

Wait for it to react

Product launches, sharper focus on pharmaceuticals and greater opportunities in clinical research lend strength to the company.

HOLD

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Investors can retain their holdings in GlaxoSmithKline Pharma (GSK Pharma), the listed subsidiary of global pharma major GlaxoSmithKline, despite the stock underperforming over the past year. A slew of product launches (both patented and in-licensed), sharper focus on pharmaceuticals (after having divested the animal health-care and fine chemicals businesses) and opportunities for uptake of clinical research by the parent company indicate that prospects may change for the better.

At the current price of Rs 1,010, the stock discounts its FY-08 per share earnings by about 19 times. The valuation is not cheap, given GSK Pharma's muted top line and profit growth over the past three years (compounded annual growth rate of 4 per cent in sales and 3 per cent in profits including sold-off businesses).

However, the valuation is justified by the expected ramp up in earnings from at least four exclusive launches (a cancer drug and vaccines), which will also help it foray into new niches. GSK Pharma holds a 4.8 per cent share in the domestic drug market, making it one of the top three manufacturers.

Any delay in product launches due to an uncertain patent regime and the looming



Mr Hasit Joshipura, MD...Injecting promise.

threat of more drugs being brought under the Drug Price Control Order (GSK Pharma now derives around 30 per cent from price-controlled products) are risks to the company's prospects.

LAUNCHES TO DRIVE GROWTH

In 2005, GSK Pharma had announced that it would leverage its parent's robust pipeline by launching four vaccines (Rotarix, Cervarix, Streptorix and Infanrix) latest by 2009. Being new drugs targeting key areas, 2008 will see the company finally benefiting from Infanrix (combo vaccine for tetanus, diphtheria and pertussis in infants), Boostrix (Infanrix but targeted at the preteen/teens) and Rotarix (vaccine against Rotavirus — the main cause of diarrhoea).

The company does not produce vaccines in India and sources them from its parent's facilities worldwide.

Revenues from vaccines contributed around 6 per cent of the company's first half turnover in 2007. This will be

scaled up, driven by launches; the easing of supply constraints at its global vaccine production facilities augurs well.

After December 2008, GSK Pharma is also tipped to launch Cervarix (vaccine for cervical cancer) and, post-2010, other vaccines for malaria, tuberculosis, dengue and Streptorix (combo vaccine for 11 indications) are also on cards.

Once launched, these could provide a significant upside to earnings, but are subject to the hurdles of pricing pressure and delays in patent approvals and subsequent registrations.

In patent protected drugs, GSK Pharma is slated to launch Tykerb (first in class breast cancer medicine for a focus patient group) by second quarter in 2008, which would ensure exclusivity for some years. Other launches could be in the form of Allermist (targeting allergic rhinitis), Alvimopan (first in class medicine to treat impairment of bowel motility due to surgery) and Pleuromutilin (topical anti-



biotic). These could be launched in 2008/2009. However, regulatory delays and legal hold-ups akin to those being recently faced by innovator companies in India, pose risk to these plans. (None of GSK's vaccines and in-licensed products are claimed to have incremental innovation.) Patented products are expected to contribute 10 per cent of the company's revenues by 2010.

With around eight in-licensed products under its belt, GSK Pharma is well-placed to leverage on a strong sales and marketing set up to access doctors and retailers. This year, the company may introduce two such products (one might be a patentable drug).

Overall, these initiatives in the form of launches in vaccines, patented drugs and in-licensing opportunities could help GSK Pharma maintain operating margins at current levels (about 31 per cent), as pricing power may enable the company to bear heavy promotional expenses. Disposal of non-core businesses has al-

so been a margin accretive step in this light.

BETTER FOCUS

Till 2006, GSK Pharma had to divide its attention between the pharmaceutical business and non-core businesses such as animal health and fine chemicals business. The company exited the animal health business in April 2006 and the fine chemicals business in July 2007. These initiatives have not only brought substantial cash flows (around Rs 450 crore from both) but also allowed GSK Pharma to focus on its strength: Pharmaceuticals.

The company still has minor interests in diagnostics, laboratory equipment and exports related to drugs, but are aligned with the pharmaceutical model. In the first half of 2007, GSK Pharma's revenues were distributed between the focus, other segments and price-controlled drugs in the proportion of 29 per cent, 27 per, 27 per cent respectively.

With divestment of the non-core businesses complete,

GSK can now target higher double-digit growth in its focus group of drugs, which have hitherto grown at a slower rate than the overall market. Skincare and cardiovascular therapeutic segments are high-growth areas for the company. Progress on this front would be important as the company looks to offset flat growth and reduced contributions from the price-controlled products (consisting mainly of anti-infectives and dietary supplements).

The policy proposal to increase the number of price-controlled drugs to five times the existing number (currently 74), if carried out by the government, may expand this contribution to around half its current revenues. This scenario bears watching as it could lead to a knock-on effect on GSK Pharma's sales and profitability.

Clinical research is another promising segment for the company. GSK Pharma has till date carried out clinical trials for the parent company covering a significant 9 per cent of its global patient populace. The year 2007 saw 31 trials against 16 in 2006.

This trend might continue as the MNC subsidiary conducts trials across oncology, neuropsychiatry, cardiovascular and metabolic segments. Revenue contribution from clinical research is pegged at Rs 30 crore for 10 months of FY-07 and is slated to grow in future with the company exploring the possibility of bringing in Phase I/II trials, as Indian regulatory clearances are rigorous for overseas companies.

Furthermore, job cuts in the global pharma industry may also benefit Indian arms such as GSK Pharma as bulk drug production may witness increased uptake. GSK Pharma now manufactures a single API for the global parent.