

GSK Consumer Healthcare

4 October 2011



Contents

GSK Consumer Boost to health drinks	1
Company Snapshot	2
“Underpenetrated” Category King: Horlicks	2
Low penetration levels in product category: Significant opportunity	3
Market leader....In low competition	4
Next leg of long term growth: Rural Market	6
Strong demand Confidence: Nutritional category	7
Inorganic Growth: “GSK promises to address the specific needs of consumers”	8
Widening distribution reach: Opportunity for revenue growth	8
Product category diversification to lower Malted beverage dependence	9
Strategic entry in niche categories	12
Income as segmentation variable	13
Financial analysis	
Top – line expected to grow at 20% CAGR over CY11-13E	14
Margins rising, trend likely to be sustained	15
Rising input prices: Key risk for GSK	16
Lower ad spend in future, margins to improvise	17
Cash pot: Strong balance sheet, possibility for Inorganic growth	18
Sluggish ROE on account of low dividend payout	19
Return ratio could improve	19
Quarterly trend to remains a focus area	19
We expect earnings to increase at 21% CAGR in CY10-13E	20
Initiate coverage with 'BUY' rating and price target of Rs3100/Share	20
Company background	21
Financial Table	22

- Research & Advisory
- Execution
- Corporate Access & Events



INITIATING COVERAGE

CMP: Rs2360

TARGET: Rs3100

BUY

As on 3 Oct, 2011

Market Cap. (Rsmn)	100426
52 Week High/Low (Rs)	2525/1805
Book Value (Rs)	228.28
Face Value (Rs)	10

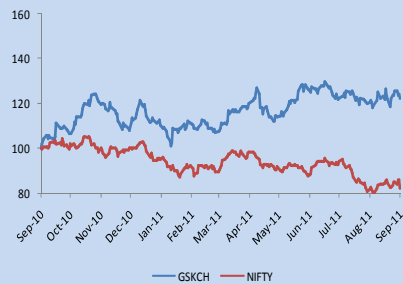
Codes

BSE Code	500676
NSE Code	GSKCONS
Bloomberg Code	SKB: IN
Reuters Code	GSLM.NS

Shareholding Pattern (%)

	Jun 2011	Mar 2011	Dec 2010
Promoters	43.16	43.16	43.16
FII	12.72	12.08	11.31
DII	18.07	18.59	18.90
Others	26.05	26.17	26.63

Share Price Performance



Share Price Returns (%)

	1M	6M	12M
Absolute	2.7	9.2	20.1
Relative	0.9	23.3	37.9

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GSK Consumer: Boost to health drinks

Taller, Stronger & Sharper

GSK Consumer is the overriding market leader in the malted beverage drink market in India, with more than 70% market share. In recent years it has tightened its hold on the market through continuous product innovation and brand building. We believe that low penetration levels and demand confidence in nutritional category bode well for the long term growth of the company. Moreover, company's focus on introducing new product variants and expansion into newer categories, by leveraging the brand Horlicks, provides further growth opportunities. In our view GSK Consumer is well positioned to increase its market share, as we expect the top-line to grow at a CAGR of 21% over CY11-CY13E. We initiate with BUY rating.

Market leader in a speedy mounting category

GSK consumer is the major leader in the Indian malted beverage drink market with more than 70% market share. We expect GSK to grow by 21%, above industry expected growth of 18%.

Rising demand in nutritional category: Explain sufficient growth visibility

We expect company to outperform industry growth based on rising demand and awareness for functional food, increasing nutritional labels on array of food products in store shelves and India's escalating inclination towards health and wellness.

New Launches: Long term growth trigger

Diversification of product portfolio towards Non-MFD (malted food drink) category (noodles, biscuits, glucose, sports drinks and nutritional bars). We believe this as a positive catalyst in the long term and this will provide significant headroom for growth.

Low Category penetration: Head room for growth

The malted food category has high scope for growth as penetration levels are low at 22%, where rural penetration is below 5% and urban figures stand at 20%. Now with the increasing pack size flexibility, ramp up in demand in north and west, continuous launches will increase category penetration.

Cash pot: Opportunity for Inorganic growth

A strong balance sheet with cash of Rs 9.7 bn and steady operating cash flow of approx Rs 5 bn in CY10 provides an option to pursue inorganic growth.

Outlook & Valuation

We initiate coverage with a BUY rating and Rs3100 Dec13 price target, representing 31% upside from current levels. Our target is implying CY11E, CY12E and CY13E P/E of 29X, 27X and 24X, supported by an earning CAGR forecast of 21% over CY11-CY13E and led by strong volume growth and rising penetration of the category. We value the stock at 24X FY13E EPS of Rs129.1

Key financials & valuations

YE-Mar	Net Sales	EBITDA (Core)	(%)	PAT	EPS (Rs)	EV/EBITDA	P/BV	Div Yld (%)
CY2009	19,215	3,143	16.4	2334	55.5	24.7	11.0	0.8%
CY2010	23,061	3,836	16.6	3006	70.8	20.1	10.3	2.1%
CY2011E	27,605	4,585	16.6	3589	85.4	16.8	8.3	1.3%
CY2012E	33,195	5,589	16.8	4403	104.7	13.7	6.8	1.7%
CY2013E	40,273	6,954	17.3	5428	129.1	11.3	5.6	2.2%

Source: Company, Jaypee Research

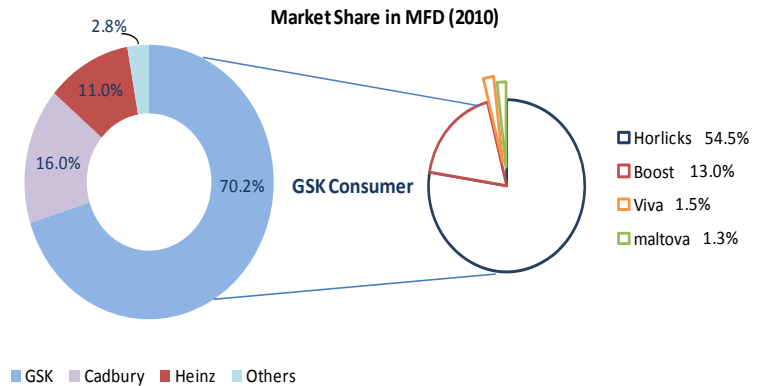
Company Snapshot

GSK Consumer is the Indian subsidiary of worldwide healthcare giant Glaxo Smithkline Plc UK, which holds 43% stake in the company. GSK Consumer is the largest player in Rs32bn malted food drink (MFD) category with 70% market share.

It is one of the leading food companies in India, through its flag ship brands **Horlicks and Boost** and other brands such as Maltova and Viva. In recent years GSK entered into Non-MFD category with *Foodles* in instant noodles, *Horlicks Nutribar* in multi cereal bar and *Lucozade* as isotonic sports drink.

In addition to the above, it also sells Eno Digestive, Sensodyne toothpaste, Breathe rite nasal strip, Crocin analgesic, and Iodex pain relief ointment. These products are manufactured by an associate company and GSK earns commission on these sales.

GSK Consumer's Market Share



Source: Company, Jaypee Research

“Underpenetrated” Category King: Horlicks

Things to See:-

Positives & Long term growth drivers:

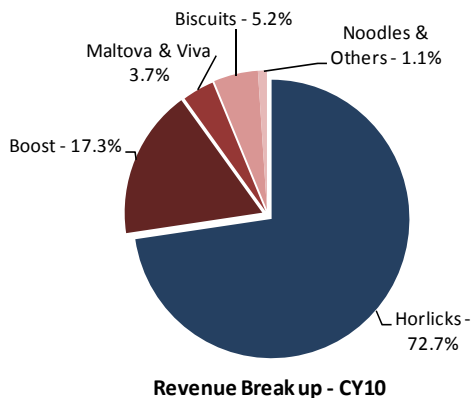
- Low penetration levels in product category
- Market leader in main product offering
- Rural markets to provide long term growth opportunity
- Strong demand confidence in nutritional category
- Entry into other categories

Investment Risk & Concerns:

- Inflationary trend in raw material prices
- Entry of new players in MFD space
- High dependence on single category

Catalyst:

- Success in new products launched and continuous innovation
- Increase in distribution reach
- High dividend payout



Source: Company, Jaypee Research

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Food offers more long term growth visibility than those of HPCs mainly on account of changing consumption pattern, low penetration, and low price elasticity of demand, whereas HPCs operates in escalating competition, deep penetration and rising commodity cost environment.

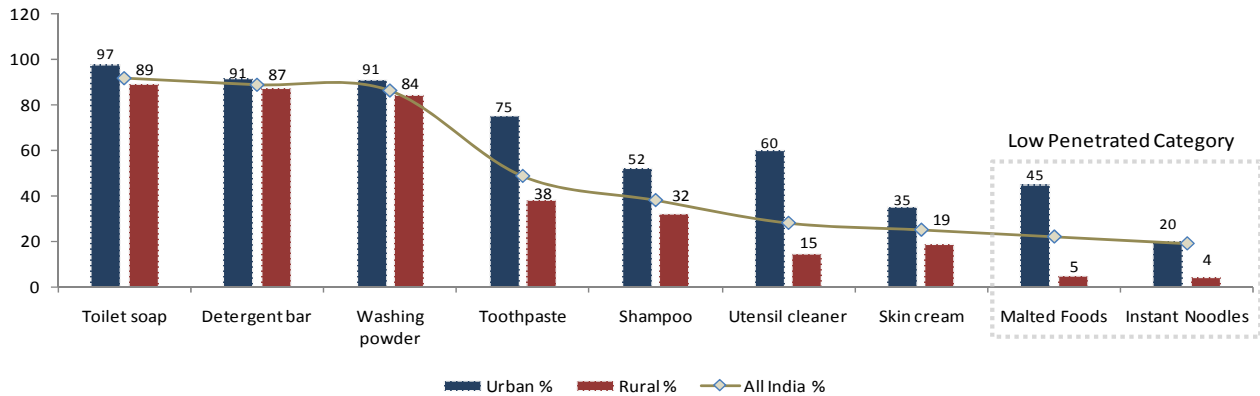
Glaxo SmithKline Consumer Healthcare (GSKCH) is a dominant leader in Indian malted beverage drink segment. It operates in the processed food sector in India, which is one of the most attractive segments in the consumer space. Food sector is showing strong double digit growth outperforming Hygiene and Personal care (HPC) category noticeable by low penetration levels, rising demand & changing culture. In such an environment, we believe there is a sizeable market and great potential for organized player like GSKCH who rule and enjoy strong brand equity.

Positives & Long term growth drivers

Low penetration levels in product category: Significant opportunity

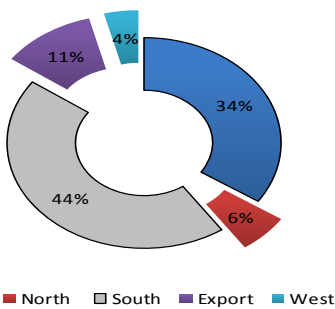
Penetration levels in malted beverage category remains fairly low at 22%, as compared to packaged foods consumption in India, even with continuous increase in demand and rising volumes. We expect it to grow in line with other packaged foods.

Operates in Low Penetrated Category



Source: Company, Jaypee Research

Revenue Contribution (CY 2010)



Source: Company, Jaypee Research

Head room for growth from North & South

The current penetration is mainly contributed by southern and eastern markets of India which account for ~40% as against 10% from northern and western India. Management believes that there is a scope for increasing the category size in the long run by driving the penetration levels in northern and western region. This ramp up can be done faster by focusing on distribution expansion, entering with different price points and increasing advertising and promotion spend.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Price point game show yet to be played, to boost penetration levels

Low price point packs (below Rs20) account for less than 3% of company's total sales, which is very low when compared to the average contribution of these packs to HPCs sales is more than 60%.

Increasing wages and other government initiatives will drive the rural consumption of smaller SKUs (on account of affordability).

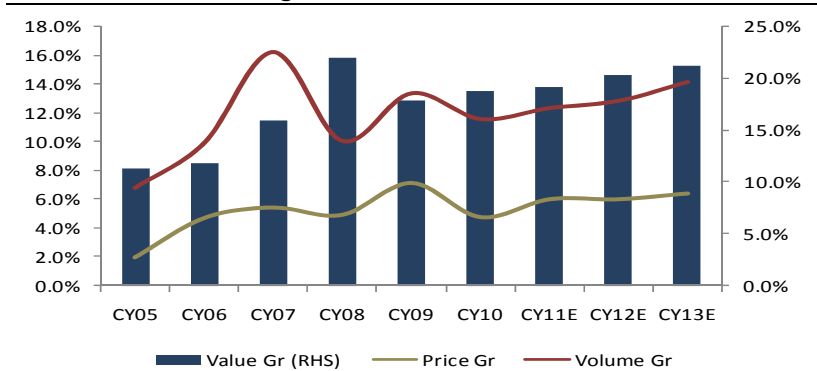
We believe that the low price points packs drive the category penetration at a faster rate, GSK being the market leader has not yet exploited the price point game on a serious note. Presently company offers Rs20 packs, which are made available at selected retail outlets, therefore these packs account for less than 3% of company's revenue. For urban sector the price point available is ranging from Rs80 – Rs200. Considering HPCs, they have also made their premium personal care products available in packs priced below Rs20 which led to some pressure on gross margins but has driven penetration and volume growth. We believe GSK will launch low price point units, but will ensure the safety of similar gross margins as those of large packs. In future this will act as a catalyst to drive penetration.

Market leader...In low competition

Robust volume growth & pricing power

GSK has seen strong growth in the past few years, as the markets for malted beverages has shown an extreme upturn, especially in urban markets. Being the market leader and with the reduced elasticity of product volumes vs pricing, GSK has been able to pass on the input cost and maintain its margins.

Volume & Realization growth for GSK Consumer



Source: Company, Jaypee Research

If we look at the value and volume growth since CY07, despite aggressive price hikes taken and increasing competition, GSK has been able to consistently achieve the average volume growth of more than 12% with realizations also moving up close to 6%.

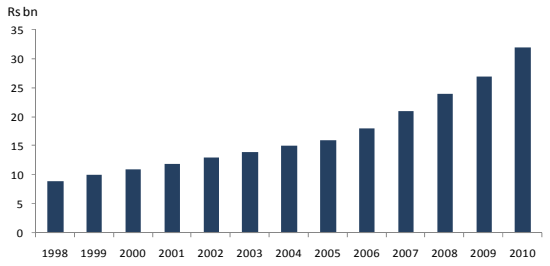
Successful brand extension, continuous launch of innovative products and increasing distribution reach have helped GSK consumers in holding pricing power and thereby has led to an increase in its market dominance.

We expect GSK to maintain 12-14% volume growth for malted beverage products on account of (1) Shift in usage of the product from milk substitute to milk additive, (2) Increasing penetration in north and west India, (3) Strategic brand extension as a complete family offering (Women's Horlicks, Mothers Horlicks, Junior Horlicks, and Horlicks Lite), (4) Mounting distribution reach, (5) New variant launch.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Indian Malt based drink market size



Source: Company, Jaypee Research

Strong Foothold: Threat to new entrants

Malted food category presents a huge entry potential on account of hefty market value of Rs.32bn, high growth rates of 16-18% and low competition. In the past, big players such as Dabur, HUL and Nestle entered with considerable investment, strong distribution network in India supported by aggressive advertising and promotion but failed to shake GSK's position and market dominance.

Strength of Horlicks Brand Equity

Year	Company	Brand	Comments
1997-2008	Nestle	Milo	Leading product in South East Asia Strong distribution reach in India Milo exited with a market share of 3%
2007-2009	HUL	Amaze	Developed by Unilever's global R&D team Positioned as a brain food for children
2009-2010	Dabur	Chwayan Junior	Launched to leverage the equity of Chwayanprash
2011	HUL	Kissan NutriSmart	HUL launched it under Kissan brand as a Brain food Priced 25% premium to Horlicks, at the price of Horlicks Gold

Source: Company, Jaypee Research

Category king Horlicks' range addresses pregnant women, children and entire families

Introducing new flavors is one way GSK has maintained its excitement among consumers, where they are looking forward to drive their experience. Apart from new flavors, GSK also witnessed transmission with respect to need specific variants such as Horlicks Junior and Mother Horlicks. Such diversifications in the offering have unquestionably enabled expansion in the consumption base –from mothers and children to working women, aged people and even an entire family.

On the marketing front, innovation or advancements in packaging have also played a great role in expanding consumption among price-sensitive middle and lower-middle class consumer sets. Keeping in mind consumers' expectations and affordability issues, GSK products are now available in refill packs, pouches, sachets, pet jars and large family size packs.

The revitalized packaging was synergistic with the new brand personality, and one that helped in becoming a favorite among mothers for its nourishment and children for the variety of tastes it offered. "The contemporary Horlicks not only provides nourishment but scores on taste as well. Horlicks has always been scientifically developed to cater to the needs of Indian diet by supplementing it with essential nutrients such as iron, vitamin etc,"

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Next leg of long term growth: Rural Market

Largely focused on urban market, now aggressively expanding its presence in rural market

GSK Consumer is largely urban based, where 70% of its revenue comes from core urban markets and is now aggressively looking to expand its presence in rural markets. We believe that rural opportunity for food segment is largely untapped and presents a great long term opportunity.

Rising income levels on account of government support to improve consumer spending

In the present scenario rural sector per capita income is rising consistently on account of: (1) Government support programs such as National Rural Employment Scheme (NREG) and (2) Rising minimum support prices, we believe rising income of consumers would increase the demand in coming years.

GSK is focusing on low – priced malted food and smaller SKUs to tap rural market

GSK Consumer has recently launched smaller SKUs and low price product targeted at rural market and focusing on price points to drive consumer aspiration. Such affordable packs would increase the rural exposure to GSK products and will fuel its contribution to GSK revenue.

....Even Urban Markets are underpenetrated

Malted beverage category is still underpenetrated and now riding on the wheels of health consciousness

GSK Consumer has mainly been focused on Urban markets but we believe that now the penetration levels will grow drastically mainly because of rising income, increasing awareness of health consciousness and GSKs entry in North and West region.

Growth Strategy based on Nutrition & Extending Distribution

In recent years, India's new found health kick has expanded the shelf space for functional foods. High fiber, cholesterol-free, nutrients enriched, and fortified with essential vitamins, minerals, and carbohydrates are some of the legends on nutrition labels on an array of food products in Indian supermarkets.

GSK products are always focusing on nutrition and health: Looking at the GSK journey so far, it has always been focusing on scientifically developed products to cater to the needs of Indian diet by supplementing it with essential nutrients such as iron, vitamin etc.

Horlicks journey so far with MFD

Year	Brand	Comments
1997	Mother's Horlicks	Fortified with DHA and supplemented with 26 essential nutrients, designed keeping in mind the special needs of pregnant women and breast feeding mothers
2005	Horlicks Lite	Formulated keeping in mind the needs of adults and people with diabetes, and was high fiber and low in fat
2006	Horlicks Junior 1-2-3	Especially introduced for pre-school children, offers complete nutritional re-quirements.
2008	Women's Horlicks	Enriched with HEMOCAL™ nutrients – a unique combination of good quality milk protein, and 100 percent daily requirements, promises to address the daily nutritional needs of the busy, overstressed modern Indian woman

Source: Company, Jaypee Research

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Strong demand Confidence: Nutritional category

New products under same umbrella brand, proved successful

The company has leveraged Horlicks’ well-built brand equity with existing consumers and to aim new consumers into different categories under the same umbrella brand. GSK has been successful in driving its new launches in the market.

Horlicks Brand Size

Brand	Rs Mn
Horlicks Core Brand	13000
Junior Horlicks	2200
Mother Horlicks	400
Horlicks Lite	350
Women's Horlicks	200

Source: Industry, Jaypee Research

Since ages Indian mothers have been adding malted food powder in their children’s milk for better growth and development or as an essential nutrient supplement. GSK’s interest in matching the pace of changing consumer preference and demand has resulted in the value of its umbrella brand Horlicks. Overall brand value of Horlicks stands at Rs16 bn including value of other Horlicks brands (Mother Horlicks, Junior Horlicks, Horlicks Lite & Women Horlicks) worth ~Rs.3bn in the malted space, on our estimates.

We believe that the strategy of targeting new consumers into specific need category has shown very good results. Going ahead, growth in core Horlicks brands together with other extensions will benefit the company and generate a significant value over the coming years.

Introduction of new brands in MFD

GSK continued its focus on boosting the segment with the launch of another brand, BOOST, in 1975. A chocolate flavored drink, its success described GSKs capabilities and knowledge of analyzing and developing, with which they respond to the changing needs with time.



The new Boost was a better product with advanced energy boosters such as zinc, iron and magnesium, along with other key vitamins and minerals and was made available in two variants – Boost and Boost Choco blast (with extra chocolate).

It has strong brand equity in South India, now with distribution expansion in northern & western India(23% growth in distribution reach), all-new look and innovative packaging with the great taste of chocolate has helped Boost to register 17% volume growth and 25% value growth in CY10, currently holding more than 13% market share.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Inorganic Growth: “GSK promises to address the specific needs of consumers”

Acquired brands Viva & Maltova from Jagatjit industries in 2000

GSK Consumer continued expanding its width in the category with acquisition of two brands – Viva and Maltova from Jagatjit Industries in the year 2000.

Maltova: Fun health Drink, Yummy Choco-malt

Maltova was positioned as ‘fun’ health drink, extremely tasty and especially nourishing for kids. The brand was restaged in 2004, with an attractive new packaging that signified a high taste appeal and a sense of fun and excitement.

Viva: Good start to a bright & healthy day

Viva was positioned on the belief that a good start to the day ensures that the rest of it goes well too. Offering a combination of nine essential vitamins (vitamin A, C, D, B1, B2, B6, B12, niacin and folic acid), iron, phosphorus and calcium, Viva contains the natural goodness of milk, wheat and malted barley.



Widening distribution reach: Opportunity for revenue growth

- 25 Warehouse
- 500+ Distributors
- 66 mn Direct outlet
- 1.4 mn indirect outlet

Current distribution gap that exist as compared to the industry average is an opportunity for growth

GSK Consumer’s distribution reach is much lower than that of average reach of any other FMCG company in India. GSK is currently riding on a direct reach of 660,000 outlets in CY10 (520,000 in CY09) as compared to the average of 950,000 for any mid cap FMCG company in India. Further, including indirect reach its total presence is in 1.4 mn outlet as compared to an average of 3mn+ outlets. It is likely to extend it rural distribution by adding more distributors and super stockist. We believe that the distribution expansion would drive the penetration levels and will show sizeable boost in sales.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Product category diversification to lower Malted beverage dependence

New product launches to drive revenue growth

Malted beverage contributes 94% to its consolidated revenue.

One of the major concerns with GSK is that it's mainly a single product company. Its dependence on malted beverages remains quite high (~94% of its revenue). However, in order to deal with these concerns the company has been continuously diversifying into newer categories.

GSK entered into Biscuit, Instant noodles, Cereal bars, Glucose & Energy drink space

GSK Consumer entered into several new categories including Biscuits, Cereal bars, Glucose and Instant noodles by leveraging on the strong brand equity of its principal brand **Horlicks**. The company has also launched Lucozade in the energy drink space from its global brand portfolio, we expect GSK to further expand its product offering by introducing key brands from its global portfolio in the coming years.

GSK to further expand its product portfolio by introducing key brands from global portfolio

GSK is looking to bring down its dependence on Malt drink

On the basis of GSK's strategy, it is looking to lower its dependence on malt based drinks to a significant proportion in next few years. In our view, the non malted food drink will account for more than 15% of the total revenue within a decade.

GSK's journey in Non-MFD

Year	Brand	Comments
Horlicks		
1992	Horlicks Biscuits	Product focuses on power of calcium
2005	Lite Bite Biscuits	Nutritional food for Diabetic and Health Concious adults
2005	Flavor Drink	Chocolate, Vanilla, Honey Buzz, Standard, Toffee, Elaichi
2009	Horlicks Chilled Doodh	Chocolate flavor drink for kids
2009	Horlicks Nutri Bar	Low fat low sugar, filler in between the meals
2009	Active Grow	Nutritious product launched for infant population
2009	Junior Horlicks Biscuits	Nutritional food for pre school kid as a part of their daily diet
2010	Horlicks Foodles	A brand of Instant Noodles
2010	Glaxose D	Glaxose D under Horlicks brand for East India.
Boost		
2004	Boost energy shake	Ready to drink milk shake target for kids
2010	Boost Glucose	New glucose drink launched in North and West India
Lucozade		
2010	Lucozade Sport	International Isotonic sports drink

Source: Company, Jaypee Research



Horlicks Foodles



Horlicks Biscuit



Horlicks NutriBar

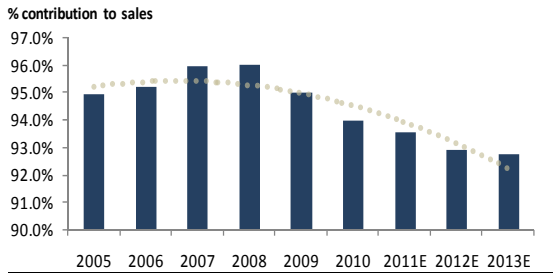


Lucozade

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

MFD Contribution for GSK Consumer

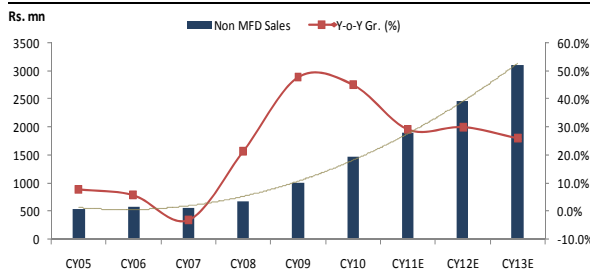


Source: Company, Jaypee Research

Lowering dependence on malted beverage drink

In the recent past, GSK has been successful in lowering its dependence on malted beverage by 200 bps from a high of 96% in 2008. In order to lower this dependence, the company is leveraging on the strong brand equity of its Horlicks brand to other processed foods categories. Moreover it is also expanding its product offering by introducing key brands from its global portfolio. We expect these new launches will provide strong growth opportunity.

GSK's sales of non-malted food & Y-o-Y growth

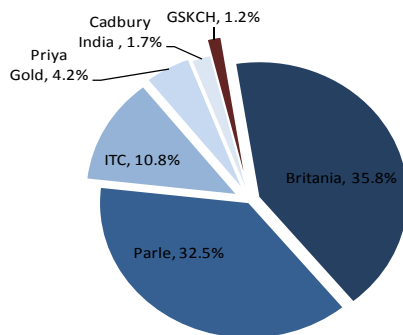


Source: Company, Jaypee Research

Diversification to reap benefits

GSK's non malted food revenues have gone up sharply in last 3 years primarily owing to great acceptance of new products launched, moreover over the recent past GSK Consumer has aggressively grown its biscuits and instant noodles businesses. We expect GSK's Non-MFD portfolio to grow at a CAGR of 30% over CY11-CY13. It will further decrease GSK's dependence from a single category to a well diversified portfolio that would provide a broader base for earning growth.

Biscuits market share



Source: Company, Jaypee Research

Biscuit to propel next leg of growth

Biscuit, one of the fastest growing categories in the Indian FMCG sector with the value market size of more than Rs120 bn in FY11, this category is also the second largest revenue contributor for the company, contributing Rs1.4 bn (5.5% of sales) in CY10. Currently GSK is a marginal player in this category, with a market share of 1.2%.

We expect the category to grow at a rate of 25% over the next few years, driven primarily by continuous product innovation and new product introductions, we expect GSK Biscuit portfolio to grow at a rate of 30% above the industry expected growth rate during CY11-CY13. This strong growth over the next few years will lead contribution from biscuit category to 6.8% by CY13E, by our estimates.

Service offerings

- Research and Advisory
- Execution
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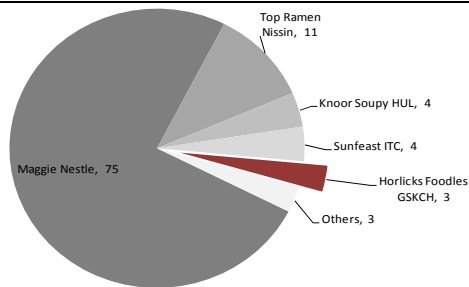
GSK brand was typically present in the glucose segment of market, segment profitability took hit on account of rising raw material prices, high competition, need for high A&P spend to grow the market and brand. However, with the slew of new product launches and better product mix GSK competitors improved their profitability. Since GSK did not enter these categories its profitability continue to hit.

We expect margins to improve in the shorter to medium term as company has recently entered and introduced premium SKUs like Horlicks cream, Horlicks cookies & Horlicks lite.

Instant noodles

Instant noodles fetched instant success to GSK

Instant Noodles market share (%)



Source: Company, Jaypee Research

Instant Noodles, Rs17 bn category is registering a growth of 25% annually and is expected to double in the coming 3-4 years. GSK Consumer entered the segment in India at the beginning of CY10. The company decided to leverage the Horlicks brand equity as health and nutrition product and launched Horlicks Foodles – a healthy range of noodles. The shade of Horlicks umbrella has helped Foodles to meet with instant success, with the company able to gain 3% market share within the first year of launch on a pan India basis.

In the recent past, with the entry of new players and product variants the instant noodle category has grown at a very fast pace. The new launches have common trait, focusing on health and has been positioned as a niche category. For instance, HUL's Knorr Soupy Noodles come together with soup; GSK's Foodles with nutrition and minerals mixed in noodles; Nestle launched new variants of Maggi (atta noodles and multi grain noodles) made from wheat and combination of other grains.

- *Attractive market with high growth*
- *Early acceptance in Instant noodle category*
- *Nutrition and health remain the focus area*
- *New launches to improve growth*
- *Horlicks strong brand equity*
- *Largely underpenetrated*

We believe that the present growth rates are riding on the health platform and low penetration levels. Moreover, the healthy noodle segment is expected to grow at a much faster rate than the plain noodles in the near future. We expect company to outperform by 30% as against the market growth of 25%, on the back of early acceptance of product from consumers and also the benefits associated with Horlicks brand equity.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Strategic entry in niche categories

Enter in niche categories such as health supplements, nutrition bars and sports drinks.

In order to widen its product offering and reduce dependence on malt beverage, GSK has entered in niche categories such as health supplements, nutrition bars and sport drinks. In India the size of these categories are very small, but they are growing at a very fast pace in the developed and established markets.

In the recent past company has launched number of new products and continuously looking to introduce its global brands from the parent product portfolio in Indian market.

Nutritional bars, healthy snack: High growth path

Launch Nutribar, a Healthy snack in the year 2009 with the target sales of more than Rs1 bn in next 5 years.

During February 2009 the company launched Horlicks Nutribar; a high nutrition cereal bar offered as a healthy snack between meals and provides convenience to the urban customers and also launched premium protein supplements – *Acti-grow and Acti-base*. The category is very small with competition from General mills offering Nature Valley and Naturell offering Rite Bite, but growing at a very fast rate, GSK management expects to take significant market share and target sales of more than Rs1 bn in next 5 years.

.... Going on with the expansion strategy

Enter Rs 60 crore chilled milk category with the new product Horlicks chilled Doodh, a summer drink available in four flavors.

In April, GSK has launched its new summer drink called **Horlicks Chilled Doodh** (milk), available in four flavors. The company will face competition in the Rs 60-crore chilled milk category from Amul Kool, Britannia and strong regional players like MAFCO in Mumbai, but the management expects that the brand can pull in revenues of Rs 50-100 crore in about five years.

Lucozade: Global brand from parent company collection

On April 2010, GSK Consumer introduced Lucozade sport (an energy drink) and made strong inroads into a nascent and fast growing energy drink market in India.

In position to extend its product offering, GSK Consumer is aggressively looking to bring in global brands from its parent product portfolio in Indian markets. It has recently launched Lucozade sport, an energy drink to mark its entry in Rs1.5 bn energy drink market. Through this launch, the company has made strong inroads into a nascent and fast growing category in India. Lucozade is already a well-established sports drink brand in the UK and has presence in several other international markets.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Income as segmentation variable

Launch of products in Super premium category

GSK has recently launched a new variant of Horlicks by name 'Horlicks Gold' priced 30% premium to the base Horlicks variant, in select market across India. Horlicks Gold is an enriched version of the regular Horlicks with better nutrition, taste and aroma.



Horlicks Gold

Horlicks gold is targeted at the urban consumers; we also believe that the move also marks a shift in the segmentation strategy of Horlicks. Horlicks has used predominantly age based segmentation for all its product development. It used gender as segmentation when it launched Women's Horlicks. Now the brand has used income as a segmentation variable. Using income as segmentation is first in this category of products.

The challenge for this variant is to convince the customer to pay a premium for Horlicks Gold, but the acceptability of the product will improve the profitability of the brand.

Road to rural bazaar

GSKCH introduced – 'Asha' a low cost malted beverage drink (40% cheaper than Horlicks) for rural markets only, variant of the brand Horlicks in CY10. Asha tastes slightly different and is priced at Rs 85 for a 500-gram pouch pack. There is also a 200-gram pack costs Rs 50.



Asha from Horlicks

It was introduced in some of the rural markets and regions of Southern India for quite some time now. However management noted that test market results are not yet positive for a commercial launch.

We believe that these products have intense opportunity of doing well in the rural markets which have tremendous potential on account of rising demand, steady increase in purchasing power and affordability. Asha, a health drink additive can be a game changer for GSK, if it reaches out well and is accepted by the rural masses.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Financial analysis

Top – line expected to grow at 20% CAGR over CY11-13E

We believe GSK Consumer will continue to record healthy revenue growth. Dominant market position, strong brand equity in malted food drink space and low competition has sustained 19% revenue CAGR over CY05-10. In the recent past GSK has launched new product variants and has also entered into new fast growing categories. The company's strong focus on extending its distribution reach, widening market segmentation by launching products which address specific need of different consumer, increasing demand for nutritional and convenient products, rising income levels and growing urbanization will further support the growth rates. We expect the revenue to grow at 20% CAGR over CY11-13E.

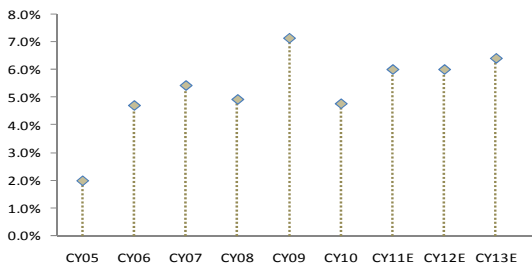
Growth rates & Sales breakdown for GSK Consumer

Sales (Rs mn)	CY2007	CY2008	CY2009	CY2010	CY2011E	CY2012E	CY2013E
Malted Foods	13389	16,318	19,236	22,837	27,190	32,510	39,326
Volume growth (%)	9.9	16.2	10.0	13.3	12.3	12.8	14.1
Price growth (%)	5.5	5.0	7.0	5.0	6.0	6.0	6.0
Value growth (%)	15.9%	21.9%	17.9%	18.7%	19.1%	19.6%	21.0%
As % of Sales	95.9%	96.0%	95.0%	93.9%	93.5%	92.9%	92.7%
Biscuits	485	602	899	1356	1758	2296	2889
Volume growth (%)	(6)	22	43	40	25	26	21
Price growth (%)	3	2	4	8	4	4	4
Value growth (%)	(3)	24	49	51	30	31	26
As % of Sales	3.5%	3.5%	4.4%	5.6%	6.0%	6.6%	6.8%
Others	81	84	116	115	142	173	222
As % of Sales	0.6%	0.5%	0.6%	0.5%	0.5%	0.5%	0.5%
Total Gross Revenue	13,954	17,004	20,251	24,308	29,090	34,979	42,437
Y-o-Y Growth		21.9%	19.1%	20.0%	19.7%	20.2%	21.3%

Source: Company, Jaypee Capital estimates

Better price/mix to fuel top line growth

Price hikes taken by GSK for MFD portfolio



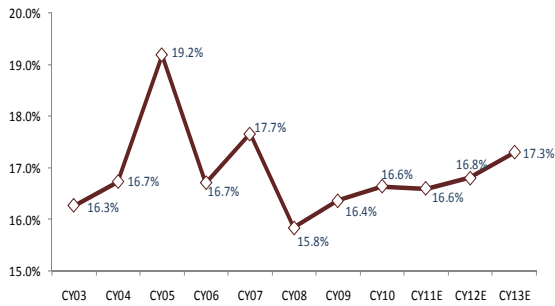
Source: Company, Jaypee Research

We expect the malted food drink portfolio to register robust volume growth of 12% over CY11-13E. Pricing power remains reasonably significant for GSK Consumer considering its 70%+ market share in the category. GSK's capability of passing on input cost and looking at the past trend of price hikes, we have built in 6-7% pricing growth over CY11-13E. We forecast MFD portfolio to register revenue CAGR of 20% over CY11-13E, largely on the volume front as we expect sales to benefit from increased penetration and new product variants.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

EBITDA Margin trends for GSK Consumer



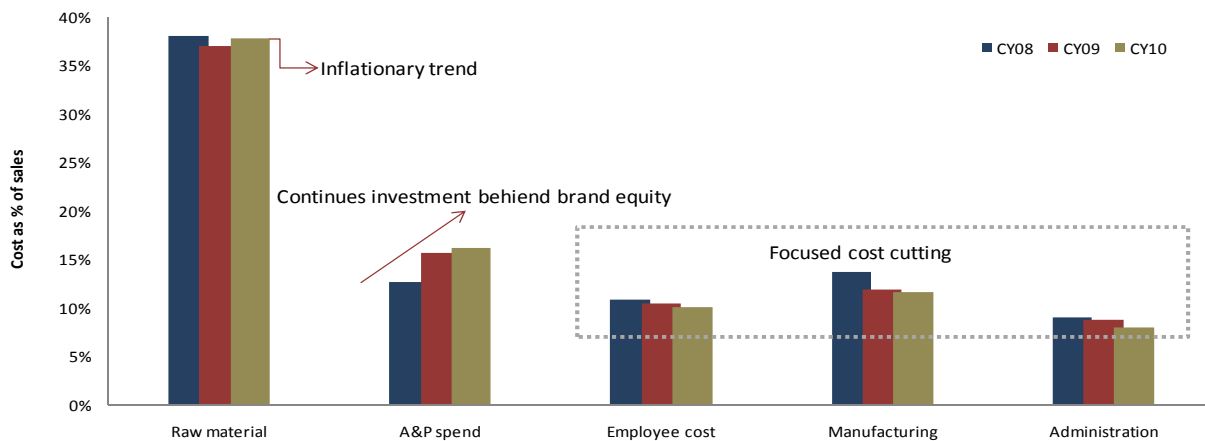
Source: Company reports

Margins rising, trend likely to be sustained

During CY10, GSK Consumer faced input cost pressure on account of high inflation (80 bps increase in material cost as a percentage of sales as compared to CY09). It has also reported highest ever A&P spend at 16.1% of sales in CY10. Despite the rising cost GSK Consumer has reported 20bps increase in its EBITDA margins to 16.6% on the back of effective cost management and reduced administration and employee cost.

Going into CY11E, we expect EBITDA margins to remain at the same level of CY10 as we acknowledge that the rising milk and barley prices will put pressure on margins, although we believe that A&P spend as a % of sales would normalize, as investments in new categories is likely to be modest. It will further be supported by focused cost management and strong pricing power.

EBITDA margins rising on back of focused cost structure



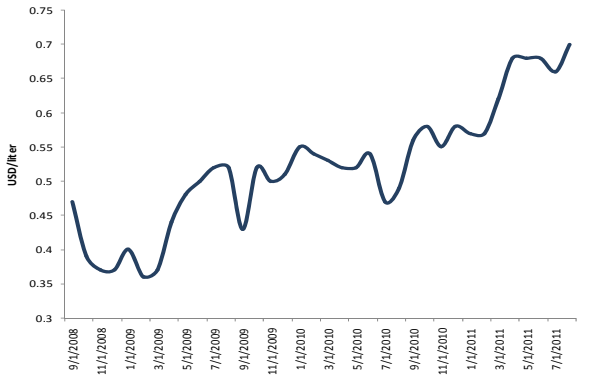
Source: Company reports

During the period CY07-CY10, GSK Consumer has seen a very mixed trend of EBITDA margin ranging between 15-17%. In CY07, GSK reported 100bps increase in margins on account of lower SG&A spends. However margins slipped by 220 bps in CY08 due to sharp increase in raw material prices (RM cost higher by 300bps). Since CY08, inspite of the inflationary trend company has been able to inject huge sum of money on brand building through higher A&P spend to support its new launches and has constructed a rising fashion in its margins mainly owing to focused cost structure. We understand that the key variables which influence margins of GSK Consumer to a large extent are – 1) Raw material price trends, and 2) Levels of marketing and promotional spend.

Service offerings

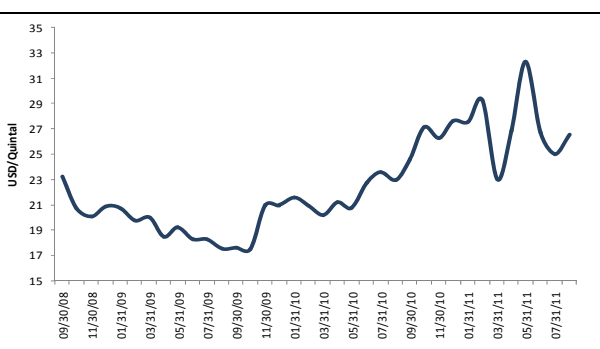
- Research and Advisory
- Execution
- Corporate Access & Events

Milk price (USD/litre)



Source: Bloomberg

Barley price (USD/Quintal)



Source: Bloomberg

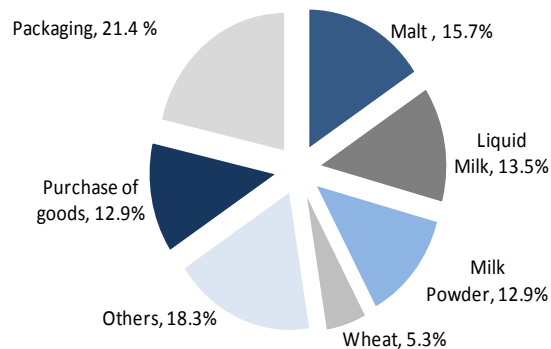
Rising input prices: Key risk for GSK

Looking at the past trend, one of the challenges company faced is soaring input cost. Key raw materials like liquid milk, milk powder, malt and wheat have witnessed uptrend in their prices. As seen in the chart below, price trend for each of the raw materials has been very volatile, especially after some cooling off in prices during CY09, the commodity prices again took a northward rally in CY10 on back of high food inflation.

Going ahead, we expect company to face the commodity cost pressure, primarily in its key inputs such as milk and barely which accounts for 40% and 35% respectively of the total input cost and has risen on average by 25% in CY10, we expect the overall input cost index to maintain up move trend by 7% Y-o-Y in CY11. We believe an annual price hike of 5-6% would be sufficient to neutralize the 11-13% cost inflation and help sustain the margins for the company.

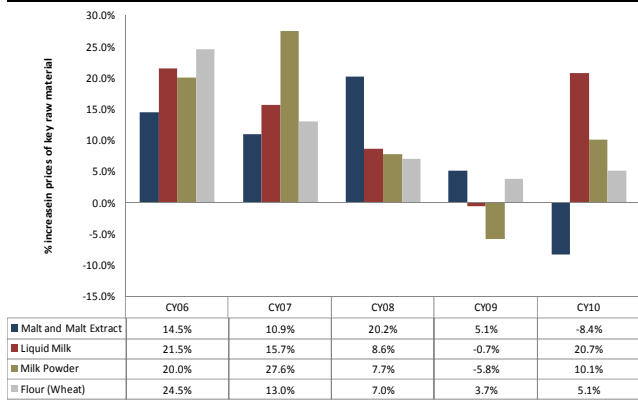
However we believe that on account of GSK Consumers long term relation with the suppliers and ability to place large amount of orders, gives it some kind of bargaining power in terms of input cost as well as the recent government initiative to encourage an increase in milk production will curb the coming headwinds from the input cost end by keeping a tab on milk prices.

COGS Break up for GSKCH (CY10)



Source: Company reports

Inflationary trend in input prices

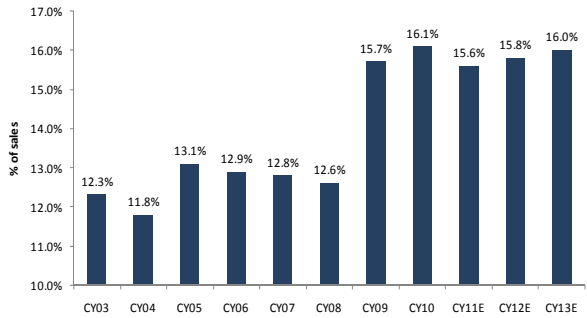


Source: Company reports

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

A&P spend (% of sales) trend for GSK Consumer



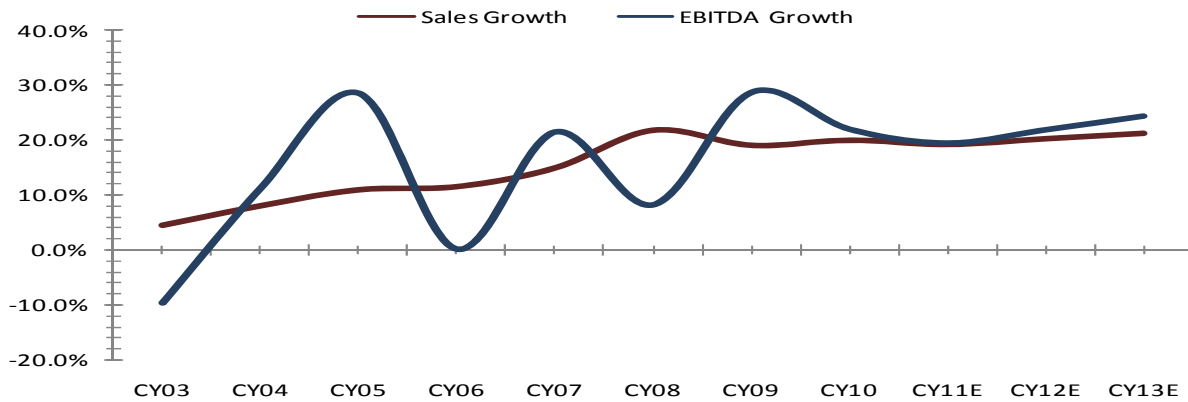
Source: Company, Jaypee Research

Lower ad spend in future, margins to improve

Continuous launches and re-launches demands back from promotion and advertisement, to support the same GSK Consumer incurred higher on A&P spend during CY09-CY10. Over the past years GSK has entered in various new segments like nutritional bars, instant noodles and has also launched new variants, as a result A&P spend has rose from 12.6% in CY08 to 16.1% in CY10. The effect of higher A&P could be seen in early success achieved by GSK in new segments entered.

We expect advertising and marketing activities to cool down in CY11, with investments in new categories are likely to be modest. We expect A&P to decline by 50bps in CY11 as it was exceptionally high in the earlier year to support new launches and entry into new segments.

Healthy revenue growth....Margins to improve



Source: Company, Jaypee Research

Overall we expect margins to improve on account of focused cost structure, decline in input cost and introduction of high margin products.

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Decrease in debtor days and a significant move in creditor days have improved working capital requirement of the company, led to increase in cash balance on the GSK books

Company has a strong balance sheet which gives a choice on decision on use of cash for larger dividend payout or acquisitions

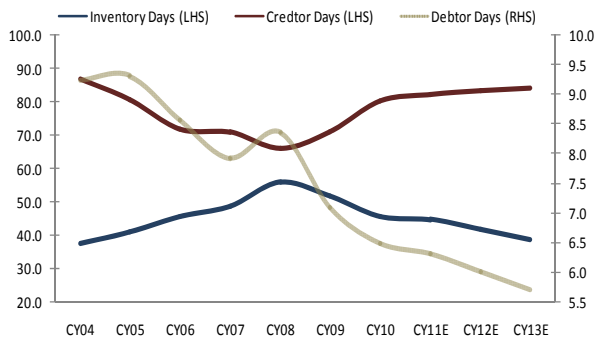
Cash pot: Strong balance sheet, possibility for Inorganic growth

GSK Consumer operates on a negative working capital cycle, sustained good efficiency and limited capex requirement will boost the FCF of the company in subsequent years aided by strong EBITDA growth.

Since 2007 company has been focusing on making efficient changes in its operating environment, particularly on working capital. For instance debtor days which have now moved to 6 from the levels close to 20 in 2002, mainly on account of electronic payment system which was put in place at the distributors end and further improvement led by successful negotiations with suppliers helped creditor days to move up significantly. These moves have resulted in significant improvement in the company's working capital requirements, which have meant that cash balance on the books rose from Rs937mn in CY07 to Rs9.7bn in CY10. We expect the momentum in cash balance to be maintained in the absence of a large dividend payout.

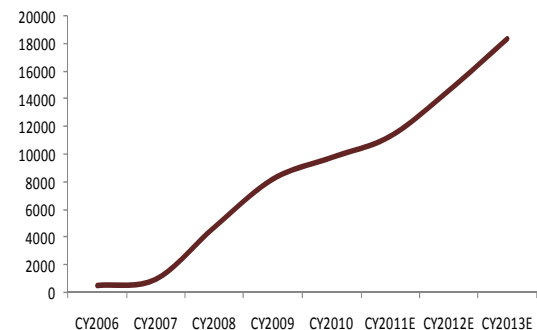
In CY10, the company spent nearly Rs1.2bn to increase its manufacturing capacity to meet increased demand over the next few years. We believe that the company's plans to move out into other categories as well as to leverage Horlicks brand equity further, will require some additional investment. In absence of an opportunity to move ahead with the investment plan the company will deploy some part of this in giving out special dividend, but the timeline of this is not known to us.

Improving working capital



Source: Company, Jaypee Research

Cash on the balance sheet (Rs mn)



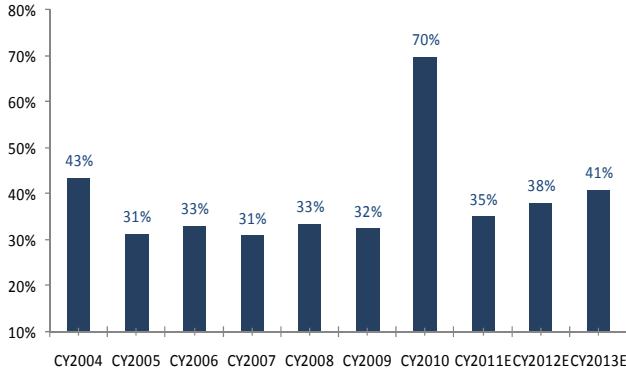
Source: Company, Jaypee Research

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Sluggish ROE on account of low dividend payout

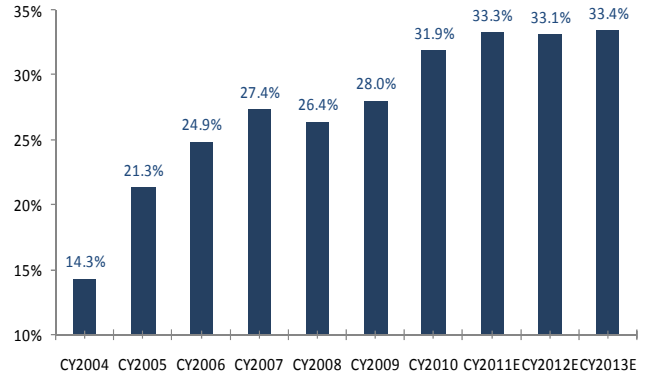
Dividend payout trends



Source: Company, Jaypee Research

Please note in 2010, company paid special dividend of Rs25/share which led to higher dividend payout.

ROE



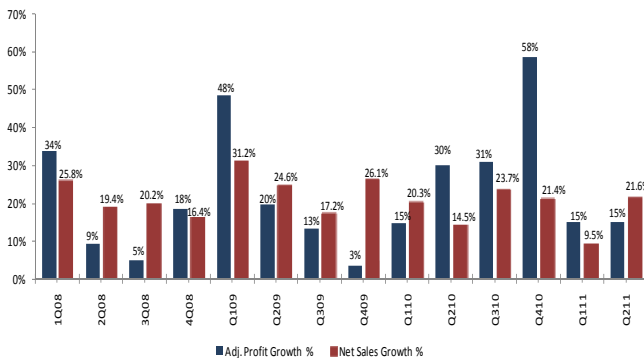
Source: Company, Jaypee Research

Return ratio could improve

In spite of the high cash on books (nearly Rs9.8 bn); ROE for GSK Consumer is at very low levels of 28%, which is on account of relatively low dividend payout of 32% in CY09. We could see a gradual improvement in return ratios, if the company could utilize the cash to increase its dividend payout to the historical levels of 43%.

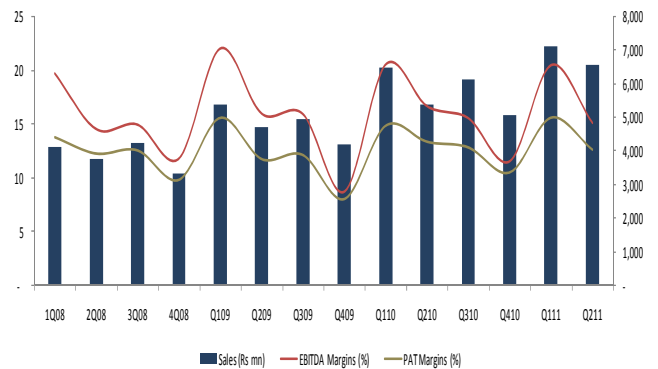
Quarterly trend to remain a focus area

Quarterly Sales and Profit growth trends (YoY)



Source: Company, Jaypee Research

Quarterly Sales and Profit margin trends



Source: Company, Jaypee Research

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

We expect earnings to increase at 21% CAGR in CY10-13E

We expect the net sales to grow at 20% CAGR during CY11-13E from Rs23.06 bn in CY10 to Rs40.2bn in CY13E. The growth will be driven by volumes and higher price realizations, indicating strong quality of performance. We forecast the core malted food drink business would grow at 19% CAGR to Rs39.3bn during CY11-1eE whereas Biscuit business would surge at 30% CAGR to Rs2.8 bn during the same period.

Despite inflation in commodity prices, price hikes implemented would help the operating margins to expand from here on. We forecast 70 bps increases in operating margins during CY11-13E period from 16.6% in CY10 to 17.3% in CY13E- driven by (1) increase of 10bps in gross margins and (2) focused cost management. We expect net profit to grow 21% CAGR in CY11-13E period from Rs3bn in CY10 to Rs5.4bn in CY13E. We expect EPS to move from Rs70.8/Share in CY10 to Rs129/Share in CY13E.

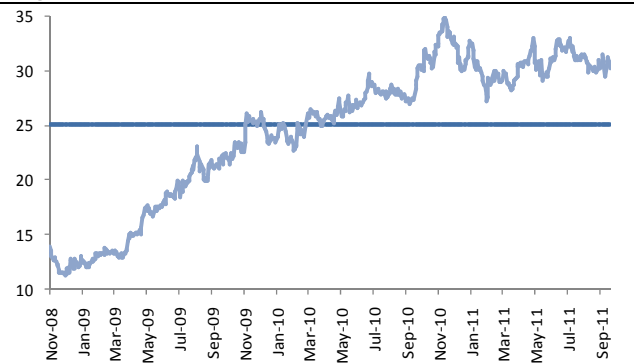
Initiate coverage with 'BUY' rating and price target of Rs3100/Share

We expect the growth momentum to sustain in a near term as we believe that (1) volume growth would remain robust with improved business conditions and (2) price hikes would catalyze sales. The price hikes implemented in the recent quarter have revived the sanctity & conduct in the business. We believe that the company would continue to pass increase input costs in the form of price hikes. Consequently, volume growth would not get impacted due to unwanted price actions in the system.

The core business would continue to improve – (1) Malted food drink business would surge with rejuvenation of pricing power, new variants, entering into new regions, recent entry into rural markets and aggressive sales activities in last few quarters (2) Instant noodle business would benefit from lower penetration and high growth assigned (3) Biscuits would grow with price hikes, new innovative launches and nutritional positioning.

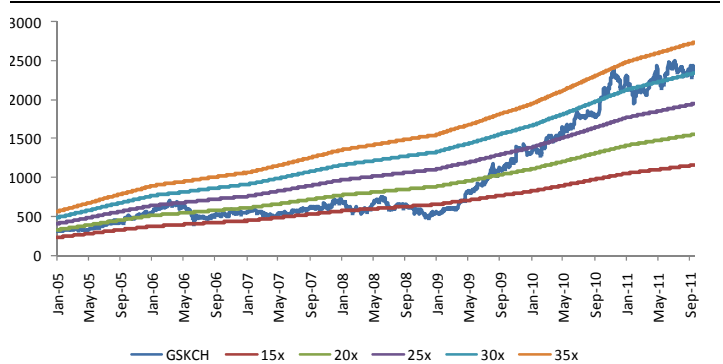
GSK has traded at an average PE of 25X in last two years. We expect earnings to grow at 21% CAGR during CY11-13E period from Rs70.8/Share in CY10 to Rs129/Share in CY13E. At the CMP of Rs2360/Share the stock is valued at 18.6 CY13E earnings - do not fully discount the earnings growth and lower risk involved. We initiate coverage with 'BUY' rating and price target of Rs3100/Share, valuing GSK at 24X CY13E earnings. This represents upside of 31% from the current level.

GSK is trading at premium than high growth phase avg. P/E



Source: Company, Jaypee Research

P/E band of GSK Consumer



Source: Company, Jaypee Research

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Company background

History

"GSK's journey began with Horlicks. In the early years, Horlicks, manufactured by Horlicks Limited, Slough, England, was being imported, bottled and sold in India. The year 1955 saw a change in import policy, following which the import of Horlicks was stopped.

In 1956-57, a team from Horlicks Limited visited India to explore the possibilities of setting up a plant. With the support of the then Maharaja of Nabha, His Highness Pratap Singh, and a plant was set up at Nabha, in Punjab. Thus was born on October 30, 1958, Hindustan Milk food Manufacturers Pvt. Ltd., promoted by Horlicks Ltd.

In the year 1969, Beecham plc., acquired Horlicks Limited and became the majority shareholder in Hindustan Milk food Manufacturers Limited. Ten years later in 1979, Beecham India (Pvt) Ltd. merged with Hindustan Milk food Manufacturers Limited and the non-resident equity shareholding was reduced to 40%. The name of the company was also changed to HMM Limited, in 1991.

Beecham plc, UK and SmithKline, USA merged in 1989 to form SmithKline Beecham plc, with its registered office in the UK. HMM Limited thus became part of SmithKline Beecham Consumer Brands, one of the three sectors of SmithKline Beecham and its name was changed to SmithKline Beecham Consumer Brands Limited.

Yet another christening took place in March 1994 when the name of the Company was changed to SmithKline Beecham Consumer Healthcare Limited, reasserting the Company's promise of providing healthcare to consumers.

The plan to form GlaxoSmithKline was announced in London on January 17, 2000. It was on December 27 that the two global giants SmithKline Beecham and Glaxo Well come merged to form GSK. The company's new identity, GSKCH, has been created to reflect our shared values towards scientific research and improving people's lives. "

Source: Company website

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

Financial Table

Income Statement

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E	CY13E
Net Sales	19,215	23,061	27,605	33,195	40,273
Growth (%)	24.6%	20.0%	19.7%	20.3%	21.3%
Expenses	16,072	19,225	23,021	27,606	33,319
Growth (%)	23.9%	19.6%	19.7%	19.9%	20.7%
Raw Materials	7,106	8,712	10,744	12,750	15,200
% Of Sales	37.0	37.8	38.9	38.4	37.7
Employee Cost	2,007	2,297	2,666	3,239	3,930
% Of Sales	10.4	10.0	9.7	9.8	9.8
Manufacturing Exps	2,272	2,682	3,156	3,795	4,604
% Of Sales	11.8	11.6	11.4	11.4	11.4
Admin Expenses	1,663	1,822	2,149	2,579	3,144
% Of Sales	8.7	7.9	7.8	7.8	7.8
Selling & Distribn Exp	3,024	3,712	4,305	5,243	6,441
% Of Sales	15.7	16.1	15.6	15.8	16.0
Ebidta	3,143	3,836	4,585	5,589	6,954
Growth (%)	28.7%	22.0%	19.5%	21.9%	24.4%
Ebidta%	16.4	16.6	16.6	16.8	17.3
Other Income	861	1,085	1,314	1,599	1,823
Interest	40	26	26	26	26
Depreciation	420	397	452	514	555
PBT	3,544	4,499	5,420	6,648	8,196
Tax	1,211	1,520	1,831	2,246	2,768
PAT (Before EO)	2,333	2,979	3,589	4,403	5,428
Growth (%)	25.4%	27.7%	20.5%	22.7%	23.3%
Net Margin%	12.1	12.9	13.0	13.3	13.5
E/O Item	2	27	0	0	0
Reported PAT	2,334	3,006	3,589	4,403	5,428

Balance Sheet

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E	CY13E
Equity Share Capital	421	421	421	421	422
Reserves	8,630	9,180	11,513	14,243	17,446
Networth	9,051	9,600	11,934	14,663	17,868
Secured Loans	0	0	0	0	0
Unsecured Loans	0	0	0	0	0
Loan Funds	0	0	0	0	0
Net Deferred Tax	0	0	0	0	0
Minority interest	0	0	0	0	0
Capital Employed	9,051	9,600	11,934	14,663	17,868
Gross Block	5,585	5,990	7,190	7,790	8,390
Less: Depreciation	3,640	3,967	4,419	4,933	5,488
Net Block	1,945	2,023	2,770	2,856	2,901
CWIP	378	1,083	583	733	883
Goodwill	0	0	0	0	0
Investments	0	0	0	0	0
Current Assets	11,729	14,231	16,002	19,805	24,208
Inventories	2,660	3,120	3,384	3,796	4,275
Debtors	314	505	475	544	627
Cash & Bank	8,198	9,761	11,298	14,518	18,230
Loans & Advances	338	501	502	604	732
Other Current Assets	220	344	344	344	344
Current Liab & Prov	5,111	8,004	7,690	8,999	10,394
Net Current Assets	6,618	6,227	8,313	10,806	13,814
Misc Expenditure	-	-	-	-	-
Capital Deployed	9,051	9,600	11,934	14,663	18,162

CashFlow

Y/E, Mar (Rs. mn)	CY09	CY10	CY11E	CY12E	CY13E
Pre-Tax Profit	3,544	4,499	5,420	6,648	8,196
Depreciation	420	397	452	514	555
Non Cash	-74	-159	0	0	0
Add/(Less) Extraordinary Item	412	345	0	0	0
Chg in Working Cap	2,284	1,954	-549	726	705
Tax Paid	-1,211	-1,520	-1,831	-2,246	-2,768
Operating Cash Flow	4,550	4,825	3,493	5,643	6,688
Capex	-409	-1,110	-700	-750	-750
Free Cash Flow	4,141	3,715	2,793	4,893	5,938
Investments	0	0	0	0	0
Add/Redn of Reserves	233	300	0	0	0
Loans	0	0	0	0	0
Dividend	-886	-2,452	-1,256	-1,673	-2,225
Others	0	0	0	0	1
Net Change in Cash	3,488	1,563	1,537	3,220	3,712
Opening Cash	4,710	8,198	9,761	11,298	14,518
Closing Cash	8,198	9,761	11,298	14,518	18,230

Key Ratios

Y/E, Mar	CY09	CY10	CY11E	CY12E	CY13E
Profitability %					
Ebidta Mgn	16.4	16.6	16.6	16.8	17.3
PAT Mgn	12.1	12.9	13.0	13.3	13.5
ROCE	42.6	48.5	50.6	50.2	50.5
ROE	28.0	31.9	33.3	33.1	33.4
Per Share Data					
EPS	55.5	70.8	85.4	104.7	129.1
BVPS	214.4	228.3	283.8	348.7	424.9
DPS	18.0	50.0	29.9	39.8	52.9
Valuations (X)					
PER	42.5	33.3	27.6	22.5	18.3
P/BV	11.0	10.3	8.3	6.8	5.6
Ev/Sales	5.1	4.3	3.6	3.0	2.5
Ev/Ebidta	24.7	20.1	16.8	13.7	11.3
Dividend Yield (%)	0.8%	2.1%	1.3%	1.7%	2.2%
Turnover (X Days)					
Debtor TO Days	7.1	6.5	6.3	6.0	5.7
Inventory TO Days	51.6	45.7	44.7	41.7	38.7
Gearing Ratio					
Net Debt/Equity (X)	-0.9	-1.0	-0.9	-1.0	-1.0
Total Debt/Equity (X)	0.0	0.0	0.0	0.0	0.0

Service offerings

- Research and Advisory
- Execution
- Corporate Access & Events

From Jaypee Institutional Equities Desk

Equity Research Products	
1. Initiating Coverage	In depth analysis coupled with detailed explanation of investment rationale
2. IPO Note	In depth analysis of an IPO with a recommendation for the same
3. Result Preview	Prediction of results to be announced with a view on margins for the stock
4. Result Review	Analysis of the results and view on the stock after the results
5. Event Update	Analysis of stock/sector specific event which has occurred and its impact
6. Economic Update	Analysis of IIP, GDP, Inflation and six core industries
7. Commodity Outlook	Future outlook on bullion, base metals and energy products
Technical Reports	
1. Impact	Technical guide giving a long term view on index and stocks
2. Market Mirror	Technical guide giving a short term view on index and stocks
3. Match	Technical analysis of Dollar index and its constituents against INR
Derivatives Research Products	
1. Pair Trades	Identification of stock pairs based on co integration and correlation
2. NIFTY Strategies	Strategies based on market view e.g., straddle, skew, condor etc
3. Arbitrage Trades	Cash Future and Special Situation Arbitrage
4. Numero-Mania	Monthly repository of trading strategies from the Derivatives Desk
Daily Reports	
1. Morning Glance	Daily update of global news before the Indian markets open
2. Post Market Update	Daily market action and key statistics in a nutshell
3. Currency Update	Analysis of the domestic currency market with an outlook for the day
4. Commodity Update	Snapshot of the commodity market with an outlook for the day
5. Derivatives Daily	Daily update of the activities in the Derivatives segment
6. Derivatives Weekly	Weekly update of the activities in the Derivatives segment
7. Rollover Analysis	Daily analysis of the rolls during the expiry week every month



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Capital Goods, Power & Shipping

Jyotsna Sawdekar +91 22 4354 2017

Banking

Vinay Chhoda +91 22 4354 2014

Mithilesh Shetty +91 22 4354 2014

Cement, Metals and Mining

Jinal Joshi +91 22 4354 2012

Sumit Poddar +91 22 4354 2016

Oil & Gas

Chirag Dhaifule +91 22 4354 2015

FMCG

Pulkeshin Shah +91 22 4354 2013

Pharmaceuticals

Divya Agarwal +91 22 4354 2011

Quantitative

Vinit Jain +91 22 4062 1016

SALES

Sales (Asia)

Vishad Turakhia +91 22 4062 1012

Hitash Dang +91 22 4354 1017

Rajat Vohra +91 22 4062 1011

Krishnakant Purohit +91 22 4062 1018

Sales Trading (Derivatives)

Dhruval Gala +91 22 4062 1032

Deep Shroff +91 22 4062 1008

Deepak Purohit +91 22 4062 1099

Vishal Vadel +91 22 4062 1099

Kaustubh Chheda +91 22 4062 1052

Sales Trading (Equity)

Gaurav Shah +91 22 4062 1007

Mahesh Bohra +91 22 4062 1005

Yogesh Dhupal +91 22 4062 1002

Jitendra Tolani +91 22 4062 1001

Sales (United States)

Amit Bansal +1 405 269 1322

Service Offerings:

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- Execution
- Corporate Access & Events



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GSK Consumer Healthcare

04 October 2011

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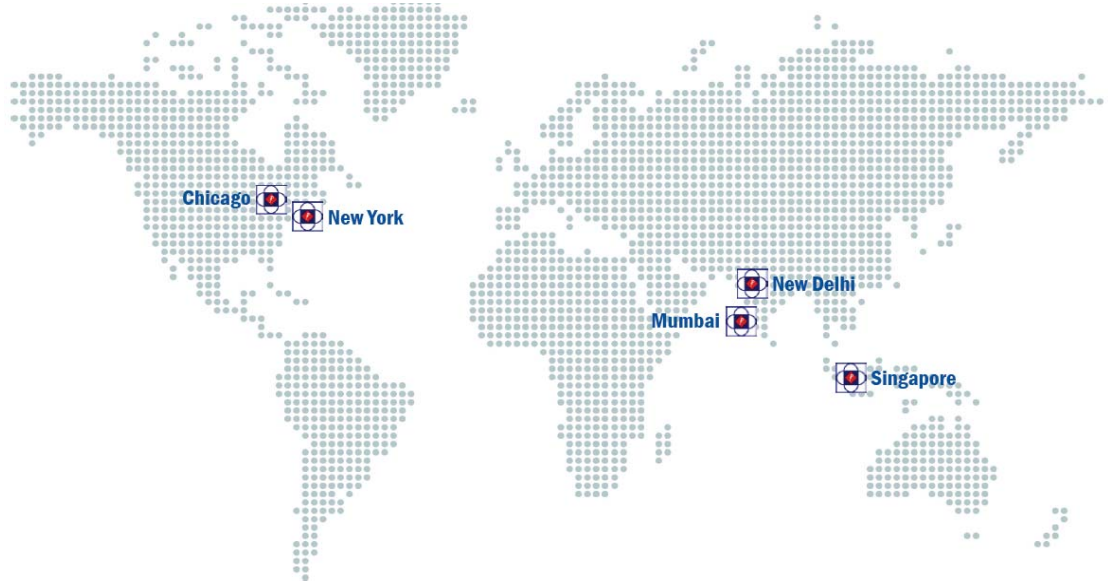
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