

GlaxoSmithKline

Price 1,627p

How attractive is GSK beyond 2016?

Fair Value 1930p vs. 1810p (+19%)

BUY

Bloomberg	GSK LN
Reuters	GSK.L
12-month High / Low (p)	1,723 / 1,280
Market Cap (GBP)	79,304
Ev (BG Estimates) (GBP)	110,226
Avg. 6m daily volume (000)	8 611
3y EPS CAGR	17.4%

GSK likely provided another illustration that through Q3 numbers, investors are now more interested in what is coming next. Q3 was indeed very good at GSK, which delivered figures well above CS estimates. Although the 2016 performance will be difficult to reiterate, we see another exciting year ahead for GSK and in light of what competition offers. Our new FV is GBP1,930 and we believe the stock still deserves a BUY rating.

ANALYSIS

- GSK's share price reaction was obviously surprising yesterday as it faced high volatility through the day and turned negative quickly after the conference call started, although it is fair to say that reported Q3 numbers were significantly above estimates and none of the comments could have suggested caution or warning.
- So what is behind this strange behaviour? It is likely the fact that currencies are strongly behind the Q3 beat and that strong double-digit core EPS growth will be difficult to reiterate in 2017 as the comp base is becoming higher, whereas Advair Gx might hit the US market sometime during the year and ViiV start to decelerate.
- First of all, we acknowledge that we have been among those who under-appreciated the Fx impact on Q3 sales and profit numbers. However, it would be wrong to say that Fx was solely behind Q3 outperformance, because Respiratory up 8% and Vaccines up 20% in CER terms were two obvious outperformers. And in the end, despite some one offs (catch-up rebate adjustment for Advair in the US, extra tenders in Vaccines), net impact from non-recurring items was negligible. New products performed strongly which bodes well for the future, with the exception of Nucala but for which Andrew Witty had very positive comments, simply saying that it takes time from transform interest to treat into actual paying patient but "feedback is fantastic" and NBRx said to be 25%.
- Moreover, as we look into 2017, it is fair to say that Fx is likely to play an important role once again: annualising the positive impact of GBP weakness over the full year could have another circa 7-8% beneficial top-line effect and another double-digit impact on core EPS. This will help greatly to mitigate Advair's US decline. That said, of course, underlying performance will matter even more and from that perspective, ViiV, Vaccines and Consumer will remain growth drivers, especially at the profit/margin level. Ex-ViiV Pharmaceuticals will depend on when, how many and under which conditions Gx Advair hits the US market.
- Longer term, it is more difficult to assess how GSK might do because it will be pipeline-dependent and we would be less comfortable than Andrew Witty from that perspective about revenues to be expected from current pipeline (so is the market and so CS is conservative anyway). Long term is also dependent on new CEO's strategy and here we have to wait until early 2017 to see what Emma Walmsley will deliver in terms of first messages and main directions.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	-2.4%	11.5%	18.5%
Healthcare	-5.8%	-11.0%	-5.3%	-13.6%
DJ Stoxx 600	0.5%	0.1%	-1.6%	-6.6%

YEnd Dec. (GBPm)	2015	2016e	2017e	2018e
Sales	23,923	27,469	29,789	30,986
% change		14.8%	8.4%	4.0%
EBITDA	7,429	9,630	10,623	10,922
EBIT	5,729	7,930	8,923	9,222
% change		38.4%	12.5%	3.4%
Net income	3,658	4,960	5,726	5,959
% change		35.6%	15.4%	4.1%

	2015	2016e	2017e	2018e
Operating margin	23.9	28.9	30.0	29.8
Net margin	15.3	18.1	19.2	19.2
ROE	78.0	94.2	89.8	70.3
ROCE	14.7	18.7	20.3	20.6
Gearing	118.9	116.9	79.6	48.2

(p)	2015	2016e	2017e	2018e
EPS	75.71	101.85	117.58	122.37
% change	-	34.5%	15.4%	4.1%
P/E	21.5x	16.0x	13.8x	13.3x
FCF yield (%)	2.4%	5.7%	6.8%	8.0%
Dividends (p)	100.00	80.00	80.00	88.00
Div yield (%)	6.1%	4.9%	4.9%	5.4%
EV/Sales	4.6x	4.0x	3.7x	3.4x
EV/EBITDA	14.7x	11.4x	10.2x	9.7x
EV/EBIT	19.1x	13.9x	12.2x	11.5x



VALUATION

- So, after a terrific 2016 performance for the stock, it may be hard to see GSK doing as well in 2017 because all catalysts will not play in a similar way. However, for the time being, as we see peers starting to comment on their own perspectives for 2017, we see GSK still very well positioned.
- We have increased our estimates for Respiratory and Vaccines (mainly Meningitis but also Flu in the US and Synflorix) in 2016 and adjusted for higher Fx impacts (estimated 21% on core EPS), even more significantly for 2017 (so far minimally influenced). In the final analysis, if core EPS for 2016 is only revised by 1%, 2017 and 2018 have been both increased by 13%. Consequently, our FV has moved up to GBP1,930, strongly supporting an unchanged BUY rating.

NEXT CATALYSTS

- 3 November 2016: ex-dividend for Q3 dividend (GBP19/share)

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Analyst :
Eric Le Berrigaud
33(0) 1 56 68 75 33
eleberrigaud@bryangarnier.com

Sector Team :
Mickaël Chane Du
Hugo Solvet
Marion Levi

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London	Paris	New York	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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