GSK/Novartis: new prescription

Pills and potions make consumers feel better. They cheer investors up, too. Shares in Novartis went up 2 per cent after it said yesterday that it would offload a $13bn minority stake in a portfolio of consumer brands. Those of GlaxoSmithKline, the buyer, bounced 6 per cent.

The latest deal strengthens GSK’s bet on consumer health — and might look as though Emma Walmsley, its newish boss, is favouring the side of the business she used to run. But Ms Walmsley has told investors her priority is pharma research. That point was underlined by its recent decision not to bid for Pfizer’s consumer health brands. In this case, it was Novartis rather than GSK that had the upper hand in the negotiations. It had the right to sell its 36.5 per cent stake in the joint venture, set up after an asset swap between the companies in 2015.

Yet buying out Novartis also makes sense for GSK. Big minority shareholders are a hindrance. The purchase clears up uncertainty and allows GSK to use its capital more effectively. It was potentially on the hook to buy the stake — if Novartis wanted it to — until 2035, creating a current liability on its balance sheet.

At a multiple of 19 times last year’s operating profits, the deal is priced at the upper end of comparable valuations. Even so, the transaction will boost GSK’s earnings — by about 5 per cent in 2019. The joint venture’s margins are already much improved. GSK is confident it can push them even higher — from 17.7 per cent to the mid-20s by 2022.

Financing the deal will push up borrowings, taking net debt to 2.5 times operating earnings before usual deductions in 2018. That would, by itself, not jeopardise the dividend, a fear when GSK started eyeing Pfizer’s consumer unit. GSK, though, would like to get its borrowings down more quickly. That would be easier if it decided to flog off Horlicks and other consumer nutrition products — potentially worth about £2.5bn.

Disposing of the milky drink would mean severing a link with a brand that dates back more than a century. Its sale, like the consolidation of the joint venture, would help streamline a group that is often viewed as something of a hotchpotch. The latest moves promise to remedy some of GSK’s problems. With its shares down by about a fifth since taking over, Ms Walmsley still has a lot to do to bring it back to health.