

GlaxoSmithKline

Price 1,697p

Q2 beat largely driven by FX although underlying performance was good too

Fair Value 1810p vs. 1740p (+7%)

BUY

Bloomberg	GSK LN
Reuters	GSK.L
12-month High / Low (p)	1,697 / 1,238
Market Cap (GBP)	82,659
Ev (BG Estimates) (GBP)	109,547
Avg. 6m daily volume (000)	9,036
3y EPS CAGR	12.5%

GSK yesterday reported very strong Q2 figures that reflect a good underlying performance but even more meaningfully, incredibly high positive currency effects. The same ingredients impact FV too.

ANALYSIS

- GSK's performance in the second-quarter was good but Q2 numbers were obviously inflated by currency impacts that were significantly under-estimated and resulted in a positive impact of 21bp on core EBIT and 26bp core EPS growth rates.
- Starting with the underlying performance, it is fair to say that ViiV Healthcare and Vaccines were again the growth engines during the quarter with respective growth rates of 44% and 11%. ViiV Healthcare is still and only driven by the outstanding performance and ongoing penetration of dolutegravir-based regimen in the treatment paradigm of HIV. One in five HIV patients now receives dolutegravir in the US. Although concerns should increase over the coming year about upcoming competition from a similar drug from Gilead to be filed next year, GSK has a meaningful head start the group will try to build upon with new combinations that will be tough to disrupt without a clear advantage. As such, ViiV's trend is very much as expected i.e. dependent only on dolutegravir although this drug is even performing better than expected. ViiV margins are no longer disclosed but we assume they are stronger than ever.
- Moving to Vaccines, the performance (+11%) was very good for the second consecutive quarter but there were some seasonal and non-recurring elements in it because of the timing of tenders (as in Mexico) or shipments (as with Bexsero in the US) favouring Q2 and set to impact coming quarters. That said, it is also fair to say that GSK has resolved some of its manufacturing issues earlier than expected and was also first to ship flu vaccines in the US for the upcoming season, which should be good for the Q3 performance. Margin for the division was steady at around 28%, which is more than 6% above last year's level. As flu drove margins up in H2 vs H1 traditionally, we expect margins to reach 29% this year (vs 26.4% in 2015).
- These two engines are therefore very much in place and delivering on schedule. Consumer Healthcare delivered another strong quarter in Q2 (+7%) but this resulted in less robust margins than in Q1 because GSK invested more significantly in products including new launches and because of mix effects too. This had been anticipated at the time of the Q1 call.
- Ending with Pharmaceuticals, it is fair to stress that Advair's performance in the US in the quarter was somewhat helped by rebate reversals but the net impact for the group was negligible as it is more or less offset by an opposite impact on Flovent. All in all, the Respiratory franchise's performance in the quarter (flat) is representative of the underlying truth and is in line with the group's target for 2016. Breo has confirmed hopes in Q2 and Nucala progressed despite a long lasting process with payers.
- Now, while GSK's core EPS for Q2 came out at GBp24.5 whereas the CS was expecting only GBp21.0, the difference mainly stemmed from currencies to be honest. And similarly, the CS will have to adjust full-year numbers to currencies too. GSK suggested a 19% positive currency impact on core EPS should FX rates stay at their end-June levels. Together with a lfl growth 11-12%, this makes core EPS growth on a reported basis for 2016 be around 30%, resulting in core EPS of about GBp100. So far, the CS was around GBp93 for the current year, requiring about a 7% upward revision.

VALUATION

- Our call is very much intact. As we move towards the end of the year, we will pay increasing attention to the CAGR for 2017-2020, excluding 2020, which represents a risk of significantly less appealing relative comparison to peers. Here is where we expect the new CEO to help.
- Our FV is revised upwards, mainly by changes to dolutegravir sales and FX assumptions.

NEXT CATALYSTS

- 11 August 2016: GSK trades ex-dividend (GBp19) - [Click here to download document](#)

	1 M	3 M	6 M	31/12/15
Absolute perf.	14.0%	14.0%	18.1%	23.6%
Healthcare	9.3%	6.0%	2.5%	-3.0%
DJ Stoxx 600	11.0%	-1.6%	0.7%	-6.3%

YEnd Dec. (GBpm)	2015	2016e	2017e	2018e
Sales	23,923	26,825	27,175	27,993
% change		12.1%	1.3%	3.0%
EBITDA	7,429	9,439	9,587	9,768
EBIT	5,729	7,739	7,887	8,068
% change		35.1%	1.9%	2.3%
Net income	3,658	4,873	5,073	5,245
% change		33.2%	4.1%	3.4%

	2015	2016e	2017e	2018e
Operating margin	23.9	28.9	29.0	28.8
Net margin	15.3	18.2	18.7	18.7
ROE	78.0	93.6	85.5	71.3
ROCE	14.7	18.8	18.9	19.4
Gearing	118.9	115.5	85.2	56.7

(p)	2015	2016e	2017e	2018e
EPS	75.71	100.27	104.39	107.91
% change	-	32.4%	4.1%	3.4%
P/E	22.4x	16.9x	16.3x	15.7x
FCF yield (%)	2.3%	5.1%	6.3%	7.2%
Dividends (p)	100.00	80.00	80.00	88.00
Div yield (%)	5.9%	4.7%	4.7%	5.2%
EV/Sales	4.6x	4.1x	4.0x	3.8x
EV/EBITDA	14.7x	11.6x	11.3x	10.9x
EV/EBIT	19.0x	14.2x	13.7x	13.2x



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