

## GlaxoSmithKline Consumer Nigeria Plc: Interim Results – Q3 September, 2011



November 10, 2011

BUY

Fair Value: N30.58

Current Price: N27.00

### Valuation/Analyst Recommendation

In placing a fair value on the Ordinary Shares of GSK, we maintained our earlier top line forecast but reviewed the bottom-line downward to take account of the decline in the profit margin over 2010. We used two valuation methods, which are Discounted Future Earnings Method (DFE) and Discounted Free Cash Flow Method (DCF). We projected Turnover, Earnings Before Interest and Tax (EBIT), Earnings Before Interest Tax Depreciation and Amortization (EBITDA), Profit After Tax (PAT) and Dividend Payment for the periods ending December 2011, 2012, 2013, 2014 and 2015. We estimated the Turnover of N20.07bn, N23.58bn, N27.35bn, N31.18bn and N35.55bn for 2011, 2012, 2013, 2014 and 2015, respectively. We estimated EBIT of N3.41bn, N4.13bn, N4.65bn, N5.15bn and N5.51bn for the same period, based on EBIT Margin of 17% for 2011, 17.5% for 2012, 17% for 2013, 16.5% for 2014 and 14.5% for 2015. We also estimated EBITDA of N3.96bn, N4.69bn, N5.22bn, N5.73bn and N5.76bn for the same period. We projected a FCF of N1.96bn, N2.86bn, N3.22bn, N3.51bn and N3.59bn, PAT of N2.17bn, N2.78bn, N3.15bn, N3.43bn and N3.73bn and Dividend Payment of N940.90mn, N1.21bn, N1.37bn, N1.49bn and N1.62bn for the period, based on a dividend payout of 43.4% from its earnings. We applied a terminal growth rate of 7.72% which is Nigeria's real GDP growth rate as at Q2 2011. We used a beta value of 0.38x based on the 5-year historical returns on the company share price and the Nigerian Stock Exchange All Share Index (NSE ASI). We used the marginal rate of 12.19% as our market risk free rate, which is the average of the one year marginal rate on 5 years Federal Government of Nigeria Bond, and a Market Premium of 8.00%. Applying foregoing parameters on the Capital Asset Pricing Model (CAPM), the cost of equity generates 15.24%. We added a premium of 1.65% to take care of specific risk in the company to arrive at 16.89% which is our cost of capital. This is about 4.70% higher than the average risk free rate. Using 956.70mn shares in issue, the DFE Model generates N31.10 per share and the DCF Model generates N30.16 per share. Applying a weight of 45% to the DFE and 55% to the DCF, we arrived at a value of N30.58 per share, which is our fair value. Buying the stock at the current market price of N27, holding it to our fair value of N30.58 and adding the present value of the 5-year forecast dividend, investors will earn a total return of 29.52%. Relating this return to the cost of equity estimated by CAPM at 16.89%, investment in GSK shares will earn an excess return (alpha return) of 12.63%. The 2011 forward earnings yield based on our fair value generate 7.41%, while the 2011 forward Dividend Yield based on N0.98 Dividend Per Share at our fair value generates 3.22%. We therefore place a BUY on the Shares of Glaxo SmithKline Plc at the current market price for both dividend payment and capital appreciation.

### Business Description

The company is engaged in the manufacture, marketing and distribution of a wide range of Consumer healthcare and Pharmaceutical brands.

Ticker	GlaxoSmith
Sector	Healthcare
Date of Incorporation	June 23, 1971
Date of Listing	July 1979
Year End	December
No of Ordinary Shares	956,701,190
Capitalisation (N)	25,830,932,130
% of Market Capitalisation	3.96
52-Week High(N)	29.65
52-Week Low(N)	23.11
YTD Return (%)	8.46
52-Week Avg. Trade	148,828
Beta Value	0.38
Trailing EPS(N)	2.12
Trailing PE(x)	12.73

### Shaping A Stronger Future:

The unaudited Q3 result of Glaxo SmithKline Plc (GSK) for the period ended 30 September, 2011 showed that its Turnover (TO) grew by 23.72% to N15.84bn, compared with N12.80bn in the corresponding period of 2010. According to the company, TO was mainly driven by growth in volume, as a result of the company's repackaging, rebranding, increased marketing drive and launching of new products into the market. Thus, the recent production expansion has helped turnover. However, Profit Before Tax (PBT) increased marginally by 0.25% between 2010 and 2011 to N2.423bn from N2.417bn in the corresponding period of 2010. The company also made a tax provision of N751.35mn in Q3 2011, compared with N749.44mn in the corresponding period of 2010. We had earlier had a telephone chat with the Executive Director, Finance upon the release of the Q2 2011 result, and he confirmed that the drop in profitability Q2, 2011 was attributable to the increased marketing and product launch expenses in Q1, 2011. He affirmed that the company's future is bright given the board's strategic direction for the company. We believe that the company is gradually recovering from its loss position and is returning to profitability with a marginal increase of 0.25% in the company's Profit after Tax (PAT), which stood at N1.672bn in 2011, compared to N1.668bn in 2010.

On account of increased cost, the PBT margin decreased marginally to 15.30% in Q3 2011 from 18.88% as at Q3 2010 and down from 19.99% as at the end of the financial year in December 2010. This shows that the company's total costs as a percentage of TO stand at 84.70%, higher than 81.12% recorded in the corresponding period of 2010. PAT Margin stood at 10.56%, down from 13.03% in the corresponding period of 2010, and down from 14.60% as at FY 2010. The results also indicate that the TO, PBT and PAT in the Q3 2011 compared with the Full Year Audited TO, PBT and PAT for the period ended December 2010 are 93.93%, 71.88% and 67.93%, respectively. Given the run rate, the company should surpass the previous year's topline but may not be able to meet up with its previous year's bottomline.

A cursory look at the balance sheet position as at Q3 2011 compared with the position as at December 2010 shows that the company's fixed assets increased marginally during the review period. Its fixed assets increased marginally by 0.12% to N6.888bn from N6.880bn in FY 2010. Stock increased by 1.60% to N4.45bn in Q3 2011 from N4.38bn in FY 2010. Cash and bank balances increased from N1.13bn in FY 2010 to N2.33bn in Q3 2011. GSK's working capital decreased marginally by 1.32% to N2.68bn in Q3 2011 from N2.71bn in FY 2010. Also, the net assets increased marginally by 0.48% to N8.37bn in Q3 2011, from N8.33bn as at FY 2010.

Our analysis of the healthcare sector in Nigeria, just like other manufacturing and distributing firms, shows that it continues to struggle with provision of basic infrastructure. The environment in which the consumer healthcare business operates is becoming more challenging particularly on energy cost. One of the opportunities is the passage of the National Health Insurance Scheme (NHIS) Bill. Also, the establishment of the National Agency for Food and Drug Administration and Control (NAFDAC) has brought about sanity in the healthcare industry in Nigeria, which had been bewildered with fake and adulterated products. Government appears to be more responsive to the industry with the suspension of the imposition of excise duties which came on stream in 2008 which would have created a higher price tariff for consumers of pharmaceutical products in Nigeria. Furthermore, the action of government, in response to pleas made to it in removing Ampiclox from the import prohibition list, has a positive impact on the industry. In order to be more competitive since 2010, GSK's plant now operates on two gas based generators to meet its energy needs. GSK has also invested in chillers plant, air compressor machine, a new tetra line, a new tablet line and improved existing facilities to meet consumer demand for nutritional and OTC products. The company is also receiving significant support from its parent company through investments in modernizing its manufacturing process, new business development and manpower training.

As at December 31, 2010, the total assets of GSK were financed by a mix of equity and liabilities in the proportion of 56.52% and 43.48%, respectively. The capital employed (i.e. total assets less current liabilities) increased from N4.88bn in 2006 to N9.59bn in 2010. Also, the total assets of GSK as at December 2010 stood at N14.74bn, while total liabilities stood at N6.41bn. The short-term liabilities stood at N5.14bn, accounting for 80.27% of the total liabilities, while the long-term liabilities stood at N1.26bn accounting for 19.73% of the total liabilities. Its long-term liabilities are deferred taxation, which represented 72.33% of the long-term liabilities and staff gratuity & long service awards, representing 26.67%. An analysis of the TO of GSK in 2010 shows that its revenue of N16.86bn was derived from the sales of Consumer Healthcare products representing 32.99% (N5.56bn) and Pharmaceuticals, representing 67.01% (N11.30bn). A further analysis of the contribution of the business segments to PBT showed that Consumer Healthcare products contributed 48.07% (N1.62bn), while Pharmaceuticals contributed 51.93% (N1.75bn). On the other hand, profit margin by business segments shows that Consumer Healthcare products recorded 14.34%, while Pharmaceuticals recorded 31.46%. Its business is divided into two broad areas: Consumer Healthcare and Pharmaceuticals. The Consumer Healthcare brands of GSK include: PANADOL, ANDREWS LIVER SALT, MACLEANS, SENSODYNE, PHENSIC, LUCOZADE and RIBENA. Pharmaceuticals brands include: AMPICLOX, AMOXIL, and AUGMENTINANTIBIOTICS, ZENTEL, the anthelmintic, the anti-malarial, HALFAN and vaccines. In 2011, the following brands were launched: Sensodyne, a premium toothpaste brand; Macleans Milk Teeth for children; Macleans Intense Whitening; Ribena Strawberry; Ribena PET; Lucozade Boost PET; Lucozade 150ml; Lucozade Sport Lemon; and Horlicks sachet. GSK is innovative in its strategy, passionate in its drive and optimistic in its outlook. As at December 2010, 46.42% of the company's shares were held by GlaxoSmithKline Plc, UK through its wholly owned subsidiaries Setfirst Limited (27.31%) and Smithkline Beecham Ltd (19.11%), while the balance of 53.58% were held by Nigerian shareholders.

## Industry Analysis (Nmn)

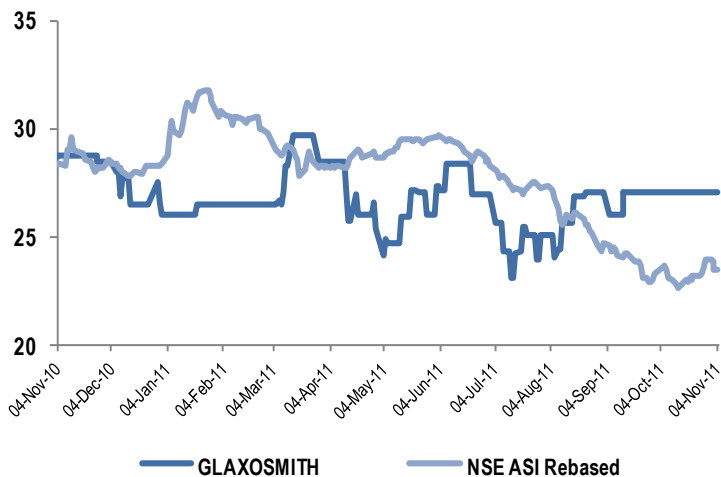
Company	TO	PBT	PAT	PAT Margin (%)	ROE (%)	EPS*	PE*
GlaxoSmithKline(Dec.2010)	16,864	3,371	2,461	14.60	29.55	2.12	12.73
Fidson (June 2010)	5,101	642	466	9.13	8.91	0.21	6.86
Neimeth (March 2010)	1,891	(117.80)	(126)	(6.67)	(13.27)	0.13	12.30
May & Baker (Dec. 2010)	4,639	307.79	193	4.16	6.69	0.21	11.61

Source: Company Annual Reports. \* Current

## Financial Performance (Nmn)

	Q3 2011	Q3 2010	%Δ	FY 2010	FY 2009	% Δ	FY 2011F
Turnover	15,840	12,803	23.72	16,864	14,952	12.78	20,068
PBT	2,423	2,417	0.25	3,371	2,470	36.50	3,187
PAT	1,672	1,668	0.24	2,461	1,702	44.63	2,167
PBT Margin (%)	15.30	18.88	(3.58)	19.99	16.52	3.47	15.88
PAT Margin (%)	10.56	13.03	(2.47)	14.60	11.38	3.21	10.80

GSK Vs NSE ASI Rebased (Nov. 2010 - Nov. 2011)



## Directors' Shareholding as at December 31, 2010

Name	Position	Holding
Chief O. Oshunkeye	Chairman	11,992,030
Mr. Chidi Okoro	Mgr. Director	Nil
Mr. Sameer Goel	Director	Nil
Mr. E. C. Onuzo	Director	28,504
Mrs. O.E. Jaiyeola	Director	22,716
Mr. Bharat L. Shah	Director	Nil
Engr. M. Ahmed	Director	Nil
Mr. Madike Seye	Director	Nil
Mr. Simon Hodge <sup>^</sup>	Director	Nil
Mr. R. Seshadri*	Director	Nil

\*Resigned March 01, 2011; ^ Appointed March 01, 2011

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