Company Results Review

2 May 2007 | 7 pages

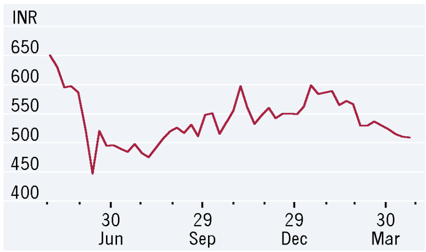
GlaxoSmithKline Consumer (GLSM.BO)

Buy: Strong 1Q07; Robust Sales, Better Margins

- Net profit higher than our expectation – GLSM's 1Q07 net profit growth of 22% was 27% higher than our expectation on account of better-than-expected EBITDA margin and higher other income (up 92% YoY); operational income of Rs100m was high due to an accounting policy change, and interest income at Rs39m was higher due to high interest rates.
- Core brands drove sales growth – Sales growth of 18% was higher than our expectation of 11%, driven by robust volume growth in core brands of Horlicks (16%) and Boost (25%+). A price hike of c.3% taken in November 2006 also aided revenue growth.
- Softening input costs and lower ad-expenses aid margin – EBITDA margin declined much lower than our expectation of 600bps at 183bps to 19.1%. The key reasons were: (1) Declining raw material costs such as sugar and wheat; and (2) Lower ad-expenses (down 122bps). Lower ad-expenses are likely to be maintained, in our view.
- Identifying inorganic growth opportunities – Management stated that it is looking to acquire brands/businesses that fit well with its current profile. It is primarily looking for nutritional, medicinal, or OTC segment brands. According to management, a deal could be finalized in the next 2-3 quarters.
- Strong outlook for 2007 – Management has given strong revenue growth guidance of 12-13%. Margin pressure of the past 2-3 quarters is likely to abate, in our view, as key input costs have started to cool. We maintain a Buy/Low Risk (1L) rating.

Buy/Low Risk	1L
Price (30 Apr 07)	Rs532.80
Target price	Rs675.00
Expected share price return	26.7%
Expected dividend yield	3.6%
Expected total return	30.3%
Market Cap	Rs22,407M
	US$546M

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	1,071	25.47	58.0	20.9	5.0	22.0	2.6
2006A	1,269	30.17	18.4	17.7	4.5	27.0	3.1
2007E	1,418	33.71	11.7	15.8	4.1	27.2	3.5
2008E	1,629	38.72	14.9	13.8	3.7	28.1	4.0
2009E	1,869	44.44	14.8	12.0	3.3	28.9	4.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Market India Private Limited

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	20.9	17.7	15.8	13.8	12.0
EV/EBITDA adjusted (x)	10.9	10.8	9.6	7.7	6.3
P/BV (x)	5.0	4.5	4.1	3.7	3.3
Dividend yield (%)	2.6	3.1	3.5	4.0	4.6
Per Share Data (Rs)					
EPS adjusted	25.47	30.17	33.71	38.72	44.44
EPS reported	25.47	30.17	33.71	38.72	44.44
BVPS	106.14	117.65	130.39	145.10	161.98
DPS	13.72	16.72	18.79	21.52	24.71
Profit & Loss (RsM)					
Net sales	9,669	11,119	12,365	13,741	15,269
Operating expenses	-8,245	-9,701	-10,780	-11,746	-12,920
EBIT	**1,423**	**1,418**	**1,585**	**1,995**	**2,349**
Net interest expense	-42	-35	0	0	0
Non-operating/exceptionals	243	522	500	400	400
Pre-tax profit	**1,624**	**1,905**	**2,085**	**2,395**	**2,749**
Tax	-553	-636	-667	-766	-880
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,071**	**1,269**	**1,418**	**1,629**	**1,869**
Adjusted earnings	1,071	1,269	1,418	1,629	1,869
Adjusted EBITDA	1,842	1,845	2,034	2,455	2,819
Growth Rates (%)					
Sales	12.1	15.0	11.2	11.1	11.1
EBIT adjusted	57.8	-0.4	11.8	25.9	17.7
EBITDA adjusted	39.9	0.2	10.3	20.7	14.8
EPS adjusted	58.0	18.4	11.7	14.9	14.8
Cash Flow (RsM)					
Operating cash flow	**1,983**	**1,630**	**1,846**	**2,042**	**2,298**
Depreciation/amortization	419	427	449	460	470
Net working capital	1,511	-66	-21	-47	-42
Investing cash flow	**-1,318**	**-839**	**-964**	**-1,032**	**-1,138**
Capital expenditure	-150	-300	-500	-150	-150
Acquisitions/disposals	-1,168	-539	-464	-882	-988
Financing cash flow	**-646**	**-785**	**-882**	**-1,010**	**-1,159**
Borrowings	0	0	0	0	0
Dividends paid	-646	-785	-882	-1,010	-1,159
Change in cash	**19**	**7**	**0**	**0**	**0**
Balance Sheet (RsM)					
Total assets	**6,736**	**7,485**	**8,259**	**9,089**	**10,057**
Cash & cash equivalent	1,000	1,000	1,000	1,000	1,000
Accounts receivable	318	366	407	452	502
Net fixed assets	2,588	2,468	2,519	2,209	1,889
Total liabilities	**2,272**	**2,536**	**2,774**	**2,985**	**3,243**
Accounts payable	1,852	2,116	2,354	2,566	2,823
Total Debt	0	0	0	0	0
Shareholders' funds	**4,465**	**4,949**	**5,485**	**6,104**	**6,814**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.0	16.6	16.5	17.9	18.5
ROE adjusted	22.0	27.0	27.2	28.1	28.9
ROIC adjusted	31.1	30.2	35.3	49.1	65.8
Net debt to equity	-22.4	-20.2	-18.2	-16.4	-14.7
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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GSK Consumer: 1Q07 Result Analysis

GSK Consumer reported net sales growth of 18%, driven by strong volume growth in core brands of Horlicks (16%) and Boost (25%+) and a price hike (c3%) taken in November last year.Net profit growth of 22% was higher than our expectation due to better EBITDA margin and higher other income (up 92% YoY).EBITDA margin decline of 183bps came in much lower than our expectation as prices of key inputs such wheat and sugar cooled, and the company spent less on advertising this quarter. However, prices of milk and milk solids, which increased by c20% in 2006, are likely to remain high in 2007. Management indicated the potential for further price hikes if these cost pressures persist.

Figure 1. GSK Consumer: 1Q07 Profit and Loss Summary (Rupees in Millions, Percent)

	1Q06	1Q07	% YoY
Net Sales	**2,769.1**	**3265**	**17.9**
Total Expenses	-2,189.2	-2,641.0	20.6
EBITDA	**579.9**	**624.0**	**7.6**
EBITDA margin (%)	*20.9*	*19.1*	*-183 bps*
Interest	-7.7	-11	42.9
Depreciation & Amortization	-104.2	-108	3.6
Other Income	72.2	139	92.5
PBT	**540.2**	**644.0**	**19.2**
Tax	-195.8	-221	12.9
Tax rate (%)	*36.2*	*34.3*	*-193 bps*
Net Profit	**344.4**	**423.0**	**22.8**
Net margin (%)	*12.4*	*13.0*	*52 bps*

Source: Company data

Figure 2. GSK Consumer: 1Q07 Cost Details (Rupees in Millions, Percent)

	1Q06	1Q07	% YoY
Raw Materials	980.4	1166	18.9
As % of Sales	*35.4*	*35.7*	*31 bps*
Staff costs	261.8	349	33.3
As % of Sales	*9.5*	*10.7*	*123 bps*
Advertising and Promotions	398.6	430	7.9
As % of Sales	*14.4*	*13.2*	*-122 bps*
Other expenses	548.4	696	26.9
As % of Sales	*19.8*	*21.3*	*151 bps*

Source: Company data

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 thesis

We rate GSK Consumer shares as Buy/Low Risk (1L) with a target price of Rs675. 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 started improving from 3Q03, with management guiding strong sales continuing for 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 Rs675, based on 20x 2007E P/E, puts the stock at about 20% premium to Sensex valuations but still at a discount to our consumer-sector universe. We believe that the stock should trade at a premium to the Sensex given its relatively better earnings profile and higher capital-efficiency ratios.

At Rs675, the stock would be trading at an implied EV/EBITDA of 11.5x one-year forward EV/EBITDA. This is at the lower end of its historical trading range. We believe our target multiple is conservative because we benchmark it against the lower end of the historical trading range, and hence provides downside support to our price target. A higher dividend payout is likely to help stock valuations and should provide downside support.

Risks

We rate GSK shares 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 switching; (2) a rural recovery may not fully manifest into additional sales for GSK; and (3) competition.

Appendix A-1

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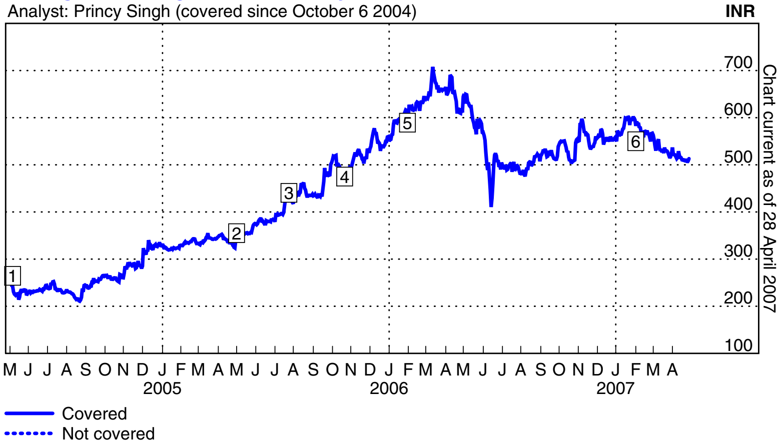
GlaxoSmithKline Consumer (GLSM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since October 6 2004)



#	Date	Rating	Target Price	Closing Price
1:	3 May 04	1L	360.00	250.90
2:	2 May 05	1L	*395.00	341.35
3:	25 Jul 05	1L	*500.00	434.80
4:	21 Oct 05	1L	*540.00	478.35
5:	31 Jan 06	1L	*725.00	607.75
6:	1 Feb 07	1L	*675.00	582.60

*Indicates change.

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