

GSK Consumer (SKB IN)

Healthy enough to drive growth

INDIA | FMCG | Company Update

We believe recent correction (12%) provides an attractive risk-reward as Indian business remains on strong footing 1) driven by change in management, whose priority is profitable volume growth 2) focus on high margin science based products and 3) driving penetration by pushing Low unit packs in rural areas. In our view, correction in GSK consumer stock price is unwarranted and even if deal goes through, it is likely to happen at premium valuations (vs current market cap) as 1) well funded competitors making a beeline for iconic brand and 2) scarcity premium for health related brands in India. We reiterate our high conviction BUY with TP of 7160 (35x FY20 EPS) with 23% upside.

New management team to focus on volume growth – GSK consumer saw compounded annual sales decline of 4% over FY15-17 due to management excessive focus on pricing over volume's (6%+ price Cagr over past 5 years resulted in gross margin improving to 66% in FY17 from 62% in CY11) which led to price-value equation going for a toss; moreover this collided alongwith a) category and economic slowdown and b) emergence of value players (Power Vita). We can draw parallel between the new management team (**refer table 4**) with Suresh Narayanan, MD of Nestle India, where growth has made strong comeback driven by focus on volume in core categories via innovation and leveraging existing distribution network and entry into new categories. We believe new management strategy –1) product simplification 2) innovation and 3) improving execution capability on distribution front to bear fruits in medium term.

Science based products to drive next leg of growth – We believe GSK consumer's management also has acknowledged following challenges in driving growth of core categories -

- Increased availability of milk in South and East India, key markets (c80%+ of sales).
- Children preferring to have cereals (cornflakes, Chocó's etc) with milk rather than malted foods.
- Better quality of milk reducing need of taste enhancer.

Management plans to revive growth by launching 1) more science based products and 2) gradual increase in tie-up with healthcare professionals (**refer table 1 and 3**)

- Growth Plus - targeting children in age group of 3-9 years (competing with PediaSure from Abbott).
- Cardia plus – helps to reduce cholesterol, blood sugar and manage weight.
- Protein Plus – targeting working adults, who may be protein deficient due to hectic lifestyle (competing with Protinex from Danone).

Driving penetration via LUP at the bottom of the pyramid – Our channel checks suggest that company is focussing on LUP's (Rs 5,10) primarily in rural areas to drive penetration, but its availability has been limited in urban areas due to management's fear that it may cannibalize sales of big packs. Our ground checks suggest that Horlicks powder when put in idle glass/plastic bottle faces risk of attracting moisture thereby reducing consumption and consumer are finding single serving sachets to be more convenient and easy to use. We expect management to focus on LUP's even in urban areas, since it is likely to be Ebitda neutral as low-margin nature of LUP's gets compensated by higher volumes, thereby recruiting new users and expanding the base.

Who are likely to be contenders for the brand/company? - Within listed space, Nestle is best suited to acquire GSK consumer given its 1) deep knowledge of malted food category worldwide through Milo and 2) focus on health and wellness categories; however MNC companies like HUL and Nestle may face issues in structuring the deals as parent of these companies may not be willing to dilute stake in respective Indian arm's. We believe it will be relatively easy for ITC to structure the deal since it does not have promoter dilution related

2 April 2018

Buy (Maintain)

CMP RS 5832
TARGET RS 7160 (+23%)

COMPANY DATA

O/S SHARES (MN) :	42
MARKET CAP (RSBN) :	245
MARKET CAP (USDBN) :	4
52 - WK HI/LO (RS) :	6888 / 4856
LIQUIDITY 3M (USDMN) :	1.8
PAR VALUE (RS) :	10

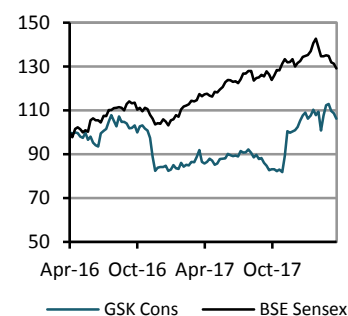
SHARE HOLDING PATTERN, %

	Dec 17	Sep 17	Jun 17
PROMOTERS :	72.5	72.5	72.5
FII / NRI :	4.1	4.0	4.2
FI / MF :	8.7	8.9	8.6
NON PRO :	2.7	2.7	2.7
PUBLIC & OTHERS :	12.0	12.0	12.0

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-14.1	-10.0	13.0
REL TO BSE	-11.4	-7.6	0.4

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY17	FY18E	FY19E	FY20E
Net Sales	37,739	41,531	45,902	50,663
EBIDTA	8,335	8,792	10,020	11,135
Net Profit	6,567	6,854	7,753	8,602
EPS, Rs	156	163	184	205
PER, x	37.4	35.8	31.6	28.5
EV/EBIDTA, x	25.7	23.7	20.7	17.0
ROE, %	21.0	19.9	20.4	20.5

Source: PhillipCapital India Research Est.

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Issues and increasing focus on dairy segment (recently launched Aashirvaad milk in Bihar and has been present in ghee segment for a while). In unlisted space, we believe all MNC's – Danone, Abbott, and Kraft – Heinz (Complan) and Mondelez (Bourvita) are equally competent in acquiring GSK consumer business. We do not foresee any major challenges in current distribution structure for distributing OTC products since acquirer will keep receiving distribution fees post sale of business.

What can be done with the Horlicks brand? - We believe Horlicks enjoys enormous brand equity in health related space and can be easily expanded into adjacent categories like protein bars, museli, launching Horlicks in ready to drink format (Nestle has recently launched RTD Milo in India) and further expanding biscuit range. Large FMCG companies (ITC, Nestle, HUL etc) can leverage their distribution network since current distribution strength of GSK consumer is restricted to 3-3.5 m outlets.

Table 1: Science based product comparison

Company	Brands	Grammage	MRP	Rs /Kg	Discount to Competition
Children (Plus 2-9 years)					
GSK Consumer	Horlicks Growth Plus (Jar)	400g	520	1,300	-4%
Abbott	Pediasure (Jar)	400g	540	1,350	
Performance					
GSK Consumer	Horlicks Protein Plus (Jar)	400g	495	1,238	-15%
Danone	Protinex (Jar)	400g	585	1,463	
Medical					
GSK Consumer	Cardia Plus (Jar)	400g	680	1,700	

Source: Big Basket, Company

Table 2: Brand comparison

Company	Brands	Grammage	MRP	Rs/Kg
Base Drink				
GSK Consumer	Horlicks Classic Malt	500g	215	430
GSK Consumer	Boost	500g	210	420
Mondelez	Bournvita Pro-Health Chocolate drink	500g	199	398
Patanjali	Power Vita	500g	180	360
Sri Sri Products	Ojas Vita	500g	250	500
Infant				
Nestle	Lactogen - Stage 1	400g	302	755
Abbott	Similac - Stage 1	400g	525	1,313
Children				
GSK Consumer	Junior Horlicks - Stage 1 (2-3 years)	500g	256	512
Kraft- Heinz	Complan	500g	220	440
Mondelez	Bournvita Lil' Champs	500g	262	524
GSK Consumer	Horlicks Growth Plus (3-9 years) (Jar)	400g	520	1,300
Abbott	PediaSure (Jar)	400g	540	1,350
Women				
GSK Consumer	Women's Horlicks - Chocolate (Jar)	400g	270	675
Mother (Pregnancy/ breast-feeding)				
GSK Consumer	Mother Horlicks	450g	456	1,013
Nestle	Nestle Mom & Me	400g	440	1,100
Danone	Mama Protinex	400g	560	1,400
Performance				
Abbott	Ensure (Jar)	400g	485	1,213
Danone	Protinex (Jar)	400g	585	1,463
GSK Consumer	Horlicks Protein Plus (Jar)	400g	495	1,238
Specialized				
GSK Consumer	Cardia Plus (Jar)	400g	680	1,700

Source: Big Basket, Company

Table 3: Horlicks Key brands comparison

Products	Grammage	MRP	Rs/Kg
Boost	500g	210	420
Horlicks Classic Malt	500g	215	430
Junior Horlicks - Stage 1 (2-3 years)	500g	256	512
Mother Horlicks	450g	456	1,013
Horlicks Protein Plus (Jar)	400g	495	1,238
Horlicks Growth Plus (3-9 years) Jar	400g	520	1,300
Horlicks Cardia Plus (Jar)	400g	680	1,700

Source: Big Basket, Company

Management Profile

Table 4 - Management profile
Mr. Navneet Saluja

	Tenure	Company	Role
Experience	Jan-18 - Present	GSK Consumer India	Managing Director
	Jan-13	GSK Midle East & Africa	VP & General Manger
	Nov-08	GSK India	Head of sales
		Reliance Retail	Setup North India Operations
	1.5- 2 years	Reliance Infocomm	
	1.5 years	Kellogg's	Head of sales in Marketing and Director
	11 years	Gillette	Sales & Marketing
	4 years	Cadbury	Sales & Marketing
Education Qualification	1987	JBIMS - Mumbai	Post Graduation

Mr. Vikram Bahl

	Year	Company	Designation
Experience	May 2017 - Present	GSK Consumer Healthcare India	Executive VP Marketing
	Feb 2014 - April 2017	Kellogg Company	Global Innovation Lead - Savory and Natural Snacks
	Jan 2013 - Feb 2014	Kellogg Company	Brand Lead - Cheez It
	Jul 2008 - Dec 2012	Kellogg Company	MD. India & South Asia
	Jan 2006 - Jun 2008	P&G	Regional Marketing Manager, ASEAN
	Apr 2002 - Dec 2005	Gillette	Marketing Manager
	Jul 1999 - Mar 2002	P&G	Regional Brand Manager - AMEE
	Aug 1996 - Jun 1999	P&G	Brand Manager
	Jun 1993 - Jul 1996	Wipro Consumer Care and Lighting	Area Sales Manager
Education Qualification	1991 -1993	IIM - Bangalore	PGDM, Marketing & Finance
	1988 - 1991	St. Stephen's College	

Source: LinkedIn, Company

Financials

Income Statement

Y/E Mar, Rs mn	FY17	FY18E	FY19E	FY20E
Net sales	37,739	41,531	45,902	50,663
Growth, %	-4	10	11	10
Total income	39,865	43,762	48,178	53,053
Raw material expenses	-12,969	-14,604	-15,918	-17,589
Employee expenses	-4,580	-5,267	-5,636	-6,059
Other Operating expenses	-13,980	-15,099	-16,604	-18,270
EBITDA (Core)	8,335	8,792	10,020	11,135
Growth, %	(0.6)	5.5	14.0	11.1
Margin, %	22.1	21.2	21.8	22.0
Depreciation	-642	-666	-802	-939
EBIT	7,693	8,127	9,218	10,196
Growth, %	(1.5)	5.6	13.4	10.6
Margin, %	20.4	19.6	20.1	20.1
Interest paid	-28	-16	-16	-16
Other Non-Operating Income	2,439	2,500	2,800	3,136
Pre-tax profit	10,104	10,610	12,002	13,316
Tax provided	-3,537	-3,756	-4,249	-4,714
Profit after tax	6,567	6,854	7,753	8,602
Net Profit	6,567	6,854	7,753	8,602
Growth, %	(4.5)	4.4	13.1	10.9
Net Profit (adjusted)	6,567	6,854	7,753	8,602
Unadj. shares (m)	42	42	42	42
Wtd avg shares (m)	42	42	42	42

Balance Sheet

Y/E Mar, Rs mn	FY17	FY18E	FY19E	FY20E
Cash & bank	30,874	37,243	38,046	55,633
Debtors	3,210	2,934	3,857	3,639
Inventory	4,611	3,390	5,332	4,306
Loans & advances	2,182	1,661	1,836	2,027
Other current assets	1,178	1,666	1,478	1,992
Total current assets	42,056	46,895	50,548	67,597
Gross fixed assets	6,316	7,316	8,816	10,316
Less: Depreciation	-1,442	-2,108	-2,910	-3,849
Add: Capital WIP	577	366	441	516
Net fixed assets	5,451	5,574	6,347	6,983
Total assets	49,602	54,564	58,990	76,675
Current liabilities	18,375	20,185	21,044	34,772
Total current liabilities	18,375	20,185	21,044	34,772
Non-current liabilities	4	4	4	0
Total liabilities	18,379	20,189	21,048	34,772
Paid-up capital	421	421	421	421
Reserves & surplus	30,802	33,955	37,521	41,482
Shareholders' equity	31,223	34,375	37,942	41,903
Total equity & liabilities	49,602	54,564	58,990	76,675

Source: Company, PhillipCapital India Research Estimates

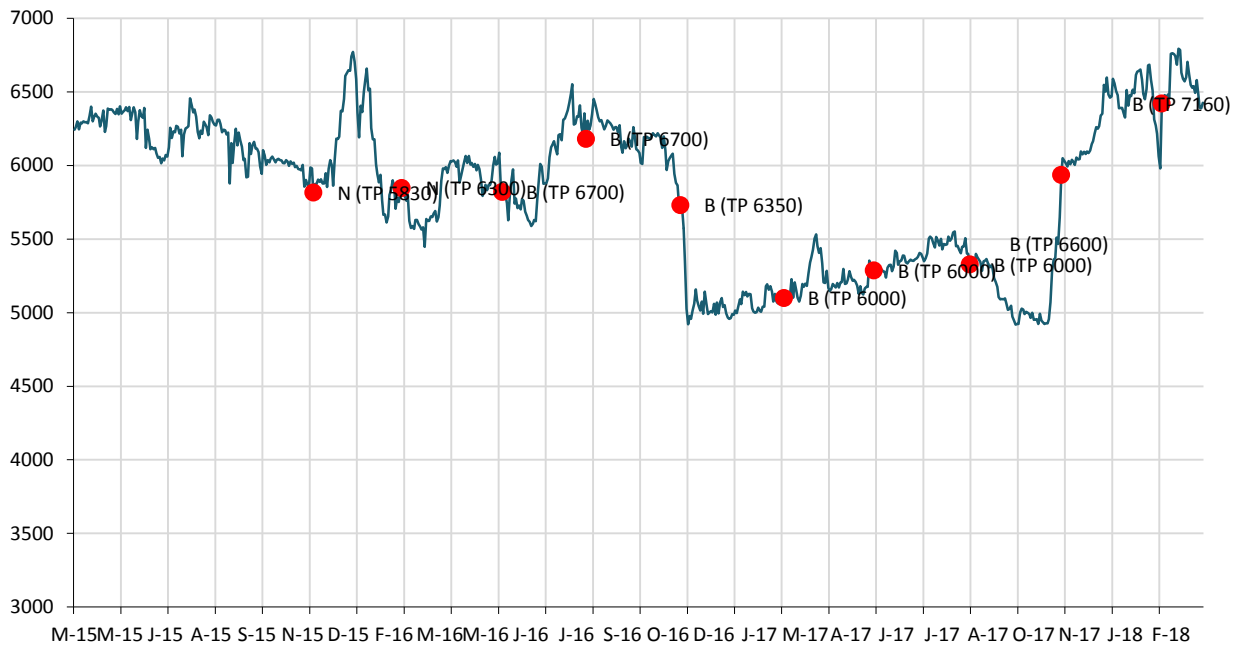
Cash Flow

	FY17	FY18E	FY19E	FY20E
Pre-tax profit	10,104	10,610	12,002	13,316
Depreciation	642	666	802	939
Chg in working capital	1,186	3,340	-1,991	14,262
Total tax paid	-4,087	-3,756	-4,249	-4,714
Other operating activities	219	-700	-700	-700
Cash flow from operating activities	8,063	10,160	5,865	23,103
Capital expenditure	-766	-789	-1,575	-1,575
Cash flow from investing activities	-766	-789	-1,575	-1,575
Free cash flow	7,297	9,370	4,290	21,528
Equity raised/(repaid)	0	700	700	700
Dividend (incl. tax)	-3,543	-3,701	-4,187	-4,645
Cash flow from financing activities	-3,543	-3,001	-3,487	-3,945
Net chg in cash	3,754	6,369	803	17,583

Valuation Ratios

	FY17	FY18E	FY19E	FY20E
Per Share data				
EPS (INR)	156	163	184	205
Growth, %	(4.5)	4.4	13.1	10.9
Book NAV/share (INR)	742	817	902	996
FDEPS (INR)	156	163	184	205
CEPS (INR)	171	179	203	227
CFPS (INR)	129	199	90	491
DPS (INR)	70.0	73.3	83.0	92.0
Return ratios				
Return on assets (%)	13.9	13.2	13.7	12.7
Return on equity (%)	21.0	19.9	20.4	20.5
Return on capital employed (%)	22.2	20.9	21.5	21.6
Turnover ratios				
Asset turnover (x)	(31.1)	(12.4)	(12.8)	(5.6)
Sales/Total assets (x)	0.8	0.8	0.8	0.7
Sales/Net FA (x)	7.0	7.5	7.7	7.6
Working capital/Sales (x)	(0.2)	(0.3)	(0.2)	(0.5)
Fixed capital/Sales (x)	0.7	0.6	0.6	-
Working capital days	(69.6)	(92.6)	(67.9)	(164.3)
Liquidity ratios				
Current ratio (x)	2.3	2.3	2.4	1.9
Quick ratio (x)	2.0	2.2	2.1	1.8
Interest cover (x)	276.7	507.9	576.1	637.3
Dividend cover (x)	2.2			
Net debt/Equity (%)	(98.9)	(108.3)	(100.3)	(132.8)
Valuation				
PER (x)	37.4	35.8	31.6	28.5
Price/Book (x)	7.9	7.1	6.5	5.9
Yield (%)	1.2	1.3		
EV/Net sales (x)	5.7	5.0	4.5	3.7
EV/EBITDA (x)	25.7	23.7	20.7	17.0
EV/EBIT (x)	27.9	25.6	22.5	18.6

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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