GlaxoSmithKline Plc

Isin / FactSet Code	**GB0009252882 / GSK-GB**	Market cap (in EUR mn)	**76 374**	52-week high	**17.25**	Rating	**NEUTRAL**
Sector	**Health Care**	Market cap (in local curr. mn)	**67 877**	52-week low	**13.67**	12-month target price	**14.00**
Industry	**Pharmaceuticals**	Local currency	**GBP**	YTD return%	**-12.10**	Last price (26/10/17)	**13.80**
Benchmark	**MSCI AC World / Health Care -SEC**	Free-float	**98%**	12-month return%	**-15.59**	Potential upside	**1%**

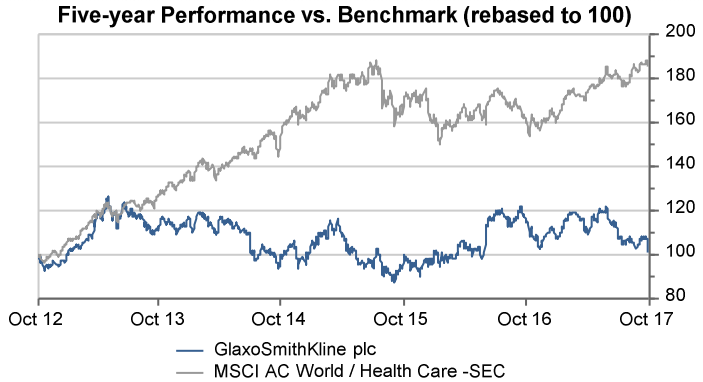
Investment Case:

- GSK's objectives for 2020 are to prioritise Pharma (58% of sales and 71% of profits), maximise the value from product launches, address pricing exposure and improve R&D productivity. Commercial expansion in the US is a priority.
- We wrote that GSK had the right long-term strategy, but execution would take time and be fraught with risk. Unfortunately, it seems like the transition will be harder than expected. Sales of new drugs (Breo, Anoro, Triumeq, Shingrix) are disappointing. Competition in HIV is increasing. Sector growth in Consumer Healthcare (CH) has significantly decreased. GSK wants to expand in CH, looking at the acquisition of Pfizer's CH, which could be a risky acquisition.
- Because of the need for cash, the CEO hinted that the dividend could be cut in 2019. This risk undermines GSK's appeal as a dividend stock. We lower our target price from GBP 18.60 to GBP 14.00. This low valuation (~12.7x FY18E EPS) is due to the absence of earnings growth and the dividend uncertainty post 2018.

Company Description:

GSK is a global healthcare company with a range of innovative products in three segments: Pharmaceuticals, Vaccines and Consumer Healthcare (CH). It has significant global presence with commercial operations in more than 150 countries, 89 manufacturing sites and large R&D centres in the UK, US, Belgium and China.

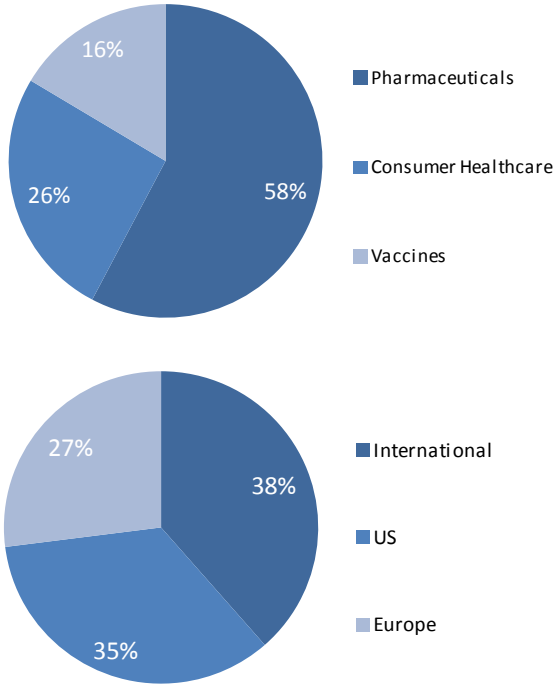
Five-year Performance vs. Benchmark (rebased to 100)



Sources: SGPB, FactSet

Revenue by Key Segments & Geographies: FY16

(FY ending December)



Sources: SGPB, FactSet

Recent Developments Analysis:

- GSK published 3Q17 sales of GBP 7.8 bn (+2% LFL) with core EPS of GBp 32.5 (flat at constant currencies/cc). New product sales were GBP 1.7 bn (+40%). FY17 EPS growth guidance was maintained at 3–5% at cc.
- FY20 outlook is for low-to-mid single-digit sales growth and mid-to-high single-digit EPS growth. GSK expects stronger new product performance and a Pharma margin in the low 30s by FY20. Management recognised the need to improve the output of Pharma R&D (GBP 3.8 bn in FY17E). GSK is looking to acquire companies with promising early-stage science to bolster its pipeline.
- GSK's outlook for CH sales growth is low-to-mid single-digit. Peers reported weak 3Q sales growth. The fact that GSK is considering the acquisition of Pfizer's CH is seen as a risk (overpaying for decelerating growth).
- GSK has a FY20 savings target of GBP 1 bn, but will incur cash restructuring costs of GBP 0.7 bn in FY17 and GBP 0.4 bn in FY18. Other negatives are an expected increase of the tax rate and a higher part of profits for minorities (due to growth in HIV and CH).
- FY18 EPS estimates have been downgraded by 3%.

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GlaxoSmithKline Plc

DESCRIPTION			VALUATION					GROWTH				PROFITABILITY			BALANCE SHEET		
FactSet Code	Company	Cap (mn€)	EV/EBITDA (e)		P/E (e)		Div. Yield	Sales Growth		EPS Growth		EBITDA Margin	Net Margin	ROE	Net Debt/ EBITDA		Net Debt/ Equity
			FY1x	FY2x	FY1x	FY2x	FY1%	FY1%	FY2%	FY1%	FY2%	FY1%	FY1%	FY1%	FY0x	FY1x	FY0x
PFE-US	**Pfizer Inc.**	181 619	10.5	10.0	14.0	13.0	3.6	-0.1	2.6	6.7	7.7	42.1	29.3	26.4	1.2	1.0	0.41
NOVN-CH	**Novartis AG**	164 780	16.4	15.1	17.0	15.5	3.5	0.9	3.4	1.8	9.5	28.9	22.9	15.6	1.1	1.3	0.21
SAN-FR	**Sanofi**	103 139	9.4	9.1	14.4	14.0	3.7	6.9	1.7	2.3	3.3	32.4	19.8	11.9	0.8	0.4	0.14
BAYN-DE	**Bayer AG**	92 990	8.8	7.9	15.7	14.4	2.5	6.0	3.7	-2.0	8.8	23.6	10.5	18.4	1.5	0.9	0.63
AZN-GB	**AstraZeneca PLC**	71 931	12.6	12.5	17.5	17.4	4.2	-9.3	1.0	-16.3	0.6	34.9	21.8	32.8	2.0	1.6	0.73
		Average:	**11.5**	**10.9**	**15.7**	**14.9**	**3.5**	**0.9**	**2.5**	**-1.5**	**6.0**	**32.4**	**20.9**	**21.0**	**1.4**	**1.0**	**0.43**
GSK-GB	**GlaxoSmithKline plc**	76 374	8.0	7.9	12.5	12.5	5.8	7.9	1.8	8.1	0.0	34.2	18.1	378.3	1.6	1.4	12.14

na=Not available, nm=Not meaningful

Financial terms detailed in glossary

Sources: SGPB, FactSet

Risks To Our Investment Case:

- GSK owns 78.3% of ViiV Healthcare (HIV business: Pfizer 11.7%, Shionogi 10%) and 63.5% of CH (Novartis 36.5%). It has granted its partners a put option on their interests. These puts lead to a regular increase in liabilities.
- Pricing pressure, launch costs and pipeline investments weigh on margins.
- Advair, GSK's biggest selling drug (12% of group sales in FY16), is facing competition from generics and is expected to lose more than GBP 2 bn in sales by 2020. Three US Advair generics are expected in 2018 (US Advair sales will drop to GBP 200–300 mn by FY20). The biggest risk would be a slowdown in sales of the newly launched respiratory products (asthma, mixed data for Nucala in COPD or smoker's cough).
- GSK's pipeline must deliver, particularly in HIV where it is engaged in a fierce battle for market share with Gilead. GSK sees opportunities in third generation immuno-oncology, but it is far behind competitors.
- About 36% of sales are exposed to the USD, 20% to the EUR and 7% to the JPY.

Business Quality Review:

- GSK has a strategy of balancing the risks and rewards of drug development with higher-volume, lower-margin businesses without patent-expiry risks.
- The group had a high net profit margin of 17.8% in FY16 and high FCF of GBP 4.0 bn (FY17E: GBP 4.1 bn).
- Net debt grew from GBP 10.7 bn in FY15 to GBP 13.8 bn in FY16 (mainly due to a forex effect) and GBP 14.2 bn at 3Q17.
- S&P credit rating: A+ (Stable outlook)

Dividend Policy:

- GSK has pledged to pay an annual ordinary DPS of GBP 0.80 in FY17 and FY18, a payout ratio of ~72%.
- FactSet consensus expects a flat DPS of 0.80 until FY20. However, a cut of DPS in FY19 is a major risk.
- GSK intends to build FCF cover of the annual dividend to a target range of 1.25–1.50x before returning the dividend to growth. FY17E coverage is 1.4x (based on FactSet FCF, which can differ from GSK definition of FCF).

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Financial Terms And Acronyms

BV (Book Value): is the total value of net assets of a company.

BV/S (Book Value Per Share): is the total value of the net assets of a company divided by the total number of outstanding shares.

C/I (Cost Income Ratio): is used for valuing banks. It shows a company's costs in relation to its income.

CAGR (Compound Annual Growth Rate): is a term used for the geometric progression ratio that provides a constant rate of return over a specific time period.

CAPEX (Capital Expenditure): is the fund used by the company to acquire or upgrade the physical assets such as property, industrial buildings or equipment. The most capital intensive industries include oil, telecom and utilities.

CAR (Capital Adequacy Ratio): is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures.

CET I (Common Equity Tier I Ratio) : is a measure of the bank's common equity capital as a percentage of risk-weighted assets. It is generally compared to a defined benchmark stipulated by the regulatory authority to determine whether a bank is sufficiently capitalised.

COMBINED RATIO: It represents the total of acquisition and administrative expenses, and claims and insurance benefits incurred, divided by net premiums earned.

DIVIDEND PER SHARE (DPS): Dividend per share or DPS (total dividend paid out divided by the total number of shares) expressed as a percentage of current stock price.

EBIT (Earnings Before Interest and Taxes): profit before taking into account interest payments and income taxes.

EBIT Margin: Ratio that expresses EBIT as a percentage of total sales (EBIT/Sales*100)

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): profit before taking into account interest payments, income taxes and non-cash operating expenses (depreciation and amortisation).

EPS (Earnings Per Share): is the division of total net profit by the number of shares.

EQUITY is the difference between the value of the assets and the cost of the liabilities.

EV (Enterprise Value) is a measure of a company's value, often used as an alternative to straightforward market capitalisation. It is calculated as (market cap + debt + minority interest + preferred shares) − total cash − cash equivalents.

FCF (Free Cash Flow): represents the difference between operating cash flow and capital expenditures.

FFO (Funds from Operations): measures a REIT's operating performance. It is net income plus gains (minus losses) from property sale and purchase. FFO per share is often used in place of earnings per share when analysing REITs.

FY0: Realised year, **FY1**: Current unrealised year, **FY2**: next year, **FY17E:** Fiscal year 2017 estimation

GOODWILL: is an intangible asset that arises as a result of the acquisition of one company by another company for a premium value.

GROSS INCOME: gross profit calculated as a company's total sales minus its cost of goods sold (COGS) that corresponds to labour and production costs.

GROSS MARGIN: expresses gross income as a percentage of total sales.

LIKE FOR LIKE (LFL) GROWTH: is a measure of growth in sales, adjusted for new or divested businesses.

Loan-to-deposit (L/D) ratio: Loans/Deposits. This helps in assessing a bank's liquidity, lending capacity and balance sheet quality.

LTV (Loan-To-Value Ratio): is a financial term used to express the ratio of a loan to the value of an asset purchased.

NAV (Net Asset Value): is similar to book value and is also called per investment unit. NAV is the marked-to-market value of the company's property investments less liabilities.

ND (Net Debt): is calculated as a company's total debt minus cash and other similar liquid assets.

NET MARGIN: is a financial ratio which measures the profitability of the net income of a company.

NI (Net Income or Bottom Line): represents a company's total earnings (or profit) which is calculated by adjusting revenues for the costs, depreciation, interest, taxes and other expenses.

NIM: Net Interest Margin

NON-PERFORMING LOANS (NPL) RATIO: NPLs/Loans. This indicates the percentage of the loans that are non-performing or are in stressed segments.

OPERATING MARGIN: See definition of EBIT Margin.

ORGANIC GROWTH: is the growth rate that a company can achieve by increasing its output and enhancing sales, excluding any profits or growth from takeovers or M&A activities.

P/E or PER (Price Earnings Ratio): reflects the trading price of a share in relation to the expected earnings.

P/BV (Price To Book Value): expresses the share price with regard to the accounting value of the company.

PAYOUT RATIO: is the proportion of earnings paid out as dividends to shareholders and typically expressed as a percentage.

PROFIT WARNING: is the announcement made by the company before its earnings release indicating the investors that its earnings would not meet the analysts' expectations.

RWA (Risk Weighted Assets): is a measure of the bank's assets, weighted according to their risk. It involves the risk weighting of both on and off-balance-sheet exposures.

REVENUE GROWTH: Illustrates the growth of sales over a given period.

ROA (Return on assets): a financial ratio that is calculated as net income divided by total assets and shows how profitable a company is relative to its total assets.

ROC (Return on invested capital): a profitability ratio which is calculated as net income minus dividends divided by total invested capital.

ROE (Return On Equity): The amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by disclosing how much profit a company generates with the money shareholders have invested.

TBV (Tangible Book Value): is the book value excluding intangible assets.

TBV/S (Tangible Book Value Per Share): allows to estimate the accounting value of a company by measuring its stockholders' equity per share. Formula: Re-valued Net Assets/Total Shares of Company.

WACC (Weighted Average Cost of Capital): also referred to as the firm's cost of capital, it is the rate that a company is expected to pay on an average to all its security holders to finance its assets.

WORKING CAPITAL: is the difference between a company's current assets and current liabilities and shows whether the company has sufficient short-term assets to cover its short-term debts.

Appendix

Investment Rating Definitions:

Buy Stock that is expected to outperform its MSCI sector index over a 12-month investment horizon.

Neutral Stock that is expected to perform in line with its MSCI sector index over a 12-month investment horizon.

Sell Stock that is expected to underperform its MSCI sector index over a 12-month investment horizon.

Restricted Covered stock that is not rated or assigned a target price as the Societe Generale group has a capital market transaction with that company.

Termination Stock is subject to be deleted from the SGPB recommended universe and will no longer be followed. In this case, a coverage termination alert is issued.

Recommended Universe Principle:

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Product Risk Rating:

The product category of single equity, stock, share is rated at '4'.

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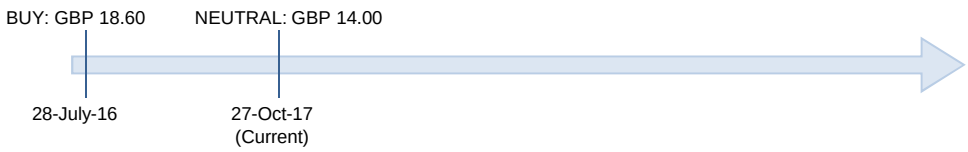
Risk Levels	Losses
0 - Lowest Risk	There is a 95% probability that the product will not depreciate in value in one year.
1 - Low Risk	There is a 95% probability that the product will not lose more than 5% of its value in one year.
2 - Medium Risk	There is a 95% probability that the product will not lose more than 15% of its value in one year.
3 - High Risk	There is a 95% probability that the product will not lose more than 30% of its value in one year.
4 - Highest Risk	There is a minimum of 5% probability that the product will lose more than 30% of its value in one year.

1Y Target Price:



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SG acted as Co-manager in Novartis Finance's Bond issue(EUR;RegS;4yr/10.5yr).

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Risk Classification
R0: Lowest Risk
R1: Low Risk
R2: Medium Risk
R3: High Risk
R4: Highest Risk

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