

GSK Consumer Healthcare Ltd.

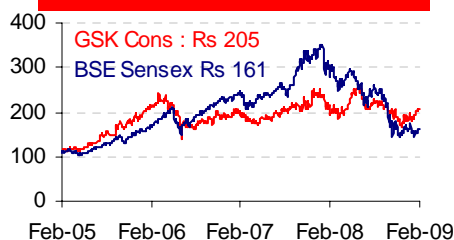
Buy

Target Price: Rs 940

Market data

Current price	Rs 625 (BSE)
Market cap	Rs 26,288 m
Face value	Rs 10.0
FY08 DPS (Rs)	15.0
BSE Code	500676
NSE symbol	GSKCONS
No. of shares	42.1 m
Free float	56.8%
52 week H/L	Rs 750 / 480

Rs 100 invested is now worth



Stock price Performance

	GSK Cons	Index*
1-yr	11.6%	-45.9%
3-yr	0.4%	-1.7%
5-yr	16.5%	9.8%

Returns are on compounded basis
*BSE Sensex

Shareholding (Dec - 2008)

Category	(%)
Promoters	43.2
FII's	2.7
Public	16.9
Others	37.2
Total	100.0

Report prepared by

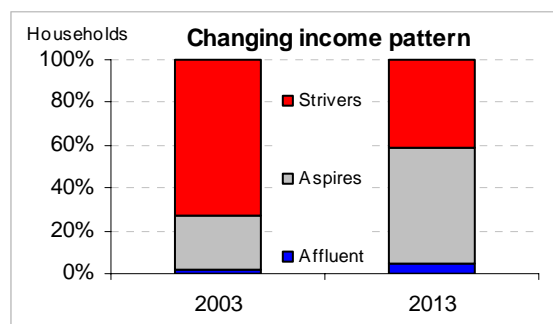
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Investment Rationale

- **Maintaining its leadership:** GSK Consumer continues to dominate the Rs 15 bn Indian malted beverage market with a 70% share (in volume terms). In spite of new players (HUL, Dabur) entering the segment and the company taking a price hike of 7% YoY during CY08, GSK Consumer witnessed 15% volume growth during the year. This indicates its strength in the malted beverage segment. Its white beverage brand 'Horlicks' pioneered the broadening of the malted beverage market in India. Besides this flagship brand which is one of the most well recognized in India, the company's other brands 'Boost', 'Viva' and 'Maltova' are also performing well.
- **Aggressive growth strategy:** GSK has plans to double its revenues over the next 4 years. The company has articulated a strategy to achieve this goal.
 - **Focus on new launches through continuous innovations:** GSK Consumer has aggressive plans to launch new products in CY09 by leveraging the 'Horlicks' brand. It is also planning to introduce products from its global parent's portfolio in oral care, energy drink and other segments over the next 3 to 4 years. The company wants to leverage the global brands as they are well-established. In the past, the company launched new variants like Chocoblast, Mothers' Horlicks, Junior Horlicks, Women's Horlicks and Actibase that have helped boost its topline growth (CAGR of 15% between CY03 and CY08). Besides this segment, the biscuits portfolio which currently contributes around 6% of total revenue grew by 24% YoY during CY08. It is expected to touch 10% of revenue by 2010. Further, GSK will be increasing its capacity and has outlined capex to the tune of Rs 1.3 bn over the next 2 years.
 - **Targeting the 'aspirers':** GSK Consumer will be launching new products targeting the bottom of the pyramid segment in the next two fiscals. As per the National Council of Agriculture & Economic Research (NCAER), the size of the 'aspirers' segment is going to triple over the next four years. Also the growth in rural markets for expenditure on FMCG has shot to 20% in recent times compared to around 17% for urban markets. Hence companies have sharpened their focus in these areas with more value for money products and GSK Consumer is no exception. Government incentives to boost rural and agricultural growth would ensure strong demand for these products in the coming years. In India, the overall malted beverage penetration is still around 10% of the population, which is indicative of immense potential for this market.



Source: NCAER

- Strong balance sheet:** GSK Consumer is one of the better-placed companies on this front as a study of its historical financial gearing reveals that the company's debt to equity ratio has always remained well below alarming levels (maximum debt to equity ratio 0.2 times). Such a long period of prudent capital structure lends comfort with regard to the company's future leverage ratios. Also the company ranks higher in terms of dividend payout, average being 34% since CY00. We expect the dividend payout and the balance sheet to remain strong going forward.

Investment Concerns

- Intensifying competition:** The segment has competitor brands such as Bournvita (Cadbury), Complan (Heinz) and Milo (Nestle). According to market research firm AC Nielsen, Horlicks leads the health food drink category with a 55% share, Cadbury's Bournvita follows at 16% to 17%, GSK's other brand Boost, has a market share of 14% and is marginally ahead of Complan. Seeing the huge potential, HUL (through Amaze) and Dabur India (through Chawan Junior, a variant of its Chyawanprash) have entered this segment. Though GSK Consumer is widening its portfolio and focusing on new segments, increasing competition can affect company's growth prospects going forward.
- Product concentration:** GSK Consumer is virtually a single product company (85% of revenues comes from malted drinks). Also of the Rs 14 bn revenue in CY08 nearly Rs 10 bn (71%) came from Horlicks. This also makes it vulnerable as competition heats up.
- Rising input costs:** GSK Consumer witnessed higher cost of raw materials in the last two years. The raw material cost as a percentage of

sales have increased from 24% in CY06 to 27% in CY08. The company's main inputs are all agri-based which have witnessed wide price fluctuation in recent times. Prices of these commodities are dependant on uncontrollable factors like good and timely monsoons. Major raw materials of the company are milk and milk powder both of which account for 5.6% of net revenues. The prices of milk, sugar and malted barley are also witnessing double digit rise. Though the company had taken a 7% YoY price hike in CY08 and another 5.5% hike in January 2009, further hikes would be difficult on account of competition and downgrading. We expect the company's operating margins to decline from 18% in CY08 to 17% by CY11E.

Background

GSK Consumer dominates the Rs 15 bn Indian malted beverage market with a significant 70% share (in volume terms). Its white beverage brand 'Horlicks' pioneered the broadening of the malted beverage market in India. Horlicks alone, as a white beverage, is believed to have over 55% market share. The company's other brands include 'Boost', 'Viva' and 'Maltova'. An Indian associate of GlaxoSmithKline PLC UK, it also promotes and distributes prominent brands such as 'Eno' and 'Crocin' and 'Iodex' its over-the-counter (OTC) portfolio.

Comparative Parameters

CY08/CY08E	GSK Consumer	Nestle **
Net sales (US\$ m)	379	1,001
EBIDTA margins	18.0%	19.9%
Net profit margins	11.8%	12.3%
Debtor days	9	8
Sales/GFA	2.7	2.8
Return on net worth	24.7%	87.8%
P/E (x)*	14.0	27.9

* Based on trailing 12-months' EPS ** Nestle numbers are for CY08E

Industry Prospects

Valued at Rs 15 bn, the malted food beverage industry is a low penetrated category in India. It is composed of two segments - brown and white. While the brown drinks are considered energy boosters, the white drinks are regarded as milk substitutes. The white category accounts for 70% of the total beverage volumes. The established brands in this segment include Horlicks, 'Complan' and

'Viva' (white beverages) and 'Boost', Bournvita, 'Milo' and 'Maltova' (brown drink). The consumption pattern differs as per the usage patterns across geographic zones. In the southern and eastern regions white beverages are preferred as substitute for milk as these regions have been traditionally milk deficient. Also, the penetration level is low as the malted drinks were perceived as luxury drinks. However, over the last few years, on account of rising standard of living and growth in the middle class income, increasing awareness and health consciousness amongst people, the segment is witnessing uptrend.

Risk Analysis

Please see 'Risk Matrix' table on page 5 of this report

Sector: The size of the Indian food industry is around US\$ 6.1 bn and forms 44% of the FMCG sales. The segment is growing at 9% YoY. The health drinks segment which forms 6% of the food sector is growing due to changing lifestyle and higher income levels. Although currently the penetration level is very low in India (around 10%), with growing health and wellness consciousness and an increasing importance given to fitness and healthy lifestyle, the sector has a strong growth potential. However, higher raw material prices and increasing competition remain the prime risks. Thus we assign a medium rating on this parameter.

Company standing: GSK Consumer dominates the Rs 15 bn Indian malted beverage market with a significant 70% share (in volume terms). Its white beverage brand 'Horlicks' pioneered the broadening of the malted beverage market in India. With low penetration levels and rising income, the company is attractively placed. We have, thus, assigned a strong rating to the stock on this parameter.

Sales: GSK Consumers earned average revenues of US\$ 276 m between CY04 and CY08 and revenues to the tune of nearly US\$ 379 m in CY08. Given the growth prospects of the FMCG sector, rising consumerism and the company's strong presence and brands, we estimate that the company's topline will grow a compounded annual rate of 12% over the next three years. We thus assign a medium rating of 5 to the stock on this parameter.

Operating margin: Operating margin is a measurement of what proportion of a company's revenue is left over after paying for variable costs of production such as raw materials, wages, and sales

and marketing costs. A healthy operating margin is required for a company to be able to pay for its fixed costs, such as interest on debt. The higher the margin, the better it is for the company as it indicates its operating efficiency. GSK Consumer's average operating margin for the past five years has been 17.3%. We expect the margins to decline to 16.9% by CY11. We thus assign a rating of 5 on this parameter.

Long term EPS growth: GSK Consumers has grown its net profits at a CAGR of 19.8% in the past five years. Going forward earnings are expected to grow at a compounded rate of 9.6% during CY08 to CY011. As such, the rating assigned to the stock on this factor is 3.

Return on capital invested (ROIC): ROIC is an important tool to assess a company's potential to be a quality investment by determining how well the management is able to allocate capital into its operations for future growth. A ROIC of above 15% is considered decent for companies that are in an expansionary phase. Considering GSK Consumer's last five years' average ROIC of 38% and projected average ROIC over the next three years expected to improve to 65%, we have assigned a low-risk rating of 9 to the stock on this parameter.

Dividend payout: A stable dividend history inspires confidence in the management's intentions of rewarding shareholders. GSK Consumer's average payout ratio has been 36% over the past 5 fiscals. Thus, we have assigned a low-risk rating of 8.

Promoter holding: A larger share of promoter holding indicates the confidence of the people who run it. We believe that a greater than 40% promoter holding indicates safety for retail investors. At the end of December 2008, the promoter holding in GSK Consumer stood at 43%. We have assigned a low-risk rating of 7 to the stock.

FII holding: We believe that FII holding of greater than 25% can lead to high volatility in the stock price. The FII holding in GSK Consumer at the end of December 2008 stood at 2.7%. Based on our parameters, the rating assigned is 9.

Liquidity: The average daily trading volumes of GSK Consumer's stock over the past 52 weeks stand at over 7,528 shares. This is low and hence the rating assigned is 1.

Current ratio: GSK Consumers average current ratio during the period CY04 to CY08 has been 1.9 times. This indicates that it is comfortably placed to pay off its short-term obligations, which gives comfort to its lenders. We assign a medium risk rating of 6

Debt to equity ratio: A highly leveraged business is the first to get hit during times of economic downturn, as companies have to consistently pay interest costs, despite lower profitability. We believe that a debt to equity ratio of greater than 1 is a high-risk proposition. GSK Consumers being a debt free company, we have assigned a low risk rating of 10.

Interest coverage ratio: This ratio is used to determine how comfortably a company is placed in terms of payment of interest on outstanding debt. The interest coverage ratio is calculated by dividing a company's earnings before interest and taxes (EBIT) by its interest expense for a given period. The lower the ratio the greater is the risks. GSK Consumer being almost a debt free company, we have assigned a low-risk rating of 10 to the stock.

P/E Ratio: The P/E ratio (price-to-earnings ratio) of a stock is a measure of the price paid for a share relative to the per share income or profit earned by the company. This is one of the important metrics to judge the attractiveness of a stock, and thus gets the highest weightage in our risk matrix. GSK Consumers's P/E on its earnings of CY08 stands at 14.0 times. As such, we have assigned a medium risk rating of 5 to the stock on this parameter.

Considering the above analysis, the total ranking assigned to the company is 78 that, on a weighted basis, stands at 6.2. This makes the stock a low-risk investment from a long-term perspective

Valuations

Huge segmental growth potential, strong brand recall, strong balance sheet and cash flows makes GSK Consumer one of the best plays in the FMCG space. Furthermore, its growth strategy of launching new products, capacity expansions and targeting new segments will continue to drive its growth in future. We believe that the increase in the earnings power of the company in the medium term is not being reflected in the current stock price. At the current price of Rs 625, the stock is trading at 10.6 times our estimated CY11 earnings. We recommend investors to BUY the stock with December 2011 target price of Rs 940, which translates into compounded annual returns of 15.0%.

Valuation table

(Rs m)	CY08UA	CY09E	CY10E	CY11E
Net sales (Rs m)	15,923	17,834	19,974	22,371
Net profit (Rs m)	1,882	2,078	2,209	2,475
EPS (Rs)	44.7	49.4	52.5	58.8
Price to earnings (x)	14.0	12.7	11.9	10.6
Price to sales (x)	1.7	1.5	1.3	1.2
Price to book value (x)	3.5	3.0	2.7	2.3

Risk Matrix

Rating	Weightage* (A)	Rating accorded	
		Rating# (B)	Weighted (A*B)
Sector risk	-	Medium	NA
Company's standing	-	Strong	NA
Performance parameters			
Sales	5.0%	5	0.3
Operating margins	5.0%	5	0.3
Long term EPS growth	10.0%	3	0.3
Return on invested capital	10.0%	9	0.9
Technical parameters			
Dividend payout	5.0%	8	0.4
Promoter holding	10.0%	7	0.7
FII holding	5.0%	9	0.5
Liquidity	10.0%	1	0.1
Safety parameters			
Current ratio	5.0%	6	0.3
Debt to equity ratio	10.0%	10	1.0
Interest coverage ratio	5.0%	10	0.5
P/E ratio	20.0%	5	1.0
Final Rating**		78	6.2

Rating has been assigned on the basis of the company's performance over the past five years and expected performance over the next 3 to 5 years. Rating is on a scale of 1 to 10, with 1 indicating highest risk and 10 indicating lowest risk.

* 'Weightage' indicates the relative importance in percentage terms of the parameter. For instance, for an investor, given all the performance metrics, return on equity should be the foremost criteria for buying/not buying stocks.

** The final rating has been arrived at by multiplying the rating/points given on each parameter with the respective weightage

Financials at a glance

(Rs m)	CY08UA	CY09E	CY10E	CY11E
Sales	15,923	17,834	19,974	22,371
Sales growth (%)	24.6%	12.0%	12.0%	12.0%
Operating profit	2,870	3,183	3,396	3,781
Operating profit margin (%)	18.0%	17.9%	17.0%	16.9%
Net profit	1,882	2,078	2,209	2,475
Net profit margin (%)	11.8%	11.7%	11.1%	11.1%
No of shares	42.1	42.1	42.1	42.1
EPS	44.7	49.4	52.5	58.8
Net fixed assets	2,613	3,052	3,401	3,404
Current assets	5,445	6,531	7,827	9,665
Investments	2,978	2,978	2,978	2,978
Total assets	11,037	12,561	14,206	16,048
Current liabilities	3,424	3,834	4,294	4,810
Net worth	7,613	8,727	9,911	11,238
Total debt	-	-	-	-
Total liabilities	11,037	12,561	14,206	16,048

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