

# GSK Consumer Healthcare

## Energising multi-growth initiatives

Our visit with GSK Consumer's management ranged over various topics on the structural changes boosting consumption in India, the company's strategy to maximize its growth potential, and its actions on the ground. We come away further convinced about GSK Consumer's growth potential and maintain our **Outperformer** rating with revised target price of Rs 1,564.

- Eyeing huge opportunities in bottom of pyramid (BoP) sales**  
 Horlicks relies on SEC C, D and E for almost 50% of its current sales. Given that overall penetration of health drinks in India remains a low 20%, opportunities to tap the BoP segment remain huge as just two out of 10 Indians consume health drinks. Penetration in SEC D/E is low at 5-6%.
- Price points work but may not be the game changer**  
 Management believes in the importance of price points and that they help in pushing growth for bottom-of-pyramid consumers but the long-term strategy to serve the BoP will be to create products suited to their needs. The company is test marketing Asha from Horlicks at Rs 85 in AP towards this end.
- Not ignoring the top of the pyramid—focusing on multiple initiatives**  
 Although the core business (Horlicks) continues to show growth, management recognises that its aggressive foray into the BoP segment may put pressure on gross margins. So, they are looking at multiple segments in order to grow and are putting money behind multiple initiatives. They have recently launched Acti Base and Acti Grow at premium price points.
- Earnings estimates changed; target price revised to Rs 1,564**  
 We have revised our earnings estimates for CY10E and CY11E marginally by 3% and 6% respectively. We maintain our **Outperformer** rating with a revised target price of Rs 1,564.

**Figure 1: Key financials**

Rs million (or as indicated), year-end December

	CY07	CY08	CY09E	CY10E	CY11E
Revenue	12,785	15,428	18,989	22,969	27,674
Growth	15.4%	20.7%	23.1%	21.0%	20.5%
EBITDA	2,201	2,306	3,288	4,051	5,055
EBITDA margin	17.2%	14.9%	17.3%	17.6%	18.3%
PAT	1,627	1,883	2,479	2,968	3,692
EPS (Rs)	38.7	44.8	58.9	70.6	87.8
Growth	28.2%	15.8%	31.6%	19.8%	24.4%
P/E (x)	35.9	31.0	23.5	19.7	15.8

Source: Company data, Reliance Equities estimates.

## Outperform

Rs 1,388

Target price: Rs 1,564

### FMCG

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Bloomberg code	SKB IN
Reuters code	GLSM.BO
3m avg. traded value (Rs m)	30.2
52-wk H/L (Rs)	1436/482.5
Sensex	16855
Mcap (US\$ m/Rs bn)	1246.7/58

### Shareholding (%)

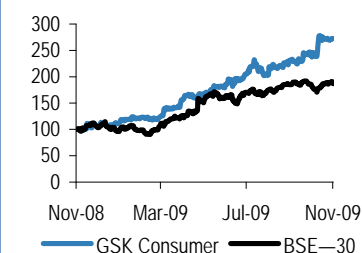
	Sep-09	Jun-09
Promoters	43.2	43.2
MFs, FIs, banks	23.8	24.8
FIIIs	8.3	6.4
Others	24.8	25.7

### Stock performance (%)

	1m	6m	1yr
Absolute	10.5	62.6	174.6
BSE 30 Index	2.3	23.6	97.8

### Share price performance

Base=100



Source: Bloomberg, Capitaline.

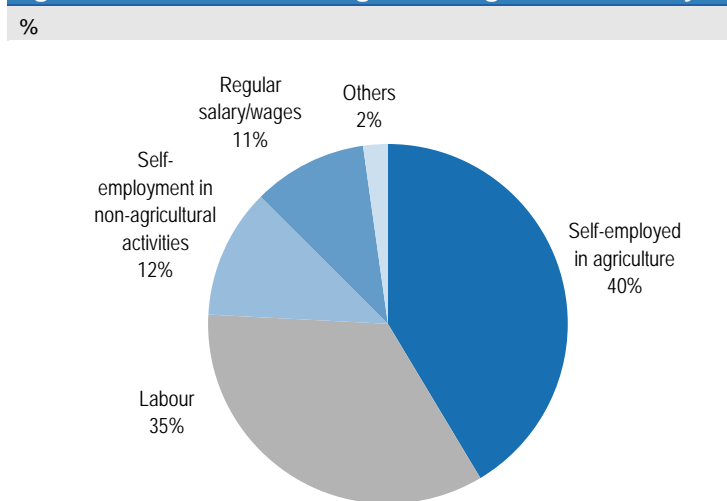
## Company visit note

Our visit with GSK Consumer’s management ranged over various topics on the company’s future strategy, its current brand status in various markets and the manner in which it plans to grow.

### Structural changes happening in India

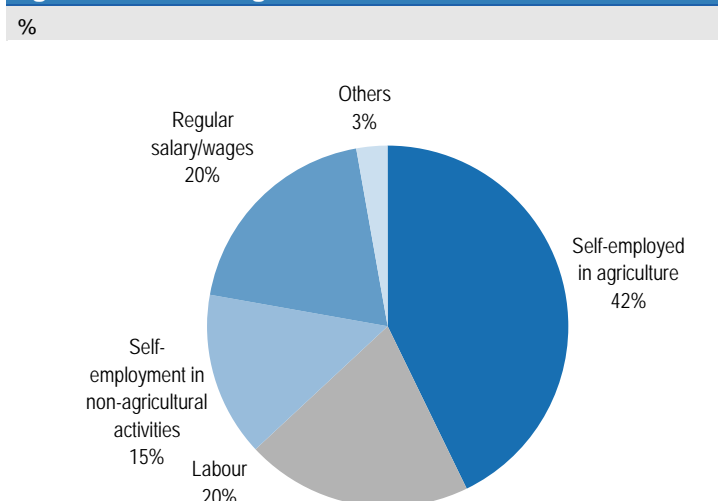
- Management believes that structural changes are taking place in rural India: the rural economy is converging with the urban economy and, as a result, rural mindsets are converging with urban ones. We believe that is the real trigger for the consumption boom in rural India. The National Rural Employment Guarantee Act (NREGA) gives a sense of confidence and an assurance of sustainable income for the populace. It gives money in the hands of the people and the sustained inflows are resulting in sustained outflows.

**Figure 2: Rural India shifting to non-agrarian economy...**



Source: NCAER 2004-05, Reliance Equities research.

**Figure 3: ...resulting in sustainable cash inflows**



Source: NCAER 2004-05, Reliance Equities research.

- The important change has been that the focus of control has shifted from outside to inside, or, as we define it, from a socialist to a capitalist consumption pattern. There is no longer any guilt in consuming.

### Eyeing huge opportunities at the bottom of pyramid

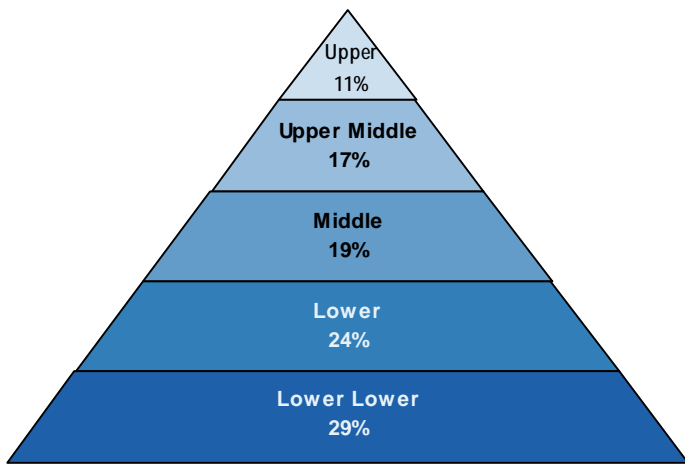
- We believe GSK Consumer Healthcare conducted bottom of pyramid (BoP) research globally in the BRIC economies, to try and identify whether huge opportunities existed for GSK worldwide to play the segment. Even now, more than 50% of Horlicks’ sales come from SEC C/D/E with at least 25% being contributed by the SEC D/E category.
- Overall penetration of health drinks in India remains low, at 20%, though it is higher in urban India and in the south and east. Opportunities remain huge, as just two out of 10 Indians consume health drinks and the frequency remains just four out of 12 months in a year. Penetration in SEC D/E is low at 5-6%.
- Traditionally, the north and west regions have remained nutritionally confident and so natural foods remain a basic form of their diet, while for the south and east, due to their

lack of nutrition confidence, add on / supplement foods like Horlicks become a substitute form of nutrition.

- In SEC D/E, penetration of health food drinks is low, at 5-6%, while the frequency is a meager one out of 12 months in a year. There are three basic hindrances for the rural population accepting the product category: cultural (nutrition intake being a natural form), pricing and reach. Bihar is the fastest-growing market.

**Figure 4: Huge opportunity lies at bottom of pyramid**

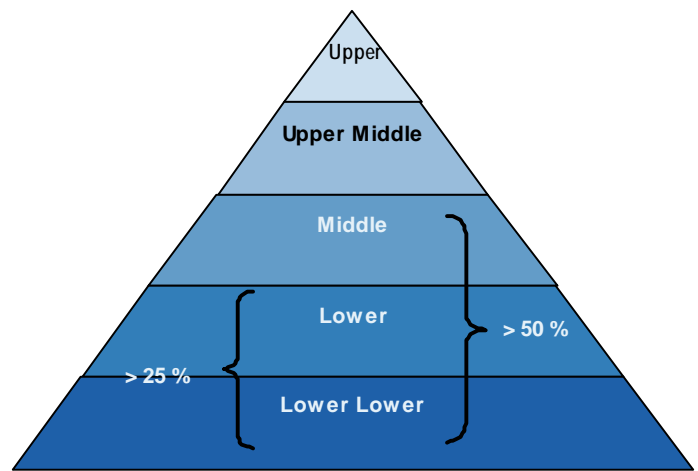
Total households: 209 million



Source: Indian Market Research Bureau, Reliance Equities research.

**Figure 5: Contributes ~25% to Horlicks' revenues**

% of Horlicks sales



Source: Company data, Reliance Equities research.

## Price points work, but are not the game changer

- The Rs 10 price point is doing well in rural India, as can be interpreted from Iodex sales. Last year, sales declined by 18% while in the past 12 months, post the introduction of its Rs 10 stock keeping unit (SKU), sales have grown by 18%. It is too early to comment on the impact of the Rs 20 price point SKU on the sales of Boost and Horlicks. We believe that Rs 20 SKUs are doing well in the north and west, but not so well in the south and east. We believe that for a product like Horlicks, which is regularly consumed, consumers prefer to buy in bulk with a value-for-money perspective (buying more means lower price per unit), while for a product like Boost, where consumer intake is not regular, a price point strategy may work better.
- We believe that price points give a company short-term gains; they are not the game changer as price point offerings are flooding the market from every company.
- Management is of the opinion that the company should understand the needs of BoP consumers and offer them a product that addresses their needs, while pricing it appropriately. Towards that end, the company has test-launched 'Asha from Horlicks' at Rs 85 compared to Rs 135 for regular Horlicks. Management states that it is only test marketing the product to try and understand the implications on cannibalisation and dilution of brand equity and is not in a hurry to roll out this product. The company is test marketing three messaging media in three different markets: street plays, cinemas and a micro finance company (the third has proved to be the most successful in the initial days).

## Not ignoring top of the pyramid: Multiple initiatives are on

- GSK Consumer is looking at multiple segments in order to grow and is thus putting money behind multiple initiatives, measuring them and preparing contingency plans. Management realises that its initiatives to target the BoP segment will put pressure on gross margins. It hopes to compensate for this by beefing up the premium end as well through initiatives such as launching Acti Grow and Acti Base.
- The test marketing for Breathe Right (snoring and congestion relief) has been successful and the product is being rolled out across India. However, this will be brought under GSK Asia while GSK India will receive normal commissions.

**Figure 6: Acti Base—Part of GSK’s multi-brand strategy**



Source: Company data, Reliance Equities research.

**Figure 7: Breathe Right—Test marketing was a success**



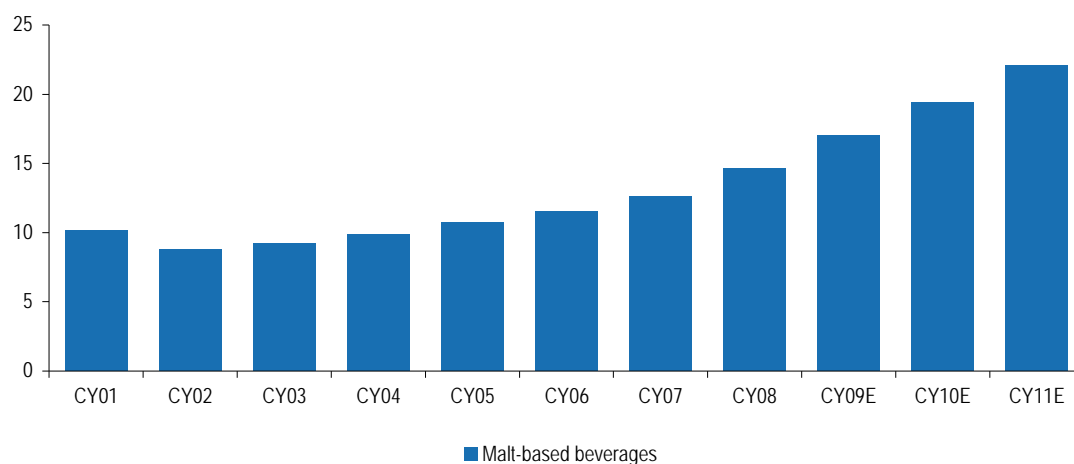
Source: Company data, Reliance Equities research.

## Core business continues to show healthy growth

- GSK Consumer has been conservative about pricing but has kept up its focus on gross margins. Its pricing conservatism may be due to the bad time it had in 2002 when management’s decision to increase prices resulted in volumes declining.
- About 50-60% of Horlicks’ growth comes from new users, 30-35% from increased usage, and the balance comes from gain/loss from/to competition.
- Since 2005, volumes have grown at a CAGR of 9.3%, which may be attributed to the “Taller, Sharper, Stronger” campaign started in mid-2005.

**Figure 8: 2005 marks the change in core business growth**

Quantity in million dozens

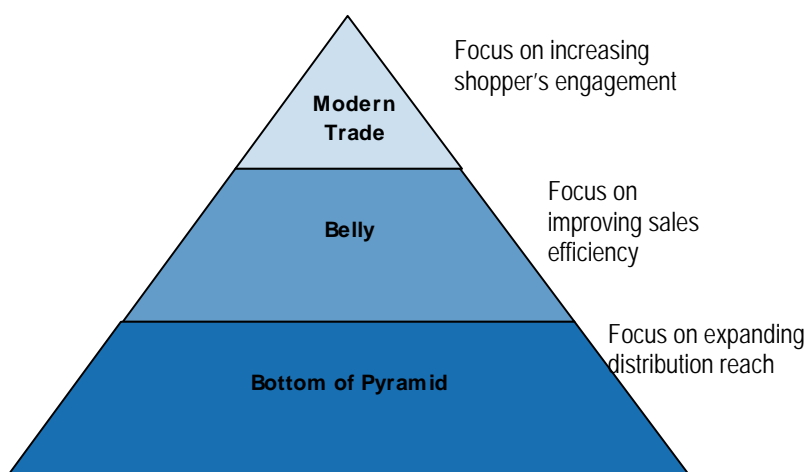


Source: Company data, Reliance Equities estimates.

## Distribution expansion

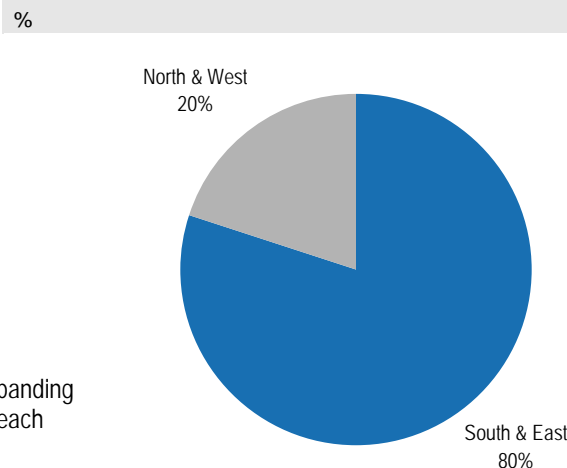
- The company currently has 500-600 distributors with about 3,000 sub-distributors and the direct reach of about 500,000 outlets all over India. We believe that the company has not yet begun to see the gains from the distribution expansion it did in 2009, the effects of which will be felt only in 2010-11.
- Management is looking to play across the pyramid of distribution: at the top end through modern retail (looking at ways to engage shoppers); for the belly focusing on sales efficiency; and for the bottom of pyramid, expanding reach and accessibility, launching low unit packs.

**Figure 9: Focusing across the pyramid of distribution**



Source: Company data, Reliance Equities research.

**Figure 10: Looking at ways to grow sales in north, west**



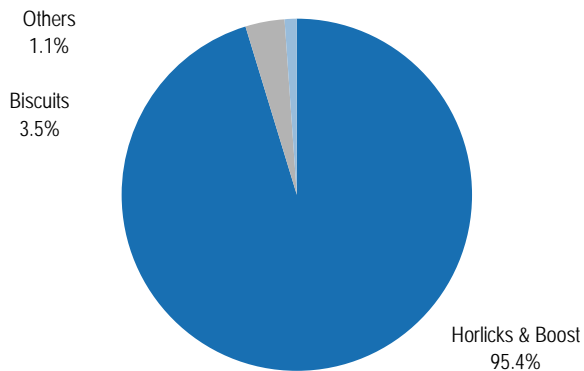
Source: Company data, Reliance Equities research.

## New launches / innovation

- GSK Consumer is not looking to be a leading player in biscuits. The idea behind its foray into this category is that, even if it can grab 1% market share in the segment profitably, it can be a strong business opportunity. The company has offerings at the Rs 5, 10, 15, 20, and 25 price points. The idea is to leverage Horlicks' brand equity and ride on its health promise to consumers.
- Nutribars, or energy snack bars, do not exist as a category in the country. Initial response to GSK Consumer's launch has been good and management believes they are still learning the dynamics of this category. GSK Consumer has two price point offerings in this category: Rs 10 and Rs15.
- Innovation is key for the company. This year, it has launched six new products, and management is confident that it will continue the pace going forward. The company is looking at new brands contributing 25% to its sales by 2011-2012.
- Management is looking to grow the core business 2x in five years, Horlicks extensions (like Mother's Horlicks, Women's Horlicks) 2x in three years, and new categories [like energy bars, biscuits etc] 2x every year.
- Only 5% of the company's current sales come from global brands.

- Management stated that they will not enter into any category which does not involve consumer experience and science. We believe the other categories which the company may look to add in the near future are noodles, breakfast cereals and energy drinks.

**Figure 11: Traditionally dependent on health food drinks**



Source: Company data, Reliance Equities research.

**Figure 12: New categories, new variants galore**



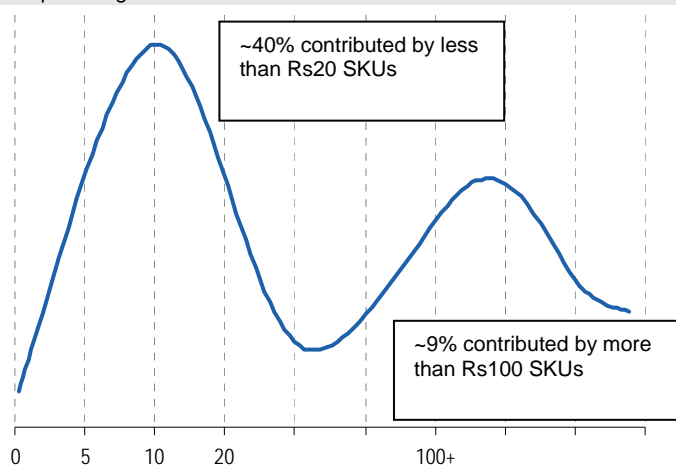
Source: Company data, Reliance Equities research.

### Price point segmentation

- Management realised that GSK was leading in the FMCG SKUs priced above Rs 100 through Horlicks (Rs 135), which forms about 9% of the industry. However, in the categories below Rs 20 (which constitute about 40% of the FMCG market), GSK hardly had any presence. So, GSK is looking to enter new categories to increase its presence in these price points.

**Figure 13: Low presence at <Rs20 price points**

Price point segmentation of Indian FMCG market



Source: Company data, Reliance Equities research.

\* Chart not to scale

**Figure 14: New launches offer those price points**

Units as indicated

New product launched	Price
Junior Horlicks Biscuits	Rs 10 & Rs 35
Horlicks NutriBar	Rs 10 & Rs 15
Horlicks Chill Dood	Rs 10
Horlicks Asha	Rs 85
Horlicks sachets	Rs 20
Boost sachets	Rs 20

Source: Company data, Reliance Equities research.

## Earnings estimates and valuation

We have revised our earnings estimates for CY10 and CY11 marginally by 3% and 6% respectively, factoring in higher sales growth led by new initiatives. We value the stock on a weighted average metric of three valuations: P/E (20x CY10E earnings; Rs 1,421), DCF (WACC of 11% and terminal growth rate of 3%; Rs 1,736), and market cap-to-sales (3x CY10E; Rs 1,638), resulting in an average value of Rs 1,564 for the stock—an upside of 13%. At the current market price of Rs 1,388 the stock trades at 19.7x CY10E and 15.8x CY11E earnings. We maintain our **Outperformer** rating with a revised target price of Rs 1,564.

**Figure 15: Estimate changes**

As indicated			
	EPS - CY10E (x)	EPS - CY11E (x)	Target Price (Rs)
<b>Old</b>	68.5	82.8	1,501
<b>New</b>	70.6	87.8	1,564
<b>Change</b>	3.1%	6.0%	4.2%

Source: Reliance Equities estimates.



**Figure 16: Key financials**

Rs million (unless indicated otherwise), year-end December				
<b>Income statement</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
<b>Sales</b>	<b>15,428</b>	<b>18,989</b>	<b>22,969</b>	<b>27,674</b>
Raw material	(6,318)	(7,765)	(9,598)	(11,685)
Employee expenses	(1,720)	(2,015)	(2,358)	(2,759)
SG&A expenses	-	-	-	-
Other operating expenses	(5,085)	(5,919)	(6,962)	(8,176)
Other op. income	-	-	-	-
<b>EBITDA</b>	<b>2,306</b>	<b>3,288</b>	<b>4,051</b>	<b>5,055</b>
Depn and amort.	(419)	(436)	(559)	(591)
<b>EBIT</b>	<b>1,886</b>	<b>2,852</b>	<b>3,493</b>	<b>4,463</b>
Net int. income/exp.	-	-	-	-
Inc./loss from assoc.	-	-	-	-
Other non-op inc./exp.	955	907	1,043	1,200
PBT	2,841	3,759	4,536	5,663
Provision for taxes	(958)	(1,281)	(1,568)	(1,971)
Minority interest	-	-	-	-
Preference dividend	-	-	-	-
Reported net profit	1,883	2,479	2,968	3,692
<b>REIPL net income</b>	<b>1,883</b>	<b>2,479</b>	<b>2,968</b>	<b>3,692</b>
Wtd avg # of shares	42.1	42.1	42.1	42.1
EPS (basic, rep) (Rs)	44.8	58.9	70.6	87.8
EPS (dil., rep.) (Rs)	44.8	58.9	70.6	87.8
<b>EPS (dil., adj.) (Rs)</b>	<b>44.8</b>	<b>58.9</b>	<b>70.6</b>	<b>87.8</b>
DPS (Rs)	15.0	17.7	21.2	26.3
Divid payout ratio (%)	33.5	30.0	30.0	30.0
<b>Balance sheet</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
Cash and equiv.	4,710	5,896	5,757	8,050
A/c.s receivable	433	525	635	765
Loans and adv.	338	416	504	607
Inventory	2,772	3,362	4,067	4,900
Other current assets	281	346	419	505
<b>Total curr. assets</b>	<b>8,534</b>	<b>10,546</b>	<b>11,382</b>	<b>14,826</b>
Accounts payable	1,725	2,120	2,621	3,191
Short-term debt	-	-	-	-
Other curr. liab.	1,399	1,710	2,094	2,537
<b>Total curr. liab.</b>	<b>3,125</b>	<b>3,830</b>	<b>4,714</b>	<b>5,728</b>
<b>Net curr. assets</b>	<b>5,409</b>	<b>6,715</b>	<b>6,667</b>	<b>9,098</b>
Net fixed assets	2,266	2,529	4,471	4,380
Net intangibles	-	-	-	-
Investments	0	0	0	0
Other long-term assets	(0)	(0)	(0)	0
<b>Total assets</b>	<b>7,675</b>	<b>9,244</b>	<b>11,138</b>	<b>13,478</b>
Total loans	-	-	-	-
Other long-term liab.	66	31	11	(0)
Shareholders' funds	7,609	9,214	11,136	13,526
Pref. shrs/other equity	-	-	-	-
Minority interest	-	-	-	-
<b>Total liab. and equity</b>	<b>7,675</b>	<b>9,244</b>	<b>11,146</b>	<b>13,526</b>
<b>BVPS (Rs)</b>	<b>180.9</b>	<b>219.1</b>	<b>264.8</b>	<b>321.6</b>
<b>DuPont analysis</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
Margin (%)	12.2	13.1	12.9	13.3
Asset turnover (x)	1.5	1.6	1.6	1.6
Leverage (x)	1.4	1.4	1.4	1.4
ROE (%)	26.8	29.5	29.2	29.9
<b>Cash Flow Statement</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
PBT	2,841	3,759	4,536	5,663
D&A add back	(419)	(436)	(559)	(591)
Taxes paid	(1,065)	(1,316)	(1,588)	(1,982)
(Inc)/dec in w. cap	(4,184)	(1,306)	48	(2,431)
Other op. cash flow	4,612	2,059	979	3,475
<b>Cash flow from op. (A)</b>	<b>1,785</b>	<b>2,760</b>	<b>3,416</b>	<b>4,134</b>
Cap exp. (B)	(252)	(700)	(2,500)	(500)
Acquisitions	-	-	-	-
Divestitures	-	-	-	-
Others	2,978	-	-	-
<b>Cash flow from investing</b>	<b>2,727</b>	<b>(700)</b>	<b>(2,500)</b>	<b>(500)</b>
FCF (A+B)	1,533	2,060	916	3,634
Divids pd (com. and pref.)	(738)	(874)	(1,046)	(1,301)
Inc. in equity	-	-	-	-
Inc./(dec.) in debt	-	-	-	-
Other financing cash flows	(0)	(0)	0	(0)
<b>Cash flow from financing</b>	<b>(738)</b>	<b>(874)</b>	<b>(1,046)</b>	<b>(1,301)</b>
<b>Total cash flow</b>	<b>3,773</b>	<b>1,186</b>	<b>(130)</b>	<b>2,332</b>
<b>Capital management</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
Inventory days	55.8	59.0	59.0	59.1
Receivable days	8.4	9.2	9.2	9.2
<b>Growth and margins (%)</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
Sales growth	20.7	23.1	21.0	20.5
EBITDA growth	4.7	42.6	23.2	24.8
EPS growth	15.8	31.6	19.8	24.4
EBITDA margin	14.9	17.3	17.6	18.3
EBIT margin	12.2	15.0	15.2	16.1
Net margin	12.2	13.1	12.9	13.3
Rev. growth – peers	-	-	-	-
EBITDA growth – peers	-	-	-	-
EBITDA margin – peers	-	-	-	-
EPS growth – peers	-	-	-	-
Noplat	1,250	1,880	2,286	2,910
Invested capital	7,675	9,244	11,138	13,478
ROIC (%)	22.1	22.2	22.4	23.6
ROIC/WACC (x)	-	-	-	-
ROIC – peers (%)	-	-	-	-
<b>Valuations</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
P/E (x)	31.0	23.5	19.7	15.8
P/E (peers) (x)	-	-	-	-
EV/sales (x)	3.5	2.8	2.3	1.8
EV/sales – peers (x)	-	-	-	-
EV/EBITDA (x)	23.3	16.0	13.0	10.0
EV/EBITDA (peer group)	-	-	-	-
P/B (x)	7.7	6.3	5.2	4.3
P/B peer group (x)	-	-	-	-
Div yield (%)	1.1	1.3	1.5	1.9
Free cash flow yield (%)	2.6	3.5	1.6	6.2
<b>Quality of earnings</b>	<b>CY08</b>	<b>CY09E</b>	<b>CY10E</b>	<b>CY11E</b>
Op. cash flow/net income (x)	0.9	1.1	1.2	1.1
Capex/Depn (x)	0.6	1.6	4.5	0.8
Tax charge/pre-tax income (x)	33.7	34.1	34.6	34.8
Net debt/equity (%)	(0.6)	(0.6)	(0.5)	(0.6)

Source: Company data, Reliance Equities estimates.



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**Key to REIPL recommendations**

**Outperform** = Expected total return is more than the hurdle rate.

**Neutral** = Expected total return is less than the hurdle rate but more than zero.

**Underperform** = Expected total return is negative.

**Expected total return** is defined as expected price appreciation over the next 12 months plus our dividend yield forecast for the stock.

**Hurdle rate** is defined as the ten-year government securities yield + our market risk premium assumption.

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**DISCLOSURES**

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