

GlaxoSmithKline Consumer Healthcare

14 May 2018

Reuters: GLSM.NS; Bloomberg: SKB IN

Uncertainties

GlaxoSmithKline Consumer Healthcare's (SKB) top-line performance in 4QFY18 was below our estimate by 3%, but its operating profit was largely in line because of favourable commodity prices. Category growth is still in mid single digits. Although SKB has launched new products across sub-segments, competitors are already present in each of them. Also, its key brand Horlicks has lost 40bps market share on a full-year basis. Strategic review of Horlicks and other consumer healthcare nutrition products - as announced by the parent company earlier in this financial year - is expected to be completed by December 2018 and no further details were shared during the conference call. We have retained our Accumulate rating on SKB on account of sluggish category growth and lesser headroom for margin expansion. Also, we have cut down our earnings multiple to 32x (from 35x earlier) to factor in the uncertainty about key brands which account for more than 90% of the company's revenues. Our revised target price on the stock of Rs6,700 (from Rs7,300 earlier) is based on FY20E EPS.

Volume growth on a favourable base: Top-line during the quarter on reported basis grew 7.1% and 8% on comparable basis (comparable sales growth in HFD category was 10% led by 8% volume growth on the base of -1% in the base quarter). Adjusted for a favourable base, the growth improvement remains modest for the full year. SKB is not in a position to command pricing power in key markets because of lot of competition. There were new launches in protein, women and children categories during the quarter. We believe this space is already crowded and with mid single-digit category growth and lack of unique products, SKB will find it difficult to grow its top-line in double digits in the medium term.

Favourable input prices support margin expansion: Lower commodity prices led to gross margin expansion of 250bps YoY during the quarter. But staff costs and other overheads moved up substantially on account of distribution-related expenses. As a result, EBITDA grew 15.2% on reported basis and margin expanded 150bps. On a comparable basis, profit growth could be lower than this as the management stated that underlying PBT growth was 9%, but on a reported basis it shows 18.3%. In our opinion, although input prices are in SKB's favour, higher competition and availability of other alternatives for the category will require it to spend even more on media and promotion, distribution network and innovation which will not give any major headroom for margin expansion.

Outlook and valuation: Overall, we maintained our view on the stock based on sluggish category growth, high competitive intensity, low focus of parent on this category and no headroom for margin expansion. To factor in the uncertainty over the strategic review of Horlicks and other consumer nutrition products (90%+ revenue share) being called by SKB's parent company, we have cut down our target earnings multiple to 32x (from 35x earlier). We have retained our Accumulate rating on SKB with a revised target price Rs6,700 (from Rs7,300 earlier) based on FY20E EPS.

ACCUMULATE

Sector: FMCG

CMP: Rs5,919

Target Price: Rs 6,700

Upside: 13%

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Key Data

Current Shares O/S (mn)	42.1
Mkt Cap (Rsbn/US\$bn)	248.8/3.7
52 Wk H / L (Rs)	6,940/4,851
Daily Vol. (3M NSE Avg.)	22,858

Price Performance (%)

	1 M	6 M	1 Yr
GSK Consumer	(1.2)	(2.3)	12.8
Nifty Index	3.7	4.7	14.7

Source: Bloomberg

Y/E March (Rsmn)	4QFY17	3QFY18	4QFY18	YoY (%)	QoQ (%)	FY17	FY18	YoY (%)
Net sales	11,019	10,347	11,796	7.1	14.0	39,864	43,149	8.2
COGS	3,764	3,223	3,737	(0.7)	15.9	12,969	14,326	10.5
% of sales	34.2	31.2	31.7	(250bps)	50bps	32.5	33.2	70bps
Gross margin %	65.8	68.8	68.3	250bps	(50bps)	67.5	66.8	(70bps)
Employee costs	1,036	1,336	1,376	32.8	3.0	4,672	5,346	14.4
% of sales	9.4	12.9	11.7	230bps	(120bps)	11.7	12.4	70bps
Advertising costs	1,735	1,125	1,693	(2.5)	50.4	5,147	5,467	6.2
% of sales	15.7	10.9	14.3	(140bps)	350bps	12.9	12.7	(20bps)
Other expenses	2,312	2,623	2,490	7.7	(5.1)	8,741	9,193	5.2
% of sales	21.0	25.3	21.1	10bps	(420bps)	21.9	21.3	(60bps)
EBITDA	2,171	2,040	2,500	15.2	22.6	8,335	8,818	5.8
EBITDA margin %	19.7	19.7	21.2	150bps	150bps	20.9	20.4	(50bps)
Depreciation	177	151	145	(17.9)	(4.0)	642	644	0.3
EBIT	1,994	1,889	2,355	18.1	24.7	7,693	8,174	6.3
EBIT margin %	18.1	18.3	20.0	190bps	170bps	19.3	18.9	(40bps)
Interest expense	9	2	8	(11.5)	352.9	28	20	(28.1)
Other income	710	642	842	18.6	31.1	2,439	2,590	6.2
PBT	2,695	2,529	3,189	18.3	26.1	10,104	10,744	6.3
Tax	936	892	1,071	14.4	20.0	3,537	3,743	5.8
Effective tax rate %	34.7	35.3	33.6	(110bps)	(170bps)	35.0	34.8	(20bps)
PAT	1,759	1,637	2,118	20.4	29.4	6,566	7,001	6.6
PAT margin %	15.0	14.9	16.8	180bps	190bps	15.5	15.3	(20bps)
EPS	41.8	38.9	50.4	20.4	29.4	156.1	166.5	6.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Net sales	41,364	39,864	43,149	46,937	51,852
YoY growth (%)	(4.0)	(3.6)	8.2	8.8	10.5
EBITDA	8,420	8,335	8,818	9,810	10,999
EBITDA margin (%)	20.4	20.9	20.4	20.9	21.2
Reported PAT	6,873	6,566	7,001	7,767	8,828
EPS	163.4	156.1	166.5	184.7	209.9
YoY change (%)	17.7	(4.5)	6.6	10.9	13.7
RoCE (%)	31.7	25.9	24.7	24.7	24.8
RoE (%)	28.0	22.2	21.2	21.1	21.4
P/E (x)	36.9	33.0	36.6	32.1	28.2
P/B (x)	9.1	6.9	7.4	6.4	5.7
EV/EBITDA (x)	26.9	22.3	25.0	21.1	18.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: New launches and campaigns

Particulars	Description
Horlicks Protein Plus	For active office-going adults. Roped in R. Madhavan as brand ambassador.
Horlick Growth Plus	Target consumer – young children. TV campaign to create awareness among the parents.
Women's Horlicks	New chocolate flavour launched. Bone health campaign led by Taapsee Pannu.
Exam-time campaign	For right nutrition among the children during the stress period.
Boost RTD	On the Go RTD launched in Tamil Nadu at Rs30/- (similar to Milo).

Source: Media reports

Exhibit 4: Our estimates versus actual performance

Y/E March (Rsmn)	4QFY17	3QFY18	4QFY18	YoY (%)	QoQ (%)	NBIE estimate	Variation (%)
Net sales	11,019	10,347	11,796	7.1	14.0	12,121	(2.7)
EBITDA	2,171	2,040	2,500	15.2	22.6	2,436	2.6
EBITDA (%)	19.7	19.7	21.2	150bps	150bps	20.1	110bps
PAT	1,759	1,637	2,118	20.4	29.4	1,946	8.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Change in our estimates

Y/E March (Rsmn)	Earlier Estimates		New Estimates		Change (%)	
	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Net sales	47,291	52,242	46,937	51,852	(0.7)	(0.7)
EBITDA	9,708	11,229	9,810	10,999	1.1	(2.1)
EBITDA margin (%)	20.5	21.5	20.9	21.2	40bps	(30bps)
Net income	7,532	8,792	7,767	8,828	3.1	0.4

Source: Company, Nirmal Bang Institutional Equities Research

Conference call key takeaways

HFD Volume growth is a function of a favourable base: The company reported comparable sales growth of 8% wherein HFD category grew by 10% driven by volume growth of 8%. This volume growth is on the base of negative 1% growth in the same quarter last year. Category growth during the quarter is still in mid single digits. SKB's growth after adjusting for the base quarter has been below category growth or at max at par with it. Volume growth during the full year is also a function of a favourable base, and adjusted for the same will give a flat or marginally positive volume growth.

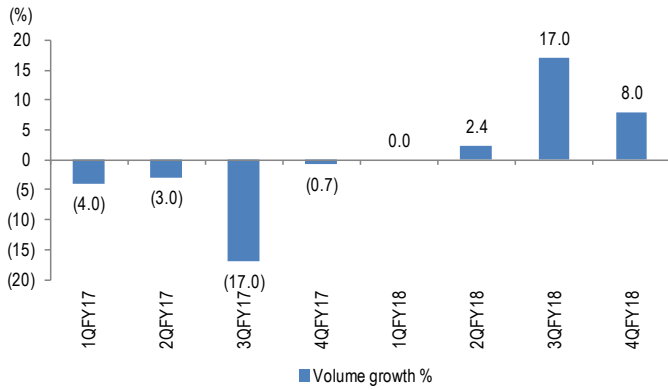
Horlicks has not gained market share: The management stated that its key brand Horlicks has lost around 40bps market share on a full-year basis. Volume and value market share stood at 51.3% and 44.3%, respectively. Boost gained around 70bps market share on a full-year basis. Volume and value share of Boost was 14.3% and 11.3%, respectively. SKB's new launches in protein category received good consumer response and gained around 0.3% market share within two months. However, the contribution of the same is currently miniscule. In the eastern region, which is a key market for SKB, competitors have gained around 200bps value market share mainly because SKB cut prices of its products post GST rate cut in November 2017; but all players have not gone for similar price cuts. This shows lack of pricing power on the part of SKB.

Distribution: SKB's total distribution reach clocked around 1.8mn outlets wherein around 150,000 outlets were added by the company during the year. SKB has formed new dedicated sales vertical to approach the experts and increase product penetration. The rise in distribution network comes at a cost and as a result, staff costs and other overheads continued to be on the higher side during the quarter. Hence, the favourable impact of raw material prices got partially netted off.

No clarity on Strategic review of Horlicks and other consumer nutrition brands: The management did not share much details about the strategic review of Horlicks and other nutrition brands announced by the parent company at the beginning of this financial year. The management stated that it is still evaluating various options. It is to be noted that revenue share is more than 90% in the Indian entity. It was indicated that in case the parent decides to sell off the brand, there is no additional compensation provision stated in the brand licensing agreement and the same can be done just with a 90-day prior notice. Globally, the parent is only focusing on pharmaceutical and vaccine business and also exited Horlicks in the UK last year. Hence, the outlook of the brand is uncertain. Also, the parent company holds around 72% share in the Indian entity and therefore capital gains tax implications are also to be examined.

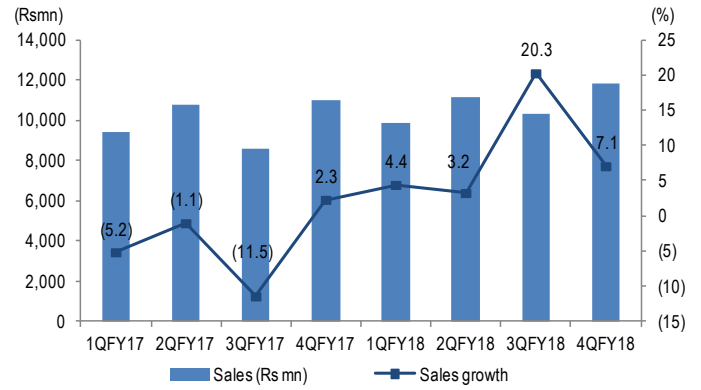
Other points: Business auxiliary income, which forms a major part of other income, grew just 4% for the full year and 3.5% YoY in 4QFY18. However, this was largely on account of lower realisation post price cuts. Volume growth is around 10% both for the quarter and full year. SKB declared a dividend of Rs75 per share for FY18 as against Rs70 in the previous year.

Exhibit 6: HFD Volume growth trend



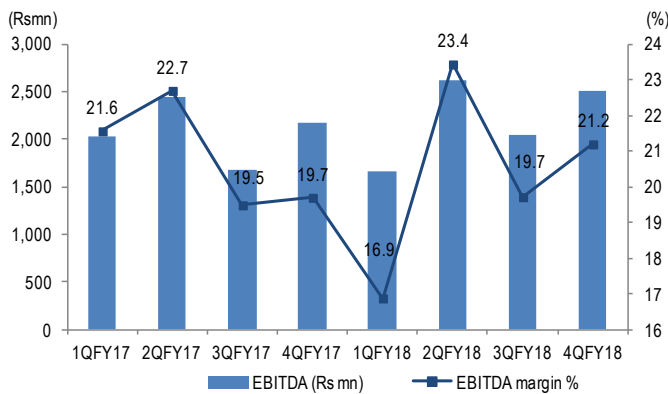
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Revenue growth trend



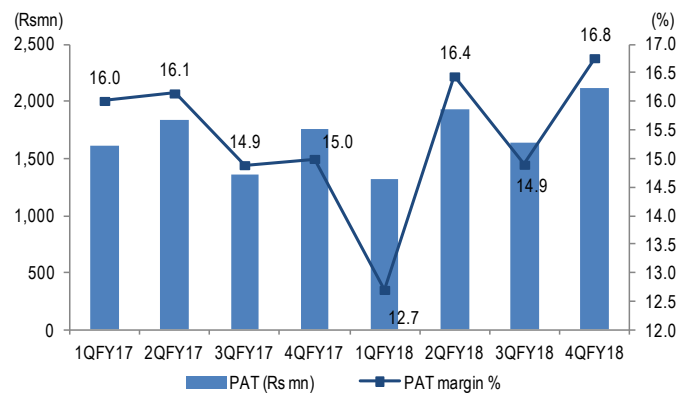
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Operating margin profile



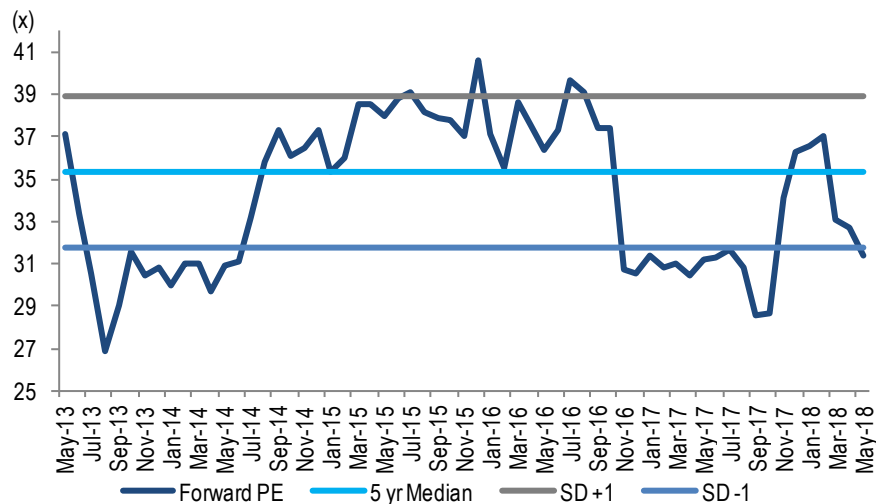
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Net income trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: 1-year forward P/E



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 11: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Net sales	41,364	39,864	43,149	46,937	51,852
% Growth	(4.0)	(3.6)	8.2	8.8	10.5
COGS	13,436	12,969	14,326	15,533	17,311
Staff costs	5,050	4,672	5,346	5,823	6,342
Other expenses	14,459	13,888	14,660	15,771	17,201
Total expenses	32,944	31,530	34,332	37,127	40,854
EBITDA	8,420	8,335	8,818	9,810	10,999
% growth	15.3	(1.0)	5.8	11.3	12.1
EBITDA margin (%)	20.4	20.9	20.4	20.9	21.2
Other income	2,215	2,439	2,590	2,868	3,371
Interest costs	23	28	20	25	25
Depreciation	613	642	644	705	764
Profit before tax (before exceptional items)	9,999	10,104	10,744	11,949	13,581
Exceptional items	561	-	-	-	-
Tax	3,687	3,537	3,743	4,182	4,753
PAT	6,873	6,566	7,001	7,767	8,828
Adj. PAT	6,312	6,566	7,001	7,767	8,828
Adj. PAT margin (%)	14.5	15.5	15.3	15.6	16.0
% Growth	17.8	4.0	6.6	10.9	13.7

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
Share capital	421	421	421	421	421
Reserves	27,566	30,806	34,431	38,469	43,271
Minority interest	-	-	-	-	-
Net worth	27,987	31,227	34,851	38,890	43,692
Total debt	127	84	-	-	-
Deferred tax liability	(1,131)	(1,278)	(1,155)	(1,155)	(1,155)
Total liabilities	51,294	32,313	35,546	41,147	46,244
Gross block	5,694	6,316	7,016	7,816	8,616
Depreciation	882	1,442	2,085	2,790	3,554
Net block	4,813	4,874	4,931	5,026	5,062
Intangible assets	-	89	27	27	27
Capital work-in-progress	514	492	357	407	457
Investments	-	-	-	-	-
Inventories	4,616	4,612	4,094	4,843	5,117
Debtors	3,542	3,210	2,787	2,871	3,380
Cash	27,123	30,874	35,852	42,140	48,590
Loans & advances	24,489	423	311	2,018	2,748
Other current assets	703	2,579	2,739	2,816	3,111
Total current assets	37,576	41,391	45,620	52,811	60,353
Creditors	7,852	8,757	10,347	10,506	13,018
Other current liabilities & provisions	3,660	4,558	4,303	5,069	5,444
Total current liabilities	14,567	15,956	17,426	19,095	22,351
Net current assets	23,009	25,435	28,194	33,715	38,002
Total assets	51,294	32,313	35,546	41,147	46,244

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18	FY19E	FY20E
PAT	6,873	6,566	7,001	7,767	8,828
Depreciation	613	642	644	705	764
Other income	(2,215)	(2,439)	(2,590)	(2,868)	(3,371)
(Inc.)/dec. in working capital	(2,656)	1,726	2,410	837	2,473
Cash flow from operations	2,615	6,495	7,465	6,440	8,694
Capital expenditure (-)	(599)	(681)	(565)	(850)	(850)
Net cash after capex	2,017	5,814	6,900	5,590	7,844
Dividends paid (-)	(2,313)	(2,944)	(3,150)	(3,107)	(3,354)
DDT paid (-)	(471)	(599)	(630)	(621)	(671)
Inc./(dec.) in investments	-	-	-	-	-
Cash from financial activities	1,195	(25,787)	(4,255)	(2,166)	(3,730)
Opening cash balance	22,965	27,123	30,874	35,852	42,140
Closing cash balance	27,123	30,874	35,852	42,140	48,590
Change in cash balance	4,157	3,751	4,978	6,288	6,450

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Key ratios

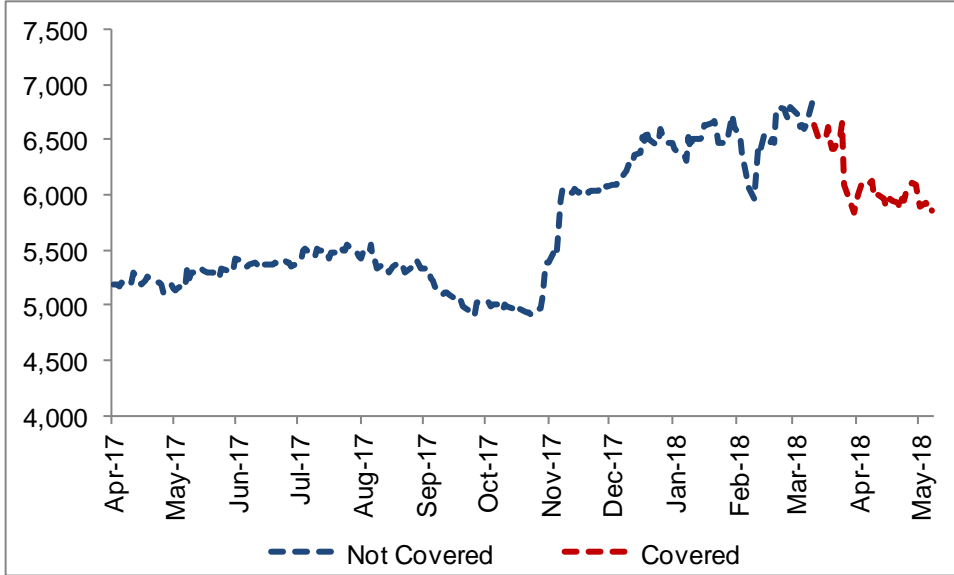
Y/E March	FY16	FY17	FY18	FY19E	FY20E
Per share (Rs)					
EPS	163.4	156.1	166.5	184.7	209.9
Book value	665.5	742.5	828.7	924.7	1038.9
DPS	55.0	70.0	74.9	73.9	79.8
Valuation (x)					
P/Sales	6.1	5.4	5.9	5.3	4.8
EV/sales	5.5	4.7	5.1	4.4	3.9
EV/EBITDA	26.9	22.3	25.0	21.1	18.2
P/E	36.9	33.0	36.6	32.1	28.2
P/BV	9.1	6.9	7.4	6.4	5.7
Return ratios (%)					
RoCE	31.7	25.9	24.7	24.7	24.8
RoE	28.0	22.2	21.2	21.1	21.4
Profitability ratios (%)					
Gross margin	67.5	67.5	66.8	66.9	66.6
EBITDA margin	20.4	20.9	20.4	20.9	21.2
EBIT margin	18.9	19.3	18.9	19.4	19.7
PAT margin	24.2	23.9	23.5	24.0	24.6
Liquidity ratios (%)					
Current ratio	2.6	2.6	2.6	2.8	2.7
Quick ratio	2.3	2.3	2.4	2.5	2.5
Solvency ratio (%)					
Debt-to-equity ratio	-	-	-	-	-
Turnover ratios					
Total asset turnover ratio (x)	0.6	0.8	0.8	0.8	0.8
Fixed asset turnover ratio (x)	7.8	7.4	8.4	8.6	9.4
Inventory days	126.0	129.8	110.9	105.0	105.0
Debtors days	29.5	30.9	25.4	22.0	22.0
Creditor days	209.9	233.7	243.4	245.0	248.0

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 March 2018	Buy	6,837	7,300
14 May 2018	Buy	5,919	6,700

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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