

GLAXOSMITHKLINE CONSUMER HEALTHCARE

FMCG

18 MAY 2017

Quarterly Update

BUY

Target Price: Rs 5,950

Likely turnaround; reasonable valuations

After maintaining a neutral to negative stance for four years, we upgrade GSKCH to **BUY** with TP of Rs 5,950 (earlier Rs5,300) based on fwd. P/E of 29x. Strong pricing power, category leadership and attractive valuation (26x P/E for FY19E) is a reality and improvement in the core category volume growth a strong possibility given multiple initiatives taken by the management.

Q4FY17 ahead of expectations: Net sales, EBITDA and Adj PAT grew 2%, 2% and 8% (vs. consensus expectation of 2%, -4% and -4%). Domestic sales grew 2% aided by ~2.7% price hike. OPM contracted 10 bps YoY (at 20.8%), as impact of lower employee costs (-403 bps YoY) was absorbed by higher raw material costs (+229 bps YoY) and A&P spend (+146 bps YoY). Value market share for Horlicks at 44.8% (-130 bps YoY) and for Boost at 11.2% (-40 bps YoY).

CMP : Rs 5,280
Potential Upside : 13%

MARKET DATA

No. of Shares : 42 mn
Free Float : 28%
Market Cap : Rs 222 bn
52-week High / Low : Rs 6,584 / Rs 4,650
Avg. Daily vol. (6mth) : 31,262 shares
Bloomberg Code : SKB IB Equity
Promoters Holding : 72%
FII / DII : 4% / 8%

Topline pressure continues: Gross sales increased 1% YoY. Aided by lower excise rate, net sales grew 2% YoY. Business auxiliary income increased 8% YoY to Rs 601 mn. Gross margin declined 229bps YoY at 63.9% affected by higher trade promotions. A&P increased 146 bps YoY to 16.7%. Staff costs decreased 403 bps YoY at 9.9% (down 27% YoY absolute) due to changes in actuarial assumption. The company has maintained leadership position in health food drink category with value and volume market share at 56.3% and 64.4% respectively.

Our view: In past 10 years (CY06-FY17), GSKCH has delivered a stellar performance with 17% EPS CAGR on the back of 14% revenue CAGR. We like its (a) HFD category leadership (volume share at ~64%), (b) strategy to strengthen itself in North and West (market share of only 20-22% in these markets) and (c) pricing power (price hike every year slightly ahead of CPI). Sharp slowdown in the category growth has been a concern, but with multiple initiatives by management (attractively priced low unit packs, multiple region specific campaigns, new summer time drink formulation and renewed focus on the premium end) we are hopeful of a healthy volume growth in FY18. We estimate sales and EPS CAGR of 11% and 13% respectively over FY17-19E. The stock is reasonably valued at 26x P/E for FY19E.

Financial summary (Standalone)

Y/E March	FY16	FY17P	FY18E	FY19E
Sales (Rs mn)	41,066	39,413	43,665	48,019
Adj PAT (Rs mn)	6,869	6,560	7,540	8,405
Con. EPS* (Rs)	-	-	177.3	199.9
EPS (Rs)	163.3	156.0	179.3	199.8
Change YOY (%)	17.7	(4.5)	14.9	11.5
P/E (x)	32.3	33.9	29.4	26.4
RoE (%)	30.1	25.3	26.0	26.4
RoCE (%)	48.7	40.8	41.3	41.3
EV/E (x)	25.3	22.8	20.1	17.7
DPS (Rs)	70.0	90.0	110.0	130.0

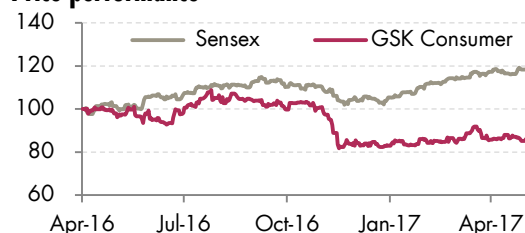
Source: *Consensus broker estimates, Company, Axis Capital

Note: Our model has not been updated for the latest IndAS changes

Key drivers

	FY16	FY17P	FY18E	FY19E
Sales growth	-0.7%	-4.0%	10.8%	10.0%
Gross margin	67.3%	67.1%	67.2%	67.3%
A&P to sales	16.9%	16.7%	16.8%	16.9%
EBITDA margin	20.3%	21.2%	21.4%	21.6%

Price performance



Conference call highlights

♦ Growth drivers

- Volume improvement through higher penetration: LUP important part of access strategy. Of new users, ~20% upgraded to large pack size
- Focus on premium + super premium offerings: Products offerings for consumers at different life stages
- Investment behind brands: Three new campaigns launched in Q4
- Cost optimization: Company maintained price hikes in line with CPI and ahead of inflation. It highlighted ~4% price hike will be sufficient to maintain the gross margin. Cost optimization to be met through value engineering in procurement, network optimization and rationalizing marketing spend

- ### ♦ Market share erosion:
- Demonetization impact continued, hurting the company's market share both in terms of volume and value. Market at lower end has shrunk (given pressure in rural wholesale), while premium/ super premium segments posted good growth on better salience in modern trade channel. As such, super premium segment (protein supplements) gained market share. Market share of *Bournvita*, the key competitor, has remained flat over past couple of quarters. The company highlighted that taste scores over nutritional value for success in the industry

♦ Positioning in market:

The company has launched three marketing campaigns

- Connecting with the youth in South for *Boost* – New advertisement campaign features cricketer Virat Kohli (ad claims 3x increase in stamina). Volume decline in *Boost* has been arrested with start of the campaign
- Summer-time drink in North and West – Launched summer-time campaign for North and West market, targeting children who do not want to have hot drink in summer (in new formulation, *Horlicks* dissolves in cold milk). New packaging displays ice cubes on pack. Sipper also added
- Addressing malnutrition needs – For its key markets of South and East, the company is running campaigns to promote nutritional needs

- ### ♦ Chocolate Horlicks re-positioning:
- North and West are considered as 'brown belts', given strong preference for chocolate variants in these regions. With sustained focus on gaining market share in the belt, the company has adopted the following strategies: (a) formulation change (b) competitive pricing, (c) bigger advertising campaign (summer consumption) and (d) access strategy. The company has tested its strategy in Delhi market (before taking it to entire North and Western markets), where it has gained market share and is now at par with *Bournvita*.

- ### ♦ Business auxiliary income:
- Non-Novartis portfolio business grew 9% in Q4, but margin adjustment (reduction in margin from 16.5% to 15% last year for GSK portfolio) led to lower income. The company is aiming for 10% growth in FY18. Arrangement with Novartis started w.e.f. 1st July 2016

- ### ♦ Wholesale contribution is ~30% of sales
- (largely focused in small towns and rural). The company highlighted part recovery in the channel and hopes for a full recovery by the end of Q1FY18. Direct reach at ~900,000 outlets, which the company is looking to expand to 1 mn. It will continue to rely on wholesale for sales expansion

- ♦ **Lower staff cost in Q4** due to (a) long term settlement impact of Rs150 mn in base and (b) Rs 230 mn favorable impact of change in actuarial assumption
- ♦ **Capex:** The company is looking to spend Rs 6-7 bn over next three years. Capex allocation will also be towards system automation, energy efficiency and quality improvement projects. For FY18, it aims capex spend of ~ Rs 1 bn

Exhibit 1: Result update

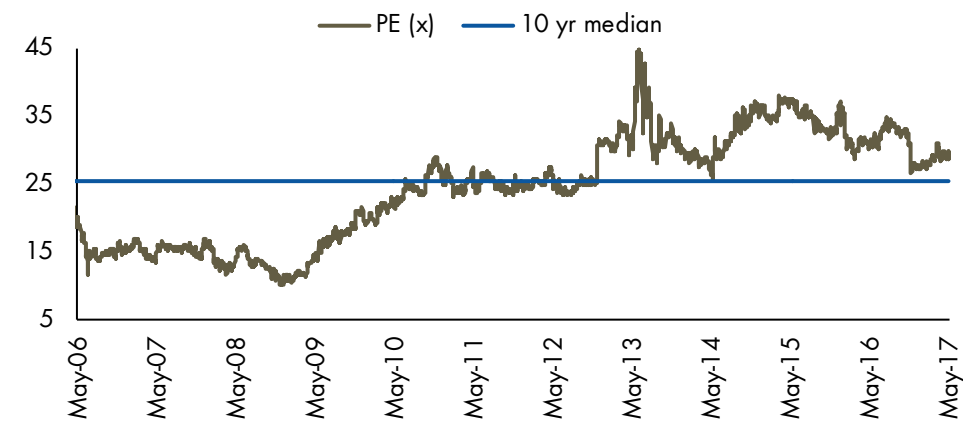
(Rs mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg
Net sales	10,418	10,217	2.0	8,219	26.8
Raw material cost	3,764	3,457	8.9	2,771	35.8
(% of net sales)	36.1	33.8	229 bps	33.7	241 bps
Staff expenditure	1,036	1,428	(27.4)	1,067	(2.9)
(% of net sales)	9.9	14.0	-403 bps	13.0	-303 bps
A&P spends	1,735	1,553	11.7	924	87.8
(% of net sales)	16.7	15.2	146 bps	11.2	541 bps
Other expenses	2,312	2,198	5.2	2,165	6.8
(% of net sales)	22.2	21.5	69 bps	26.3	-415 bps
EBITDA	2,171	2,139	1.5	1,677	29.4
EBITDA margin (%)	20.8	20.9	-10 bps	20.4	43 bps
Other income	710	501	41.7	559	26.9
PBITD	2,880	2,639	9.1	2,236	28.8
Depreciation	177	146	21.3	171	3.7
Interest	9	3	234.6	6	38.1
PBT	2,695	2,491	8.2	2,059	30.9
Tax	936	869	7.7	695	34.6
PAT	1,759	1,622	8.4	1,364	28.9

Source: Company, Axis Capital

Exhibit 2: Regional split

	Q1FY15	Q2FY15	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17
North	6%	7%	7%	7%	6%	7%	7%	7%	7%	7%	6%	6%
South	47%	46%	45%	46%	47%	45%	42%	46%	47%	44%	44%	45%
East	36%	36%	35%	36%	37%	38%	38%	36%	37%	39%	37%	38%
West	4%	4%	5%	5%	4%	5%	5%	5%	4%	3%	4%	4%
Exports	6%	7%	8%	7%	6%	5%	8%	7%	5%	6%	9%	7%

Source: Company, Axis Capital

Exhibit 3: 1-year forward PE (on consensus earnings)


Source: Bloomberg, Axis Capital

Profit & loss (Rs mn)

Y/E March	FY16	FY17P	FY18E	FY19E
Net sales	41,066	39,413	43,665	48,019
Other operating income	2,021	2,325	2,689	3,086
Total operating income	43,087	41,738	46,354	51,105
Cost of goods sold	(13,435)	(12,973)	(14,322)	(15,702)
Gross profit	29,652	28,765	32,032	35,402
Gross margin (%)	72.2	73.0	73.4	73.7
Total operating expenses	(21,303)	(20,416)	(22,680)	(25,013)
EBITDA	8,349	8,349	9,352	10,390
EBITDA margin (%)	20.3	21.2	21.4	21.6
Depreciation	(574)	(642)	(713)	(791)
EBIT	7,774	7,707	8,640	9,599
Net interest	(8)	(10)	(10)	(10)
Other income	2,787	2,403	2,795	3,050
Profit before tax	10,554	10,100	11,425	12,639
Total taxation	(3,685)	(3,540)	(3,884)	(4,234)
Tax rate (%)	34.9	35.1	34.0	33.5
Profit after tax	6,869	6,560	7,540	8,405
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	6,869	6,560	7,540	8,405
Adj. PAT margin (%)	16.7	16.6	17.3	17.5
Net non-recurring items	-	-	-	-
Reported net profit	6,869	6,560	7,540	8,405

Balance sheet (Rs mn)

Y/E March	FY16	FY17P	FY18E	FY19E
Paid-up capital	421	421	421	421
Reserves & surplus	24,036	27,051	30,035	32,869
Net worth	24,456	27,472	30,455	33,290
Borrowing	-	-	-	-
Other non-current liabilities	(1,125)	(1,278)	(1,278)	(1,278)
Total liabilities	23,332	26,194	29,177	32,012
Gross fixed assets	10,995	11,736	13,236	15,036
Less: Depreciation	(6,135)	(6,777)	(7,489)	(8,280)
Net fixed assets	4,860	4,959	5,747	6,756
Add: Capital WIP	514	492	500	500
Total fixed assets	5,374	5,451	6,247	7,256
Total Investment	16,506	-	-	-
Inventory	4,616	4,611	5,437	5,613
Debtors	3,542	3,210	4,187	4,736
Cash & bank	10,617	31,638	34,282	37,975
Loans & advances	1,754	1,965	2,200	2,464
Current liabilities	20,532	22,281	24,937	27,969
Net current assets	1,452	20,743	22,930	24,756
Other non-current assets	-	-	-	-
Total assets	23,332	26,194	29,177	32,012

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17P	FY18E	FY19E
Profit before tax	10,554	10,100	11,425	12,639
Depreciation & Amortisation	574	642	713	791
Chg in working capital	567	1,729	(556)	854
Cash flow from operations	5,723	6,707	5,202	7,350
Capital expenditure	(598)	(719)	(1,508)	(1,800)
Cash flow from investing	(1,569)	18,020	997	910
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	-	-	-	-
Dividend paid	(2,784)	(3,543)	(3,544)	(4,557)
Cash flow from financing	(2,792)	(3,706)	(3,554)	(4,567)
Net chg in cash	1,363	21,021	2,645	3,693

Key ratios

Y/E March	FY16	FY17P	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	163.3	156.0	179.3	199.8
CEPS (Rs)	177.0	171.2	196.2	218.7
DPS (Rs)	70.0	90.0	110.0	130.0
Dividend payout ratio (%)	42.9	57.7	61.4	65.1
GROWTH				
Net sales (%)	(0.7)	(4.0)	10.8	10.0
EBITDA (%)	14.4	-	12.0	11.1
Adj net profit (%)	17.7	(4.5)	14.9	11.5
FDEPS (%)	17.7	(4.5)	14.9	11.5
PERFORMANCE				
RoE (%)	30.1	25.3	26.0	26.4
RoCE (%)	48.7	40.8	41.3	41.3
EFFICIENCY				
Asset turnover (x)	3.2	8.1	(10.9)	(11.3)
Sales/ total assets (x)	1.0	0.9	0.9	0.8
Working capital/ sales (x)	(0.2)	(0.3)	(0.3)	(0.3)
Receivable days	31.5	29.7	35.0	36.0
Inventory days	48.5	50.4	53.6	50.3
Payable days	82.5	94.1	89.8	88.2
FINANCIAL STABILITY				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.5)	(1.2)	(1.2)	(1.2)
Current ratio (x)	1.1	1.9	1.9	1.9
Interest cover (x)	981.7	798.4	895.0	994.3
VALUATION				
PE (x)	32.3	33.9	29.4	26.4
EV/ EBITDA (x)	25.3	22.8	20.1	17.7
EV/ Net sales (x)	5.1	4.8	4.3	3.8
PB (x)	9.1	8.1	7.3	6.7
Dividend yield (%)	1.3	1.7	2.1	2.5
Free cash flow yield (%)	2.3	2.7	1.7	2.5

Source: Company, Axis Capital

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HOLD	Between 10% and -10%
SELL	Less than -10%

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