Company Focus

24 October 2007 | 10 pages

GlaxoSmithKline Consumer (GLSM.BO)

Target price change ☑
Estimate change ☑

Buy: 3Q07 – Defying Cost Pressures; Raise TP to Rs980

- **Delivering amidst cost pressures** — We are enthused by GSK's consistently strong profit growth despite raw material cost pressures. Management strategy of new product launches, price hikes and cost containment measures is paying off, driving strong sales and profit growth. 3Q07 net profits increased 40% yoy.
- **Cost pressures to continue** — Management indicated 25% increase in milk prices and 15% increase in wheat prices YTD. Milk prices could increase further, post lifting of export ban on SMP and expected weak milk output in Australia and NZ. GSK could take more price hikes to counter cost inflation.
- **Volume growth remains robust** — Malted products volumes are growing 7%, despite about 7% average price hikes effected in 2007 (5.5% at the consumer end). New product variants such as Junior Horlicks are aiding volume growth. GSK is likely to launch new products from its parent's portfolio in 2008, while continuing to expand variants for the existing malt beverages.
- **Raising EPS and price target** — We raise 07E-09E EPS estimates by 11.9%-26.6%, following better than expected 9m07 results and lift our price target to Rs980, still based on our 20x P/E multiple, but rolled forward to Dec-08.
- **Attractive valuations, cash support** — GSK is trading at 12.8x 08E P/E, lowest in our Indian consumer universe. GSK also has about Rs110 cash per share on its books, which offers downside support. While management is seeking inorganic growth opportunities, we see strong case for higher dividend payout.

Buy/Low Risk	1L
Price (23 Oct 07)	Rs626.45
Target price	Rs980.00
from Rs770.00	
Expected share price return	56.4%
Expected dividend yield	3.6%
Expected total return	**60.1%**
Market Cap	Rs26,346M
	US$664M

Price Performance (RIC: GLSM.BO, BB: SKB IN)

Statistical Abstract

Year to 31 Dec	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	1,430	34.00	110.9	18.4	5.5	28.5	2.2
2006A	1,269	30.18	-11.2	20.8	4.9	24.9	2.7
2007E	1,755	41.74	38.3	15.0	4.3	30.4	3.6
2008E	2,061	49.00	17.4	12.8	3.8	31.7	4.3
2009E	2,369	56.33	15.0	11.1	3.4	32.2	5.0

Source: Powered by dataCentral

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[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	18.4	20.8	15.0	12.8	11.1
EV/EBITDA adjusted (x)	11.0	13.0	9.6	8.0	6.6
P/BV (x)	5.5	4.9	4.3	3.8	3.4
Dividend yield (%)	2.2	2.7	3.6	4.3	5.0
Per Share Data (Rs)					
EPS adjusted	34.00	30.18	41.74	49.00	56.33
EPS reported	34.00	30.18	41.74	49.00	56.33
BVPS	112.97	129.05	145.30	163.96	185.36
DPS	13.73	16.73	22.81	27.18	31.31
Profit & Loss (RsM)					
Net sales	9,668	11,119	13,002	14,737	16,405
Operating expenses	-7,887	-9,701	-11,020	-12,396	-13,620
EBIT	**1,782**	**1,418**	**1,981**	**2,340**	**2,784**
Net interest expense	-42	-35	0	0	0
Non-operating/exceptionals	243	522	600	690	794
Pre-tax profit	**1,983**	**1,905**	**2,582**	**3,030**	**3,578**
Tax	-553	-636	-826	-970	-1,209
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,430**	**1,269**	**1,755**	**2,061**	**2,369**
Adjusted earnings	1,430	1,269	1,755	2,061	2,369
Adjusted EBITDA	2,200	1,845	2,440	2,851	3,306
Growth Rates (%)					
Sales	12.1	15.0	16.9	13.3	11.3
EBIT adjusted	97.6	-20.4	39.7	18.1	19.0
EBITDA adjusted	67.1	-16.1	32.2	16.9	15.9
EPS adjusted	110.9	-11.2	38.3	17.4	15.0
Cash Flow (RsM)					
Operating cash flow	**1,181**	**2,993**	**1,973**	**2,532**	**2,842**
Depreciation/amortization	419	427	459	511	522
Net working capital	350	1,297	-241	-40	-48
Investing cash flow	**-131**	**-2,302**	**-985**	**-1,256**	**-1,373**
Capital expenditure	-131	-105	-850	-750	-150
Acquisitions/disposals	0	-2,197	-135	-506	-1,223
Financing cash flow	**-646**	**-785**	**-1,072**	**-1,275**	**-1,469**
Borrowings	0	0	0	0	0
Dividends paid	-646	-785	-1,072	-1,275	-1,469
Change in cash	**404**	**-94**	**-84**	**0**	**0**
Balance Sheet (RsM)					
Total assets	**6,856**	**7,753**	**8,672**	**9,765**	**10,940**
Cash & cash equivalent	1,858	479	1,000	1,000	1,000
Accounts receivable	241	281	427	484	539
Net fixed assets	2,838	2,579	2,645	2,884	2,512
Total liabilities	**2,105**	**2,327**	**2,561**	**2,870**	**3,144**
Accounts payable	1,766	1,882	2,461	2,770	3,044
Total Debt	0	0	0	0	0
Shareholders' funds	**4,751**	**5,427**	**6,111**	**6,896**	**7,795**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.8	16.6	18.8	19.3	20.2
ROE adjusted	28.5	24.9	30.4	31.7	32.2
ROIC adjusted	40.0	25.4	40.0	47.0	54.4
Net debt to equity	-39.1	-8.8	-16.4	-14.5	-12.8
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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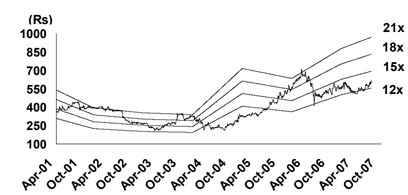
Figure 2. GSK Consumer P/E Bands



Source: Company Reports and Citi Investment Research Estimates

Raising price target to Rs980

We are raising the price target for GSK Consumer to Rs980 (Rs770 earlier) based on 20x 08E P/E. Our price target increase is based on 1) Increasing our EPS estimates for 2007E-09E by 11.9%-26.6%; and 2) Rolling forward our target P/E multiple from mid-08 to Dec-08, given that we are already in 4Q07 and GSK stock's valuation is increasingly likely to reflect 2008 earnings.

We are increasing our EPS estimates for GSK Consumer for 2007E-09E by 11.9%-26.6%. Our increase in estimates is based on GSK Consumer's significantly better than expected profit growth in 9m07 and management guidance of 13%-14% sales growth going forward, which is higher than our earlier sales growth estimates of 12%-13% (9m07 sales growth has been almost 18%). In addition, we also incorporate savings from the company's cost containment programme as well as higher price hikes, given that the company has already taken almost 7% price hikes against our expectations of about 4% hikes. We now forecast an EPS CAGR of 23.1% over 2006-09E, driven by 13.8% sales CAGR, and 330bps margin expansion over the same period. Our earnings revision summary is enumerated below:

Figure 1. GSK Consumer Earnings Revision Summary

	EPS (Rs)			Net Profit (Rs Mils)			DPS (Rs)		
	Old	New	% Change	Old	New	% Change	Old	New	% Change
2007E	37.3	41.7	11.9	1,568.3	1,755.4	11.9	20.6	22.8	10.8
2008E	41.0	49.0	19.6	1,723.3	2,060.6	19.6	22.9	27.2	18.8
2009E	44.5	56.3	26.6	1,871.3	2,368.8	26.6	24.9	31.3	25.8

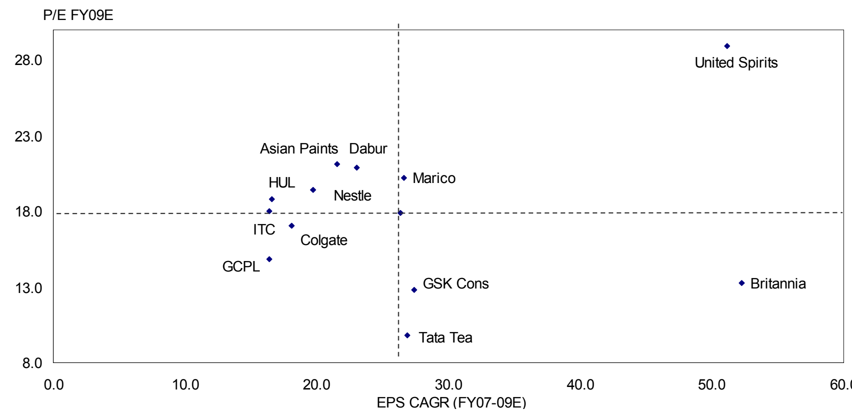
Source: Company Reports and Citi Investment Research Estimates

Valuations are attractive

GSK Consumer stock is currently trading at 12.8x 08E P/E, which is at almost 50% discount to our Indian consumer universe and the lowest as well. We find the stock valuations attractive, given the robust earnings growth, which the company is delivering despite raw material cost pressures. While it is difficult to make a call at this juncture on a potential softening of key raw materials (milk and wheat), a turn in the cost cycle can throw up material positive earnings surprises. In addition, GSK is planning to introduce new products from its parent's stable in 2008, which could add to growth momentum.

GSK also has about Rs4.6bn of cash on its books, which translates to almost Rs110 cash per share (or almost 17.5% of current market cap), which should provide downside support to the stock price. While management has been looking at inorganic growth opportunities, we believe that it will be difficult for GSK to find an accretive acquisition in the current valuation environment. In our view, there is a strong case for the company to hike its dividend payout, which we believe can also act as a strong catalyst for the stock price. In the event of an acquisition opportunity arising, GSK can easily increase its gearing on the balance sheet (no debt currently). GSK had a net worth of Rs5.4bn for year ending December 2006.

Figure 3. Citi Investment Research Indian Consumer Universe- P/E vs. EPS CAGR



Source: Company Reports and Citi Investment Research Estimates

3Q07 results and management call summary

1. **Strong profit growth:** 3Q07 profits grew strong 39.7% yoy, driven by 17% growth in sales and 166bps EBITDA margin improvement. 50.9% increase in non operating income also helped boost profit growth.

2. **Volumes, price hikes drive sales growth:** 3Q07 sales grew 17%, driven by 7% volume growth for malted foods, improving mix and almost 7% increase in prices. Management expects volume growth to remain strong and sales to grow by 13%-14%. GSK has launched new variants of its flagship brand 'Horlicks', which have been well accepted by consumers and are contributing strongly to sales growth.

3. **Margins:** GSK Consumer's 3Q07 EBITDA profits grew 28% yoy, driven by a 166bps margin expansion. GSK has been facing raw material cost pressure, but has been able to pass this on through price increases. So far in 2007, milk and milk product prices have increased by almost 25%, while wheat prices are up 15%. GSK management expects raw material cost pressures to continue going forward. Milk product prices are gaining strength, following recent lifting of ban on SMP exports by the government, and a bullish global milk price outlook driven by estimates of lower milk production in Australia and New Zealand. GSK management also expects pressure on wheat prices to continue. GSK is likely to continue to use a combination of price hikes and cost cutting measure to sustain margins. So far, consumers have absorbed the price hikes, without any materially adverse impact on volume growth.

4. **New products:** GSK is planning to launch new products in 2008. While roll out of variants of the existing brands will continue, the company is planning to introduce products from its parent's stable in 2H08. Management has not yet disclosed which products it is likely to bring to India.

Figure 4. GSK Consumer 3Q07 Results Summary (Rupees in Million, Percent)

	3Q06	3Q07	% YoY
Net Sales	**3,006.0**	**3,516.0**	**17.0**
Expenditure	-2,477.0	-2,839.0	14.6
EBITDA	**529.0**	**677.0**	**28.0**
EBITDA Margin (%)	*17.6*	*19.3*	*166 bps*
Interest	-11.0	-12.0	9.1
Depreciation & Amortisation	-110.0	-111.0	0.9
Other Income	138.5	209.0	50.9
PBT	**546.5**	**763.0**	**39.6**
Tax	-185.0	-258.0	39.5
Tax Rate (%)	*33.9*	*33.8*	*-4 bps*
PAT	**361.5**	**505.0**	**39.7**

Source: Company Reports

Figure 5. GSK Consumer 3Q07 Key Costs (Rupees in Million, Percent)

	3Q06	3Q07	% YoY
Net Sales	3006.0	3516.0	17.0
Total Raw Material Cost	1,096.0	1,240.0	13.1
% of Sales	*36.5*	*35.3*	*-119 bps*
Employee/Staff Cost	328.2	398.0	21.3
% of Sales	*10.9*	*11.3*	*40 bps*
Advertising Cost	365.8	465.0	27.1
% of Sales	*12.2*	*13.2*	*106 bps*
Other Expenditure	687.0	736.0	7.1
% of Sales	*22.9*	*20.9*	*-192 bps*

Source: Company Reports

GlaxoSmithKline Consumer

Company description

GSK Consumer is the leading player in the white and brown beverage segments. The parent company, GlaxoSmithKline, has a 40% stake in the domestic subsidiary. Horlicks and Boost are GSK's key brands, which enjoy a strong franchise among consumers in India. The company dominates the white powder market with more than an 80% share. GSK has commissioned a plant in Baddi, which is likely to save excise of around Rs300m per annum.

Investment strategy

We rate GSK Consumer as Buy/Low Risk (1L) with a target price of Rs980. We believe the stock is a re-rating candidate because we see the re-launch of flagship brand Horlicks putting the company back on the growth path. After five quarters of negative volume growth, business fundamentals have started improving from 3Q03 and strong sales continuing in 2007. We believe volume growth will likely intensify. The re-launch of flagship brand Horlicks and the introduction of innovative variants have met with good responses from consumers, and management has indicated that it hopes this will convert to secondary sales over time. With the new Horlicks facility operating below optimum levels, there are gains to be made from operating efficiencies as volumes pick up. We believe the worst is past and expect better performance from GSK. The company is investing in long-term growth through product innovations, the widening of its distribution network and growing sales through new delivery mechanisms.

Valuation

GSK Consumer is likely to have steady growth in earnings despite some minor hiccups in the past 24 months, and we believe P/E is best suited to value the company. Our target price of Rs980 is based on 20x CY08E P/E. The stock has historically traded at a range of 12x to 21x, with an average of about 15x, over the past seven years. We feel a 20x multiple is warranted given relatively better earnings profile and higher capital-efficiency ratios. It currently has the lowest PE among our Indian consumer universe and above average EPS growth, which makes it an attractive buy, in our view. A higher dividend payout is likely to help stock valuations and should provide downside support.

Risks

We rate GSK as Low Risk because the company operates in a branded segment in which earnings visibility is high and earnings follow a secular trend. The key downside risks to our target price include: (1) the re-launch of Horlicks could confuse users and lead to brand switches; (2) a rural recovery may not fully manifest into additional sales for GSK; and (3) competition.

Appendix A-1

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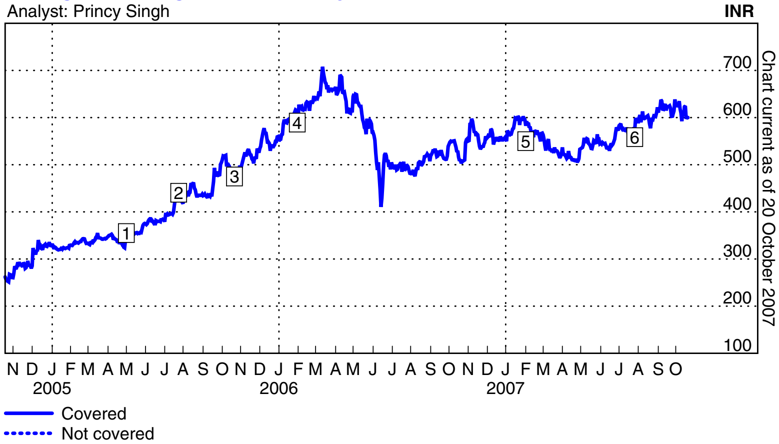
IMPORTANT DISCLOSURES

GlaxoSmithKline Consumer (GLSM.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Princy Singh



#	Date	Rating	Target Price	Closing Price
1:	2 May 05	1L	*395.00	341.35
2:	25 Jul 05	1L	*500.00	434.80
3:	21 Oct 05	1L	*540.00	478.35
4:	31 Jan 06	1L	*725.00	607.75
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6:	26 Jul 07	1L	*770.00	574.15

*Indicates change.

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