

23 October 2013 | 10 pages

Pharmaceuticals  
Western Europe | United Kingdom

# GlaxoSmithKline PLC (GSK.L)

Results: Strong cost management and tax drive 3Q EPS beat.  
China sales down >60%. NEUTRAL

- Citi's Take** — GSK reported a good set of numbers driven primarily by OPEX cost management (aided also by a £267m savings from restructuring of post retirement medical obligations) and a c.100 bps reduction in the tax rate. US Advair sales were down 1% (4% miss) driven by 5% volume decline and a 3% negative impact from stocking offset by pricing. Importantly, GSK have started shipping Breo to wholesalers in the US now. China sales were down 61%. We continue to prefer Buy-rated Novartis (NOVN.VX; SFr69.35; 1) and Roche (ROG.VX; SFr246.10; 1) in Europe.
- Key Headlines** — Group Sales of £6,510m vs. cons £6,646m; core operating profit of £2,059m vs. cons £1,999m, core EPS 28.9p vs. cons 27.2p. Advair sales £1,209m vs cons £1,265m, Vaccines £987m vs. cons £966m, Avodart: £207m vs. cons £213m, Dermatology: £194m vs. cons £202m, Lovaza: £135m vs. cons £153m, Flovent: £172m vs. cons £192m.
- Implications** — We expect the shares to trade slightly ahead given evidence of strong cost management. Key focus for the call: colour on Advair sales trends including stocking patterns, launch plans for Breo and ongoing impact of China.

Neutral	2
Price (23 Oct 13)	£15.79
Target price	£18.10
Expected share price return	14.7%
Expected dividend yield	4.9%
Expected total return	19.6%
Market Cap	£76,791M
	US\$124,673M

Price Performance  
(RIC: GSK.L, BB: GSK LN)



## GlaxoSmithKline PLC (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (£M)	27,387.3	26,431.0	26,629.0	26,936.4	28,061.6
Profit Before Tax (£M)	8,111.3	7,543.0	7,443.6	7,740.4	8,288.4
Diluted EPS (p)	113.9	109.6	110.2	119.6	131.8
Diluted EPS (Old) (p)	113.9	109.6	110.2	119.6	131.8
PE (x)	13.9	14.4	14.3	13.2	12.0
EV/EBITDA (x)	9.0	9.4	11.4	11.1	10.5
DPS (p)	75.0	74.0	78.4	83.1	88.1
Net Div Yield (%)	4.7	4.7	5.0	5.3	5.6

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Figure 1. GSK 3Q13 Actuals vs Previews

P&L (£m, except per share quantities)	3Q12A	3Q13E	Cons	3Q13 Actuals	Actuals vs. cons	Actuals vs. Citi
Pharmaceuticals	5,259	5,350	5,328	5,197	-2.5%	-2.9%
Consumer healthcare	1,268	1,324	1,318	1,313	-0.4%	-0.9%
<b>Total sales</b>	<b>6,527</b>	<b>6,675</b>	<b>6,646</b>	<b>6,510</b>	<b>-2.0%</b>	<b>-2.5%</b>
Core COGS	(1,855)	(1,896)	(1,881)	(1,878)	-0.1%	-0.9%
Margin	28.4%	28.4%	28.3%	28.8%	55bps	45bps
<b>Core Gross Profit</b>	<b>4,672</b>	<b>4,779</b>	<b>4,765</b>	<b>4,632</b>	<b>-2.8%</b>	<b>-3.1%</b>
Margin	71.6%	71.6%	71.7%	71.2%	-55bps	-45bps
Core S,G&A	(1,946)	(1,969)	(1,968)	(1,876)	-4.7%	-4.7%
Margin	29.8%	29.5%	29.6%	28.8%	-79bps	-68bps
Core R&D	(871)	(893)	(889)	(791)	-11.0%	-11.4%
Margin	13.3%	13.4%	13.4%	12.2%	-123bps	-123bps
Royalty Income	92	94	81	94	16.0%	-0.1%
<b>Core Operating Profit</b>	<b>1,947</b>	<b>2,011</b>	<b>1,999</b>	<b>2,059</b>	<b>3.0%</b>	<b>2.4%</b>
Margin	29.8%	30.1%	30.1%	31.6%	155bps	149bps
Core net financials	(178)	(184)	(178)	(178)	0.0%	-3.2%
Core profits of associates	9	11	15	14	-6.7%	27.3%
<b>Core PBT</b>	<b>1,778</b>	<b>1,838</b>	<b>1,836</b>	<b>1,895</b>	<b>3.2%</b>	<b>3.1%</b>
Core Taxation	(431)	(449)	(450)	(446)	-0.8%	-0.6%
Core tax rate	24.2%	24.4%	24.5%	23.5%	-96bps	-86bps
Minority interest	(74)	(60)	(63)	(49)	-22.2%	-18.8%
<b>Core Profit attributable to shareholder</b>	<b>1,283</b>	<b>1,329</b>	<b>1,314</b>	<b>1,400</b>	<b>6.5%</b>	<b>5.3%</b>
<b>Core EPS</b>	<b>26.2</b>	<b>27.5</b>	<b>27.2</b>	<b>28.9</b>	<b>6.3%</b>	<b>5.1%</b>

Products (£m)	3Q12A	3Q13E	Cons	3Q13 Actuals	Actuals vs. cons	Actuals vs. CIRA
Advair	1,216	1,276	1,265	1,209	-4.4%	-5.2%
Flovent	185	190	192	172	-10.4%	-9.4%
Lovaza	151	160	153	135	-11.8%	-15.4%
Avodart	199	229	213	207	-2.8%	-9.4%
Cervarix	45	46	48	41	-14.6%	-10.1%
Vaccines	940	980	966	987	2.2%	0.7%
Dermatology	201	206	202	194	-4.0%	-6.0%
Consumer Health	1,268	1,324	1,318	1,313	-0.4%	-0.9%

Source: Citi Research

## GlaxoSmithKline PLC

### Valuation

Our Target Price of £18.10 represents an c.14x '14E P/E multiple (in line with the sector), commensurate with an 8% 5 year EPS CAGR inline with the sector.

Our DCF-derived Intrinsic Value is £17.7. We project free cash flows for an explicit forecast period of 10 years and thereafter apply terminal growth assumptions. Consistent with our sector methodology, we employ a WACC of 7.7% and assume a 0% terminal growth rate.

### Risks

The sustainability of the respiratory franchise is the key longer-term risk for the company. Ongoing investigation into corruption-related practices in China could be a material risk to GSK's ongoing remedial efforts in the US and could lead to fines in the UK, US and elsewhere. Failure to gain approval and subsequently commercialise key late-stage pipeline assets is another material risk in the longer term.

On the upside, positive data for key pipeline assets darapladib (cardiovascular) and MAGE-A3 (cancer) is a key upside risk, which could lead to significant upside to low expectations for these assets. These risks could cause the share price to deviate significantly from our target price.

## Novartis AG

### Valuation

Our target price of SFr83 is arrived at by using a 10% premium to the sector '14E core EPS multiple. Our forecasts anticipate that Novartis will grow core EPS at 10% CAGR over the 2014E-19E timeframe, compared with 7% for the EU peer group. We calculate a DCF-derived Intrinsic Value for Novartis of SFr84. We go about this by projecting free cash flows for an explicit 10-year period, thereafter applying terminal growth assumptions. Consistent with our sector methodology, which makes use of the CAPM to calculate the cost of equity, we use an 8% WACC and assume a 0% terminal growth rate.

### Risks

Near-term risks include risks to our Gilenya forecasts from competitors as well as reimbursement pressures in the EU for two critical meningitis vaccines, Menveo and Bexsero, which present downside risk to our forecasts. Longer-term downside risks include returns on Novartis's above-average R&D investment, and a continuation of the recent history of disappointing US regulatory reviews, as with the respiratory development pipeline. Near-term upside risks include Afinitor in HER2 breast cancer, early approval of Serelaxin in heart failure and positive data for LCZ696 in heart failure. These risks could cause the share price to deviate significantly from our target price.

## Roche Holding AG

### Valuation

Our SFr280 Target Price reflects a multiple of c.16x 2014E core earnings, which is reflective of a 9 % CAGR growth in 2014-19E core EPS. Our DCF-derived Intrinsic Value is \$296. We project free cash flows for an explicit forecast period of 10 years and thereafter apply terminal growth assumptions. We employ a CAPM-derived WACC of 8.1% and assume a 0% terminal growth rate. A three-stage DCF that extends beyond our forecast horizon of 10 years gives us an intrinsic value of \$289/share, which we believe more accurately captures the durability and profitability of Roche's incipient immunotherapy franchise and other key pipeline assets.

### Risks

Key risks to our positive thesis include (i) larger downside than anticipated to the lucrative Lucentis franchise in the wake of competition; (ii) stronger/earlier-than-anticipated erosion of the Herceptin franchise in Europe from biosimilar competition from 2014 onwards, especially in the wake of recent biosimilar Remicade approval in Europe; (iii) higher erosion of the Rituxan franchise in blood cancers from competition as well as biosimilars. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock could be impeded from reaching our target price.

## Appendix A-1

### Analyst Certification

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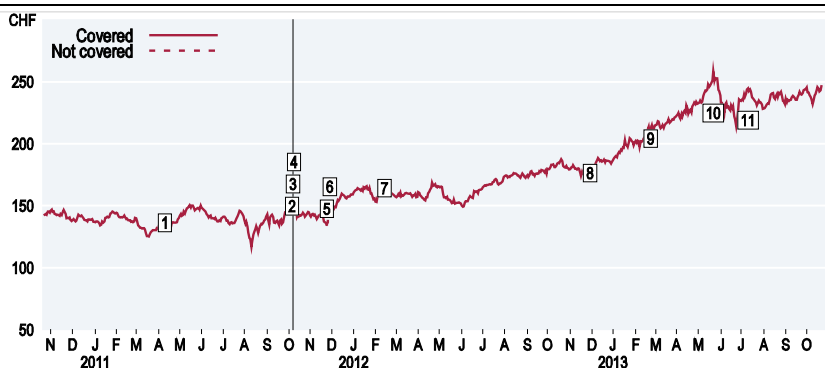
#### Roche Holding AG (ROG.VX)

#### Ratings and Target Price History

#### Fundamental Research

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	11-Apr-11	2M	*135.00	134.50
2	6-Oct-11	2M	*143.00	146.60
3	7-Oct-11	Stock rating system changed		
4	8-Oct-11	*2	143.00	149.20

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	24-Nov-11	Coverage terminated		
6	29-Nov-11	*1	*159.00	141.60
7	14-Feb-12	*2	*157.00	162.20
8	29-Nov-12	2	*180.00	182.20

	Date	Rating	Target Price	Closing Price
9	22-Feb-13	2	*210.00	212.20
10	22-May-13	*1	*300.00	258.50
11	10-Jul-13	1	*280.00	244.70

Rating/target price changes above reflect Eastern Standard Time

## Roche Holding AG (ROG.VX)

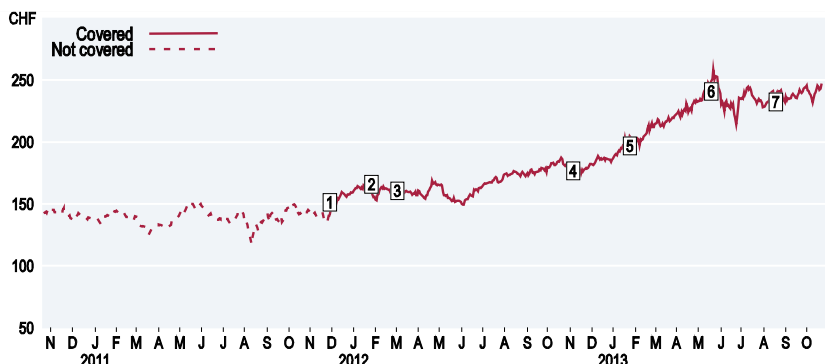
### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	29-Nov-11	*ADD MP	-	141.60
2	26-Jan-12	*REM MP	-	160.20
3	2-Mar-12	*ADD LP	-	157.40

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	6-Nov-12	*REM LP	-	182.70
5	24-Jan-13	*ADD LP	-	204.50
6	20-May-13	*REM LP	-	247.00

	Date	Rating	Target Price	Closing Price
7	19-Aug-13	*ADD MP	-	238.30

Rating/target price changes above reflect Eastern Standard Time

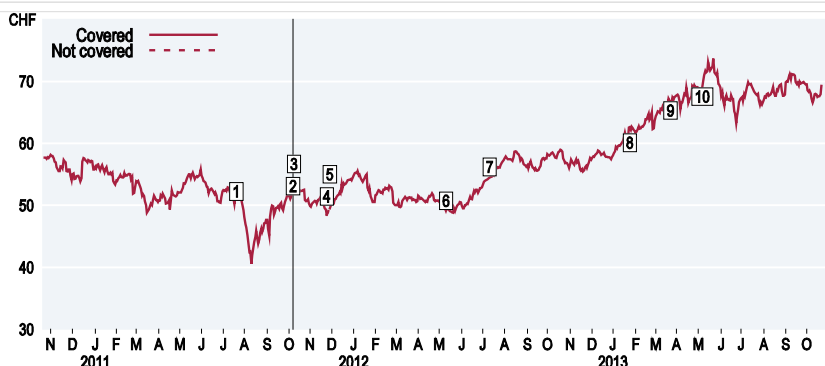
## Novartis AG (NOVN.VX)

### Ratings and Target Price History

#### Fundamental Research

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	20-Jul-11	1L	*71.02	52.05
2	7-Oct-11	Stock rating system changed		
3	8-Oct-11	*1	71.02	52.71
4	24-Nov-11	Coverage terminated		

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	29-Nov-11	*2	*50.73	49.54
6	10-May-12	2	*50.00	49.15
7	11-Jul-12	2	*57.00	54.50
8	24-Jan-13	*1	*72.00	62.60

	Date	Rating	Target Price	Closing Price
9	22-Mar-13	1	*80.00	68.45
10	7-May-13	1	*83.00	68.95

Rating/target price changes above reflect Eastern Standard Time

## Novartis AG (NOVN.VX)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	21-Mar-11	*ADD MP	-	49.91
2	24-Nov-11	*REM MP	-	48.50

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	29-Nov-11	*ADD LP	-	49.54
4	24-Jan-13	*REM LP	-	62.60

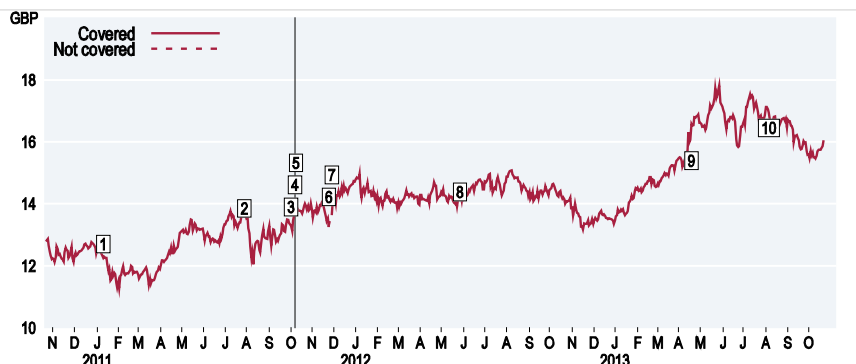
Rating/target price changes above reflect Eastern Standard Time

## GlaxoSmithKline PLC (GSK.L)

### Ratings and Target Price History Fundamental Research

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	11-Jan-11	*2L	*12.75	12.25
2	28-Jul-11	2L	*14.25	13.85
3	3-Oct-11	2L	*13.65	13.29
4	7-Oct-11	Stock rating system changed		

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	8-Oct-11	*2	13.65	13.74
6	24-Nov-11	Coverage terminated		
7	29-Nov-11	*1	*15.70	13.67
8	28-May-12	1	*16.10	14.32

	Date	Rating	Target Price	Closing Price
9	18-Apr-13	1	*18.10	16.58
10	6-Aug-13	*2	18.10	16.94

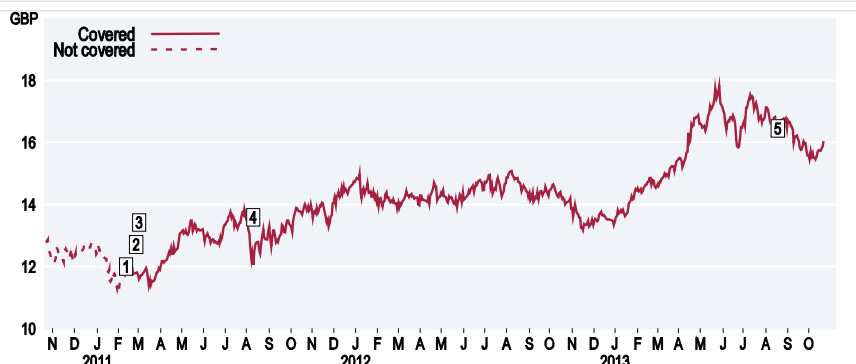
Rating/target price changes above reflect Eastern Standard Time

## GlaxoSmithKline PLC (GSK.L)

### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Andrew S Baum

Covered since November 29 2011



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	11.76
2	25-Feb-11	*REM LP	-	11.80

\* Indicates change

	Date	Rating	Target Price	Closing Price
3	2-Mar-11	*ADD LP	-	11.59
4	10-Aug-11	*REM LP	-	12.05

	Date	Rating	Target Price	Closing Price
5	19-Aug-13	*ADD LP	-	16.45

Rating/target price changes above reflect Eastern Standard Time

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