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GSK Pharma provides exit opportunity

For short-term investors; there are arguments for others to stay in the scrip, at least partially, though substantial gains would take some time

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The stock of GlaxoSmithKline Pharmaceuticals (GSK Pharma) opened nearly 20 per cent higher on the National Stock Exchange (NSE) at Rs 2,950 levels before closing the day at Rs 2,925, following the open offer by its parent, GlaxoSmithKline Pharmaceuticals Plc. The open offer is to acquire 20.62 million shares, representing 24.33 per cent of the total voting share capital of GSK Pharma, for Rs 3,100 apiece from the public and institutional shareholders.

If fully successful, the London Stock Exchange-listed GlaxoSmithKline Plc will see its stake in GSK Pharma rise from the current 50.7 per cent to 75 per cent.

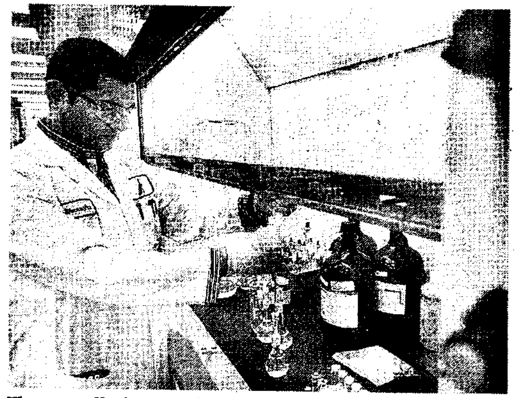
While the offer reflects the foreign parent's increased commitment, it also provides a good exit opportunity for investors with a short-term perspective, given GSK Pharma's muted performance and high stock valuations (price to earnings multiple of over 40 times CY2014 earnings per share). However, long-term investors should stay put, say analysts, as GSK Pharma is investing Rs 850 crore to expand its domestic business and also the parent's move to raise stake, both of which provide confidence.

Sarabjit Kour Nangra, vice president–research (pharma) at Angel Broking, says investors lacking the patience to stay invested in the counter for another four–five years should tender their shares in the open offer. She adds the investment plans announced by the company recently, coming from GSK after a long time, shows they see visibility in earnings growth in the Indian market. And, long-term investors can get a return of around 20 per cent from these levels.

Prior to the open offer announcement, of 12 analysts polled by Bloomberg since November, eight had 'Sell' ratings, three of 'Hold' and only one a 'Buy' rating, with a consensus one-year target price of Rs 2,189.

GSK Pharma's performance between calendar years 2010 and 2012 was unexciting, with low growth in sales (10-12 per cent) and adjusted (excluding one-off items) net profits (two to 12 per cent). Not surprisingly, its stock moved in the Rs 1,850-2,400 range from 2010 to mid-2013. Its recent performance was also weak, due to pressure on margins leading to a decline in profit. As a result, analysts have cut their earnings estimates for the company.

GSK, which follows a January–December financial year, had reported a 38 per cent decline in standalone adjusted net profit, at Rs 101 crore for the third quarter ended September. For the nine months to September, net sales were up 11.2 per cent to Rs 2,600 crore; adjusted net profit was down nine per cent to Rs 679 crore, versus the year-ago period. While the company estimates a five per cent hit on annual sales due to the new drug pricing rules, most analysts have cut their earnings estimates for CY14 (by 15 per cent) and expect muted sales growth of seven to eight per cent.

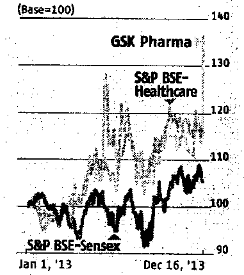


The open offer is to acquire 20.62 million shares, representing 24.33 per cent of the total voting share capital of GSK Pharma, for ₹3,100 apiece from the public and institutional shareholders

Although profits are seen rising by 20-25 per cent, it is due to a low base (decline in CY13), and estimated to be lower than those reported in CY12. Nevertheless, the estimated earnings per share of Rs 70-71 for CY14 would still translate into a P/E of over 40 times, indicating the stock might recede after the offer's closing. Hence, investors could tender now and buy later, say analysts.

Says Surajit Pal, analyst with Prabhudas Lilladher, "Fundamentally, the company won't have much to say, at least for a year, and that is mainly due to the DPCO (Drug Price Control Order) issues." Adding, "Given the nature of the company, which was never seen as a growth oriented one, it remains a good dividend play. So, investors who are in this stock for dividend income might not tender shares".

SHORT TERM GAINS



The offer's success, though, depends heavily on how institutional investors react. Foreign institutional investors and domestic institutions together hold 34 per cent, with the rest held by the public (15 per cent).

A senior Life Insurance Corporation official said the offer looked good on the face of it. It is a good stock. "However, the market is subject to several fluctuations. If at that point, there is a sudden change in the price, then we might have to take that into consideration," said the official. Industry sources say as it is a good company for an investment, LIC might not aim to offload its entire stake.

Pharma MNCs bullish

Pharmaceutical multinational corporations (MNCs) remain bullish on India, despite challenges on product patents and pricing. The recently completed Mylan acquisition of Agila from Strides Arcolab for $1.75 billion is testimony. Likewise with Glaxo's open offer plan after an Rs 864-crore investment announcement (by GSK Pharma) in November.

There are multiple reasons. The country's health care sector's growth is likely to remain 15 per cent annually, as the Indian market remains under-penetrated, says Kapil Bhatia, assistant vice-president, Systematix Capital. Further, after clarity emerging on drug pricing policy, MNCs are likely to see volume growth and gain market share from Indian companies as the former's products become competitive, believe analysts.

Additionally, favourable currency movement and foreign direct investment in pharma can act as strong triggers. India also enjoys the image of a low-cost and high-quality manufacturing destination.

(With inputs from M Saraswathy in Mumbai)

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