Indian market and has maintained a market share of over 4%. It has registered single digit revenue CAGR over the past five years but growth rates have picked up over the past two years and are expected to remain in the double digit range.

Investment strategy

We rate GSK Pharma Neutral (2), with a TP of Rs2,200. While we rate GSK as a good play on the stronger IPR regime and growing penetration of healthcare in India, we expect any upside to be gradual over a number of years. Although GSK has plans for launching several new products in the vaccines, dermatology and branded generics space, we expect a lag before any material step up in growth rate and profitability. In the interim, with an EPS CAGR of 14.5% (CY10-13E) and no near-term catalysts, we see limited upside over the next 12-18 months.

Valuation

Our target price of Rs2,200 for GSK Pharma is based on 25x Dec 2012E 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 c23x over the last five years. GSK launched its first patented product in India two years back and has announced plans to launch a 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

The key upside risks to our hypothesis include: a) Higher than expected product launches - esp. from the patented basket & vaccines; b) Any accretive acquisitions, given the sizeable cash balance (cUS\$450m+) on its books. The key downside risks to our hypothesis include: a) Slowdown in Indian market growth, given that GSK operates entirely in this market and is among the top 5 companies; b) Further price control related regulations in India, given more than 20% of the current revenues are from price controlled products. Any of these risk factors could cause the shares to deviate from our target price.

Appendix A-1 Analyst Certification

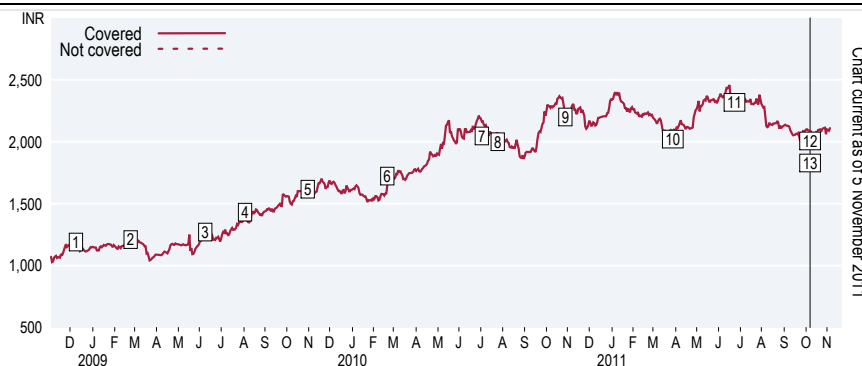
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Glaxosmithkline Pharmaceutical (GLAX.BO)

Ratings and Target Price History Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	9-Dec-08	*1L	*1,300.00	1,149.75
2	24-Feb-09	1L	*1,336.00	1,181.25
3	9-Jun-09	1L	*1,372.00	1,248.85
4	4-Aug-09	*3L	*1,360.00	1,387.15
5	30-Oct-09	3L	*1,400.00	1,578.30

* Indicates change

	Date	Rating	Target Price	Closing Price
6	19-Feb-10	3L	*1,550.00	1,649.65
7	2-Jul-10	3L	*1,820.00	2,162.15
8	26-Jul-10	3L	*1,880.00	2,062.70
9	28-Oct-10	3L	*2,030.00	2,261.85
10	29-Mar-11	3L	*2,100.00	2,085.30

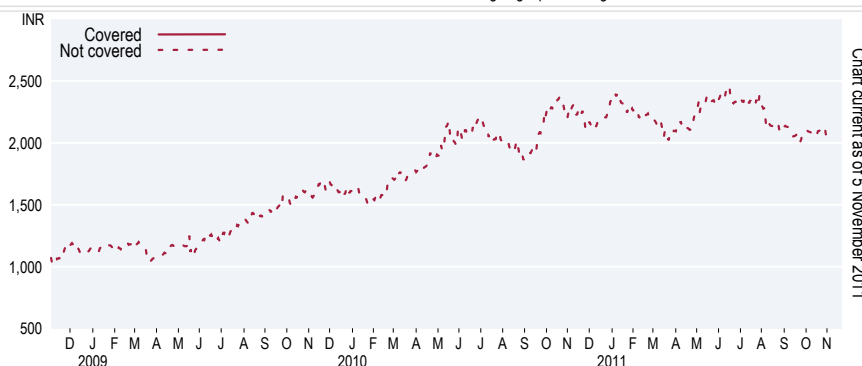
	Date	Rating	Target Price	Closing Price
11	23-Jun-11	3L	*2,170.00	2,329.10
12	7-Oct-11	Stock rating system changed		
13	7-Oct-11	*2	2,170.00	2,086.45

Rating/target price changes above reflect Eastern Standard Time

Glaxosmithkline Pharmaceutical (GLAX.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Prashant Nair, CFA



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