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GSK Consumer Healthcare Ltd

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Health & wellness brands to drive growth

GlaxoSmithKline Consumer Healthcare (GSKCH) is an associate of GlaxoSmithKline plc UK, which holds 72.46% stake in the company. It is India's dominant player in health food drink (HFD) category with 67.3% market share. While Horlicks leads the market, Boost is among the top three health food drink brands.

Investment Rationale

Undisputed market leader with a strong brand recall: GSKCH is a dominant player in the HFD segment with 67.3% volume share. GSK's Horlicks has 53.5% volume share of the HFD market and remains an undisputed leader by a huge margin. GSKCH has consistently gained market share over the years. It gained 1.4% YoY volume market share (at 66.2%) in FY15 and has further strengthened its leadership position in HFD category to 67.3% volume market share in Q3FY16 from 66.8% in Q2FY16.

Under-penetrated category provides significant headroom for growth: With increasing health awareness, rising income levels and availability of variants & flavours, more and more consumers are opting for healthy and nutritional products. HFD market is estimated to have grown 3.6x from Rs. 2,000 crores in 2009 to Rs. 7,100 crores in 2015 & is further expected to reach Rs. 9,800 crores by 2018. Hence, the Indian HFD category is expected to grow at a CAGR of 11.3% over CY15-CY18E. Being the market leader, GSKCH is well placed to tap this opportunity taking into account the overall low penetration level (~25%) of HFD category. While market penetration of HFDs (for GSKCH) are skewed towards South & East India, penetration in North and West India remains low. Taking this into consideration, we expect GSKCH to aggressively target these unexplored markets. Therefore, we expect HFD segment to grow at a CAGR of 11.5% over FY15-FY18E.

Brand Extensions gaining traction: GSKCH has continuously focused on expanding its product portfolio. With judicious brand extensions for different age groups, GSKCH's product portfolio now caters to broad range of consumers. The company's success has come from brand extensions such as Horlicks Junior (for kids & at 20% premium to base Horlicks), Women's Horlicks, Horlicks Lite (for entire family & at 36% premium to base one) and Mother's Horlicks (at 107% premium to base one). Interestingly, the contribution of brand extensions to the total Horlicks has increased from 20% in FY11 to 27% in FY16.

Valuation: GSKCH is better placed than peers given its strong pricing power, leadership position and distribution reach in the core HFD portfolio. We expect revenue and PAT to grow at a CAGR of 9.8% and 15.8% over FY15-FY18E. Further, we rate the stock as 'BUY' assigning a forward P/E of 31.5x arriving at a target price of Rs. 6,788 which implies potential upside of ~12% for next 12 months.

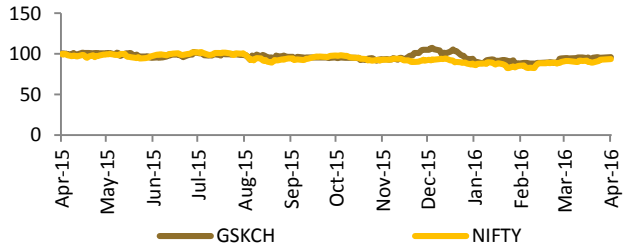
Market Data

Rating	**BUY**
CMP (Rs.)	6,067
Target (Rs.)	6,788
Potential Upside (%)	~12
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	6,800/5,405
Adj. all time High (Rs.)	6,800
Decline from 52WH (%)	10.8
Rise from 52WL (%)	12.2
Beta	-
Mkt. Cap (Rs.Cr)	25,515

Fiscal Year Ended

Y/E	FY15	FY16E	FY17E	FY18E
Revenue (Rs.Cr)	4,308	4,429	4,982	5,707
Adj. Profit (Rs.Cr)	584	649	788	906
EPS (Rs.)	138.8	154.3	187.4	215.5
P/E (x)	45.4	39.3	32.4	28.2
P/BV (x)	12.5	10.3	8.7	7.4
ROE (%)	29.7	28.2	29.1	28.3

One year Price Chart



Shareholding Pattern	Mar-16	Dec-15	Change
Promoters (%)	72.5	72.5	0.0
FII (%)	9.0	10.3	(1.3)
DII (%)	3.7	2.4	1.3
Others (%)	14.8	14.9	(0.1)

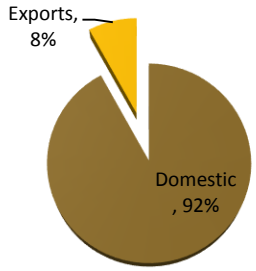
GSKCH is a dominant player in HFD segment with 67.3% market share.

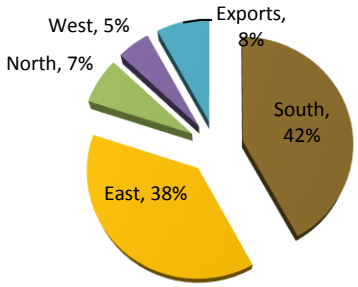
GSKCH: Undisputed market leader in HFD category

GlaxoSmithKline Consumer Healthcare (GSKCH) is an associate of GlaxoSmithKline plc UK, one of world's largest consumer healthcare companies. It is India's dominant player in HFD segment with 67.3% market share. While Horlicks leads the market, Boost is among the top three health food drink brands.

GSKCH also sells biscuits, oats and instant noodles under the Horlicks brand. Apart from the core business, the company also earns commission from distribution of OTC products manufactured by group companies. Key OTC products which GSKCH distributes are well established brands, like Crocin, Eno, Iodex and Sensodyne. Its marketing & distribution network comprises of over 700 distributors and a direct coverage of over 8 lakh retail outlets. Its key manufacturing facilities are located at Nabha (Punjab), Rajahmundry (Andhra Pradesh) and Sonepat (Haryana).

Regional Split of Revenues





Source: Company, In-house research

Core HFD category contributes ~95% to the total revenues of GSKCH & the contribution of Horlicks to HFD category is around 59%.

Horlicks: A 100 years+ 'young' brand

Horlicks has been in India for more than 100 years and has established a very strong equity with consumers. Horlicks has become synonymous with its category (HFD) and maintains leadership position in the domestic HFD industry. While Horlicks has 53.5% volume share of the HFD market, Boost commands a 13.3% volume share. Further, core HFD category contributes ~95% to the total revenues of the company and the contribution of Horlicks to HFD category is around 59%. GSKCH has strengthened its leadership position in HFD category to 67.3% volume market share in Q3FY16 from 66.8% in Q2FY16. Even in FY15, GSKCH gained 1.4% YoY volume market share and maintained leadership at 66.2%.

Further, GSKCH has continuously focused on expanding its product portfolio. With judicious brand extensions for different age groups, GSKCH's product portfolio now caters to broad range of consumers. The company's success has come from brand extensions such as Horlicks Junior (for kids & at 20% premium to base Horlicks), Women's Horlicks, Horlicks Lite (for entire family & at 36% premium to base one) and Mother's Horlicks (at 107% premium to base one). Interestingly, the contribution of brand extensions to the total Horlicks has increased from 20% in FY11 to 27% in FY16. In Q3FY16, most brands including base Horlicks and extensions (Lite, Mother) clocked double digit growth.

Key Brands of GSKCH

Under-penetrated category provides significant headroom for growth

With increasing health awareness, rising income levels and availability of variants & flavours, a growing number of consumers are opting for healthy and nutritional products. HFD market is estimated to have grown 3.6x from Rs. 2,000 crores in 2009 to Rs. 7,100 crores in 2015 & is further expected to reach Rs. 9,800 crores by 2018. Hence, the Indian HFD category is expected to grow at a CAGR of 11.3% over CY15-CY18E. Being the market leader in this space, we believe GSKCH would be the key beneficiary.

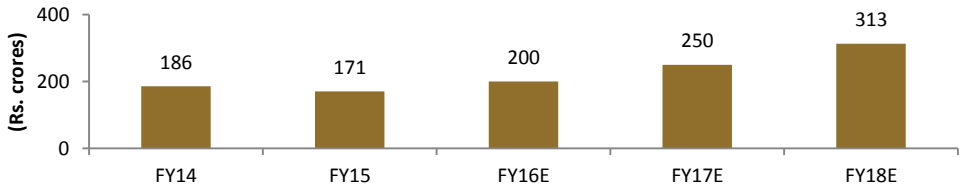
While market penetration of HFDs (for GSKCH) are skewed towards South & East India (GSKCH derives 42% & 38% of sales from South & East India respectively), penetration in North and West India remains low. Taking this into consideration, we expect GSKCH to aggressively target these unexplored markets. In order to garner more share in these markets, the company launched chocolate Horlicks in north and west India in October 2015. Consequently, the company has gained share over there and is now market leader in UP & Delhi with 27% and 32% share, respectively. The low penetration level (~25%) of HFD category provides huge growth opportunities for GSKCH. Besides, the company's new campaign is pitching about the importance of having Horlicks in the evening (to increase consumption of the product to 2 times a day). This would further act as a catalyst for the segment's growth. Hence, we expect HFD segment of the company to grow at a CAGR of 11.5% over FY15-FY18E.

Auxiliary income to aid growth ahead

Apart from the core business, the company also earns auxiliary service commission from distribution of OTC products manufactured by group companies (GlaxoSmithKline Asia Private Ltd. and GlaxoSmithKline Pharmaceuticals). Key OTC products which GSKCH distributes are well established brands, like Crocin, Eno, Iodex and Sensodyne. Currently, GSKCH receives ~16.75% of sales commission for distribution of products from these group companies. Further, the deal is likely to be revised in April 2016 (first time in a decade when revision will happen). Interestingly, auxiliary income witnessed strong CAGR of 29.1% from Rs. 79.5 crores in CY11 to Rs. 171.1 crore in FY15. During 9MFY16, all brands grew in double digit with 20% YoY growth and the management expects OTC brands to grow upwards of 20% over the next one year. Importantly, the inclusion of Novartis brands (Otrivin and Voltaren) from July 2016 would augur well for the auxiliary income. Therefore, we expect this division to grow at a CAGR of 22.3% over FY15-FY18E.

The inclusion of Novartis brands (Otrivin and Voltaren) from July 2016 would augur well for the auxiliary income

Auxiliary income to grow at a CAGR of 22.3% during FY15-FY18E



Source: Company, In-house research; Note: FY14 is a 15 month period due to change in accounting year

Strong distribution network in India

Going forward, the increasing distribution network would help in enhancing the volume growth of the company. Its marketing & distribution network comprises of over 700 distributors and a direct coverage of over 8 lakh retail outlets. Further, GSKCH added ~108,000 outlets in Q3FY16, taking its distribution reach to ~3.3 mn outlets (both direct & indirect) from ~3.1 mn outlets in Q3FY15. Moreover, GSKCH has presence across ~20,000 villages.

Sharp focus on increasing the penetration level in rural market

The penetration of HFD category in rural India is quite low when compared to urban India. In FY15, GSKCH's products were available in over 2 lacs outlets through 13,000 rural sub distributors. The company has launched two key rural programmes namely Horlicks Swasthya Abhiyan (HSA) and Village Level Entrepreneurs (VLE). HSA program aims to improve the standard of living in the rural areas, engaging with rural medical practitioners and community workers, thus creating awareness, education and relevance for its brands. Further, VLE initiative has reached 390 villages and has helped GSKCH in reaching out to bottom of the pyramid. The pressure on the rural segment (sachets are witnessing some slowdown) is likely to continue in the near term. However, going forward, we expect rural demand to revive as IMD predicts above-normal monsoon in 2016 (after two consecutive years of poor monsoon). Besides, government has recently taken several initiatives (crop insurance, enhanced allocation for NREGA in Union Budget) to boost rural growth.

EBITDA margin to rise to 20.8% by FY18E owing to better product mix & strong pricing power

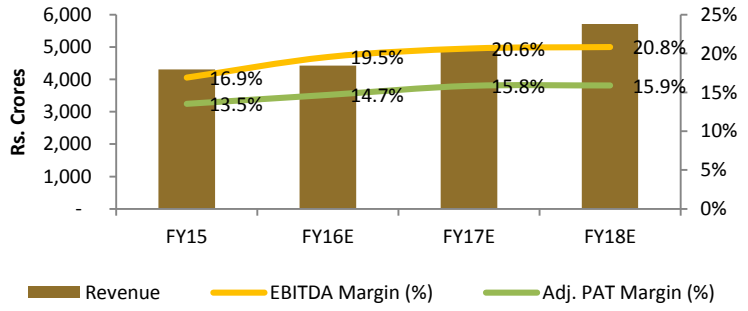
Strong pricing power and change in product mix (higher share of Horlicks brand extensions) would lead to higher margins going forward. In FY16, GSKCH has increased the prices by 5% & 6% in July 2015 & January 2016 respectively (cumulatively ~11% YTD). We project margins would improve to 20.8% by FY18E. The company has consistently shown strength in efficiently managing its costs and ad spends (in the last two years, ad spends as % of sales has hovered in the range of 15%-17%) in order to maintain the margins. Besides, we believe GSKCH would continue to launch new products from its parent's product portfolio, while continuing to leverage its existing brand equity.

We expect top-line of the company to grow at a CAGR of 9.8% over FY15-FY18E.

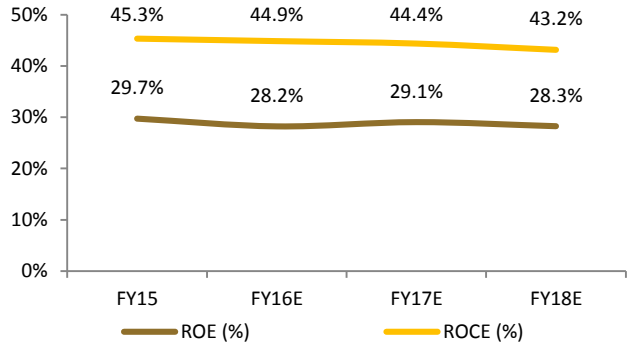
Revenue and PAT to grow at a CAGR of 9.8% and 15.8% respectively over FY15-18E

During FY15-FY18E, we expect the top-line of the company to grow at a CAGR of 9.8%. This growth is expected to be driven by strong pricing power along with improvement in product mix. Further, we estimate 15.8% CAGR in Adjusted PAT over FY15-18E mainly on account of EBITDA margin expansion. However, return ratios are lower due to huge cash (Rs. 2,297 crores in FY15) on the company's balance sheet. Going forward, return ratios may improve if the company deploys the idle cash on capex or pays higher dividend.

Revenue to grow at a CAGR of 9.8 % over FY15-FY18E



Return ratios trend



Source: Company, In-house research

Key Risks:

1 Rise in the prices of milk, barley and sugar.
2 Any slowdown in economy would impact the revenues.
3 Increase in competition from new and existing players could affect the revenues.

Profit & Loss Account

Y/E (Rs.Cr)	FY15	FY16E	FY17E	FY18E
Total operating Income	**4,308**	**4,429**	**4,982**	**5,707**
Raw Material cost	1,499	1,379	1,566	1,796
Employee Cost	431	507	511	583
Other operating expenses	1,647	1,677	1,877	2,139
EBITDA	**730**	**866**	**1,028**	**1,189**
Depreciation	62	65	72	83
EBIT	**668**	**801**	**956**	**1,106**
Interest cost	1	1	1	1
Other income	222	230	248	279
Profit before tax	**889**	**1,030**	**1,204**	**1,384**
Tax	306	381	415	477
Profit after tax	584	649	788	906
Minority Interests	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	584	649	788	906
E/oincome/ (Expense)	-	56	-	-
Reported Profit	**584**	**705**	**788**	**906**

Balance Sheet

Y/E (Rs.Cr)	FY15	FY16	FY17E	FY18E
Paid up capital	42	42	42	42
Reserves and Surplus	2,071	2,442	2,901	3,427
Net worth	**2,113**	**2,484**	**2,943**	**3,470**
Minority Interest	-	-	-	-
Total Debt	-	-	-	-
Other non-current liabilities	218	239	263	290
Total Liabilities	**2,331**	**2,723**	**3,206**	**3,759**
Total fixed assets (inc CWIP)	534	594	672	789
Goodwill	-	-	-	-
Investments	-	-	-	-
Net Current assets	1,616	1,945	2,342	2,769
Other non-current assets	180	184	192	201
Total Assets	**2,331**	**2,723**	**3,206**	**3,759**

Cash Flow Statement

Y/E (Rs.Cr)	FY15	FY16E	FY17E	FY18E
Pretax profit	889	1,030	1,204	1,384
Depreciation	62	65	72	83
Chg in Working Capital	120	22	90	136
Others	(164)	(229)	(247)	(278)
Tax paid	(296)	(381)	(415)	(477)
Cash flow from operating activities	**611**	**507**	**703**	**847**
Capital expenditure	(107)	(125)	(150)	(200)
Chg in investments	-	-	-	-
Other investing cashflow	438	230	248	279
Cash flow from investing activities	**331**	**105**	**98**	**79**
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	-	-	-	-
Dividend paid	(189)	(278)	(329)	(380)
Other financing activities	(33)	(1)	(1)	(1)
Cash flow from financing activities	**(222)**	**(279)**	**(330)**	**(380)**
Net chg in cash	720	332	472	545

Note: FY14 is a 15 month period due to change in accounting year

Key Ratios

Y/E	FY15	FY16E	FY7E	FY18E
Valuation (x)				
P/E	45.4	39.3	32.4	28.2
EV/EBITDA	33.1	26.4	21.8	18.4
EV/Net Sales	5.9	5.4	4.7	4.1
P/B	12.5	10.3	8.7	7.4
Per share data (Rs.)				
EPS	138.8	154.3	187.4	215.5
DPS	55.0	55.0	65.0	75.0
BVPS	502.4	590.6	699.8	825.0
Growth (%)				
Net Sales	(11.7)	2.2	11.9	14.0
EBITDA	(16.3)	18.6	18.8	15.6
Net Profit	(13.5)	11.2	21.5	15.0
Operating Ratios (%)				
EBITDA Margin	16.9	19.5	20.6	20.8
EBIT Margin	15.5	18.1	19.2	19.4
PAT Margin	13.5	14.7	15.8	15.9
Return Ratios (%)				
RoE	29.7	28.2	29.1	28.3
RoCE	45.3	44.9	44.4	43.2
Turnover Ratios (x)				
Net Sales/GFA	4.3	3.7	3.7	3.8
Sales/Total Assets	1.1	1.0	1.0	1.0
Sales/Working Capital	(6.9)	(6.2)	(6.6)	(6.6)
Liquidity&Solvency Ratios (x)				
Current Ratio	2.0	2.2	2.2	2.3
Net Debt/Equity	(1.1)	(1.1)	(1.1)	(1.1)

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* GSKCH is a large-cap company

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