Godrej Consumer Products Ltd

Margin pressures now visible

Godrej Consumer Products (GCPL) reported Q3FY11 net sales/EBITDA/adjusted PAT growth of 89%/66%/40%—strong at the topline but below our EBITDA/PAT estimates by 3%/6%. Domestic household insecticides (GHPL), soaps and the Latin America businesses performed well, while domestic hair colour, Keyline and the African operations underperformed. Given the margin pressures in domestic soaps and the sub-par performance from Keyline and Africa, we are cutting our EPS estimates for FY11/FY12/FY13 by 10.9%/8.1%/8.2% and lowering our target price to Rs 420 from Rs 460. We expect consensus estimates to trend down as well, capping stock outperformance.

GHPL the saviour: Q3 performance was helped by strong numbers from GHPL which delivered 24% YoY revenue growth (like-to-like) and ~150bps QoQ margin expansion. We expect GHPL to remain a key growth driver for consolidated performance. However, growth is likely to trend down to ~15% going forward given the high base.

Domestic soaps and hair colour to remain lacklustre: During the quarter, the domestic soap and hair colour segments grew at a muted 6% and 9% YoY respectively. The company lost market share of ~50bps QoQ in both categories. We expect the soaps business to pick up given likely price increases, but margins would trend down sharply due to higher input costs and limited pricing power (ITC and HUVR now quite aggressive on market share). In hair colour, growth was a disappointing 9% due to price hikes of 10% in Q2FY11. Even though we expect a better growth rate in Q4, we believe this category will face added challenges from uptrading to foreign brands and higher competitive pressures.

Megasari profitability remains key for international business: Megasari delivered a strong topline with 27% YoY growth. However, EBITDA margins declined 150bps QoQ which bears careful monitoring as this business is the primary driver of international business profitability. Keyline reported a 15% YoY drop in revenue to Rs 300mn (EBITDA of Rs 10mn) due to a high base and unfavourable currency movement. The African business also performed below par with weakness in both Rapidol and Kinky. We don't expect significant improvement in growth rates for Keyline, though Africa operations should do slightly better in FY12.

Valuation: We are cutting our FY11/FY12/FY13 EPS by 10.9%/8.1%/8.2%. Our revised target price is Rs 420 based on 23x September '12 earnings. Key downside risks include a sharper-than-expected decline in soap business profitability, a slowdown in GHPL, a rise in LIBOR, and lower margins out of Megasari.

What's New?	Target	Rating	Estimates

CMP	TARGET	RATING	RISK
Rs 400	Rs 420	HOLD	MEDIUM

BSE	NSE	BLOOMBERG
532424	GODREJCP	GCPL IN

Company data

Market cap (Rs mn / US$ mn)	129,436 / 2,834
Outstanding equity shares (mn)	324
Free float (%)	32.6
Dividend yield (%)	1.4
52-week high/low (Rs)	485 / 225
2-month average daily volume	271,253

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
GCPL	400	1.3	1.9	11.4
BSE FMCG	3,547	(1.1)	(2.3)	10.3
Sensex	19,151	(4.6)	(5.0)	5.6

Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	35.3	28.7	23.9	20.4
P/E @ Target	37.1	30.1	25.1	21.5
EV/EBITDA @ CMP	34.6	23.0	18.5	16.0

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	20,412	35,558	44,651	51,718
Growth (%)	*46.5*	*74.2*	*25.6*	*15.8*
Adj net income	3,396	4,510	5,424	6,336
Growth (%)	*96.0*	*32.8*	*20.3*	*16.8*
FDEPS (Rs)	11.3	13.9	16.8	19.6
Growth (%)	*66.0*	*23.0*	*20.3*	*16.8*

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	20.0	17.2	17.0	17.0
EBIT margin	18.8	15.8	15.7	15.8
Adj PAT margin	16.6	12.7	12.1	12.3
ROE	44.5	33.7	29.0	29.0
ROIC	54.4	25.4	19.0	21.6
ROCE	37.9	22.4	17.0	18.0

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Result highlights

Results below estimates on account of lower margins in Domestic business and Megasari

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	9,804	9,100	7.7
EBITDA	1,678	1,730	(3.0)
Adj net income	1,188	1,270	(6.4)
FDEPS (Rs)	3.67	3.92	(6.4)

Source: RCML Research

Net sales growth led by GHPL and Megasari

Margin decline due to higher A&P and other expenses

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Gross Sales	10,012	5,282	89.5	9,759	2.6
Excise duty	208	106	95.5	231	(10.0)
Net sales	9,804	5,176	89.4	9,528	2.9
Cost of Revenues	4,738	2,459	92.6	4,619	2.6
Gross profit	5,066	2,716	86.5	4,909	3.2
Staff cost	831	601	38.4	804	3.4
A&P spend	1,058	433	144.4	980	8.0
Other operating expenses	1,499	668	124.2	1,436	4.4
EBITDA	1,678	1,014	65.5	1,690	(0.7)
EBITDA margin (%)	*17.1*	*19.6*	*(250 bps)*	*17.7*	*(60 bps)*
Depreciation	135	56	141.7	155	(12.6)
Other income	63	111	(43.3)	194	(67.6)
Interest	132.9	20.2	557.9	88.9	49.5
PBT	1,473	1,049	40.5	1,649	(10.6)
Tax	285	198	44.2	338	(15.7)
Adj. PAT	1,188	851	39.6	1,304	(8.9)
FDEPS (Rs)	3.67	2.76	32.9	4.03	(8.9)

Source: Company, RCML Research

Fig 3 - Revised estimates

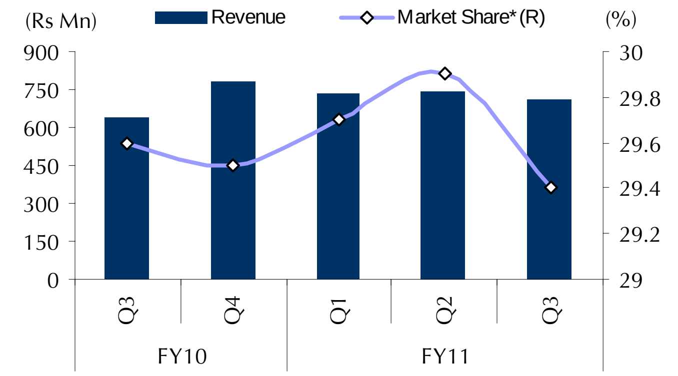
Key parameters	FY11E			FY12E			FY13E		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
Revenue (Rs mn)	35,558	35,558	0.0	43,998	44,651	1.5	50,972	51,718	1.5
EBITDA (Rs mn)	7,099	6,124	(13.7)	8,669	7,612	(12.2)	10,041	8,813	(12.2)
EBITDA margin (%)	20.0	17.2	(275bps)	19.7	17.0	(265bps)	19.7	17.0	(265bps)
Net profit (Rs mn)	5,064	4,510	(10.9)	5,902	5,424	(8.1)	6,900	6,336	(8.2)
EPS (Rs)	15.64	13.94	(10.9)	18.24	16.76	(8.1)	21.34	19.58	(8.2)

Source: RCML Research

Key highlights from the concall

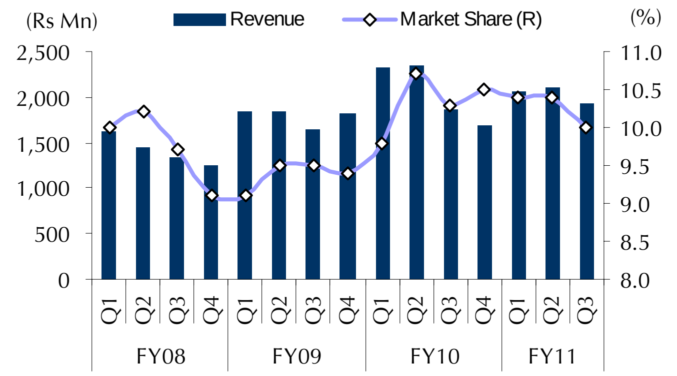
- The **liquid detergents** segment reported 9% YoY growth, whereas **toiletries** grew at a strong 17% YoY. *Godrej Protect* also reported robust growth.
- GCPL has taken price hikes of 3–5% in its **soaps segment** in January, with further hikes being contemplated to offset the margin erosion from rising palm oil prices. It has a cover on palm oil till April-May '11; nonetheless, the management expects lower margins going forward compared to FY10. The management acknowledged increased competition in the soaps category on account of price cuts by ITC and aggressive brand promotion by HUL.
- The **hair colour** business reported lower sales growth (9% YoY) on account of the 10% price increase taken by the company in Q2FY11, resulting in lower primary sales due to a run-down of old inventory by retailers. The company expects sales to bounce back to industry levels in Q4FY11, also aided by major new launch plans.
- **Household Insecticide (HI)** registered strong growth, both in India and Indonesia, with Megasari reporting 27% YoY sales growth and GHPL rising 24% YoY. The company expects the merger of GHPL with itself to lead to value and cost synergies over a period of time.
- **Megasari's** margins contracted 150bps QoQ on account of an unfavourable product mix in the quarter and variations in brand investments. The management still expects margins to hold up at current levels and does not see any significant rise in competitive activity in HI or the air care business in Indonesia.
- GCPL has a foreign currency **debt** of US$ 350mn, which is financed at LIBOR+150–175bps. It also has a Rs 2.5bn debt which is likely to be refinanced at a rate of 9.5–10% (current rate at 8%).
- The company will pay the **MAT** rate for its Indian business, with the consolidated tax rate likely to be in the range of 21–22% for the next 2–3 years.

Fig 4 - Domestic Hair colour – Revenue & Mkt share



Source: RCML Research

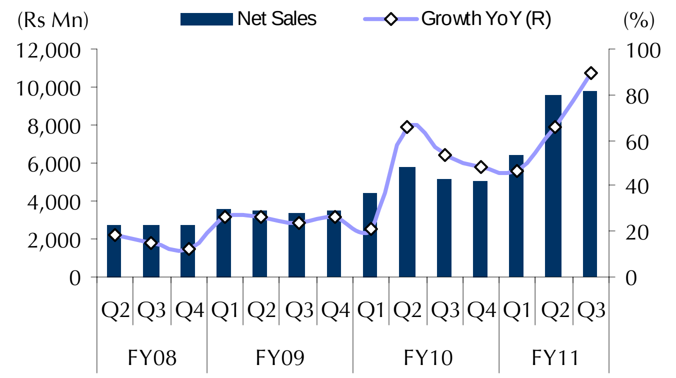
Fig 5 - Domestic Soaps Business - Revenue & Market Share



Source: RCML Research

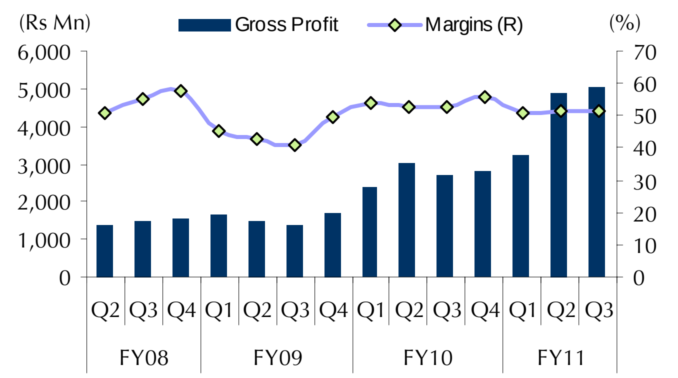
Quarterly Consolidated Financials Trend

Fig 6 - Net sales and net sales growth trend



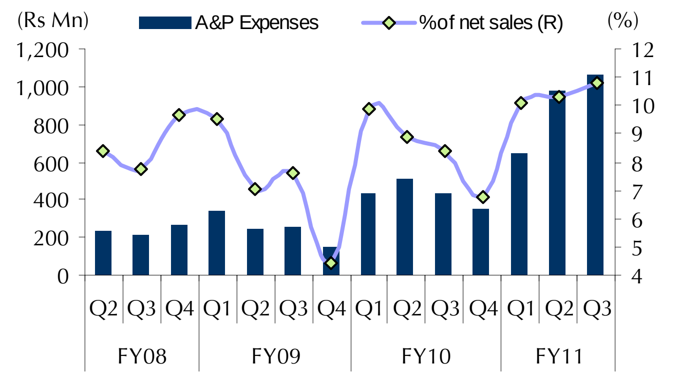
Source: RCML Research

Fig 7 - Gross profit and gross profit margin trend



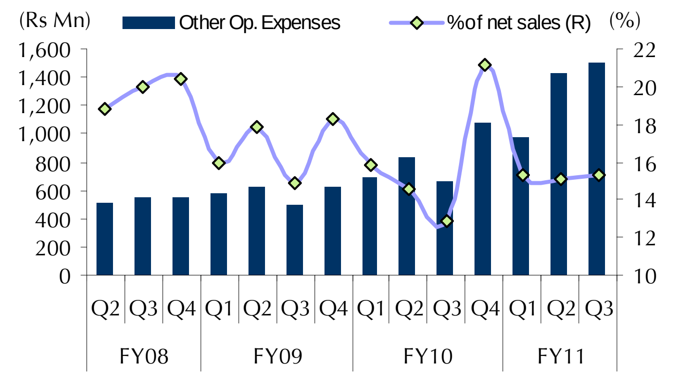
Source: RCML Research

Fig 8 - A&P expenses trend



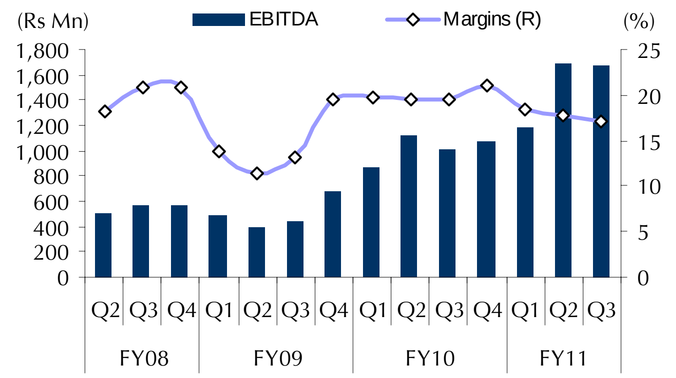
Source: RCML Research

Fig 9 - Other operating expenses trend



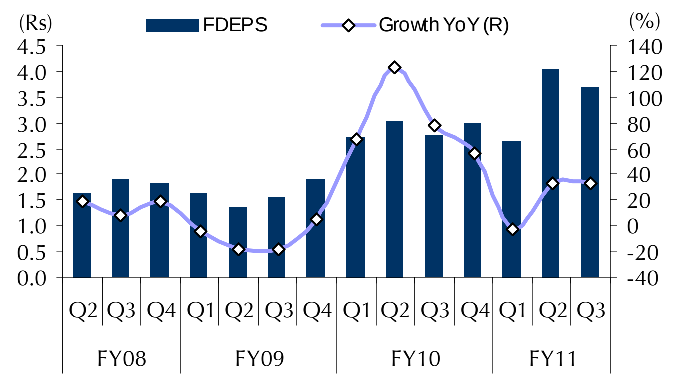
Source: RCML Research

Fig 10 - EBITDA and EBITDA margin trend



Source: RCML Research

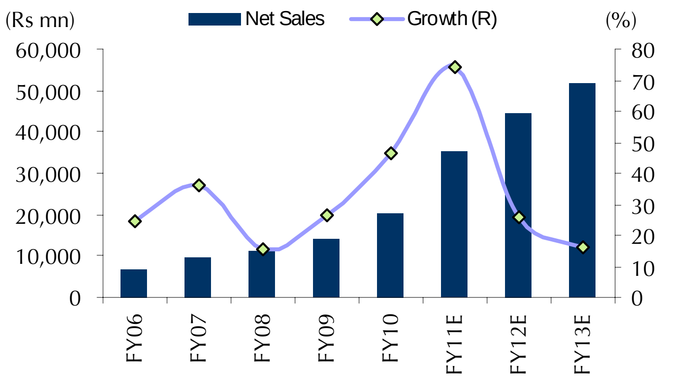
Fig 11 - Fully diluted EPS and EPS growth trend



Source: RCML Research

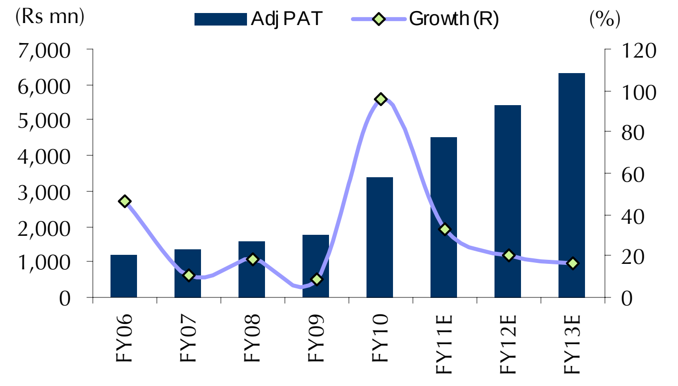
Yearly Consolidated Financials Trend

Fig 12 - Net sales and net sales growth trend



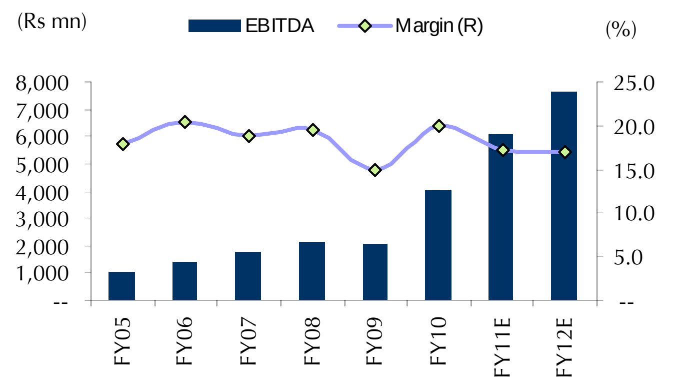
Source: RCML Research

Fig 13 - Adj PAT and Adj. PAT growth trend



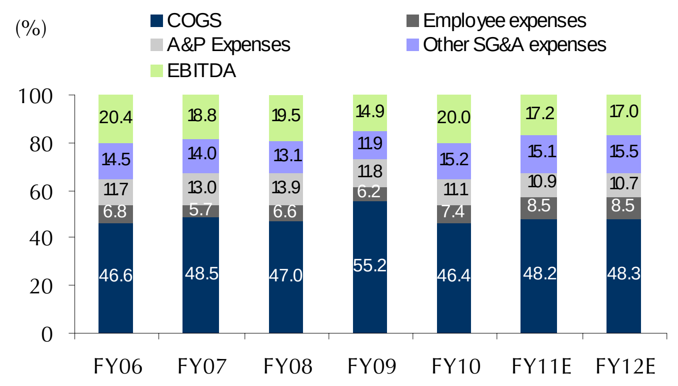
Source: RCML Research

Fig 14 - EBITDA and EBITDA margin trend



Source: RCML Research

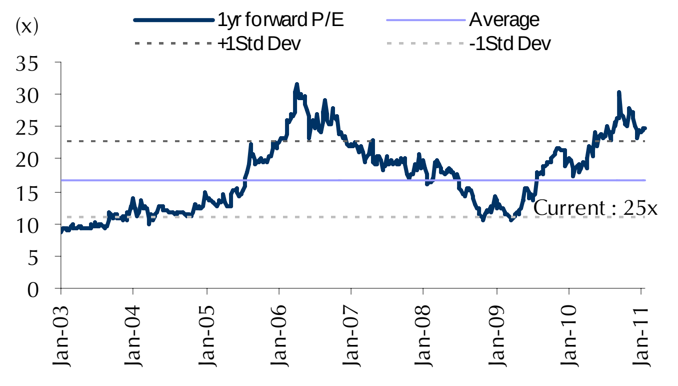
Fig 15 - Cost break-up



Source: RCML Research

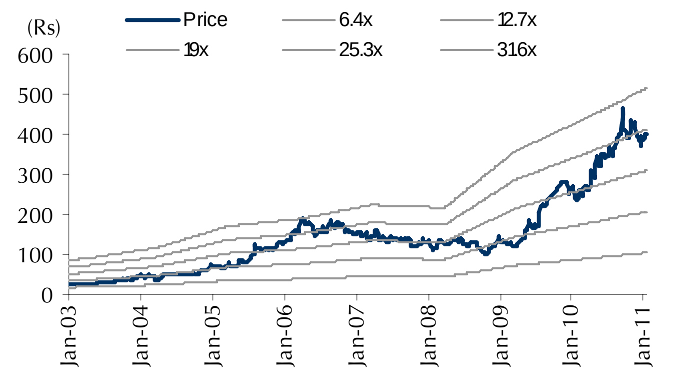
Valuation

Fig 16 - 1 year forward P/E



Source: RCML Research, Bloomberg

Fig 17 - 1 year forward P/E bands



Source: RCML Research, Bloomberg

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	**20,412**	**35,558**	**44,651**	**51,718**
Growth (%)	*46.5*	*74.2*	*25.6*	*15.8*
EBITDA	**4,073**	**6,124**	**7,612**	**8,813**
Growth (%)	*96.6*	*50.4*	*24.3*	*15.8*
Depreciation & amortisation	236	499	580	667
EBIT	3,837	5,625	7,031	8,146
Growth (%)	*104.2*	*46.6*	*25.0*	*15.8*
Interest	111	440	648	648
Other income	473	524	570	626
EBT	4,199	5,708	6,953	8,123
Income taxes	803	1,199	1,530	1,787
Effective tax rate (%)	*19.1*	*21.0*	*22.0*	*22.0*
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	3,396	4,510	5,424	6,336
Adjustments	-	-	-	-
Adjusted net income	**3,396**	**4,510**	**5,424**	**6,336**
Growth (%)	*96.0*	*32.8*	*20.3*	*16.8*
Shares outstanding (mn)	299.6	323.6	323.6	323.6
FDEPS (Rs) (adj)	**11.3**	**13.9**	**16.8**	**19.6**
Growth (%)	*66.0*	*23.0*	*20.3*	*16.8*
DPS (Rs)	4.2	5.6	6.7	7.8

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	3,662	5,009	6,004	7,003
Non-cash adjustments	147	11	732	287
Changes in working capital	(133)	94	(116)	(72)
Cash flow from operations	3,405	5,114	5,903	6,949
Capital expenditure	(570)	(22,555)	(843)	(1,087)
Change in investments	262	-	-	-
Other investing cash flow	(228)	-	(717)	(269)
Cash flow from investing	(536)	(22,555)	(1,559)	(1,356)
Issue of equity	-	5,309	-	-
Issue/repay debt	(119)	15,838	-	-
Dividends paid	(1,039)	(2,110)	(2,538)	(2,965)
Other financing cash flow	(2,451)	-	-	-
Change in cash & cash eq	(469)	1,595	2,522	2,896
Closing cash & cash eq	3,052	4,647	7,169	10,065

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	3,052	4,647	7,169	10,065
Accounts receivable	1,153	2,435	3,058	3,542
Inventories	2,644	4,794	6,026	6,981
Other current assets	2,247	2,904	3,632	4,198
Investments	670	670	670	670
Gross fixed assets	3,483	6,027	6,869	7,957
Net fixed assets	2,152	4,196	4,458	4,878
CWIP	8	20	20	20
Intangible assets	3,584	23,584	23,584	23,584
Deferred tax assets, net	(66)	(78)	(93)	(110)
Other assets	-	-	-	-
Total assets	**15,444**	**43,174**	**48,525**	**53,829**
Accounts payable	1,370	4,752	5,968	6,912
Other current liabilities	3,956	4,502	5,654	6,549
Provisions	202	457	556	650
Debt funds	369	16,207	16,207	16,207
Other liabilities	-	-	-	-
Equity capital	308	324	324	324
Reserves & surplus	9,239	16,932	19,817	23,188
Shareholder's funds	9,547	17,255	20,141	23,511
Total liabilities	**15,444**	**43,174**	**48,525**	**53,829**
BVPS (Rs)	31.9	53.3	62.2	72.7

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	20.0	17.2	17.0	17.0
EBIT margin	18.8	15.8	15.7	15.8
Net profit margin	16.6	12.7	12.1	12.3
ROE	44.5	33.7	29.0	29.0
ROCE	37.9	22.4	17.0	18.0
Working Capital & Liquidity ratios				
Receivables (days)	16	18	22	23
Inventory (days)	83	79	92	95
Payables (days)	49	65	91	94
Current ratio (x)	1.7	1.6	1.7	1.8
Quick ratio (x)	0.3	0.3	0.3	0.3
Turnover & Leverage ratios (x)				
Gross asset turnover	6.6	7.5	6.9	7.0
Total asset turnover	1.5	1.2	1.0	1.0
Interest coverage ratio	34.6	12.8	10.8	12.6
Adjusted debt/equity	0.0	0.9	0.8	0.7
Valuation ratios (x)				
EV/Sales	6.9	4.0	3.2	2.7
EV/EBITDA	34.6	23.0	18.5	16.0
P/E	35.3	28.7	23.9	20.4
P/BV	12.6	7.5	6.4	5.5

Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	5,176	5,092	6,431	9,528	9,804
YoY growth (%)	*53.1*	*48.1*	*46.5*	*65.5*	*89.4*
QoQ growth (%)	*(10.1)*	*(1.6)*	*26.3*	*48.2*	*2.9*
EBITDA (Rs mn)	1,014	1,075	1,191	1,690	1,678
EBITDA margin (%)	*19.6*	*21.1*	*18.5*	*17.7*	*17.1*
Adj net income (Rs mn)	851	918	854	1,304	1,188
YoY growth (%)	*112.5*	*56.3*	*22.5*	*40.2*	*39.6*
QoQ growth (%)	*(8.5)*	*7.8*	*(7.0)*	*52.8*	*(8.9)*

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	82.8	80.9	79.0	78.0	78.0
Interest burden (PBT/EBIT)	111.3	109.4	101.5	98.9	99.7
EBIT margin (EBIT/Revenues)	13.5	18.8	15.8	15.7	15.8
Asset turnover (Revenues/Avg TA)	149.8	149.9	121.3	97.4	101.1
Leverage (Avg TA/Avg equtiy)	250.3	178.4	218.7	245.2	234.5
Return on equity	**46.6**	**44.5**	**33.7**	**29.0**	**29.0**

Company profile

GCPL, a part of the Godrej group, is one of the mid-sized players in the Indian FMCG market. The company was primarily engaged in soap and hair colour products with now having expanded its business internationally to South Asia, Africa and Latin America. The Household Insecticide business under GHPL has also been fully merged in GCPL.

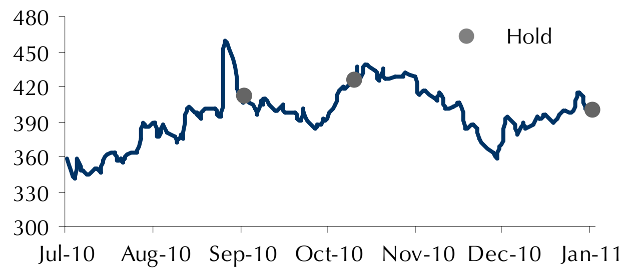
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	71.4	67.7	67.4
FIIs	18.9	19.7	19.4
Banks & FIs	0.8	1.5	1.8
Public	8.9	11.1	11.4

Recommendation history

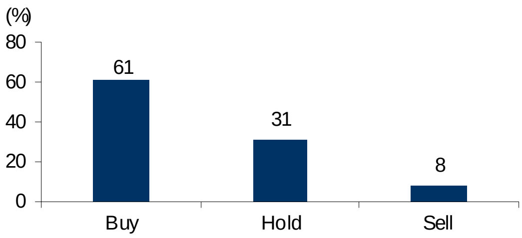
Date	Event	Reco price	Tgt price	Reco
27-Sep-10	Initiating Coverage	413	420	Hold
1-Nov-10	Results Review	424	460	Hold
24-Jan-11	Results Review	400	420	Hold

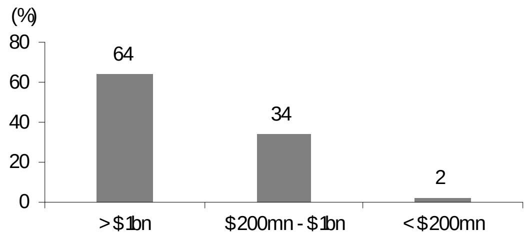
Stock performance



Coverage Profile

By recommendation	By market cap (US$)





Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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Disclaimer