

GLAXOSMITHKLINE CONSUMER HEALTHCARE

FMCG

24 JUL 2017

Annual Report Analysis

BUY

Target Price: Rs 6,025

Annual Report Analysis

GSK Consumer's FY17 annual report largely highlights the company's renewed thrust on the core portfolio by making the brand more relevant through scientific findings and consumer awareness. Company's performance has weakened in the last couple of years and we feel there is an urgent need to revive the growth back, which is reflected in the measures taken by it in the last few quarters.

Strong pricing power, category leadership, and attractive valuation (28x P/E for FY19E) is a reality and improvement in the core category's volume growth is a strong possibility given multiple initiatives taken by the management. We have recently upgraded it to a BUY. Our TP at Rs 6,025 (earlier Rs 5,950) is based on forward P/E of 29x.

CMP : Rs 5,456
Potential Upside : 10%

MARKET DATA

No. of Shares : 42 mn
Free Float : 28%
Market Cap : Rs 229 bn
52-week High / Low : Rs 6,584 / Rs 4,650
Avg. Daily vol. (6mth) : 17,316 shares
Bloomberg Code : SKB IB Equity
Promoters Holding : 72%
FII / DII : 4% / 8%

Cash flow analysis: Free cash flow conversion post capex at 85% in FY17 (76% in FY16) improved on lower working capital days. Net working capital days at four days as on Mar-17 reduced by eight days YoY aided by eight days' increase in payable days. RoCE at 22.2% contracted ~580 bps YoY on reduced profit and sustained retention of profit. Royalty payout at Rs 1.3 bn reduced 11% YoY. Net cash as on Mar-17 stood at Rs 31 bn. Interest income constituted 19% of PBT in FY17.

Our view: Over the past 10 years (CY06-FY17), GSK Consumer 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 the management (attractively priced low unit packs, multiple region specific campaigns, new summer time drink formulation and renewed focus on the premium end) we expect better volume growth in FY18. We estimate sales and EPS CAGR of 10% and 12% over FY17-19E. The stock is reasonably valued at 28x P/E for FY19E.

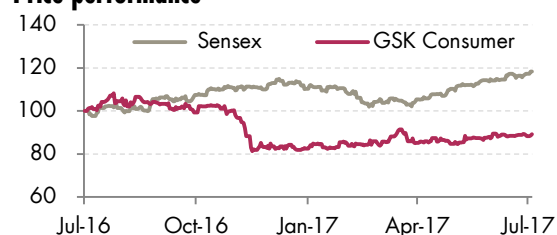
Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs mn)	39,341	37,739	41,408	45,826
Adj PAT (Rs mn)	6,873	6,567	7,346	8,259
Con. EPS* (Rs)	-	-	175.6	196.3
EPS (Rs)	163.4	156.1	174.7	196.4
Change YOY (%)	17.8	(4.5)	11.9	12.4
P/E (x)	33.4	34.9	31.2	27.8
RoE (%)	28.0	22.2	22.5	23.4
RoCE (%)	45.1	35.7	35.6	36.3
EV/E (x)	26.1	26.7	24.2	21.5
DPS (Rs)	70.0	70.0	90.0	110.0

Key drivers

	FY16	FY17	FY18E	FY19E
Sales growth	-0.7%	-4.1%	9.7%	10.7%
Gross margin	65.8%	65.6%	65.7%	65.8%
A&P to sales	13.8%	13.6%	13.7%	13.8%
EBITDA margin	21.3%	22.1%	22.2%	22.4%

Price performance



Source: *Consensus broker estimates, Company, Axis Capital
Note: CMP as on July 14, 2017

Annual Report Analysis

Key takeaways from MD&A

Overall message remained that the company would focus on (a) innovation, (b) delivering products of value with superior science and (c) enter the advanced nutrition segment for consumers who want very high science products. It retained its leadership position in HFD category with volume and value market share at 64.4% and 56.3% respectively. Some of the key launches during the year are mentioned below:

- ♦ **Horlicks Growth+**, launched in May 2016, is clinically proven formula for catch up growth for children between 3-9 years. Product is available in Vanilla and Chocolate variants
- ♦ The new & improved **Horlicks**, re-launched in April, 2016, has 2X Immuno Nutrients, scientifically proven to support immunity to help the body's natural defence system. Horlicks 2X immunity addresses the mental & physical growth of children
- ♦ **Cardia+**, launched in May, 2016, contains Nutriose, which keeps the consumer fuller for longer so that they eat less and do not eat in between meals

Noteworthy actions in key offerings:

- ♦ **Women's Horlicks**: The company re-staged this offering in August, 2016. The company has launched digital campaign "Strong to the Bone" on Women's Day, which includes an online Bone Mineral Density test
- ♦ **Mother's Horlicks**: It has launched offering with great tasting Kesar flavor in June 2016 to address the taste fatigue of expecting and new mothers
- ♦ **Marie biscuits**: The company has launched offering in September 2016 in East, positioned as "The Perfect Marie" backed by *Horlicks'* equity. The brand has garnered 1% market share
- ♦ **Junior Horlicks**: To better target consumer base the company has launched communication series in August, 2016 to drive differentiation around brain development emphasizing the need for a specialized health drink in early years
- ♦ **Boost**: Product was reintroduced in March 2016 with a new communication platform of "Play a Bigger Game". The brand had a growth of 7% and reached highest ever market shares in its core market in South. In FY18, a new campaign was launched with Indian cricket team captain Virat Kohli

Exhibit 1: Science based new product launches



Source: Company, Axis Capital

Exhibit 2: Boost repositioned as 3x more stamina



Source: Company, Axis Capital

Cash flow analysis

Net working capital days reduced to four days, down eight days YoY

GSK Consumer's net working capital days stood at four days as at Mar-17, reduced by eight days YoY. Higher payable days (80 days, increased by eight days) and reduced receivable days (39 days, down two days) absorbed increase in inventory days (at 39 days, increased by two days).

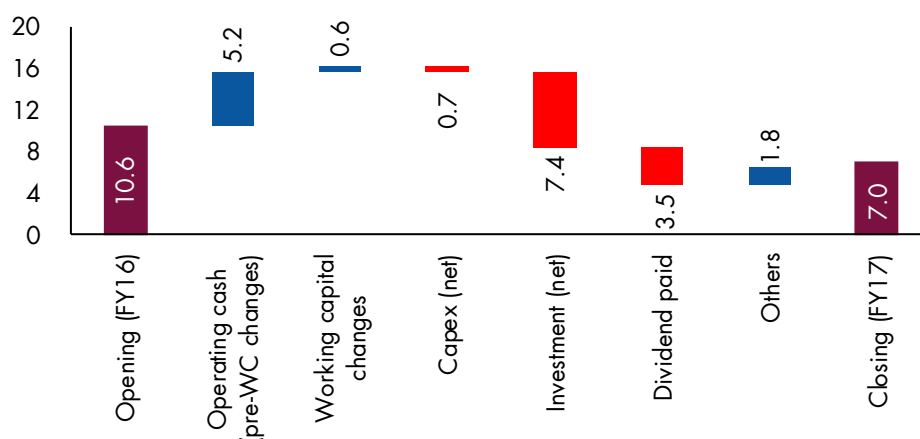
FCF conversion improved to 85%

Free cash flow (post-capex) conversion at 85% for FY17 (vs. 76% in FY16) was better on the back of lower working capital days. Total capex for FY17 stood at ~Rs 682 bn, up 25% YoY. Dividend per share at Rs 70/share was flat YoY. Dividend payout for FY17 stood at 54%, up 240 bps YoY.

Net cash position strengthened

Net cash as at Mar-17 improved to Rs 31 bn (largely parked in bank deposits for duration less than 12 months) from Rs 27 bn as at Mar-16. Interest income constituted 19% of PBT in FY17. The company is looking to deploy cash towards expansions both internally (SAP implementation, distributor management system implementation and capacity expansion) and externally (M&A opportunity).

Exhibit 3: Cash flow analysis – FY17 (Rs bn)



Source: Company, Axis Capital

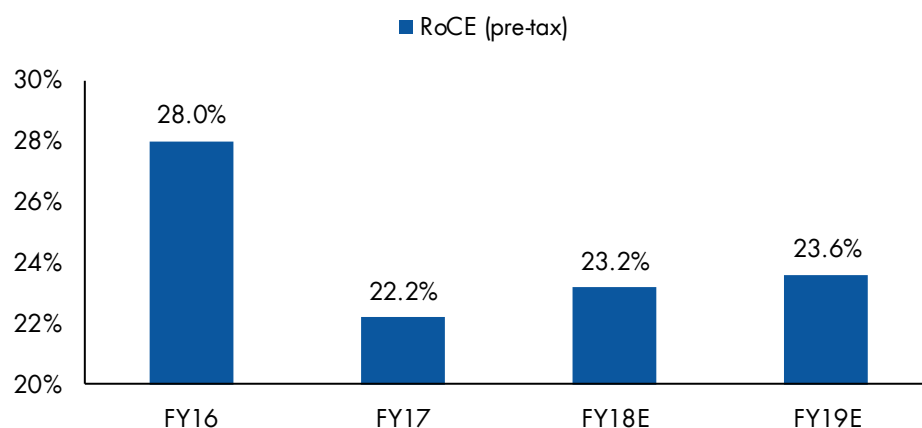
Royalty payout reduced

Royalty payout for the year at Rs 1.3 bn reduced 11% YoY. As a % to total revenue, royalty payout stood at 3.3%, down 20 bps YoY.

Return ratio

RoCE for FY17 at 22.2% contracted ~580 bps YoY affected by reduced profit and sustained cash retention. Going forward, with improved earnings performance and higher dividend payout, we expect return ratios to recover gradually.

Exhibit 4: RoCE (pre-tax) trend



Source: Company, Axis Capital

Managerial remuneration

Amid muted topline show, Manoj Kumar's (MD) salary increased 1% to Rs 58.4 bn (at 0.13% of sales and 0.58% of PBT). For Vivek Anand (Director Finance), salary increased by 10% YoY.

Exhibit 5: Remuneration to key management personnel

	Manoj Kumar (MD)			Vivek Anand (Director Finance)		
	FY16	FY17	YoY%	FY16	FY17	YoY%
Basic + HRA	21.7	28.6	32%	10.3	13.5	30%
Perquisites and allowances	5.4	5.8	6%	3.3	3.8	15%
Performance incentive	30.5	24.0	-21%	14.6	13.8	-5%
as a % of basic	141%	84%		141%	103%	
as a % of total remuneration	53%	41%		52%	44%	
Total	57.7	58.4	1%	28.2	31.1	10%

Source: Company, Axis Capital

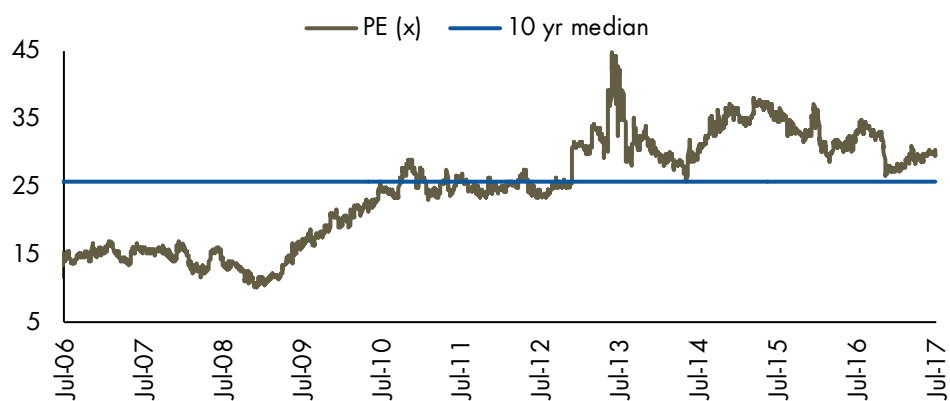
Exhibit 6: Company's performance under different MDs

	From	till	Tenure (years)	Revenue CAGR	PAT CAGR
Nicholas J. Massey	1-Nov-02	31-Dec-06	4	12%	18%
Zubair Ahmed	1-Jan-07	31-May-15	7	18%	20%
Manoj Kumar	1-Jun-15		2	-2%	6%

Source: Company, Axis Capital

Valuations

Exhibit 7: 1-year forward PE (on consensus earnings)



Source: Bloomberg, Axis Capital

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	39,341	37,739	41,408	45,826
Other operating income	2,021	2,125	2,361	2,666
Total operating income	41,363	39,865	43,769	48,492
Cost of goods sold	(13,435)	(12,969)	(14,203)	(15,673)
Gross profit	27,927	26,895	29,566	32,819
Gross margin (%)	71.0	71.3	71.4	71.6
Total operating expenses	(19,546)	(18,560)	(20,380)	(22,533)
EBITDA	8,382	8,335	9,186	10,287
EBITDA margin (%)	21.3	22.1	22.2	22.4
Depreciation	(574)	(642)	(712)	(791)
EBIT	7,807	7,693	8,473	9,496
Net interest	(23)	(28)	(28)	(28)
Other income	2,775	2,439	2,685	2,859
Profit before tax	10,560	10,104	11,130	12,327
Total taxation	(3,687)	(3,537)	(3,784)	(4,068)
Tax rate (%)	34.9	35.0	34.0	33.0
Profit after tax	6,873	6,567	7,346	8,259
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	6,873	6,567	7,346	8,259
Adj. PAT margin (%)	17.5	17.4	17.7	18.0
Net non-recurring items	-	-	-	-
Reported net profit	6,873	6,567	7,346	8,259

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	421	421	421	421
Reserves & surplus	27,566	30,806	33,595	36,284
Net worth	27,987	31,227	34,015	36,705
Borrowing	21	-	-	-
Other non-current liabilities	(1,131)	(1,278)	(1,278)	(1,278)
Total liabilities	26,876	29,949	32,737	35,427
Gross fixed assets	5,694	6,316	7,816	9,616
Less: Depreciation	(882)	(1,442)	(2,154)	(2,945)
Net fixed assets	4,813	4,874	5,662	6,671
Add: Capital WIP	514	577	500	500
Total fixed assets	5,327	5,451	6,162	7,171
Total Investment	16,506	23,865	25,000	27,000
Inventory	4,616	4,611	4,918	5,628
Debtors	3,542	3,210	3,971	4,520
Cash & bank	10,617	7,009	7,145	8,035
Loans & advances	342	423	473	530
Current liabilities	16,945	18,375	19,062	22,001
Net current assets	5,044	633	1,575	1,256
Other non-current assets	-	-	-	-
Total assets	26,876	29,949	32,737	35,427

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	10,560	10,104	11,130	12,327
Depreciation & Amortisation	574	642	712	791
Chg in working capital	567	1,037	(807)	1,210
Cash flow from operations	5,723	6,225	4,885	7,768
Capital expenditure	(598)	(683)	(1,423)	(1,800)
Cash flow from investing	(1,569)	(6,218)	(164)	(1,281)
Equity raised/ (repaid)	-	-	-	-
Debt raised/ (repaid)	-	-	-	-
Dividend paid	(2,784)	(3,543)	(4,557)	(5,570)
Cash flow from financing	(2,792)	(3,615)	(4,585)	(5,598)
Net chg in cash	1,363	(3,608)	136	890

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	163.4	156.1	174.7	196.4
CEPS (Rs)	177.1	171.4	191.6	215.2
DPS (Rs)	70.0	70.0	90.0	110.0
Dividend payout ratio (%)	42.8	44.8	51.5	56.0
GROWTH				
Net sales (%)	(4.9)	(4.1)	9.7	10.7
EBITDA (%)	14.8	(0.6)	10.2	12.0
Adj net profit (%)	17.8	(4.5)	11.9	12.4
FDEPS (%)	17.8	(4.5)	11.9	12.4

PERFORMANCE

RoE (%)	28.0	22.2	22.5	23.4
RoCE (%)	45.1	35.7	35.6	36.3

EFFICIENCY

Asset turnover (x)	2.7	1.8	1.6	1.7
Sales/ total assets (x)	0.9	0.8	0.8	0.8
Working capital/ sales (x)	(0.2)	(0.2)	(0.1)	(0.1)
Receivable days	32.9	31.0	35.0	36.0
Inventory days	51.1	53.4	51.9	53.8
Payable days	86.9	99.6	86.4	94.5

FINANCIAL STABILITY

Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.4)	(0.2)	(0.2)	(0.2)
Current ratio (x)	1.3	1.0	1.1	1.1
Interest cover (x)	342.4	276.0	304.0	340.7

VALUATION

PE (x)	33.4	34.9	31.2	27.8
EV/ EBITDA (x)	26.1	26.7	24.2	21.5
EV/ Net sales (x)	5.6	5.9	5.4	4.8
PB (x)	8.2	7.3	6.7	6.3
Dividend yield (%)	1.3	1.3	1.6	2.0
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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

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