

## Company Flash

26 October 2006 | 6 pages

# GlaxoSmithline Consumer (GLSM.BO)

## 3Q06 Beat Expectations; Attractively Valued at 12.4x P/E; BUY

- Attractively Valued, Buy/Low Risk** — At 12.4x07E P/E and a 07E expected dividend yield of 4.5%, GSK Consumer is among the most attractively valued stocks in our Indian Consumer universe. The company has a free cash flow yield of over 7%, which should provide downside support to the stock price.
- 3Q results beat expectations** — 3Q06 net profits grew 20% yoy, slightly ahead of our expectations. Sales growth of 16.5% surprises us positively, although EBITDA margin decline of 327bps was below expectations. Underlying margins would have been stronger but for change in accounting norms for manufacturing income for GSK's sister company, which resulted in lower reported operating profit margins.
- Growth to remain robust, margins under slight pressure** — While sales growth remains strong, higher agri-commodity prices have pressured margins. This has been mitigated to some extent by excise savings and price hikes, further price hikes will be needed to sustain margins. Management has guided at high single digit sales growth and stable margins for 2006. We believe that GSK is on course to beat sales growth guidance given by the management.
- Solid cash flows** — Besides a solid free cash flow yield of ~7%, GSK Consumer also has almost Rs60 per share cash on its books. While we would like to see this being paid out to the shareholders (given that major capex is over), management has said that it is eyeing acquisitions. We do not see many brands available that complement GSK's portfolio; to us, share buyback looks to be the likely scenario. Historical buybacks carried out by GSK have been EPS accretive.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (26 Oct 06)	Rs510.10
Target price	Rs725.00
Expected share price return	42.1%
Expected dividend yield	3.8%
<b>Expected total return</b>	<b>45.9%</b>
Market Cap	Rs23,149M
	US\$511M

Figure 1. Statistical Abstract

Year to 31-Dec	Net Profit (Rs Mills.)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	DPS (Rs)	Yield (%)	RoE (%)
2004	732	16.1	-4.2	31.6	7.0	1.4	14.3
2005	1,071	25.5	58.0	20.0	13.7	2.7	22.0
2006E	1,483	35.3	38.4	14.5	19.3	3.8	31.2
2007E	1,731	41.1	16.7	12.4	22.8	4.5	32.2
2008E	1,998	47.5	15.4	10.7	26.4	5.2	32.8

Source: Company Reports and Citigroup Investment Research

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See page 4 for Analyst Certification and important disclosures.

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## GlaxoSmithkline Consumer: 3Q06 Results Summary

Figure 2. GSK Consumer – 3Q06 Results Summary (Rupees in Million, Percent)

	3Q05	3Q06	% YoY
<b>Net Sales</b>	<b>2,586.5</b>	<b>3,014.5</b>	<b>16.5</b>
Total Expenses	-2,048.6	-2,486.2	21.4
<b>EBITDA</b>	<b>537.9</b>	<b>528.3</b>	<b>-1.8</b>
<i>EBITDA margin (%)</i>	<i>20.8</i>	<i>17.5</i>	<i>-327 bps</i>
Interest	-12.2	-10.4	-14.8
Depreciation	-96.2	-97.4	1.2
Amortization	-11.5	-11.5	0.0
Other Income	47.0	138.5	194.7
<b>PBT</b>	<b>465.0</b>	<b>547.5</b>	<b>17.7</b>
Tax	-162.4	-185.2	14.0
<i>Tax rate (%)</i>	<i>34.9</i>	<i>33.8</i>	<i>-110 bps</i>
<b>Net Profit</b>	<b>302.6</b>	<b>362.3</b>	<b>19.7</b>
<i>Net margin (%)</i>	<i>11.7</i>	<i>12.0</i>	<i>32 bps</i>
<b>Cost Details</b>	<b>3Q05</b>	<b>3Q06</b>	<b>% YoY</b>
Raw Materials	-939.3	-1,124.3	19.7
<i>As % of Sales</i>	<i>36.3</i>	<i>37.3</i>	<i>98 bps</i>
Staff costs	-279.4	-328.2	17.5
<i>As % of Sales</i>	<i>10.8</i>	<i>10.9</i>	<i>9 bps</i>
Advertising and Promotions	-284.2	-365.8	28.7
<i>As % of Sales</i>	<i>11.0</i>	<i>12.1</i>	<i>115 bps</i>
Other expenses	-545.7	-667.9	22.4
<i>As % of Sales</i>	<i>21.1</i>	<i>22.2</i>	<i>106 bps</i>

Source: Company Reports

## GlaxoSmithline 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 as Buy/Low Risk (1L) with a target price of Rs725. 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, with management guiding to significant improvement in sales and profits in 2005. 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 Rs725, based on 20x one-year forward P/E, puts the stock at a 35% 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 Rs725 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 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.

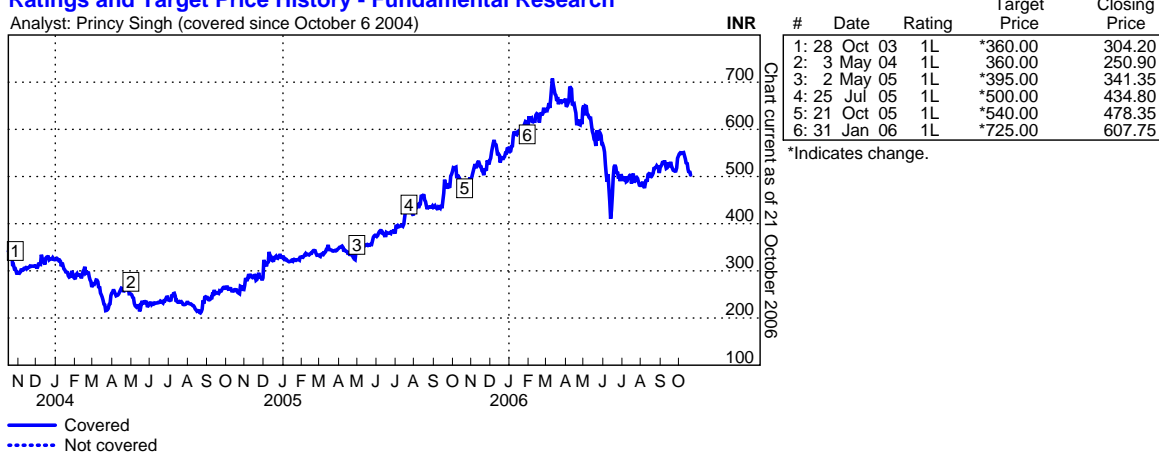
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Analyst: Princy Singh (covered since October 6 2004)



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