

GlaxoSmithKline Consumer

BSE SENSEX 17,707	S&P CNX 5,362	CMP: INR2,637	TP: INR2,395	Neutral						
Bloomberg	SKB IN									
Equity Shares (m)	42.1									
52-Week Range (INR)	2,700/1,949									
1,6,12 Rel. Perf. (%)	-6/8/29									
M.Cap. (INR b)	111.0									
M.Cap. (USD b)	2.3									
Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/Sales	EV/EBITDA
12/10A	23,800	2,998	71.3	28.8	37.0	11.6	31.2	47.3	4.2	22.4
12/11A	27,707	3,607	85.7	20.2	30.8	9.6	31.0	47.5	3.6	19.6
12/12E	32,714	4,304	102.3	19.4	25.8	8.2	31.7	47.7	3.0	15.9
13/13E	38,658	5,036	119.7	17.0	22.0	7.1	32.2	48.4	2.5	13.3

4QCY11 adjusted PAT in line; margins contract

- GlaxoSmithKline Consumer Healthcare (SKB) posted adjusted PAT of INR646m (v/s our estimate of INR655m) for 4QCY11, up 21%. Reported PAT grew 11%, impacted by INR55m tax adjustment of previous years.
- Net sales grew ~18.6%, led by 12% volume growth in MFD (v/s our estimate of 10%).
- EBITDA margin contracted 130bp due to input cost pressure (up 50bp) and higher ad spends (up 140bp) on Horlicks Oats launch and re-launch of Boost.
- SKB has increased prices of Horlicks by 4.5% (in January 2012) and Boost by 8% (in November 2011).
- Other income grew 47% due to 38% higher interest income at INR220m and 33% higher business auxiliary service commission at INR160m.

MFD growth to remain steady; new launches continue to disappoint; Neutral

- We remain positive on the core MFD portfolio given SKB's brand equity, leadership position and distribution reach. However, significant growth acceleration seems unlikely in the current operating environment. Export growth is likely to remain volatile.
- New launches over the last few years have been a disappointment; we believe that success of new launches is the key to further re-rating in the stock.
- We introduce our CY13 EPS estimate at INR119.7 (17% growth); we expect SKB to post 18.3% EPS CAGR over CY11-13. We value the stock at 20x CY13E EPS, which we believe is reasonable, given strong brand equity in the core business but lack of success in new verticals.
- The stock trades at fair valuations of 25.8x CY12E EPS of INR102.3 and 22x CY13E EPS of INR 119.7. Maintain **Neutral** with a target price of INR2,395.

Quarterly Performance

Y/E December	CY10				CY11				CY11	CY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
MFD Volume Growth (%)	12.5	10.0	18.0	10.0	5.5	14.0	8.0	12.0	10.0	10.0
Net Sales	6,484	5,374	6,126	5,078	7,100	6,534	7,201	6,021	26,855	31,722
YoY Change (%)	20.2	14.5	23.7	21.4	9.5	21.6	17.5	18.6	16.5	18.1
Total Exp	5,154	4,480	5,175	4,493	5,647	5,548	6,021	5,404	22,606	26,552
EBITDA	1,331	894	951	584	1,453	985	1,180	616	4,250	5,170
Margins (%)	20.5	16.6	15.5	11.5	20.5	15.1	16.4	10.2	15.8	16.3
YoY Change (%)	12.1	18.4	21.0	61.2	9.2	10.2	24.1	5.5	12.8	21.7
Depreciation	96	93	100	109	109	113	117	121	460	562
Interest	6	6	7	7	7	9	10	9	35	40
Other Income	236	281	334	331	340	360	476	487	1,648	1,863
PBT	1,465	1,076	1,178	800	1,677	1,223	1,530	973	5,403	6,431
Tax	503	358	392	266	571	398	499	327	1,796	2,127
Rate (%)	34.4	33.3	33.3	33.3	34.0	32.6	32.6	33.6	33.2	33.1
Adj PAT	962	718	786	534	1,106	825	1,030	646	3,607	4,304
YoY Change (%)	14.6	28.5	30.9	59.1	15.0	14.9	31.1	21.0	20.3	19.3
Extraordinary Expenses	0	0	0	0	0	0	0	55	55	0.0
Reported PAT	962	718	786	534	1,106	825	1,030	591	3552	4,304

E: MOSL Estimates

- GSK Consumer's 4QCY11 Adj PAT grew 21% YoY to INR646m (v/s est INR655m); reported PAT grew 11% impacted by INR55m tax adjustment of previous years.
- Net sales grew ~18.6%, led by 12% volume growth in MFD (est 10%) which was driven by 42% increase in exports as domestic growth was only 9%. Management expects sustainable MFD volume growth at 9-10%. Overall volume growth was 11% as the non MFD portfolio (excluding biscuits) continued to disappoint.
- EBITDA margins contracted 130bp due to input cost pressure (up 50bp) and higher ad spends (up 140bp) on Horlicks Oats launch and Boost relaunch. SKB has increased prices of Horlicks by 4.5% (in Jan-2012) and Boost by 8% (in Nov-2011) to pass on the pressure of higher milk and barley prices.
- Of the non MFD portfolio, biscuits grew 29% (15% volume growth); Foodles is back on the drawing board as SKB attempts to sort out supply chain issues; Oats has received good response in launch markets of Kerala and Tamil Nadu.
- We remain positive on the core MFD portfolio given SKB's brand equity, leadership position and distribution reach. However significant growth acceleration seems unlikely in the current operating environment; exports growth is expected to remain volatile.
- New launches over the last few years have been a disappointment, the being supply chain issues with Foodles. This follows the withdrawal of NutriBar, Chilled Dood and weak performance of Lucozade. We believe that success of new launches is key to further rerating in the stock.
- We introduce our CY13 EPS at INR119.7 (17% growth); we expect GSK Consumer to post 18.3% EPS CAGR over CY11-13. GSK has seen increased ad-spends in the past couple of years behind new launches, which have not succeeded. Any reduction in ad-spends can provide upside to our estimates.
- GSK has declared a dividend of INR35/share, a payout ratio of 41%, which is not meaningfully different from 5-year average of 37.5%.
- The stock trades at rich valuations of 25.8x CY12E and 22x CY13E EPS. **Neutral** with a target price of INR2,395 (20x CY13E EPS).

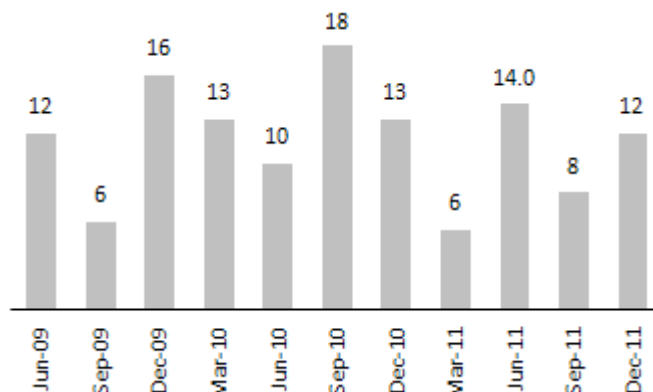
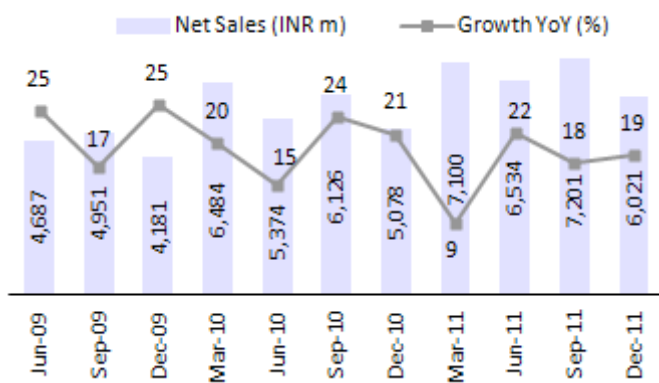
MFD (Malted Food Drink) volume growth healthy at 8% as exports surge; margins contract 130bp on higher ad expenses

- Net sales growth of ~19% was led by overall volume growth of 11% and 8% price increase.
- MFD segment volumes grew by 12% led by 42% growth in exports; domestic growth was 9.3%.
- Horlicks volumes grew 16% and Boost 2% (impacted by a high base). Horlicks sales value grew 23% and Boost 10%. The recently launched premium Horlicks Gold contributed 4% to overall Horlicks sales for the quarter. Management expects sustainable volume growth of 9-10% in MFD.
- Biscuits returned to strong growth of 29% (18% in 3QCY11) with volume growth of 15%. Biscuits growth is expected at 20-25% in the coming years.
- Other non-MFD products: SKB continues to struggle with supply chain issues in Foodles; the brand posted flat sales for the quarter and is expected to post muted growth till production and supply chain issues are not sorted out. This follows the phasing out of NutriBar and Chilled Dood. Initial response to the recently launched Horlicks Oats has been encouraging; the product is 2nd and 3rd respectively in

market share in Tamil Nadu and Kerala. We note that Horlicks has a strong brand equity in the south; we believe replicating this performance in other markets and in the current environment of stiff competition (Pepsico, Marico, Kelloggs) will be a challenge for the company.

Net sales growth healthy at 18.6%

MFD volume growth at 12% led by strong growth in exports %



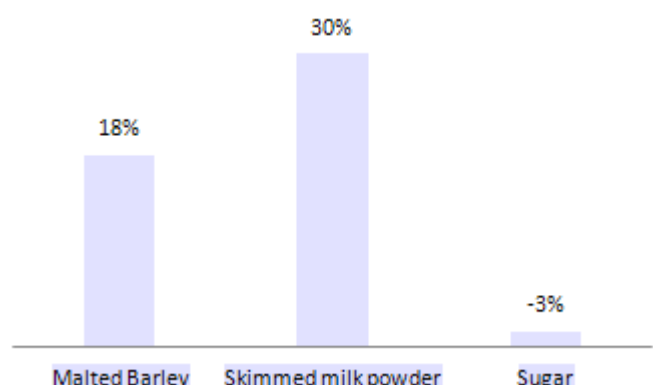
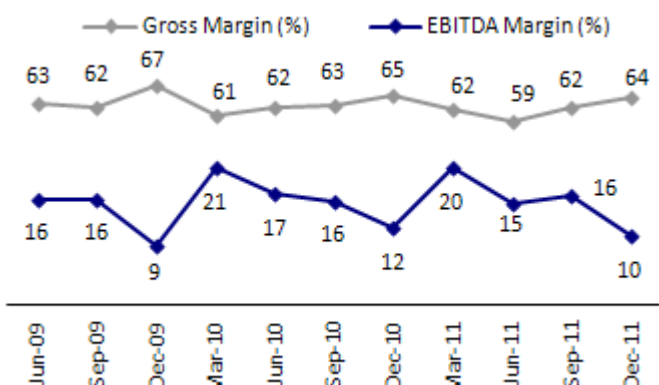
Source: Company/MOSL

140bp increase in ad spends depress EBITDA margins by 130bp; higher business auxiliary commission and yields boost other income

- Gross margin contracted 50bp to 64.4% due to higher barley and milk prices which increased by 18% and 30% respectively. Post the 2-3% price increase taken in July, the company has now taken an 8% price increase in Boost in November and a 4.5% price increase in Horlicks in January.
- 140bp increase in ad spends to 19% (highest in last 9 quarters) was due to the launch expenses of Horlicks Oats as well as the re-launch of Boost. The management maintains that annual ad spends will persist in the 15-17% band. Staff costs were 180bp lower due to higher actuarial provisions in the base.
- EBITDA margins declined 130bp to 10.2%.
- Other income grew 47% due to 38% higher interest income at INR220m and 33% higher business auxiliary service commission at INR160m, due to strong performance of Sensodyne (revenues of INR480m in first year of launch), Eno (sales up 30%) and Crocin (sales up 14-15%). Iodex sales were flat.
- Reported PAT growth was muted at 11% due to tax provisions of earlier years of INR55m excluding which Adj PAT growth was 21% at INR646m.

Margins decline on higher ad and other expenses

Milk and barley inflation (YoY) continues unabated



Source: Company/MOSL

Valuation and view: MFD growth to remain steady; New launches continue to disappoint; Neutral

- We remain positive on the core MFD portfolio given SKB's brand equity, leadership position and distribution reach. However significant growth acceleration seems unlikely in the current operating environment, exports growth is expected to remain volatile.
- New launches over the last few years have been a disappointment; the latest disappointment is Foodles' supply chain issues. This follows the withdrawal of NutriBar, Chilled Dood and weak performance of Lucozade. We believe that success of new launches is the key to further rerating in the stock.
- GSK declared a dividend of INR35/share, a payout ratio of 41%, which is not meaningfully different from 5-year average of 37.5% prior to INR50/share dividend in CY2010.
- We introduce our CY13 EPS at INR119.7 (17% growth); we expect GSK Consumer to post 18.3% EPS CAGR over CY11-13. We value the stock at 20x CY13 estimates which we believe is reasonable given strong brand equity in core business but lack of success in new verticals.
- The stock trades at fair valuations of 25.8x CY12 and 22x CY13 estimates of INR102.3 and INR 119.7. Maintain **Neutral** with a target price of INR2,395.

GlaxoSmithKline Pharmaceuticals: an investment profile

Company description

GSK Consumer is the largest player in the Rs18b Indian health drink market, with a 70% market share. The category has entered a new growth orbit with growth rates sustaining above 10%. In addition, management aims to increase the share of non MFD segment from current 5% to 15% over the next 3 years. Value added variants of Horlicks account for ~18% of brand sales.

Key investment arguments

- Volume growth in core MFD category continues to remain robust. We model 10% volume growth over CY11-13E.
- GSK Consumer enjoys strong pricing power in MFD segment as key players like Nestle, HUL and Dabur have either exited or are dormant in the segment.

Key investment risks

- Milk and milk products form more than 50% of the total raw material costs for the company and any steep increase in milk prices should impact the company's margins directly.
- Glaxo Smithkline Consumer has more than 70% market share in the health food segment and entry of any major company in this segment is likely to result in erosion of market share.

Recent developments

- GSK Consumer undertook a price hike of 8% in November 2011 in Boost and 4.5% in Horlicks in January 2012
- The company has launched Horlicks Oats recently.

Valuation and view

- We introduce CY13 EPS estimates at INR119.7; our CY12 estimate stands unchanged at INR102.3.
- The stock trades at fair valuations of 25.8x CY12 and 22x CY13E EPS. Maintain **Neutral** with a target price of INR2,395.

Sector view

- We are cautious on the volume growth in the sector given the competitive intensity and inflationary pressure.
- Companies with low competitive pressures (like ITC, GSK Consumer) will be better off.
- Longer term prospects bright, given rising incomes and low penetration.

Comparative valuations

		GSK Consumer	Godrej Consumer	Marico
P/E (x)	CY12E	25.8	25.7	29.5
	CY13E	22.0	20.2	22.4
P/BV (x)	CY12E	8.2	6.9	8.4
	CY13E	7.1	4.7	6.3
EV/Sales (x)	CY12E	3.0	3.4	2.5
	CY13E	2.5	2.7	2.1
EV/EBITDA (x)	CY12E	15.9	19.3	19.8
	CY13E	13.3	15.1	15.2

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	43.2	43.2	43.2
Domestic Inst	16.8	16.6	18.9
Foreign	15.4	14.4	11.5
Others	24.7	25.9	26.4

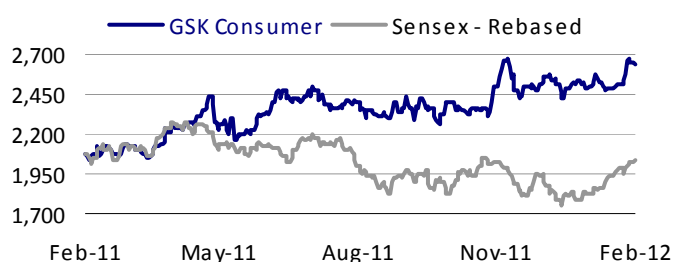
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
CY12	102.3	101.8	0.5
CY13	119.7	121.6	-1.6

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
2,637	2,395	-9.2	Neutral

Stock performance (1 year)



Financials and Valuations

Income Statement		(INR Million)				
Y/E December	2009	2010	2011	2012E	2013E	
Net Sales	19,864	23,800	27,707	32,714	38,658	
Change (%)	22.7	19.8	16.4	18.1	18.2	
Total Expenditure	-16,109	-19,294	-22,606	-26,552	-31,317	
EBITDA	3,754	4,506	5,101	6,161	7,341	
Change (%)	19.2	20.0	13.2	20.8	19.1	
Margin (%)	18.9	18.9	18.4	18.8	19.0	
Depreciation	-420	-397	-460	-562	-812	
Int. and Fin. Charges	-40	-26	-35	-40	-45	
Other Income - Recur	245	435	796	872	1,040	
Profit before Taxes	3,539	4,518	5,403	6,431	7,524	
Change (%)	23.8	27.7	19.6	19.0	17.0	
Margin (%)	17.8	19.0	19.5	19.7	19.5	
Tax	-1,387	-1,677	-1,851	-2,431	-2,844	
Deferred Tax	176	157		304	356	
Tax Rate (%)	-34.2	-33.6	-34.3	-33.1	-33.1	
Profit after Taxes	2,328	2,998	3,552	4,304	5,036	
Change (%)	23.5	28.8	18.5	21.2	17.0	
Margin (%)	11.7	12.6	12.8	13.2	13.0	
Reported PAT	2,328	2,998	3,552	4,304	5,036	

Balance Sheet		(INR Million)				
Y/E December	2009	2010	2011	2012E	2013E	
Share Capital	421	421	421	421	421	
Reserves	8,630	9,180	11,021	13,141	15,231	
Net Worth	9,051	9,600	11,442	13,562	15,651	
Loans	0	0	0	0	0	
Capital Employed	9,051	9,600	11,442	13,562	15,651	
Gross Block	5,585	5,990	6,434	8,940	12,690	
Less: Accum. Deprn.	-3,640	-3,967	-4,427	-4,989	-5,801	
Net Fixed Assets	1,945	2,023	2,007	3,951	6,889	
Capital WIP	378	1,083	1,711	500	500	
Investments	7,832	9,590		12,000	12,800	
Deferred Assets	110	267	399	267	267	
Curr. Assets, L&A	3,897	4,641	16,701	6,877	7,532	
Inventory	2,660	3,120	3,700	4,302	5,084	
Account Receivables	314	505	992	687	812	
Cash and Bank Balan	366	171	10,797	861	351	
Others	557	845	1,213	1,027	1,286	
Curr. Liab. and Prov.	5,111	8,004	9,376	9,474	11,422	
Account Payables	3,173	3,905	4,347	5,160	6,191	
Other Liabilities	1,046	1,647	2,316	2,048	2,285	
Provisions	892	2,452	2,713	2,266	2,946	
Net Current Assets	-1,214	-3,363	7,325	-2,597	-3,890	
Deferred Tax Liability	0	0	0	-559	-915	
Application of Funds	9,051	9,600	11,442	13,562	15,651	

E: MOSL Estimates

Ratios						
Y/E December	2009	2010	2011	2012E	2013E	
Basic (INR)						
EPS	55.4	71.3	84.5	102.3	119.7	
Cash EPS	65.3	80.7	96.9	115.7	139.0	
BV/Share	215.2	228.3	274.0	322.5	372.2	
DPS	18.0	50.0	34.4	46.1	59.9	
Payout %	38.0	81.8	46.8	52.7	58.5	
Valuation (x)						
P/E		37.0	30.7	25.8	22.0	
Cash P/E		32.7	27.2	22.8	19.0	
EV/Sales		4.2	3.6	3.0	2.5	
EV/EBITDA		22.4	19.6	15.9	13.3	
P/BV		11.6	9.6	8.2	7.1	
Dividend Yield (%)		1.9	1.3	1.7	2.3	
Return Ratios (%)						
RoE	25.7	31.2	31.0	31.7	32.2	
RoCE	39.5	47.3	47.5	47.7	48.4	
Working Capital Ratios						
Debtor (Days)	6	8	13	8	8	
Asset Turnover (x)	2.2	2.5	2.4	2.4	2.5	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

Cash Flow Statement		(INR Million)				
Y/E December	2009	2010	2011	2012E	2013E	
OP/(loss) before Tax	3,754	4,506	5,101	6,161	7,341	
Int./Div. Received	245	435	796	872	1,040	
Depreciation and Amort.						
Interest Paid	-40	-26	-35	-40	-45	
Direct Taxes Paid	-1,387	-1,677	-1,851	-2,431	-2,844	
(Incr)/Decr in WC	2,284	1,954	-63	-13	782	
CF from Operations	4,856	5,192	3,949	4,550	6,274	
Extraordinary Items	0	0	0	0	0	
(Incr)/Decr in FA	-409	-1,110	-1,072	-1,295	-3,750	
(Pur)/Sale of Investm	-3,327	-1,758	9,590	-12,000	-800	
CF from Invest.	-3,736	-2,868	8,518	-13,295	-4,550	
Issue of Shares	0	0	0	0	0	
(Incr)/Decr in Debt	0	0	0	0	0	
Dividend Paid	-757	-2,103	-1,446	-1,937	-2,518	
Deffered Tax Liability	-201	-416	-396	747	283	
CF from Fin. Activity	-958	-2,519	-1,842	-1,190	-2,235	
Incr/Decr of Cash	161	-195	10,625	-9,935	-511	
Add: Opening Balanc	205	366	171	10,797	861	
Closing Balance	366	171	10,796	861	351	

N O T E S

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GlaxoSmithKline Consumer

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2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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