



GlaxoSmithKline Consumer

STOCK INFO. BLOOMBERG
BSE SENSEX: 17,016 SKB IN
REUTERS CODE
S&P CNX: 5,090 GLSM.BO

28 April 2008

Buy

Previous Recommendation: Buy

Rs651

| | |
|-----------------------|---------|
| Equity Shares (m) | 42.1 |
| 52-Week Range (Rs) | 799/489 |
| 1,6,12 Rel. Perf. (%) | 3/6/4 |
| M.Cap. (Rs b) | 27.4 |
| M.Cap. (US\$ b) | 0.7 |

| YEAR | NET SALES | PAT | EPS | EPS | P/E | P/BV | ROE | ROCE | EV/ | EV/ |
|--------|-----------|--------|------|------------|------|------|------|------|-------|--------|
| END | (RS M) | (RS M) | (RS) | GROWTH (%) | (X) | (X) | (%) | (%) | SALES | EBITDA |
| 12/06A | 11,079 | 1,270 | 30.2 | 19.5 | 21.5 | 5.0 | 23.4 | 35.8 | 2.2 | 13.4 |
| 12/07A | 12,778 | 1,626 | 38.7 | 28.1 | 16.8 | 4.2 | 25.2 | 38.6 | 1.8 | 10.5 |
| 12/08E | 14,957 | 1,851 | 44.0 | 13.8 | 14.8 | 3.7 | 24.8 | 38.4 | 1.6 | 8.9 |
| 12/09E | 16,918 | 2,196 | 52.2 | 18.6 | 12.5 | 3.1 | 25.0 | 38.0 | 1.3 | 7.2 |

- 1QCY08 results were above expectations with 25.8% increase in net sales at Rs4.1b (our estimate: Rs3.75b) and 33.8% increase in PAT at Rs566m (our estimates of Rs496). Strong revenue growth was backed by 17% volume growth and 9% increase in realizations. Gross margin declined 190bp while EBIDTA margin increased 30bp due to operating leverage.
- The company maintained leadership in the malted foods segment with 70% market share - Horlicks and Boost being key brands. Inventory stocking (3%) gains and initial sales of new launches like Women's Horlicks and Active Base boosted volume growth.
- Prices of significant inputs like milk and wheat are up 20% and 15% respectively and management has guided for 15% increase in material prices. The company has increased product prices by 4% from January 2008. Higher material costs we believe will compel the company to take another round of price increase in 2HCY08.
- Competition is rising in malted foods with entry of HUL and Dabur. In addition, Nestle has dropped prices of Milo by 40% (From Rs130/500gm to Rs80/500gm). GSK has launched two new product variants and plans to launch two more in 2HCY08 and three in CY09. Management has also guided for increased capex of Rs500m in CY08 and CY09 and increase in adspend by 50-100bp. Success of new launches will hold the key to future growth keeping in view rising competitive intensity from large FMCG players. We expect the company to report EPS of Rs44 and Rs52 for CY08 and CY09. The stock trades at 14.8x CY08E and 12.5x CY09E. Maintain **Buy**.

| QUARTERLY PERFORMANCE | | | | | | | | | | (Rs Million) |
|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| Y/E DECEMBER | CY07 | | | | CY08 | | | | CY07 | CY08E |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2QE | 3QE | 4QE | | |
| Net Sales | 3,265 | 3,156 | 3,516 | 2,841 | 4,106 | 3,670 | 4,050 | 3,131 | 12,778 | 14,957 |
| YoY Change (%) | 17.9 | 17.8 | 16.6 | 7.3 | 25.8 | 16.3 | 15.2 | 10.2 | 14.9 | 17.0 |
| Total Exp | 2,641 | 2,571 | 2,839 | 2,484 | 3,309 | 3,002 | 3,281 | 2,757 | 10,535 | 12,349 |
| EBITDA | 624 | 585 | 677 | 357 | 797 | 668 | 770 | 373 | 2,243 | 2,608 |
| Margins (%) | 19.1 | 18.5 | 19.3 | 12.6 | 19.4 | 18.2 | 19.0 | 11.9 | 17.6 | 17.4 |
| Depreciation | 108 | 109 | 111 | 108 | 106 | 115 | 125 | 125 | 435 | 471 |
| Interest | 11 | 11 | 12 | 12 | 13 | 8 | 8 | 6 | 46 | 35 |
| Other Income | 139 | 166 | 209 | 175 | 186 | 190 | 195 | 156 | 689 | 727 |
| PBT | 644 | 631 | 763 | 412 | 864 | 735 | 832 | 399 | 2,451 | 2,830 |
| Tax | 221 | 208 | 258 | 137 | 298 | 250 | 291 | 139 | 824 | 978 |
| Rate (%) | 34.3 | 33.0 | 33.8 | 33.3 | 34.0 | 34.0 | 35.0 | 34.9 | 33.6 | 34.6 |
| PAT | 423 | 423 | 505 | 275 | 566 | 485 | 540 | 260 | 1,626 | 1,851 |
| YoY Change (%) | 22.8 | 36.8 | 39.4 | 9.1 | 33.8 | 14.7 | 7.0 | -5.5 | 28.4 | 13.8 |

E: MOST Estimates

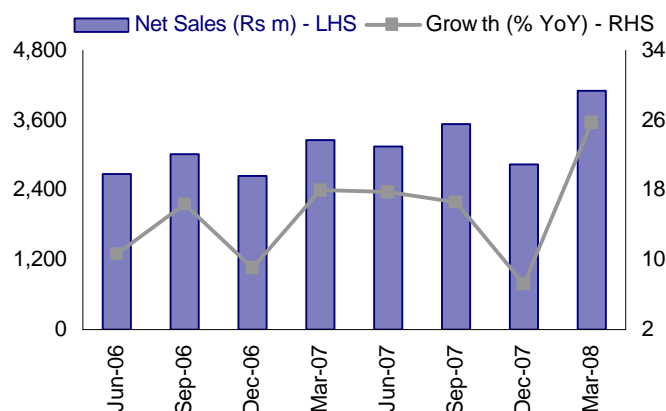
Volume growth zooms on back of new launches and inventory buildup

GSK Consumer 1QCY07 sales volumes grew by 17%. Volume growth was driven by strong performance of Boost and Horlicks across all regions and building up of the inventory pipeline. The company witnessed more than 20% growth across regions. Building up of inventory pipeline was higher by 2-3% compared with 1QCY07 as the company launched two new products - Women's Horlicks and Active Base.

Realization for the quarter was higher by 9% YoY as the company took another 4% price increase in January 2008 after taking an average 2.5% price increase in April and June 2007. The price increases were taken to pass on the raw material cost push.

GSK maintained around 70% share in the malted drinks market. The company plans to expand its reach in the rural areas by launching small SKUs targeting entry level consumers. Low priced small SKUs can attract a large number of first-time users, which would boost volumes. The company has guided for a 7-8% volume increase for the full year.

STRONG GROWTH IN REVENUE



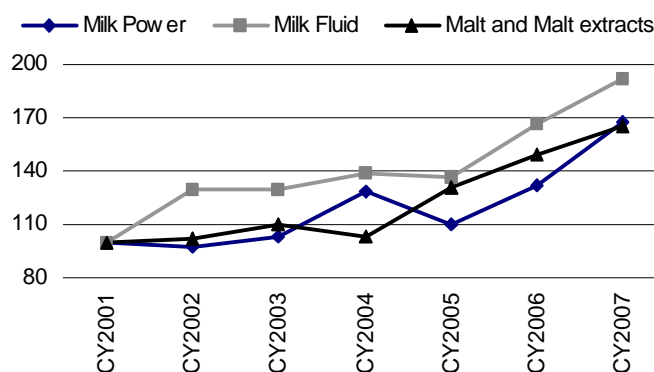
Source: Company/Motilal Oswal Securities

Consistent increase in raw material prices impacts gross margins

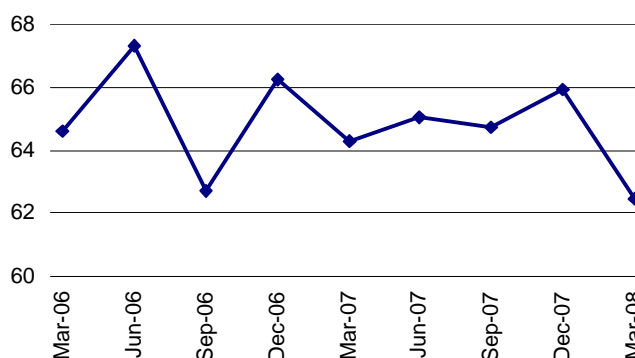
Prices of all the key raw materials like wheat, barley and milk have been on a rising trend. The price of milk and milk products is up 20% YoY while that of wheat is up by 15% YoY. The trend is likely to continue due to the prevailing mismatch in demand and supply. GSK has recently opted for a price increase of 4% in January 2008 after adopting a 5.5% price increase in CY07 and 11% in the past two years. Gross margins have declined 190bp despite price increases while EBIDTA margins have increased 30bp mainly due to the operating leverage in staff and manufacturing costs.

Management has indicated an increase in advertising costs for the support of new launches, which would increase adspend to 13.5-14% of sales from CY07 levels of 13%. Management indicated it can take a further increase of 6% without impacting volume growth for the company. However, continued uptrend in raw material cost will impact gross margins for the company.

INDEXED COST OF KEY INPUTS

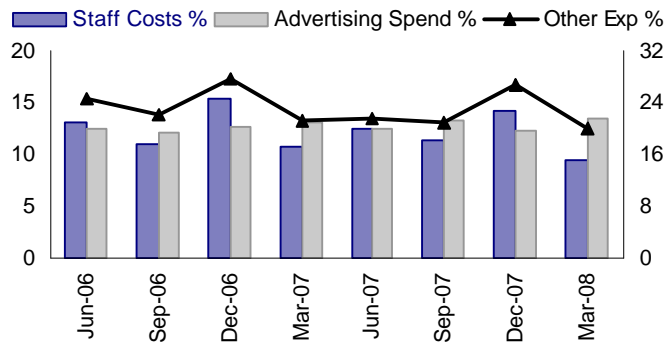


GROSS MARGIN INCHING LOWER (%)

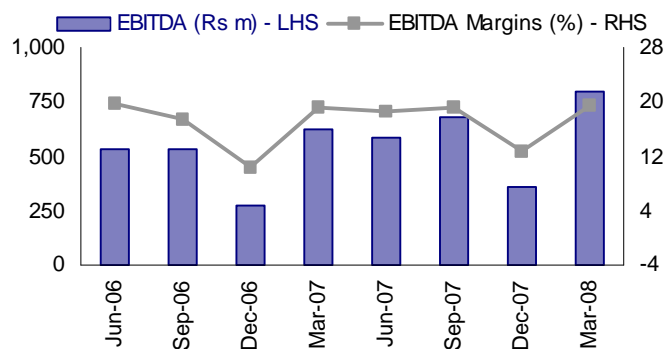


Source: Company/Motilal Oswal Securities

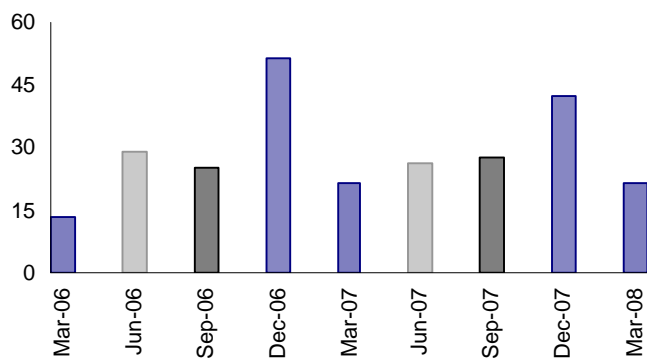
TREND IN STAFF COSTS AND ADVERTISING SPEND



EBIDTA MARGINS - QUARTERLY TREND



TREND IN OTHER INCOME/PBT (%)



Source: Company/Motilal Oswal Securities

Launch of new products would provide scalability

GSK launched two new products in the malted and health drinks category. It has launched Women's Horlicks targeting the age group between 19-50years and Active Base, a protein Supplement targeting patients (Cancer, TB) who wish to build a good physique. Both products are priced at a premium over Horlicks. Women's Horlicks is priced at

2x and Active Base at 5x the price of Horlicks. We believe success of these products would improve overall performance for the company. The profit per kilogram on these products would be higher although the EBIDTA margins would be lower. Currently, Horlicks variants contribute 30% to total revenue from Horlicks. Increase in the share of variants will boost margins for the company as they are priced at a premium to the base Horlicks.

Further, management has indicated that future launches will be a mix of new variants under existing categories and product launches in the new category. The company plans to launch two new products in 2HCY08 and three new products in CY09. It also plans to leverage the product line of its parent company by bringing some products into India. Management appears aggressive in new launches and variants. They also indicated capex of Rs500m for CY08 and CY09 and Rs1.1b for CY10. We have observed management aggression for growth, which gives us confidence for the future potential of the company.

Malted foods to witness increased competition

Malted foods, Rs20b product segment, is witnessing renewed interest from the FMCG majors in the recent past. The category has been traditionally growing at 6% and is not considered attractive unless new players garner significant market share. Recent months have seen launch of Kissan Amaze food by Hindustan Unilever, which is priced at 20% premium to Horlicks. Similarly Dabur has made a maiden entry into this segment with Chwayan Junior. In addition Nestle, global market leader in this product segment has re-launched Milo by cutting prices by 40% (Rs130/500gm to Rs80/500 gm). This we believe will result in intense competition in a category which is being ruled by Horlicks from inception. We expect GSK to respond with aggressive new launches and increased spend on advertising. We do not rule out market expansion in this period of heightened activity, but success of any large player can dent the long term growth prospects of the company and threaten the 70% share that the company enjoys in this product segment.

Valuation and view

While GSK has posted encouraging numbers, rising competition, soaring raw material prices and ad spend on new launches will keep margin expansion under check. GSK has launched two new product variants and plans to launch two more in 2HCY08 and three in CY09. Management has also guided for increased capex of

Rs500m in CY08 and CY09 and increase in adspend by 50-100bp. Success of new launches will hold the key to future growth keeping in view rising competitive intensity from large FMCG players. We expect the company to report EPS of Rs44 and Rs52 for CY08 and CY09 respectively. The stock trades at 14.8x CY08E and 12.5x CY09E. Maintain **Buy**.

GlaxoSmithkline Consumer: an investment profile

Company description

GSK Consumer is the largest player in the Rs13b Indian health foods market, with a 70% market share with brands like Horlicks, Boost, Viva and Maltova. The malted foods market is expected to grow at 7-8% in volumes. The company has launched Horlicks Lite targeted at health conscious adults, a product positioning its shrugged off few years back.

Key investment arguments

- ✎ We expect an EPS CAGR of 16.8% over CY07-09E, driven by new product launches, selective price increases and benefits of lower excise duty from third party packaging units.
- ✎ Cash rich company with Bank FD's of Rs70 per share, looking for higher yield investments and acquisitions.

Key investment risks

- ✎ Commodity linked prices of Milk and Milk solids, Malt and Sugar are the key raw material and can have significant bearing on the margins of the company.
- ✎ GSK Consumer drives 95% sales from Malted drinks, a product category which is growing in mid to high single digits only. The dependence on single product segment is key risk to future growth.

Recent developments

- ✎ GSKC has launched two new products in the malted and health drinks category. It has launched *Women Horlicks* targeting the age group 19-50 years and *Active Base*, a protein supplement targeting patients (Cancer, TB) who want to have good physique.

Valuation and view

- ✎ We have EPS forecasts of Rs44.2 for CY08 and Rs52.2 for CY09.
- ✎ The stock is currently valued at 14.8x CY08E EPS and 12.5x CY09E EPS. We maintain **Buy**.

Sector view

- ✎ We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- ✎ Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- ✎ Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

| | | GSK. CON | GODREJ. CON | MARICO |
|---------------|-------|----------|-------------|--------|
| P/E (x) | CY08E | 14.8 | 15.9 | 22.7 |
| | CY09E | 12.5 | 13.7 | 19.5 |
| EV/EBITDA (x) | CY08E | 8.9 | 12.0 | 14.8 |
| | CY09E | 7.2 | 10.3 | 12.7 |
| EV/Sales (x) | CY08E | 1.6 | 2.3 | 1.8 |
| | CY09E | 1.3 | 2.0 | 1.5 |
| P/BV (x) | CY08E | 3.7 | 5.2 | 10.5 |
| | CY09E | 3.1 | 4.8 | 7.4 |

SHAREHOLDING PATTERN (%)

| | MAR-08 | DEC-07 | MAR-07 |
|---------------|--------|--------|--------|
| Promoter | 50.7 | 50.7 | 50.7 |
| Domestic Inst | 16.4 | 15.7 | 15.2 |
| Foreign | 14.7 | 15.5 | 14.9 |
| Others | 18.3 | 18.2 | 19.3 |

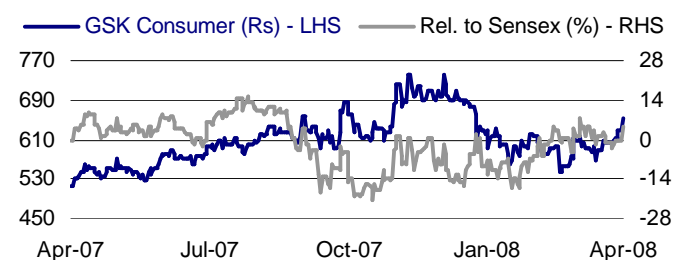
EPS: MOST FORECAST VS CONSENSUS (RS)

| | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| CY08 | 44.0 | 39.0 | 12.8 |
| CY09 | 52.2 | 44.4 | 17.5 |

TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 651 | 783 | 20.4 | Buy |

STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT | | (RS MILLION) | | | | |
|----------------------------|--------------|--------------|--------------|--------------|--------------|--|
| Y/E DECEMBER | 2005 | 2006 | 2007 | 2008E | 2009E | |
| Net Sales | 9,668 | 11,079 | 12,778 | 14,957 | 16,918 | |
| Change (%) | 2.1 | 14.6 | 15.3 | 17.0 | 13.1 | |
| Total Expenditure | -7,836 | -9,233 | -10,535 | -12,349 | -13,858 | |
| EBITDA | 1,833 | 1,846 | 2,243 | 2,608 | 3,060 | |
| Change (%) | 34.0 | 0.7 | 21.5 | 16.2 | 17.3 | |
| Margin (%) | 19.0 | 16.7 | 17.6 | 17.4 | 18.1 | |
| Depreciation | -419 | -427 | -435 | -471 | -508 | |
| Int. and Fin. Charges | -42 | -35 | -46 | -35 | -35 | |
| Other Income - Recurring | 243 | 522 | 689 | 727 | 789 | |
| Profit before Taxes | 1,615 | 1,905 | 2,451 | 2,830 | 3,306 | |
| Change (%) | 40.4 | 18.0 | 28.6 | 15.5 | 16.8 | |
| Margin (%) | 16.7 | 17.2 | 19.2 | 18.9 | 19.5 | |
| Tax | -597 | -671 | -892 | -1,030 | -1,157 | |
| Deferred Tax | 44 | 35 | 68 | 52 | 46 | |
| Tax Rate (%) | -34.2 | -33.4 | -33.6 | -34.6 | -33.6 | |
| Profit after Taxes | 1,062 | 1,270 | 1,626 | 1,851 | 2,196 | |
| Change (%) | 46.6 | 19.5 | 28.1 | 13.8 | 18.6 | |
| Margin (%) | 11.0 | 11.5 | 12.7 | 12.4 | 13.0 | |
| Non-rec. (Exp)/Income | 0 | 0 | 0 | 0 | 0 | |
| Reported PAT | 1,062 | 1,270 | 1,626 | 1,851 | 2,196 | |

| BALANCE SHEET | | (RS MILLION) | | | | |
|------------------------------|--------------|--------------|--------------|--------------|--------------|--|
| Y/E DECEMBER | 2005 | 2006 | 2007 | 2008E | 2009E | |
| Share Capital | 421 | 421 | 421 | 421 | 421 | |
| Reserves | 4,331 | 5,007 | 6,043 | 7,044 | 8,366 | |
| Net Worth | 4,751 | 5,427 | 6,463 | 7,465 | 8,787 | |
| Loans | 0 | 0 | 0 | 0 | 0 | |
| Capital Employed | 4,751 | 5,427 | 6,463 | 7,465 | 8,787 | |
| Gross Block | 5,069 | 5,217 | 5,237 | 6,401 | 6,901 | |
| Less: Accum. Deprn. | -2,339 | -2,703 | -2,976 | -3,447 | -3,954 | |
| Net Fixed Assets | 2,730 | 2,514 | 2,261 | 2,954 | 2,947 | |
| Capital WIP | 108 | 65 | 173 | 173 | 173 | |
| Investments | 0 | 2,197 | 2,978 | 2,978 | 2,978 | |
| Deferred Charges | 0 | 0 | 0 | 0 | 0 | |
| Curr. Assets, L&A | 4,018 | 2,978 | 3,719 | 4,466 | 6,140 | |
| Inventory | 1,310 | 1,456 | 1,948 | 1,946 | 2,178 | |
| Account Receivables | 241 | 281 | 274 | 374 | 423 | |
| Cash and Bank Balance | 1,858 | 479 | 937 | 1,145 | 2,414 | |
| Others | 608 | 762 | 561 | 1,000 | 1,125 | |
| Curr. Liab. and Prov. | 1,829 | 2,086 | 2,495 | 2,870 | 3,172 | |
| Account Payables | 1,444 | 1,599 | 1,865 | 2,188 | 2,439 | |
| Other Liabilities | 337 | 427 | 544 | 575 | 606 | |
| Provisions | 47 | 59 | 86 | 107 | 127 | |
| Net Current Assets | 2,189 | 893 | 1,224 | 1,596 | 2,968 | |
| Miscellaneous Expense | 0 | 0 | 0 | 0 | 0 | |
| Deferred Tax Liability | -276 | -241 | -173 | -224 | -271 | |
| Application of Funds | 4,751 | 5,428 | 6,464 | 7,477 | 8,796 | |

E: MOST Estimates

| RATIOS | | | | | | |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|--|
| Y/E DECEMBER | 2005 | 2006 | 2007 | 2008E | 2009E | |
| Basic (Rs) | | | | | | |
| EPS | 25.3 | 30.2 | 38.7 | 44.0 | 52.2 | |
| Cash EPS | 35.2 | 40.3 | 49.0 | 55.2 | 64.3 | |
| BV/Share | 113.0 | 129.0 | 153.7 | 177.5 | 208.9 | |
| DPS | 8.0 | 10.0 | 12.0 | 15.0 | 17.8 | |
| Payout % | 31.7 | 33.1 | 31.0 | 34.0 | 34.0 | |
| Valuation (x) | | | | | | |
| P/E | 25.8 | 21.5 | 16.8 | 14.8 | 12.5 | |
| Cash P/E | 18.5 | 16.1 | 13.3 | 11.8 | 10.1 | |
| EV/Sales | 2.6 | 2.2 | 1.8 | 1.6 | 1.3 | |
| EV/EBITDA | 13.9 | 13.4 | 10.5 | 8.9 | 7.2 | |
| P/BV | 5.8 | 5.0 | 4.2 | 3.7 | 3.1 | |
| Dividend Yield (%) | 1.2 | 1.5 | 1.8 | 2.3 | 2.7 | |
| Return Ratios (%) | | | | | | |
| RoE | 22.4 | 23.4 | 25.2 | 24.8 | 25.0 | |
| RoCE | 34.9 | 35.8 | 38.6 | 38.4 | 38.0 | |
| Working Capital Ratios | | | | | | |
| Debtor (Days) | 9 | 9 | 8 | 9 | 9 | |
| Asset Turnover (x) | 2.0 | 2.0 | 2.0 | 2.0 | 1.9 | |
| Leverage Ratio | | | | | | |
| Debt/Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |

| CASH FLOW STATEMENT | | (RS MILLION) | | | | |
|------------------------------|---------------|---------------|--------------|---------------|--------------|--|
| Y/E DECEMBER | 2005 | 2006 | 2007 | 2008E | 2009E | |
| OP/(loss) before Tax | 1,414 | 1,419 | 1,808 | 2,137 | 2,552 | |
| Int./Div. Received | 243 | 522 | 689 | 727 | 789 | |
| Depreciation and Amort. | 419 | 427 | 435 | 471 | 508 | |
| Interest Paid | -42 | -35 | -46 | -35 | -35 | |
| Direct Taxes Paid | -597 | -671 | -892 | -1,030 | -1,157 | |
| (Incr)/Decr in WC | -424 | -82 | 126 | -163 | -104 | |
| CF from Operations | 1,013 | 1,580 | 2,119 | 2,108 | 2,553 | |
| Extraordinary Items | 0 | 0 | 0 | 0 | 0 | |
| (Incr)/Decr in FA | -131 | -105 | -128 | -1,164 | -500 | |
| (Pur)/Sale of Investments | 0 | -2,197 | -782 | 0 | 0 | |
| CF from Invest. | -131 | -2,302 | -909 | -1,164 | -500 | |
| Issue of Shares | -1,264 | 0 | 0 | 0 | 0 | |
| (Incr)/Decr in Debt | 0 | 0 | 0 | 0 | 0 | |
| Dividend Paid | -336 | -421 | -505 | -629 | -747 | |
| Others | -65 | -236 | -248 | -106 | -38 | |
| CF from Fin. Activity | -1,665 | -657 | -753 | -735 | -785 | |
| Incr/Decr of Cash | -783 | -1,378 | 457 | 208 | 1,269 | |
| Add: Opening Balance | 2,632 | 1,858 | 479 | 937 | 1,145 | |
| Closing Balance | 1,849 | 480 | 937 | 1,145 | 2,414 | |

N O T E S



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Disclosure of Interest Statement

GlaxoSmithKline Consumer

- | | |
|---------------------------------------------------------|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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