

17 June 2013 | 28 pages

Household Products (GICS) | Home and Personal Care (Citi)
Western Europe | United Kingdom

Reckitt Benckiser (RB.L)

Early resilience in a post-generic world

■ Estimate Change

- **Buyers for the Core business, but RBP is also undervalued** — We are Buyers of Reckitt for the recovery of its core business and for its potential in Consumer Health. However, we also think RBP is under-valued by the market, particularly in light of its early resilience to the recent entry of generic competition in the US Suboxone market.
- **Film share has been very resilient** — Since generic Suboxone was launched at the end of February, Film's share of the market has increased by ~100bps to 84.7% (essentially flat share of the broader buprenorphine market at 71.6%). Generics' impressive 12.8% share gain of the Suboxone market over the period has been exclusively at the expense of branded tablets' 13.8% share loss, as expected.
- **Pricing benign for now** — We attribute the simultaneous resilience of the branded Film and the success of generic tablets to a combination of i) "format inertia" amongst residual tablet users in the context of branded tablet discontinuation, ii) incentives for pharmacists to drive switching between branded and generic tablets and iii) so far limited Film to generic price incentives for payors. We expect this last point to be tested when the branded tablet share falls to zero in the coming weeks.
- **A couple of yellow flags...** — We are aware of i) a couple of low outlier prices on generic tablet prescriptions and ii) evidence of physicians issuing "either / or" branded Film / generic tablet prescriptions. These warrant further monitoring, since they provide the incentive and the mechanics for switching from Film to generic tablets.
- **...but our base case already assumes Film loses 20% of its share** — Despite its initial resilience, our model assumes Film loses 20% of its current share to generic and branded competitors over the next two years.
- **Undervalued, despite realistic assumptions** — We value RBP at £5.2bn, or 710p per share. We think the current share price implies a £2bn valuation, or 275p per share, which our scenario analysis finds too conservative. Reiterate Buy – PT £54.50.

Buy	1
Price (14 Jun 13)	£45.89
Target price	£54.50
Expected share price return	18.8%
Expected dividend yield	3.0%
Expected total return	21.8%
Market Cap	£32,942M
	US\$51,783M

Price Performance (RIC: RB.L, BB: RB/ LN)



Reckitt Benckiser (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (£M)	9,485.0	9,567.0	10,281.9	10,802.7	11,400.1
Profit Before Tax (£M)	2,468.0	2,555.0	2,659.2	2,827.0	3,033.6
Diluted EPS (p)	247.1	264.4	273.1	290.3	311.4
Diluted EPS (Old) (p)	247.1	264.4	274.2	293.1	318.0
PE (x)	18.6	17.4	16.8	15.8	14.7
EV/EBITDA (x)	13.5	13.2	12.2	11.2	10.1
DPS (p)	125.0	134.0	138.2	146.9	157.6
Net Div Yield (%)	2.7	2.9	3.0	3.2	3.4

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

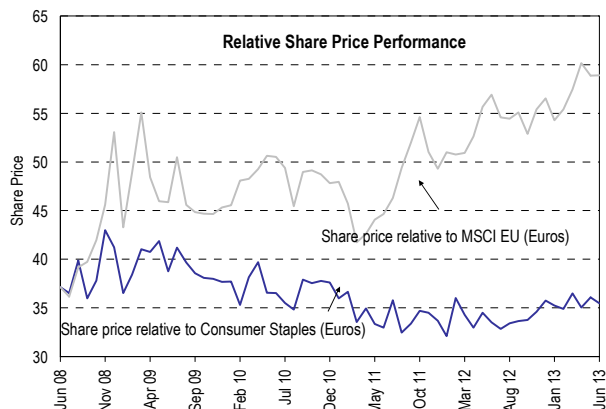
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RB.L: Fiscal year end 31-Dec						Price: £45.89; TP: £54.50; Market Cap: £32,942m; Recomm: Buy					
Profit & Loss (£m)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	9,485	9,567	10,282	10,803	11,400	PE (x)	18.6	17.4	16.8	15.8	14.7
Cost of sales	-4,036	-4,030	-4,300	-4,486	-4,700	PB (x)	5.8	5.6	5.4	4.6	3.9
Gross profit	5,449	5,537	5,982	6,317	6,701	EV/EBITDA (x)	13.5	13.2	12.2	11.2	10.1
Gross Margin (%)	57.4	57.9	58.2	58.5	58.8	FCF yield (%)	4.6	5.1	6.3	6.6	7.0
EBITDA (Adj)	2,619	2,708	2,835	2,994	3,179	Dividend yield (%)	2.7	2.9	3.0	3.2	3.4
EBITDA Margin (Adj) (%)	27.6	28.3	27.6	27.7	27.9	Payout ratio (%)	51	51	51	51	51
Depreciation	-137	-143	-154	-162	-171	ROE (%)	32.1	31.0	32.3	31.7	29.0
Amortisation	5	5	5	5	5	Cashflow (£m)					
EBIT (Adj)	2,487	2,570	2,686	2,836	3,013	EBITDA	2,619	2,708	2,835	2,994	3,179
EBIT Margin (Adj) (%)	26.2	26.9	26.1	26.3	26.4	Working capital	-175	-157	145	77	77
Net interest	-19	-15	-27	-9	21	Other	-704	-663	-669	-666	-687
Associates	0	0	0	0	0	Operating cashflow					
Non-op/Except	-92	-135	-50	0	0	Capex	-205	-177	-200	-211	-222
Pre-tax profit	2,376	2,420	2,609	2,827	3,034	Net acq/disposals	-443	-780	0	0	0
Tax	-641	-613	-665	-707	-758	Other	0	21	21	21	21
Extraord./Min.Int./Pref.div.	-9	-4	-6	-7	-8	Investing cashflow					
Reported net profit	1,726	1,803	1,938	2,113	2,267	Dividends paid	-880	-920	-994	-1,057	-1,134
Net Margin (%)	18.2	18.8	18.9	19.6	19.9	Financing cashflow					
Core NPAT	1,818	1,938	1,988	2,113	2,267	Net change in cash	66	248	1,121	1,142	1,217
Per share data						Free cashflow to s/holders					
Reported EPS (p)	234.6	246.0	266.3	290.3	311.4	Sales by Division (£ m)					
Core EPS (p)	247.1	264.4	273.1	290.3	311.4	ENA	4,837	4,678	5,024	5,133	5,236
DPS (p)	125.0	134.0	138.2	146.9	157.6	RUMEA	2,210	2,327	2,596	2,855	3,155
CFPS (p)	236.5	257.6	317.4	330.3	352.8	LAPAC	1,364	1,404	1,519	1,643	1,791
FCFPS (p)	209.3	235.2	289.9	301.4	322.2	Food	312	321	337	345	357
BVPS (p)	784.9	817.5	848.1	1,004.4	1,171.6	RBP	762	837	807	827	862
Wtd avg ord shares (m)	728	724	719	719	719	Total Sales	9,485	9,567	10,282	10,803	11,400
Wtd avg diluted shares (m)	736	733	728	728	728	EBIT by Division (£ m)					
Growth rates						ENA	na	na	na	na	na
Sales revenue (%)	12.2	0.9	7.5	5.1	5.5	RUMEA	na	na	na	na	na
EBIT (Adj) (%)	11.5	3.3	4.5	5.6	6.2	LAPAC	na	na	na	na	na
Core NPAT (%)	9.7	6.6	2.6	6.3	7.3	Food	na	na	na	na	na
Core EPS (%)	9.3	7.0	3.3	6.3	7.3	RBP	na	na	na	na	na
Balance Sheet (£m)						Corporate	na	na	na	na	na
Cash & cash equiv.	639	887	2,038	3,197	4,430	EBIT - total segments	na	na	na	na	na
Accounts receivables	1,442	1,407	1,542	1,620	1,710	Organic Sales Growth (%)					
Inventory	758	735	679	702	741	ENA	-1.0	1.0	2.5	2.0	2.0
Net fixed & other tangibles	920	846	949	997	1,049	RUMEA	11.0	11.0	11.0	11.0	10.5
Goodwill & intangibles	10,258	11,175	10,248	10,243	10,238	LAPAC	10.0	8.0	8.0	9.0	9.0
Financial & other assets	109	30	44	44	44	Food	7.0	2.0	3.0	3.0	3.5
Total assets	14,126	15,080	15,500	16,803	18,211	RBP	6.0	10.0	-7.4	2.2	4.2
Accounts payable	2,901	2,842	3,136	3,295	3,477	Total Organic Sales	4.0	5.0	4.5	5.4	5.5
Short-term debt	2,505	3,271	3,271	3,271	3,271						
Long-term debt	3	3	3	3	3						
Provisions & other liab	2,936	3,042	2,989	3,009	3,032						
Total liabilities	8,345	9,158	9,399	9,578	9,783						
Shareholders' equity	5,711	5,921	6,100	7,224	8,427						
Minority interests	70	1	1	1	1						
Total equity	5,781	5,922	6,101	7,225	8,428						
Net debt	1,869	2,387	1,236	77	-1,156						
Net debt to equity (%)	32.3	40.3	20.3	1.1	-13.7						

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For definitions of the items in this table, please click [here](#).

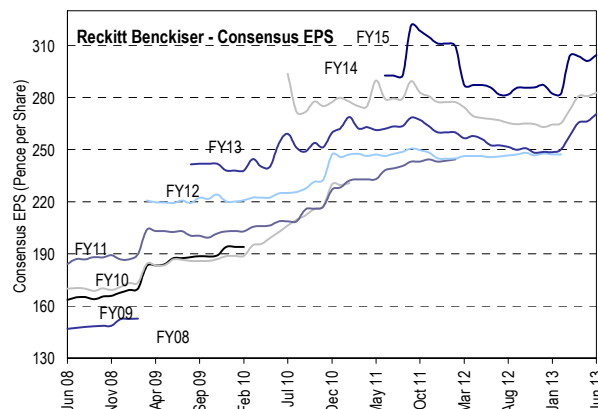
Reckitt Benckiser – The Key Charts

Figure 1. Reckitt Benckiser – Relative Share Price Performance



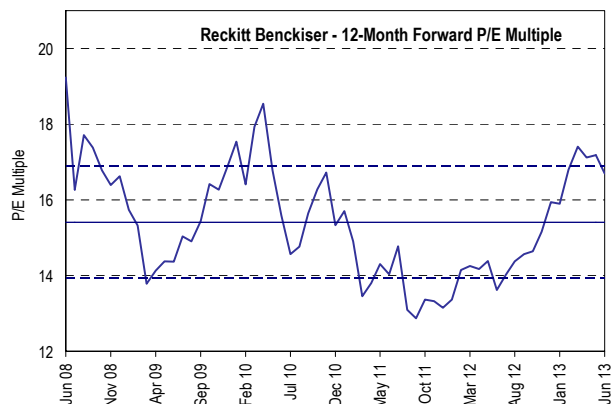
Source: DataStream and Citi Research

Figure 2. Reckitt Benckiser – Consensus EPS



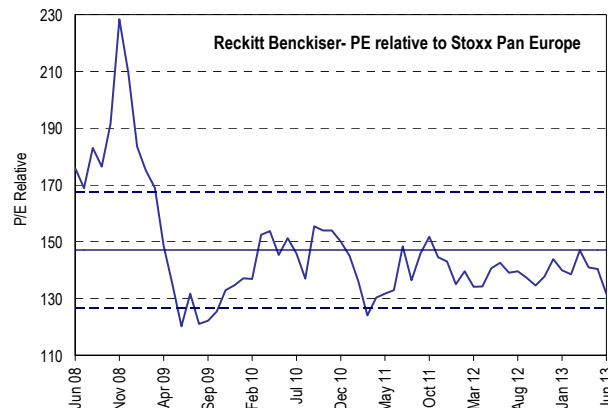
Source: DataStream and Citi Research

Figure 3. Reckitt Benckiser – 12 Month Forward P/E Multiple



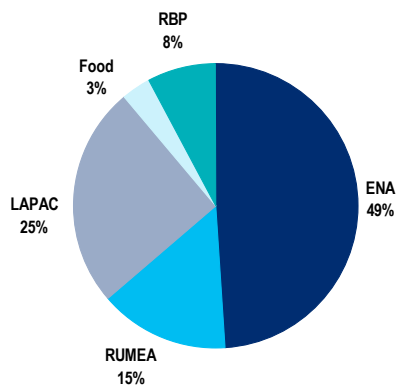
Source: DataStream and Citi Research

Figure 4. Reckitt Benckiser – P/E Relative to Stoxx Pan Europe



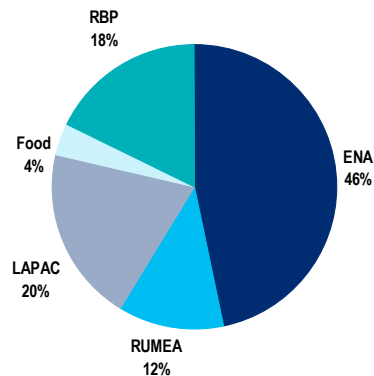
Source: DataStream and Citi Research

Figure 5. Reckitt Benckiser– Split of Sales, FY13E



Source: Citi Research

Figure 6. Reckitt Benckiser – Split of EBITA, FY13E



Source: Citi Research

Investment Summary

We reiterate our Buy rating and £54.50 PT on Reckitt Benckiser. Our Buy case is based on our expectation for positive earnings revisions from the core business and from further expansion into Consumer Health. However, we also view forecast, valuation and strategic uncertainties around RB Pharma as being an impediment for many investors to hold the stock. Although still very early, the initial data following the recent launch of generic Suboxone in the US, gives us greater confidence in our RBP model and greater conviction that this business is under-valued.

Generics are finally in the market

Nearly three and a half years after Suboxone lost orphan drug status in the US, the FDA approved two manufacturers (Actavis and Amneal) to make and distribute generic forms of the drug, which launched into the market at the end of February.

Film share has been stable so far

RBP's Film share of the Suboxone market has increased by ~100bps since generic tablets were launched and it currently stands at 84.7% (although its 71.6% share of the broader buprenorphine market is essentially flat since generic launch). Whilst "format inertia", pharmacist incentivizes to switch tablet users to generics and lack of any price incentive to switch from Film into generic tablets have likely contributed to this – and the latter two may well change once the branded tablet opportunity has been exhausted in the next few weeks – we have been encouraged by the absolute resilience of the Film business so far.

Pricing environment appears to be benign for now

Pricing is likely to be the key determinant of longer-term Film share. So far, the environment has been benign, with effective generic tablet pricing similar to that of branded Film pricing, even for cash payers.

We have seen a couple of yellow flags, including spot incidences of much lower priced prescriptions for generics and evidence of physicians prescribing "either / or" prescriptions. Combined, these could create the incentive and means for further pharmacist-directed Film share erosion and we will monitor these trends.

However, our base case assumption does already assume that Film loses ~20% of its share to generics or potential branded competitors over the next two years.

Base case RBP valuation of £5 billion suggests core RB trades on an unwarranted discount to peers

Our £5.2 billion valuation suggests that RBP is worth 710p per share before taking into consideration success in new delivery mechanisms, new markets or new treatment areas. On this basis, core Reckitt is trading on 17.0x our 2013 EPS estimate, 2 full multiple points below its peer group, on 19.3x – a discount that we do not feel is warranted for the core business, where we see upside earnings risk, largely due to the transformation into a Consumer Health-led HPC business.

Current share price implies RBP is worth £2 billion

Assuming the core business is valued in line with peers, RBP is currently valued at £2 billion. All else being equal, this implies a ~70% reduction in US profits in 2013 and no growth thereafter, despite strong underlying volume growth in the still relatively immature and under-penetrated US anti-opioid addiction treatment market. We consider this as excessively pessimistic.

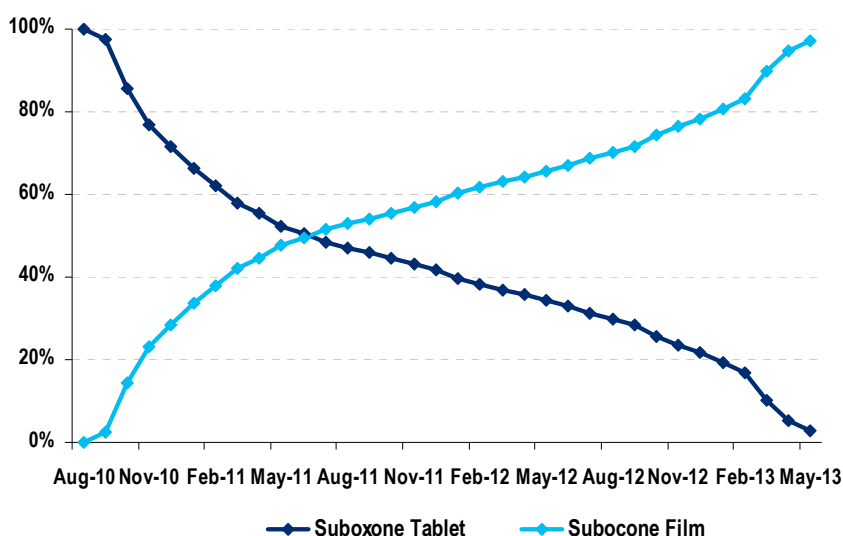
Still early days, but first three months of post-generic Suboxone data reassure

In the twelve weeks for which we have data following the 23 February FDA approval of generic versions of Suboxone, branded Suboxone's market share – specifically of the Film variant – has remained remarkably steady.

Patient migration to the Film has been hugely successful

The company's success in migrating patients to the hopefully more sustainable Film variant of Suboxone, prior to the launch of generics, has been well documented.

Figure 7. Share of the branded Suboxone market effectively now complete



Source: IMS data

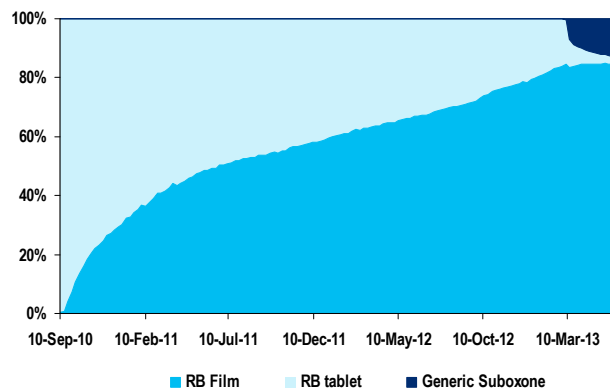
Suboxone film was released in September 2010 and, by the end of December 2010, Film already accounted for ~30% of US Suboxone prescription volumes (and ~27% of the overall buprenorphine market).

Further milestones were equally impressive. Film had:

- ~59% of the Suboxone market / ~52% of buprenorphine market by Dec-11
- ~78% of the Suboxone market / ~67% of buprenorphine by Dec-12
- ~84% of the Suboxone market / ~71% of the buprenorphine market in the final IMS data prior to the launch of generic Suboxone, although this final acceleration can partially be explained by patient and physician anticipation of tablet cessation, as announced back in September 2012

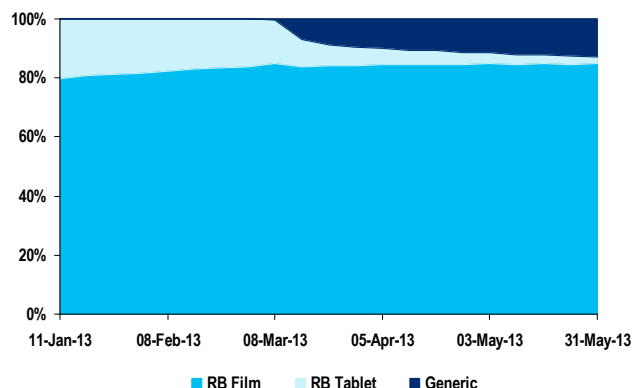
As a result of the successful pre-generic migration programme, the debate / central concern for investors about Suboxone appears to have shifted from “how will the company replace the 90% of US RBP sales and profit decline (that it has guided investors to assume ever since it foresaw the likely materiality of lost orphan drug status, back in 2006/07)?”, to “how defensible will the Film business be in a post-generic world?”

Figure 8. Extremely successful conversion to Film (by volume) within the US Suboxone market



Source: IMS data

Figure 9. Even post generic entry, Film share has been very solid, with all generic share coming from the (discontinued) tablet



Source: IMS data

So far, generics have not taken any Film share...

It is too early to have a reliable view on the trajectory of Suboxone share trends, given i) the short time – just three months – since generic Suboxone was launched and ii) the potential for the FDA to approve additional generic manufacturers, who could materially disrupt the market.

However, we view the volume share data to date as being broadly encouraging (and in line with our model), with generic tablets apparently only taking share from the (now discontinued) branded tablets – and none, yet, from RB's Film.

The Film's 2-, 3- and 4-week moving average volumes shares continue to increase, which is consistent with recent commentary from RB:

"In the early days, there [has not been a] material impact of generic tablets on our film business" (RB 22 April 2013)

And also from Actavis, the publicly listed of the two generic manufacturers:

"There has been very little or no movement from the thin film to the tablet at this point in time" (Actavis 2 May 2013)

But what when the tablet opportunity is exhausted?

...but the key test will come when branded tablet share falls to zero

The next few weeks will be critical, in our view, since it seems just a matter of weeks before the generic manufacturers will have taken 100% of the legacy tablet market (not least as residual stocks in RB's discontinued tablet business run out).

We expect this will provide a test of patient "preference" for the Film and the generic manufacturers' nerve on pricing.

Figure 10. IMS data since generics launched show no Film loss to generic Suboxone tablets

	01-Mar-13	08-Mar-13	15-Mar-13	22-Mar-13	29-Mar-13	05-Apr-13	12-Apr-13	19-Apr-13	26-Apr-13	03-May-13	10-May-13	17-May-13	24-May-13	31-May-13
Suboxone tablets	13.9%	12.6%	8.0%	6.0%	5.3%	4.6%	4.1%	3.8%	3.4%	3.1%	2.7%	2.5%	2.3%	2.1%
Suboxone film	71.4%	72.1%	71.1%	71.2%	71.4%	71.8%	71.5%	71.6%	71.5%	71.6%	71.5%	71.7%	71.3%	71.6%
Generic buprenorphine / naloxone	0.0%	0.4%	5.9%	7.6%	8.0%	8.5%	9.0%	9.2%	9.7%	9.8%	10.3%	10.3%	10.7%	10.8%
Generic buprenorphine	14.7%	14.9%	14.9%	15.2%	15.2%	15.1%	15.3%	15.4%	15.4%	15.5%	15.5%	15.5%	15.7%	15.5%
Total Buprenorphine	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: IMS data

Pricing looks orderly so far

We expect the trajectory of generic Suboxone pricing to be the key determinant of medium-term Film share loss, with different groups of patients relatively more or less sensitive to price.

Effective generic Suboxone pricing looks to be in line with the branded Film

According to RB, ~20% of patients are cash payors, with ~60% being covered by insurance (with most co-pays less than \$30) and the balance on government-funded programmes.

In our base case model, we assumed that generic Suboxone would take 100% of the residual tablet users within three months and that over the next 18 months, a further 20% of Film users would also migrate to the generic tablet or to branded alternatives, being an approximation of the cash payers, who we assume will be the most price sensitive.

At its 1Q13 results, RB stated that the generic tablets had list prices below the branded tablet, but still above the branded Film, although in-market discounts would probably alter that picture.

A sample of user-generated online prices suggests that the generic tablet is actually being sold at an average price lower than the branded Film, but that the magnitude of the discount tended to be very low single digit, which could help explain the resilience of the Film market share, with “format inertia” a more important determinant of choice than price, at this point, even for cash-paying patients.

Figure 11. Sample pricing of 8mg / 2mg Suboxone Tablet and Film vs. generic tablets

	Format	Dose	Number	Mean (\$)	Median (\$)
Suboxone brand	Tablet	8mg / 2mg	60	632.44	635.57
Suboxone brand	Film	8mg / 2mg	60	460.04	460.07
Buprenorphine / Naloxone	Tablet	8mg / 2mg	60	451.44	444.08
Generic discount to:	Tablet			-29%	-30%
	Film			-2%	-3%

Note: Mean calculated based on 10 observations for each format, excluding high / low in the case of generic
Source: goodrx.com, Citi Research

Figure 12. Sample pricing of 2mg / 0.5mg Suboxone Tablet and Film vs. generic tablets

	Format	Dose	Number	Mean (\$)	Median (\$)
Suboxone brand	Tablet	2mg / 0.5mg	60	355.43	356.95
Suboxone brand	Film	2mg / 0.5mg	60	258.35	259.48
Buprenorphine / Naloxone	Tablet	2mg / 0.5mg	60	252.14	251.06
Generic discount to:	Tablet			-29%	-30%
	Film			-2%	-3%

Note: Mean calculated based on 10 observations for each format, excluding high / low in the case of generic
Source: goodrx.com, Citi Research

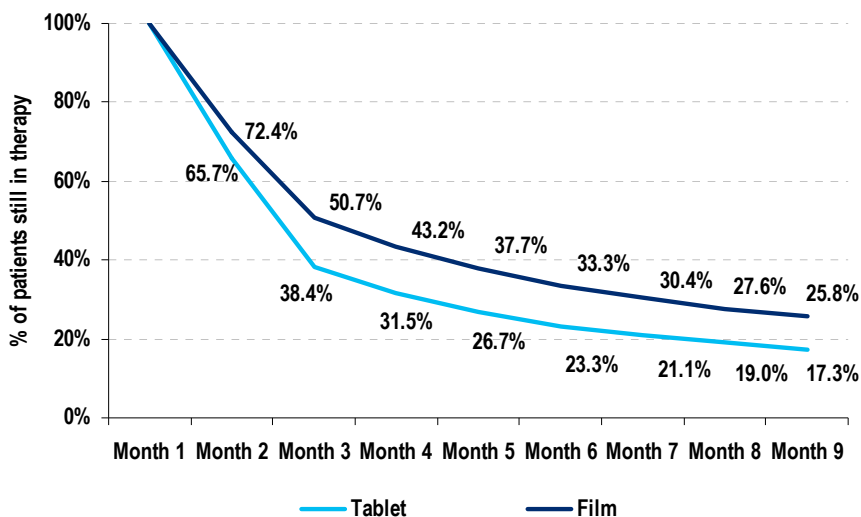
In terms of future pricing expectations, RB stated “if you have more entrants coming into the market, which we do expect to have ... you should see further erosion of generic tablet pricing”.

RBP claims that Film has higher treatment compliance rates than tablets...

Insurers should continue to prefer the Film for now

One of the reasons that RB claims that insurers prefer patient to be on the Film is their claim of better treatment compliance rates, as shown below.

Figure 13. RBP's research finds that Film patients stay in treatment longer than Tablet patients



Source: Company data

Put simply, RB describes patients who fall out of treatment as being “very high consumers of healthcare” and the company has cited an incremental cost of some \$14,500 per patient in the six months after falling out of treatment.

...which should sustain insurance payors' preference for the Film over generic tablets

Using RB's lapse data, the average monthly cost of a Film prescription from Figure 14 and assuming a \$14,500 incremental healthcare cost for those who fall out of treatment by the end of the tracked period, we estimate that generic prices would have to be some 50-60% lower than the current average branded Film price to encourage insurers to pressure physicians to switch to generics on a purely financial basis.

Figure 14. High healthcare costs of falling out of treatment favour Film

	(Branded) Film	(Generic) Tablet
Patients	1,000	1,000
Monthly cost or prescription (\$)	460	Implied - 205
9-month cost of prescriptions (\$)	1,937,060	708,500
Expected value of treatment drop-outs (\$)	14,500	14,500
Cycle cost (\$)	10,759,000	11,991,000
Total cost (\$)	12,700,000	12,700,000
Cost per patient (\$)	12,700	12,700

Source: Company reports, Citi Research Estimates

Clearly, there are some over-simplifications in the scenario, but the point is that the magnitude of price erosion required for large scale migration away from the branded Film is significantly greater than implied by current market prices, which we think makes our 20% further Film share loss look relatively conservative.

Two yellow flags on pricing and protection

Although the current pricing environment appears to be very benign, we would flag two potential sources of concern:

1) **Low outlier prices for generic tablets potentially emerging**

A couple of outliers in our review of prices found on price search websites suggested in some outlets there may be a much steeper discount for generics than the mean or median result.

Since the data aggregates user-generated content, we have not been able to confirm any of the ultra-low prices, although this remains a possibility and a genuine longer-term threat.

The key test on pricing is likely to come either i) when a third (or more) generic is approved, although we have no insight into the potential timing, or ii) when generics have claimed all of the branded tablet market share, which we expect to happen in the coming weeks.

2) **Dual prescription issuance offers a hurdle for generic growth**

On its 1Q13 results call, Reckitt confirmed previous comments on one of Suboxone Film's key protections at the point of purchase.

Specifically, the company confirmed that, since pharmacists are not authorized to make up tablet prescriptions (branded or generic) for Film scripts. Reckitt stated that pharmacists:

"cannot simply substitute a film prescription with a generic tablet prescription..."

Stating that, should the pharmacist actively want to substitute tablet-form of the drug for a film prescription, they would have to re-engage with the prescribing physician and have them alter / reissue the script.

Given Reckitt's own evidence – presented at RBP presentations over the past couple of years – for a strong preference amongst physicians for the Film, there seemed to be a very high hurdle for generic tablets to erode the "normal" pattern of Film prescription.

However, in speaking with several prescribing physicians in recent weeks, it has become apparent that some (many?) are already habitually issuing "either / or" scripts to their patients, which, in our view, undermines one of the Film format's key protections.

The data, to date, doesn't show any Film weakness or share loss, but we will be keeping a close eye on future data for signs of a change.

In summary, we expect further pricing erosion from generics to drive share loss from Film, with ~20% further loss of Film's current share in our base case by 2015.

Branded competitive environment somewhat diminished

Beyond the generic incursion on Reckitt's Suboxone business, several branded players have applications submitted with the FDA to launch competing products.

Branded entrants face the same patient access challenges as generics

However, the branded challengers will face many of the same "patient access" challenges faced by the newly authorized generic entrants, although branded entrants will typically not look to compete on price as a means of market entry.

Specifically:

- RBP has an established sales and support network in place, built up over the past decade
- Given high costs associated with patients falling out of treatment, physicians (and insurance payors) may be unwilling to migrate to a new treatment from one which is already proved to be effective
- Pharmacists will not be permitted to substitute another brand for a Suboxone script

Additional specific challenges

In addition to these general challenges, we think the branded competitive threat has diminished somewhat recently, either because of market evolution (Orexo), FDA setbacks (Titan) or delays (BDSI):

- **Orexo's** OX219 tablet, "Zubsolv", seems to be a relatively similar to the now discontinued Suboxone tablet, although Orexo claims that 9 out of 10 people surveyed preferred Zubsolv tablets to Subxone Film.
- Orexo expects to receive FDA approval on 6 July 2013, leading to a US launch in September 2013. We include the Orexo launch in our Film share loss assumptions from 1Q14.
- **Titan's** sub-dermal implant, a slow-release formulation of buprenorphine which requires a surgical procedure to replace every six months, received a set-back in April, when the FDA withheld final approval, with questions remaining about efficacy and clinical benefit.
- Following support from the Psychopharmacologic Drugs Advisory Committee, the denial was something of a surprise. Although Titan will continue to pursue FDA approval, the regulatory path from here is unclear, but the immediate competitive threat to RB is greatly diminished.
- **BDSI's** BNX adhesive film looks to be the most direct competitor to Suboxone Film and the manufacturer claims better bio-availability (requiring lower doses and causing fewer side effects), easier administration and better taste.
- BDSI is targeting 25% of the branded market (which it expects will still account for 60% of the total market) by 2018. We assume a 2H14 launch (BDSI anticipates a 3Q13 NDA submission and hopes for 2Q14 approval) and include branded competition in our 20% further Film share erosion assumption.

Branded entry is already in our base case

Although we view the branded threat as somewhat diminished, we include branded entry from 1Q14 and this contributes to our assumption that Suboxone Film loses a further 20% of its current share over the next two years.

US market growth rates remain robust

According to presentations from RB Pharma and potential new branded market entrants Orexo and BDSI, there are ~2 million opioid addicts in the US.

The market remains very under-penetrated

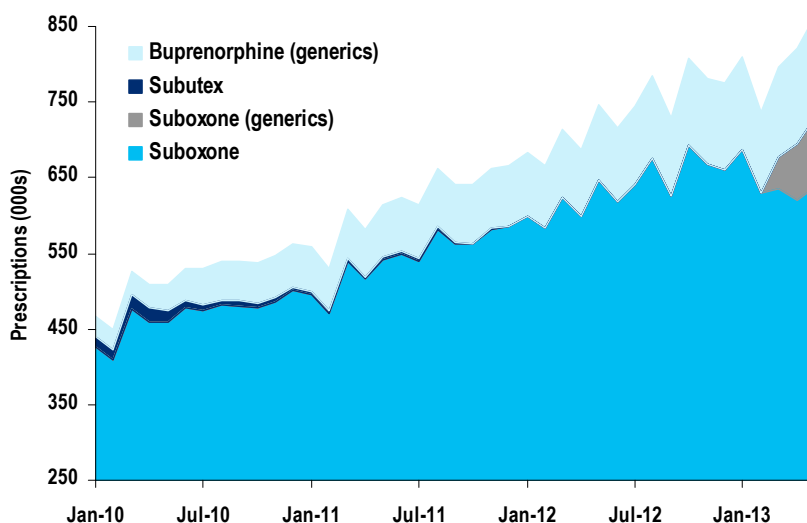
Orexo cites statistics suggesting that nearly 10% of the 50 million US Rx opioid users have developed dependence, with only ~40% of these captured as the ~2 million “diagnosed dependent” cited in the other presentations.

Within this population, only about 30-40% is currently in anti-dependency treatment, with ~20% taking Suboxone to manage their addiction and the remainder largely in methadone treatment.

IMS data shows the US market for buprenorphine-based drugs, largely Suboxone, has been growing at a mid- to high-teens rate by volume for the past few years (and has grown to a \$1.5 billion market from a standing start in 2003).

However, the very low penetration rates suggest there is plenty of runway for further double-digit growth into the medium term.

Figure 15. US market volume growth remains in mid- to high-single-digit rates



Source: IMS data

Base case RBP valuation of ~£5bn, or 710p per share...

We use a DCF model to value RBP, with the following key inputs:

- US market growth of 15% in 2013E, 14% in 2014E and 13% in 2015E.
- Loss of 100% of tablet share in 2Q13E.
- Incremental 15-20% loss of Film's share by the end of 2015 to further generic penetration and / or market entry by at least one of branded entrants, with initial branded entry assumed from 1Q14.
- Film margins stabilizing at ~65%, which assumes i) no material price reductions in the face of greater competition, but ii) no let up in the degree of couponing and iii) no reduction in technological development or distribution / market expansion investment expenditure.
- An 80-90% fall in US Suboxone revenues and profits in 2023, when the Film loses patent protection.
- No success in developing new delivery mechanisms (such as the "Once-a-Month" injectable – currently targeted for late 2015) or adjacent treatment areas (such as the cocaine overdose treatment – currently on track for 2018).
- RoW trends continuing at recent levels, with ~3-4% organic sales growth and margins stable at ~40%.
- No entry into any new geographical markets.

The result of these inputs is a 7% organic sales and ~8% EBIT decline in 2013 and low single digit sales and profit growth 2014-15 as generics and potential branded competitors enter the market, before a return to more robust growth rates in line with market volume growth thereafter.

Assuming 0% terminal growth and a WACC of 8.5%, our DCF yields a fair value of ~£5.2 billion, or ~710p per share.

Figure 16. Summary DCF valuation for RBP

	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Total RBP Sales	807	827	862	962									
Total RBP EBITDA	493	505	526	591	668	748	831	914	987	1,056	438	460	483
Growth	-10.8%	2.3%	4.3%	12.4%	13.0%	12.0%	11.0%	10.0%	8.0%	7.0%	6.0%	5.0%	5.0%
Tax @ 30%	(148)	(151)	(158)	(177)	(200)	(224)	(249)	(274)	(296)	(317)	(131)	(138)	(145)
Capex @ 2% of sales	(16)	(17)	(17)	(19)	(22)	(24)	(27)	(30)	(32)	(34)	(36)	(38)	(40)
Movement in Working Capital	2	(1)	(2)	(5)	(6)	(7)	(7)	(7)	(6)	(6)	(5)	(5)	(5)
Net Cash Flow	331	336	349	389	440	493	548	603	653	699	265	279	293
Terminal Value													3,449
Discount Factor	1.00	0.92	0.85	0.78	0.72	0.67	0.61	0.56	0.52	0.48	0.44	0.41	0.38
Present Value of Cash Flow	331	309	297	305	317	328	336	341	340	335	117	114	1,406
Net Present Value	5,192												
Implied EV / Sales	6.4												
Implied EV / EBITDA	10.5												

Source: Citi Research Estimates

... implying RB ex-pharma trades at a discount to peers

Long-term relative de-rating should reverse

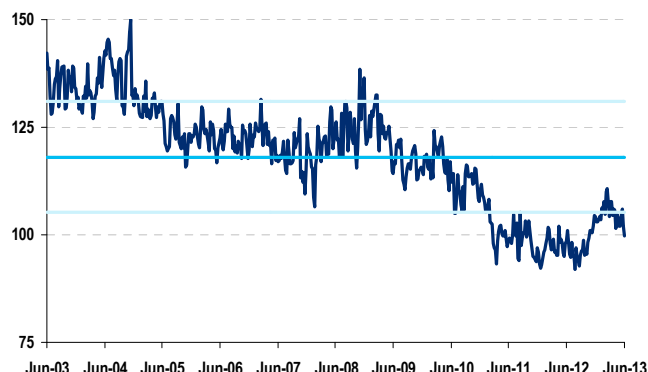
Reckitt is trading on 16.8x our 2013 EPS estimate and 15.8x our 2014 estimate vs. the European HPC peer group, which is on 21.0x and 19.0x, respectively, and the broader European Staples peer group, which is on 18.4x and 16.7x, respectively. The stock's current P/E is broadly in line with its 10-year average forward multiple, yet ~1 STD below its 10-year average P/E Relative to European Staples, reflecting its aggressive relative de-rating over the past five years.

Figure 17. Trading in line with its 10-Yr average forward P/E



Source: DataStream

Figure 18. Still ~1 STD below its historical P/E relative to EU Staples



Source: DataStream

Our base case valuation of RBP of 710p implies the pharma business is trading on 15.7x our 2013 divisional earnings estimate and 15.2x our 2014 estimate. Ex pharma, we estimate that RB Core is trading on 17.0x 2013E and 15.9x 2014E.

Figure 19. Summary peer group valuation metrics

	P/E		EV/EBITDA		Div Yield		FCF Yield	
	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Unilever NV	18.3	16.7	12.3	11.3	3.5%	3.8%	5.8%	5.9%
Procter & Gamble	19.0	17.8	12.3	11.5	2.9%	3.1%	4.4%	4.9%
Colgate	20.6	18.5	12.6	11.6	2.3%	2.5%	4.8%	4.9%
Kimberley Clark	17.0	15.6	9.7	9.2	3.3%	3.6%	5.0%	6.0%
Clorox	19.0	17.4	11.4	10.6	3.0%	3.4%	4.9%	5.2%
Church & Dwight	21.9	20.0	12.1	11.0	1.8%	2.0%	5.0%	5.0%
Average	19.3	17.7	11.7	10.9	2.8%	3.1%	5.0%	5.3%
Reckitt Benckiser	16.8	15.8	12.2	11.2	3.0%	3.2%	6.3%	6.6%
RB ex-RBP	17.0	15.9						

Source: Citi Research Estimates

Companies mentioned: Church & Dwight Co Inc (CHD.N; US\$61.25; 2); Colgate-Palmolive Co (CL.N; US\$58.46; 2); The Clorox Co (CLX.N; US\$85.35; 1); Kimberly-Clark (KMB.N; US\$97.57; 2); Procter & Gamble Co (PG.N; US\$78.43; 1); Unilever NV (UNc.AS; €30.19; 2)

Figure 19 shows that core Reckitt's peers currently trade on 19.3x 2013 estimates, a 13% premium to our estimate of Reckitt ex-RBP's 2013 P/E multiple. Given the strong momentum in the Health and Hygiene businesses, which are driving RB's transformation – the core of our positive investment stance – and richer BEI-supported improving momentum in the Home division, we do not think the company deserves this discounted multiple against its most relevant peer group.

What's implied at RBP for RB ex-pharma to be fairly valued?

Our £5 billion valuation for RBP, which implies a 2013E EV/EBITDA multiple of 10.1x (on a high 6.0x EV/Sales multiple, reflecting the very high margins) implies that core Reckitt is trading on 17.0x our 2013 ex-RBP earnings estimate, nearly two multiple points lower than the peer group.

The current share price implies RBP is worth ~£2bn...

Figure 20 shows the implied valuation of core Reckitt under various RBP valuation scenarios.

Figure 20. Implied 2013E P/E multiple in various RBP valuation scenarios

Implied 2013 EV/EBITDA (x)	RBP Value (£ mn)	Implied Core Reckitt 2013 P/E (x)
2.0	1,000	19.5
4.1	2,000	18.9
6.1	3,000	18.3
8.1	4,000	17.7
10.1	5,000	17.1
12.2	6,000	16.5
14.2	7,000	15.9

Source: Citi Research Estimates

Assuming the core business is trading in line with its global peers – and 19.2x this year's earnings is broadly in line with the broad European staples group – implies a valuation for RBP of ~£2 billion, or less than 4.0x our current year divisional EBITDA estimate.

Figure 21 illustrates what we estimate are the broad inputs required for RBP to be worth £2 billion.

...which implies a ~70% drop in US profits, which we think is excessive

Relative to our base case estimates, we make:

- No changes to the Europe / RoW business
- A ~70% reduction to US profits in 2013 and no growth thereafter, despite the apparent ongoing market momentum, driven by:
 - A 55% reduction in sales, driven either by significant share loss or materially lower prices to protect market share
 - US margin compression to ~45% (in line with the European / RoW business) from nearly 80% in 2010 and ~65% on the US Film business in 2012

Although this seems extreme, a fair value of £3 billion still implies a ~45% reduction to current year US divisional operating profit and no future growth, either from the core Suboxone franchise or from potential new innovations.

Figure 21. What's implied for RBP fair value to be £2 billion?

	2011	2012	2013e	2014e	2015e	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Sales															
US	587	658	290	290	290	290									
Europe / RoW	175	179	190	198	206	214									
Total RBP Sales	762	837	480	488	496	505									
Organic growth	6%	10%	-46%	1%	2%	2%									
EBIT															
US	438	455	131	131	131	131									
- Margin %	75%	69%	45%	45%	45%	45%									
Europe / RoW	80	81	85	89	93	96									
- Margin %	46%	45%	45%	45%	45%	45%									
Total EBIT	518	536	216	220	224	227									
- Margin %	68%	64%	45%	45%	45%	45%									
Total RBP EBITDA	533	553	226	230	233	237	241	245	250	254	258	263	199	203	206
Growth		3.7%	-59.1%	1.7%	1.6%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%	1.7%
Net Cash Flow			166	151	153	156	158	161	164	166	169	172	128	130	132
Terminal Value															1,552
Net Present Value			2,000												
Implied EV / Sales			4.2												
Implied EV / EBITDA			8.9												

Source: Citi Research Estimates

Minor revisions to our estimates

We are updating our estimates for FX and making some minor changes to our underlying estimates.

The net result is a 0.5-1.0% cut to our 2013-2014 earnings estimates.

Figure 22. Summary Growth Drivers

	2010	2011	2012	2013e	2014e	2015e
Organic Growth by Region						
ENA		-1.0%	1.0%	2.5%	2.0%	2.0%
LAPAC		11.0%	11.0%	11.0%	11.0%	10.5%
RUMEA		10.0%	8.0%	8.0%	9.0%	9.0%
Food		7.0%	2.0%	3.0%	3.0%	3.5%
Total ex RBP	4.7%	3.6%	4.7%	5.7%	5.6%	5.6%
RB Pharma	24.0%	6.0%	10.0%	-7.4%	2.2%	4.2%
Total Group	6.1%	3.8%	5.1%	4.5%	5.4%	5.5%
Organic Growth by Category						
Health		8.0%	6.0%	8.0%	8.0%	8.0%
Hygiene		4.0%	6.0%	8.5%	5.7%	5.6%
Home		1.0%	2.0%	3.0%	4.0%	4.0%
Portfolio		0.0%	1.0%	-7.5%	2.0%	2.0%
Food		7.0%	2.0%	3.0%	3.0%	3.5%
Total ex RBP		3.7%	4.5%	5.7%	5.6%	5.6%
RB Pharma		6.0%	10.0%	-7.4%	2.2%	4.2%
Total Group		3.9%	4.9%	4.5%	5.4%	5.5%
EBIT Margin by Region						
ENA	24.1%	23.9%	24.7%	25.0%	25.3%	25.6%
LAPAC	16.8%	18.9%	19.9%	20.5%	20.8%	21.1%
RUMEA	20.2%	21.5%	20.7%	21.2%	21.5%	21.8%
Food	27.5%	29.5%	28.7%	29.2%	29.5%	29.8%
Total ex RBP	22.0%	22.6%	23.3%	23.3%	23.5%	23.8%
RB Pharma	72.0%	68.0%	64.0%	59.1%	59.0%	59.0%
Total Group	26.4%	26.2%	26.9%	26.1%	26.3%	26.4%

Source: Company Reports and Citi Research Estimates

Figure 23. Summary Income Statements

	2010	2011	2012	2013e	2014e	2015e
Sales						
ENA	4,592	4,837	4,678	5,024	5,133	5,236
LAPAC	1,784	2,210	2,327	2,596	2,855	3,155
RUMEA	1,038	1,364	1,404	1,519	1,643	1,791
Food	302	312	321	337	345	357
Total ex RBP	7,716	8,723	8,730	9,475	9,976	10,538
RB Pharma	737	762	837	807	827	862
Total net revenues	8,453	9,485	9,567	10,282	10,803	11,400
Organic Growth (Ex-RBP)	4.7%	3.6%	4.7%	5.7%	5.6%	5.6%
Organic Growth (Total)	6.1%	3.8%	5.1%	4.5%	5.4%	5.5%
Currency impact	2.0%	-0.6%	-3.2%	1.9%	-0.3%	0.0%
Scope	1.0%	9.0%	-1.0%	1.0%	0.0%	0.0%
Published Growth	9.1%	12.2%	0.9%	7.5%	5.1%	5.5%
Cost of Sales	(3,542)	(4,036)	(4,030)	(4,300)	(4,486)	(4,700)
Gross Profit	4,911	5,449	5,537	5,982	6,317	6,701
Gross Margin %	58.1%	57.4%	57.9%	58.2%	58.5%	58.8%
EBIT BEI						
ENA	1,108	1,157	1,156	1,257	1,299	1,341
LAPAC	299	417	464	533	595	667
RUMEA	210	293	290	321	352	390
Food	83	92	92	98	102	106
Corporate	-	10	32	-	-	-
Total ex RBP	1,700	1,969	2,034	2,209	2,348	2,504
RB Pharma	531	518	536	477	488	509
Operating Profit - EBIT BEI	2,231	2,487	2,570	2,686	2,836	3,013
Operating Margin % - underlying	26.4%	26.2%	26.9%	26.1%	26.3%	26.4%
Exceptional items	(101)	(92)	(135)	(50)	-	-
Operating Profit - EBIT	2,130	2,395	2,435	2,636	2,836	3,013
Operating Margin % - reported	25.2%	25.3%	25.5%	25.6%	26.3%	26.4%
Net financing cost	6	(19)	(15)	(27)	(9)	21
Profit before taxation - underlying	2,237	2,468	2,555	2,659	2,827	3,034
Taxes - underlying	(577)	(641)	(613)	(665)	(707)	(758)
<i>Taxes % PBT underlying</i>	<i>25.8%</i>	<i>26.0%</i>	<i>24.0%</i>	<i>25.0%</i>	<i>25.0%</i>	<i>25.0%</i>
Profit from continuing operations - underlying	1,660	1,827	1,942	1,994	2,120	2,275
Profit from continuing operations	1,570	1,754	1,833	1,957	2,120	2,275
Minority interest	2	9	4	6	7	8
Net profit underlying (continuing)	1,658	1,818	1,938	1,988	2,113	2,267
Fully diluted EPS - underlying (pence)	226.1	247.1	264.4	273.1	290.3	311.4
DPS (pence)	115.0	125.0	134.0	138.2	146.9	157.6
<i>Growth %</i>	<i>15.0%</i>	<i>8.7%</i>	<i>7.2%</i>	<i>3.2%</i>	<i>6.3%</i>	<i>7.3%</i>
<i>Payout ratio (on basic underlying)</i>	<i>50.2%</i>	<i>50.0%</i>	<i>50.1%</i>	<i>50.0%</i>	<i>50.0%</i>	<i>50.0%</i>

Source: Company Reports and Citi Research Estimates

Figure 24. Summary Balance Sheets

	2010	2011	2012	2013e	2014e	2015e
ASSETS						
Goodwill	2,860	3,050	3,050	3,050	3,050	3,050
Other intangibles	7,005	7,208	8,125	7,198	7,193	7,188
Other non-current assets	922	930	848	969	1,017	1,069
Non Current Assets	10,787	11,188	12,023	11,217	11,260	11,307
Inventories	643	758	735	679	702	741
Other current assets	1,404	1,541	1,435	1,566	1,644	1,734
Cash & cash equivalents	588	639	887	2,038	3,197	4,430
TOTAL ASSETS	13,422	14,126	15,080	15,500	16,803	18,211
LIABILITIES						
Borrowings	(3)	(3)	(3)	(3)	(3)	(3)
Other non-current liabilities	(2,555)	(2,642)	(2,668)	(2,668)	(2,668)	(2,668)
Non-Current Liabilities	(2,558)	(2,645)	(2,671)	(2,671)	(2,671)	(2,671)
Borrowings	(2,641)	(2,505)	(3,271)	(3,271)	(3,271)	(3,271)
Trade and other payables	(2,624)	(2,901)	(2,842)	(3,136)	(3,295)	(3,477)
Other current liabilities	(469)	(294)	(374)	(321)	(341)	(364)
TOTAL LIABILITIES	(8,292)	(8,345)	(9,158)	(9,399)	(9,578)	(9,783)
TOTAL EQUITY	(5,130)	(5,781)	(5,922)	(6,101)	(7,225)	(8,428)
TOTAL EQUITY AND LIABILITIES	(13,422)	(14,126)	(15,080)	(15,500)	(16,803)	(18,211)

Source: Company reports, Citi Research

Figure 25. Summary Cash Flow Statements

	2010	2011	2012	2013e	2014e	2015e
Operating Profit - stated	2,130	2,395	2,435	2,636	2,836	3,013
Depreciation	126	137	143	154	162	171
Amortisation	1	(5)	(5)	(5)	(5)	(5)
Change in Working Capital	(90)	(175)	(157)	145	77	77
Other	48	78	7	60	50	50
Cash generated from operations	2,215	2,430	2,423	2,990	3,121	3,306
Interest (net)	8	(13)	(7)	(27)	(9)	21
Tax paid	(679)	(677)	(528)	(652)	(707)	(758)
Net cash generated from operating activities	1,544	1,740	1,888	2,311	2,405	2,568
Purchase of PPE	(170)	(164)	(166)	(200)	(211)	(222)
Other investing cash flows	(2,620)	(484)	(770)	21	21	21
Net cash generated/(used) by investing activities	(2,790)	(648)	(936)	(179)	(190)	(201)
Net cash generated/(used) in financing activities	1,471	(1,004)	(688)	(994)	(1,057)	(1,134)
Net increase/(decrease) in cash	225	88	264	1,137	1,158	1,233

Source: Company Reports and Citi Research Estimates

Reckitt Benckiser

Company description

Reckitt Benckiser is leading global Household and Personal Care company. Growing from its Home Care roots, with strong positions in fabric care, surface care, air care and ADWD, Reckitt has made a string of acquisitions in the Consumer Health market and is positioning itself as a Health-led Health & Hygiene company, with a target of 72% of ex-RBP sales to come from this source by 2016. The company is also active in the anti-opioid addiction market, primarily in the US, and RB Pharma contributed ~20% of group operating profits in 2012.

Investment strategy

We rate Reckitt a Buy based on our belief that investors underestimate i) the sustainability of the recovery in its core business, ii) potential for margin-accretive revenue acceleration from the shift into Consumer Health and iii) the improved sustainability or saleability of the RBP business, given the successful migration of patients to Suboxone film. We think a disposal of the RBP business would simultaneously provide funds to accelerate growth in Consumer Health and remove an ongoing uncertainty from investors' assessment of the core business.

Valuation

We value Reckitt on a SOTP basis, isolating the discrete pharma business and core Health-led HPC activities.

We value RBP using a DCF, which implies a current fair value of £5.2bn, or 710p per share, with the DCF result broadly underpinned by peer multiples and recent transaction precedents, which we believe is valid, since RBP is considered a non-core operation.

We value core Reckitt on peer group multiples - we believe the stock should trade in line with its global peers, given similar growth prospects, if not better if it executes well on the Health strategy. Application of the peer average c.19x 2013E P/E to our 2014E EPS (we assume the valuation holds) values Reckitt ex-RBP at 4,730p

Combined, we set our PT at 5,450p.

Risks

The following are risks to our target price not being achieved:

A bigger than expected drop in profits within the pharma business now that generics have finally entered the market.

A persistently fragile consumer in developed markets and continued promotional pressure.

Input and packaging costs, which account for 30% of sales (of which 30% are oil related), may be difficult to offset with pricing given a fragile consumer in developed markets.

Execution risk on integration of future acquisitions, which we believe will be integral to the development of the Consumer Health strategy.

Notes

Notes

Notes

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

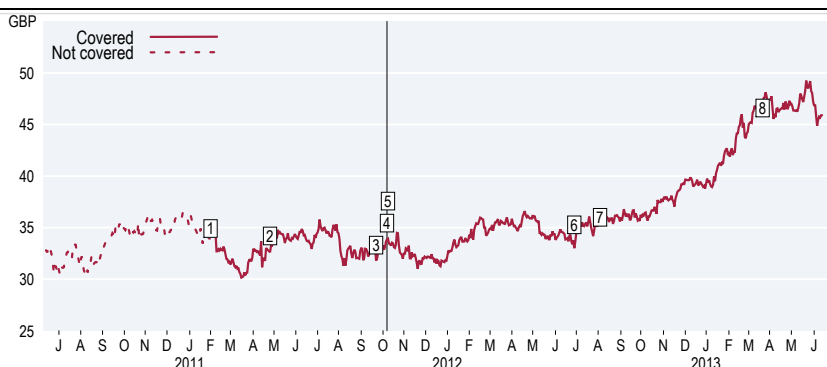
Reckitt Benckiser (RB.L)

Ratings and Target Price History

Fundamental Research

Analyst: Toby McCullagh

Covered since March 27 2013



	Date	Rating	Target Price	Closing Price
1	1-Feb-11	1L	*42.00	34.48
2	26-Apr-11	1L	*43.00	32.61
3	22-Sep-11	1L	*40.00	31.80

* Indicates change

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	8-Oct-11	*1	40.00	33.86
6	28-Jun-12	1	*38.00	33.00

	Date	Rating	Target Price	Closing Price
7	3-Aug-12	1	*40.70	35.78
8	21-Mar-13	1	*54.50	47.10

Rating/target price changes above reflect Eastern Standard Time

Reckitt Benckiser (RB.L)

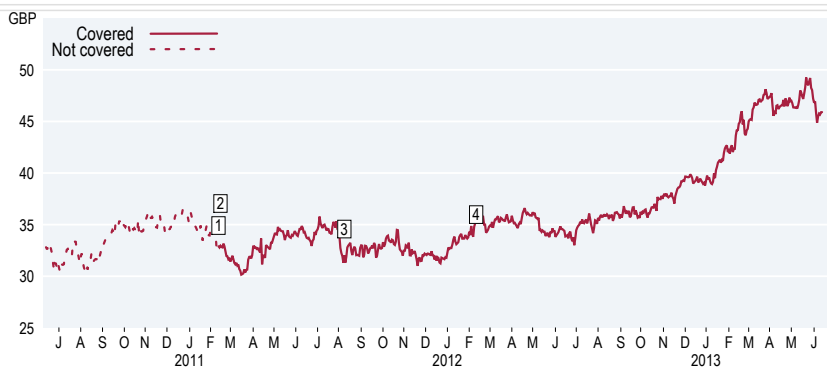
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Toby McCullagh

Covered since March 27 2013



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	32.90
2	15-Feb-11	*REM MP	-	32.95

* Indicates change

	Date	Rating	Target Price	Closing Price
3	9-Aug-11	*ADD MP	-	32.04
4	10-Feb-12	*REM MP	-	35.41

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Data current as of 31 Mar 2013

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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