

GLAXOSMITHKLINE CONSUMER

Volumes recover; other expenses zoom

India Equity Research | Consumer Goods



GSK Consumer's (GSK) Q4CY12 revenue was in line with our expectation, but PAT came below. Key positives include: (1) revenues jumped 18.6% YoY; (2) recovery in volume growth at ~9% YoY (against 6% and 7% YoY growth in Q3CY12 and Q2CY12 respectively; most food companies did not see a recovery in growth); (3) auxiliary income surged a robust 46.6% YoY primarily led by oral care segment; (4) prudent management of COGS led to 179bps YoY jump in gross margin; and (5) tight leash on ad spends (down 37bps YoY). Key negatives include 3.3% YoY decline in EBITDA and 235bps YoY margin dip due to 379bps YoY rise in other expenses. We remain positive on the company's continued dominance in the malted food drinks category. However, the stock has rerated sharply over the past three months due to successful completion of open offer and is trading at its historical high P/E. Hence we downgrade to 'HOLD'.

Robust sales surge, but EBITDA disappoints

GSK's total revenue surged 18.6% YoY to INR7.35bn primarily led by price hikes and volume growth coupled with robust growth in auxiliary income. Gross margin expansion (179bps YoY) was offset by higher other expenditure (up 379bps YoY) and staff costs (up 79bps YoY), leading to 235bps YoY dip in EBITDA margin. EBITDA declined 3.3% YoY. Tax rate plunged 658bps YoY to 32.7%, boosting PAT by 17.9% YoY.

Open offer successful; mulling mouthwash entry

GlaxoSmithKline Plc's open offer for acquisition of 31.8% stake in its Indian subsidiary GSK resulted in the former's stake in the latter rising to 72.5% from 43.2%. This, we believe, is a testament to the management's confidence in India's growth potential. Also, as per media reports, GSK is eyeing entry into the mouthwash segment.

Outlook and valuations: Fairly valued; downgrade to 'HOLD'

We like GSK's 'health and wellness' positioning, which is bolstered further by strong brand image of key brand *Horlicks*. Also, key competitor *Complan* may face medium-term issues due to change of guard as *Heinz* has been acquired by Warren Buffett's Berkshire Hathaway and PE firm 3G capital. However, the stock has rerated to its historical high P/E at 31.1x and 26.8x on CY13E and CY14E EPS. Hence, we downgrade our recommendation to 'HOLD' from 'BUY' and rate it 'Sector Performer'.

Financials

(INR mn)

Year to Dec.	Q4CY12	Q4CY11	% change	Q3CY12	% change	CY12	CY13E	CY14E
Total Rev.	7,345	6,194	18.6	8,580	(14.4)	31,875	36,404	41,740
EBITDA	764	790	(3.3)	1,710	(55.3)	5,734	6,713	7,764
PAT	696	591	17.9	1,285	(45.8)	4,368	5,106	5,926
Dil. EPS (INR)	16.6	14.1	17.9	30.6	(45.8)	103.9	121.4	140.9
Diluted P/E (x)						36.4	31.1	26.8
EV/EBITDA (x)						25.7	21.8	18.6
ROAE (%)						36.0	35.1	33.9

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Underweight

MARKET DATA (R: GLSM.BO, B: SKB IN)

CMP	: INR 3,780
Target Price	: INR 3,663
52-week range (INR)	: 4,391 / 2,179
Share in issue (mn)	: 42.1
M cap (INR bn/USD mn)	: 159 / 2,928
Avg. Daily Vol.BSE/NSE('000)	: 33.2

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	43.2	43.2	43.2
MF's, FI's & BK's	16.1	17.4	18.4
FII's	15.4	14.5	13.3
Others	25.3	24.9	25.2
* Promoters pledged shares (% of share in issue)			NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Consumer Goods Index
1 month	(0.3)	(2.7)	4.9
3 months	24.9	5.8	13.5
12 months	43.1	6.0	45.0

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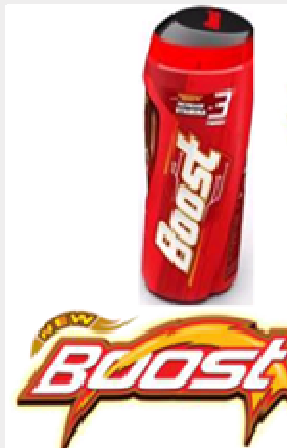
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February 18, 2013



Other key developments

- GlaxoSmithKline Plc’s open offer for acquisition of 31.8% stake in its Indian subsidiary GSK Consumer resulted in the former’s stake in the latter rising to 72.5% from 43.2%. David Redfern, Chief Strategy Officer, GSK, said there was no plan to delist the company from the Indian stock exchanges. The stake was raised as management is confident about the growth potential, demographics and rising consumer spending in India.
- As per media articles, GSK will be entering the mouthwash segment and will soon bring in products from its international portfolio. Mouthwash is an INR1,000mn category with only two major players.
- **Heinz:** Warren Buffett's Berkshire Hathaway is joining private-equity firm 3G Capital to buy ketchup-maker H.J. Heinz in a USD23bn deal, one of the largest-ever acquisitions in the food industry. Heinz’s Indian portfolio includes *Complan*, which is the next big player in the MFD category. This change of guard could have some issues for Heinz in the medium term.

Chart 1: Sales growth robust YoY

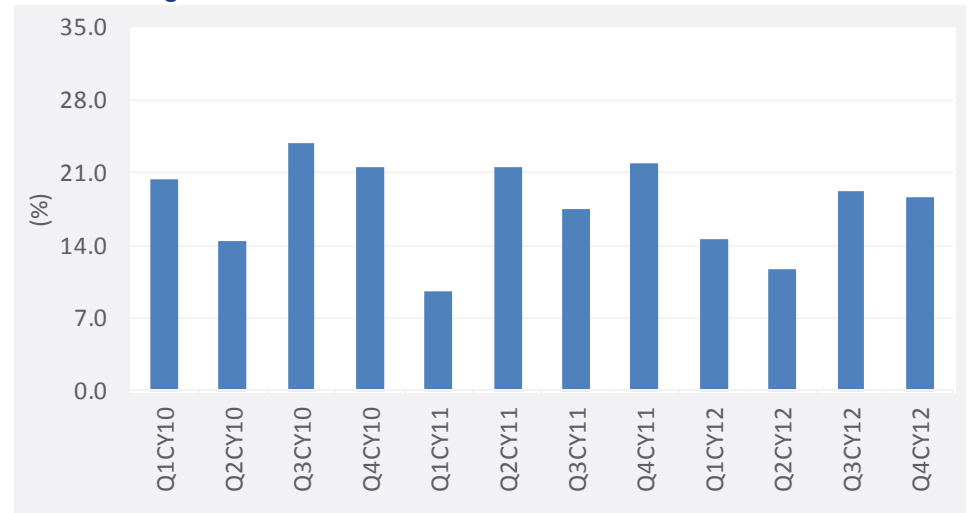
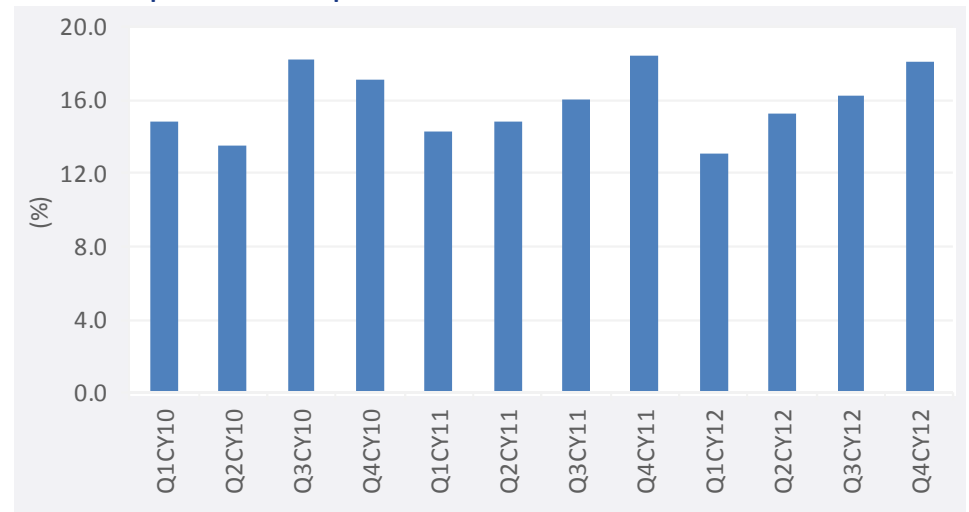


Chart 2: Ad spends down 37bps YoY



Source: Company, Edelweiss research



Chart 3: Milk price index up 6% YoY

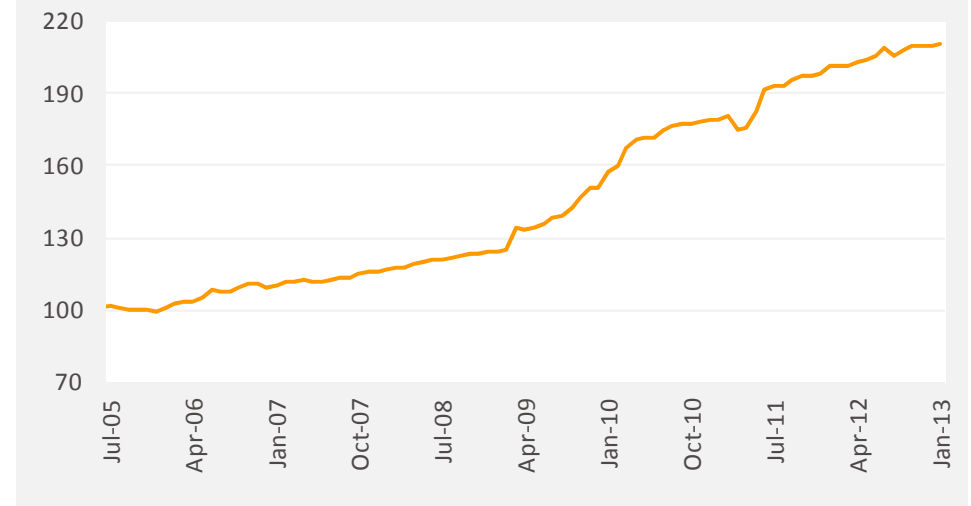


Chart 4: Wheat price index continues upward trend

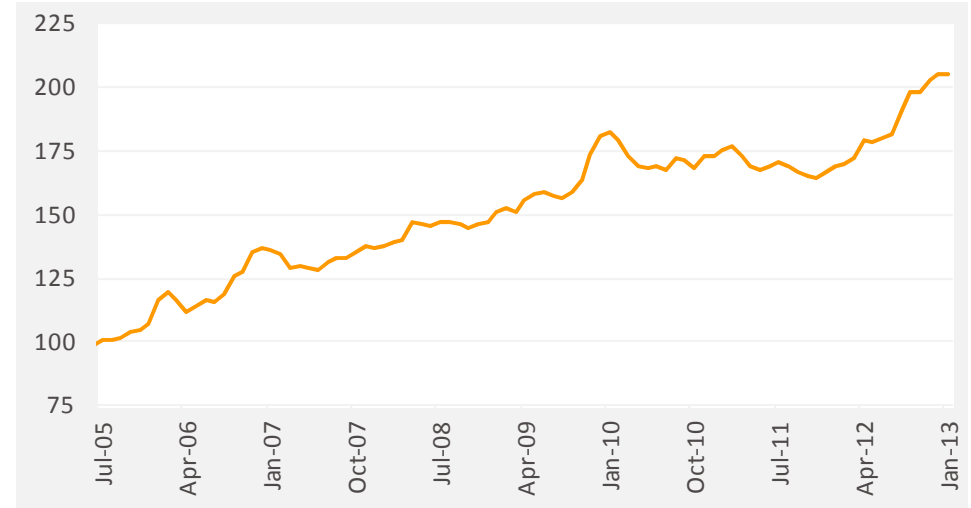
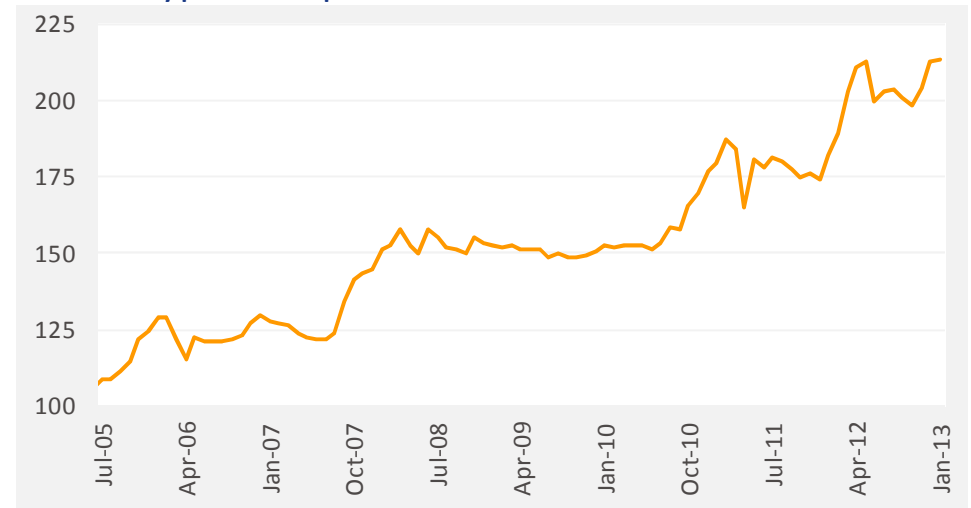


Chart 5: Barley price index up YoY

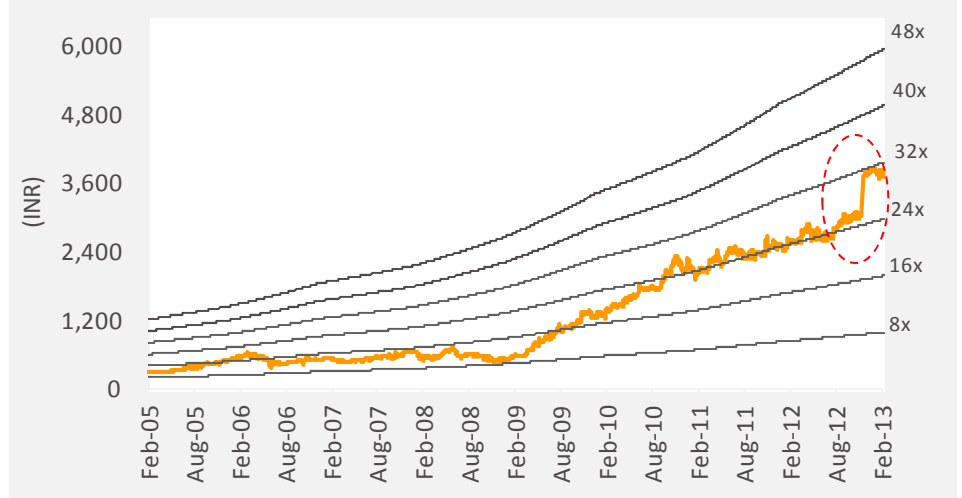


Source: Edelweiss research

Outlook and valuations: Fairly valued; downgrade to ‘HOLD’

We continue to like GSK’s core business, marked increase in business auxiliary income, gross margin expansion, good volume growth and investment in new growth drivers. We assign the stock a multiple of 26x CY14E EPS (from the earlier multiple of 28x CY13E EPS) as we roll over; arriving at a target price of INR3,663 (earlier INR3,427). However, the stock has rerated to its historical high P/E at 31.1x and 26.8x on CY13E and CY14E EPS due to the successful open offer. Hence, we downgrade our recommendation to ‘HOLD’ from ‘BUY’ and rate it ‘Sector Performer’.

Chart 6: One year forward P/E chart – further rerating unlikely



Source: Company, Edelweiss research



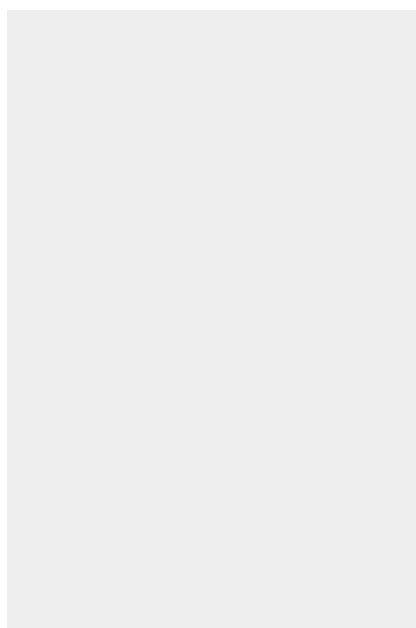
Financial snapshot

(INR mn)

Year to December	Q4CY12	Q4CY11	% change	Q3CY12	% change	CY12	CY13E	CY14E
Net revenues	7,091	6,021	17.8	8,275	(14.3)	30,794	35,031	40,023
Other operating income	254	174	46.6	305	(16.6)	1,081	1,373	1,717
Total operating income	7,345	6,194	18.6	8,580	(14.4)	31,875	36,404	41,740
Cost of goods sold	2,408	2,141	12.4	3,104	(22.4)	11,519	13,101	14,965
Advt. sales & promotions	1,327	1,142	16.2	1,386	(4.3)	4,965	5,710	6,564
Employee expenses	785	617	27.1	775	1.2	3,011	3,430	3,922
Other expenses	2,062	1,504	37.1	1,605	28.5	6,647	7,451	8,525
Total expenditure	6,581	5,404	21.8	6,871	(4.2)	26,141	29,692	33,976
EBITDA	764	790	(3.3)	1,710	(55.3)	5,734	6,713	7,764
Depreciation	79	121	(34.6)	77	2.7	361	452	546
EBIT	685	669	2.4	1,633	(58.0)	5,373	6,260	7,218
Other income (incl. associates)	351	313	12.2	273	28.8	1,138	1,355	1,621
EBIT including other income	1,036	982	5.5	1,905	(45.6)	6,511	7,615	8,839
Interest	1	9	(84.1)	3	(48.1)	24	29	34
Profit before tax	1,035	973	6.3	1,903	(45.6)	6,487	7,587	8,806
Tax	338	382	(11.5)	617	(45.2)	2,119	2,481	2,879
Core profit	696	591	17.9	1,285	(45.8)	4,368	5,106	5,926
Diluted EPS (INR)	16.6	14.1	17.9	30.6	(45.8)	103.9	121.4	140.9

As % of net revenues

COGS	32.8	34.6		36.2		36.1	36.0	35.9
Employee cost	10.7	10.0		9.0		9.4	9.4	9.4
Other expenses	28.1	24.3		18.7		20.9	20.5	20.4
Adv. & sales promotions	18.1	18.4		16.2		15.6	15.7	15.7
EBITDA	10.4	12.8		19.9		18.0	18.4	18.6
EBIT	9.3	10.8		19.0		16.9	17.2	17.3
PBT	14.1	15.7		22.2		20.4	20.8	21.1
Reported net profit	9.5	9.5		15.0		13.7	14.0	14.2
Tax rate	32.7	39.3		32.4		32.7	32.7	32.7



Company Description

GSK is a leading healthcare company in India with GlaxoSmithKline, UK, as parent. It is India's leading health food drinks manufacturer with growing presence in categories like biscuits, noodles, snacks, sports drinks, glucose powder and OTCs. The company has manufacturing facilities in Nabha (Punjab), Rajamundry (Andhra Pradesh) and Sonapat (Haryana). It has a strong marketing and distribution network in India with direct coverage of over 750,000 retail outlets.

Investment Theme

GSK Consumer's broad product portfolio provides a good play on Indian processed food spending by virtue of its strong presence in under-penetrated and high-growth categories. Its positioning on the 'health and wellness' platform backed by strong brand image of key brand *Horlicks* is progressive. This, combined with demonstrated ability to enter new categories and continuous innovations, justifies robust growth and rerating of the stock over the past five years. However, further rerating of the stock is unlikely after the successful open offer.

Key Risks

Raw material price inflation

With milk powder, milk and malt extract being major cost drivers for GSK, food inflation is one of the key risks faced by the company. In the past one year, at the wholesale level, milk prices surged 20%.

Competition getting stiffer

The processed food sector is growing significantly and all multinational as well as domestic companies are aggressively innovating and enhancing efforts to increase contribution from this segment. This aspect makes competition stiffer in this segment as companies have to innovate towards product development.

Competition to HFDs from other categories

The malted health food drink category is still at low penetration levels and faces resistance from categories like tea, coffee, juices and breakfast cereals.

Product failure

Apart from HFD, new products face greater risk of failure. *Horlicks Chill Doodh* and *Lucozade* have failed to make an impact in the market.

Economic slowdown

Urban sales contribute 73-74% to revenue. A slowdown in economic growth may negatively affect the company's business.

Financial Statements

Key Assumptions

Year to December	CY11	CY12E	CY13E	CY14E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	47.9	54.5	54.0	52.0
Company				
Volume gr. (overall)	9.1	7.0	6.5	6.9
Pricing gr. (overall)	7.4	7.9	7.3	7.2
Growth in other operating income	27.2	36.3	27.0	25.0
Vol gr. in Malt/Cereal/ Protein Food	9.0	6.5	6.0	6.5
Pricing ch in Malt/Cereal/ Protein Food	6.7	7.5	7.0	7.0
Volume growth in Packaged foods	13.5	15.0	14.0	13.0
Pricing change in Packaged foods	9.2	6.0	5.0	5.0
EBITDA margin assumptions				
COGS as % of sales	38.1	37.4	37.4	37.4
Milk powder consumed vols increase	4.2	1.9	3.1	4.9
Milk powder consumed price increase	20.6	10.0	7.0	6.0
Milk Fluid vols increase	5.1	5.8	5.7	4.5
Milk Fluid price increase	10.6	10.0	8.5	8.5
Malt and Malt Extract vols increase	9.8	6.4	6.0	7.1
Malt and Malt Extract price increase	10.2	7.0	5.0	5.0
Flour Wheat vols increase	8.0	13.0	13.0	5.0
Flour Wheat price increase	(0.4)	(5.0)	-	5.0
Packing Materials consumed growth	20.0	12.9	12.2	14.5
Purchase of goods growth	15.4	14.6	13.8	16.5
A&P as % of sales	16.3	16.1	16.3	16.4
Staff costs as % of sales	9.6	9.8	9.8	9.8
Financial assumptions				
Tax rate (%)	34.3	32.7	32.7	32.7
Capex (INR mn)	1,004	1,539	2,300	2,500
Debtor days	10	10	10	10
Inventory days	46	46	46	46
Payable days	92	92	92	92
Cash conversion cycle (days)	(35)	(36)	(36)	(36)
Depreciation as % of gross block	7.5	5.2	5.1	5.0
Dividend as % of net profit	41.4	43.3	40.0	40.0

Income statement

(INR mn)

Year to December	CY11	CY12	CY13E	CY14E
Net revenue	26,855	30,794	35,031	40,023
Other Operating Income	794	1,081	1,373	1,717
Total operating income	27,649	31,875	36,404	41,740
Materials costs	10,227	11,519	13,101	14,965
Gross profit	17,421	20,357	23,303	26,775
Employee costs	2,584	3,011	3,430	3,922
Other Expenses	5,421	6,647	7,451	8,525
Advertisement & sales costs	4,373	4,965	5,710	6,564
EBITDA	5,043	5,734	6,713	7,764
Depreciation & Amortization	460	361	452	546
EBIT	4,583	5,373	6,260	7,218
Other income	854	1,138	1,355	1,621
EBIT incl. other income	5,437	6,511	7,615	8,839
Interest expenses	35	24	29	34
Profit before tax	5,402	6,487	7,587	8,806
Provision for tax	1,851	2,119	2,481	2,879
Net profit	3,552	4,368	5,106	5,926
Profit after minority interest	3,552	4,368	5,106	5,926
Shares outstanding (mn)	42	42	42	42
Diluted EPS (INR)	84.4	103.9	121.4	140.9
Dividend per share (INR)	35.0	45.0	48.6	56.4
Dividend payout (%)	41.4	43.3	40.0	40.0

Common size metrics

Year to December	CY11	CY12	CY13E	CY14E
Materials costs	37.0	36.1	36.0	35.9
Advertising & sales costs	15.8	15.6	15.7	15.7
EBITDA margins	18.2	18.0	18.4	18.6
EBIT margins	16.6	16.9	17.2	17.3
Net profit margins	12.8	13.7	14.0	14.2

Growth ratios (%)

Year to December	CY11	CY12	CY13E	CY14E
Revenues	16.7	15.3	14.2	14.7
EBITDA	15.5	13.7	17.1	15.7
Net profit	18.4	23.0	16.9	16.1
EPS	18.4	23.0	16.9	16.1

Balance sheet		(INR mn)			
As on 31st December	CY11	CY12E	CY13E	CY14E	
Equity capital	421	421	421	421	
Reserves & surplus	11,021	13,176	15,892	19,045	
Shareholders funds	11,442	13,597	16,313	19,466	
Sources of funds	11,442	13,597	16,313	19,466	
Gross block	6,367	7,617	10,117	12,617	
Depreciation	4,360	4,721	5,173	5,718	
Net block	2,007	2,896	4,944	6,898	
Capital work in progress	1,711	2,000	1,800	1,800	
Cash and equivalents	10,797	11,629	12,765	14,307	
Inventories	3,700	3,901	4,429	5,049	
Sundry debtors	992	850	957	1,083	
Loans and advances	721	721	721	721	
Other current assets	492	492	492	492	
Total current assets	16,701	17,594	19,364	21,651	
Sundry creditors and others	6,663	6,579	7,481	8,570	
Provisions	2,712	2,712	2,712	2,712	
Total current liabilities &	9,376	9,292	10,194	11,283	
Net current assets	7,325	8,302	9,170	10,369	
Miscellaneous expenditure	399	399	399	399	
Uses of funds	11,442	13,597	16,313	19,466	
Book value per share (INR)	272.1	323.3	387.9	462.9	

Free cash flow		(INR mn)			
Year to December	CY11	CY12E	CY13E	CY14E	
Net profit	3,552	4,368	5,106	5,926	
Add : Non cash charge	(299)	385	481	579	
Depreciation	460	361	452	546	
Others	(759)	24	29	34	
Gross cash flow	3,253	4,753	5,587	6,506	
Less: Changes in WC	893	(144)	267	343	
Operating cash flow	4,146	4,609	5,854	6,849	
Less: Capex	1,004	1,539	2,300	2,500	
Free cash flow	3,142	3,070	3,554	4,349	

Cash flow metrics					
Year to December	CY11	CY12E	CY13E	CY14E	
Operating cash flow	3,872	4,609	5,854	6,849	
Investing cash flow	(362)	(1,539)	(2,300)	(2,500)	
Financing cash flow	(2,475)	(2,237)	(2,418)	(2,807)	
Net cash flow	1,036	833	1,136	1,542	
Capex	(1,004)	(1,539)	(2,300)	(2,500)	
Dividends paid	(1,711)	(2,213)	(2,390)	(2,773)	

Profitability & efficiency ratios					
Year to December	CY11	CY12E	CY13E	CY14E	
ROAE (%)	34.9	36.0	35.1	33.9	
ROACE (%)	43.6	42.9	41.9	40.3	
Inventory day	46	46	46	46	
Debtors days	10	10	10	10	
Payable days	92	92	92	92	
Cash conversion cycle (days)	(35)	(36)	(36)	(36)	
Current ratio	1.8	1.9	1.9	1.9	

Operating ratios					
Year to December	CY11	CY12E	CY13E	CY14E	
Total asset turnover	2.6	2.5	2.4	2.3	
Fixed asset turnover	13.3	12.6	8.9	6.8	
Equity turnover	2.6	2.5	2.3	2.2	

Valuation parameters					
Year to December	CY11	CY12E	CY13E	CY14E	
Diluted EPS (INR)	84.4	103.9	121.4	140.9	
Y-o-Y growth (%)	18.4	23.0	16.9	16.1	
CEPS (INR)	95.4	112.4	132.2	153.9	
Diluted PE (x)	44.8	36.4	31.1	26.8	
Price/BV (x)	13.9	11.7	9.7	8.2	
EV/Sales (x)	5.5	4.8	4.2	3.6	
EV/EBITDA (x)	29.4	25.7	21.8	18.6	
Dividend yield (%)	0.9	1.2	1.3	1.5	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted PE (X)		EV/EBITDA (X)		ROAE (%)	
		CY13E	CY14E	CY13E	CY14E	CY13E	CY14E
GlaxoSmithKline Consumer Healthcare	2,928	31.1	26.8	21.8	18.6	35.1	33.9
Asian Paints	7,955	30.3	25.5	19.6	16.4	39.9	39.6
Colgate	3,335	29.7	25.3	21.7	18.3	112.6	115.0
Dabur	4,230	25.8	21.6	18.5	15.1	37.1	35.8
Godrej Consumer	4,686	29.6	25.5	21.1	18.0	21.8	21.7
Hindustan Unilever	18,718	28.2	25.8	20.8	18.3	64.9	58.1
ITC	43,583	26.7	22.8	17.3	14.6	38.6	40.8
Marico	2,585	25.8	21.3	16.6	13.7	30.0	28.6
AVERAGE		28.9	24.3	19.7	16.6	49.6	48.8

Source: Edelweiss research

Additional Data

Directors Data

Mr. Simon J. Scarff	Non Executive Chairman	Mr. Zubair Ahmed	Managing Director
Mr. Kunal Kashyap	Non Executive Director – Independent	Mr. Mukesh H. Butani	Non Executive Director – Independent
Mr. Naresh Dayal	Non Executive Director – Independent	Mr. P. Dwarakanath	Non Executive Director – Independent
Mr. Praveen K. Gupta	Wholetime Director	Mr. Ramakrishnan Subramanian	Wholetime Director
Mr. Subodh Bhargava	Non Executive Director – Independent		

Auditors - Price Waterhouse - Chartered Accountants

**as per last annual report*

Top 10 holdings

	Perc. Holding		Perc. Holding
Arisaig Partners Asia Pte Ltd	10.02	Life Insurance Corp Of India	4.23
General Insurance Corp Of India	3.16	HDFC Life Insurance Co Ltd	2.64
Wasatch Advisors Inc	1.93	Intrade Pvt Ltd	1.75
Templeton Asset Mgmt	1.64	Commonwealth Bank Of Austr	0.96
IDFC Mutual Fund	0.94	HDFC Asset Management Co Ltd	0.73

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Asian Paints	BUY	SP	M	Bajaj Corp	BUY	SP	M
Colgate	HOLD	SP	M	Dabur	BUY	SO	M
Emami	BUY	SP	H	GlaxoSmithKline Consumer Healthcare	HOLD	SP	M
Godrej Consumer	BUY	SO	H	Hindustan Unilever	REDUCE	SU	L
ITC	BUY	SO	L	Marico	BUY	SO	M
Nestle Ltd	HOLD	SP	L	United Spirits	BUY	SO	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Consumer Goods

Asian Paints, Bajaj Corp, Colgate, Dabur, Godrej Consumer, Emami, Hindustan Unilever, ITC, Marico, Nestle Ltd, GlaxoSmithKline Consumer Healthcare, United Spirits

Recent Research

Date	Company	Title	Price (INR)	Recos
09-Feb-13	Emami	Double delight: Domestic, global businesses shine; <i>Result Update</i>	576	Buy
07-Feb-13	Bajaj Corp	Nourishing growth; <i>Initiating Coverage</i>	234	Buy
05-Feb-13	United Spirits	Robust volumes bring cheer; <i>Result Update</i>	1,858	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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