

March 26, 2010

Rating	Reduce
Price	Rs708
Target Price	Rs670
Implied Upside	(-) 5.4%
Sensex	17,559

(Prices as on March 25, 2010)

Trading Data

Market Cap. (Rs bn)	96.3
Shares o/s (m)	136.0
Free Float	49.00%
3M Avg. Daily Vol ('000)	154.1
3M Avg. Daily Value (Rs m)	106.5

Major Shareholders

Promoters	51.00%
Foreign	15.71%
Domestic Inst.	7.00%
Public & Others	26.29%

Stock Performance

(%)	1M	6M	12M
Absolute	1.3	13.1	53.8
Relative	(5.9)	7.6	(22.2)

Price Performance (RIC: COLG.BO, BB: CLGT IN)



Source: Bloomberg

According to some media reports, Procter & Gamble (P&G) is preparing to launch its global toothpaste brand, *Crest*, in India at an aggressive price point. Based on our channel checks and as mentioned in our initiation report ('The Rising Tide', dated 10-12-2009), we continue to believe that *Crest* launch will happen in late 2010 or early 2011. Earlier launch will surprise us and will aggravate the competitive environment in the Oral care category. As and when it happens, it will entail price competition and significant brand investment in the category, impacting category leader Colgate and Hindustan Unilever (HUVR).

- **Media speculation on Crest launch:** According to some media reports, P&G is about to launch its global toothpaste brand, *Crest*, in India at an aggressive price point. While speculation has been there for some time now, buzz is getting louder recently. Based on our channel checks and interaction with industry sources and as mentioned in our sector initiation note ('The Rising Tide', dated 10-12-2009), we continue to believe that Crest launch (or Oral-B ???) will happen in the late CY10 or early CY11E. P&G is currently present in oral care in India through its brand '*Oral-B*' in the Toothbrush category. As per our estimates, *Oral-B* is ~Rs1.8bn brand, growing at ~40%.
- We expect detergent price war to stretch as both HUVR and P&G realign the price ladder and cut prices/hike grammage in *Surf Excel/Ariel* and *Wheel*, post the steep price differential between premium and popular laundry segments which got created after the recent price cuts. As for Colgate, phasing out of income tax benefits at its Baddi plant, increasing competitive threat from P&G and private labels (Future group's launch of '*Sach*' brand of toothpaste) plus expensive valuations cap the upside. We maintain our 'Sell' and 'Reduce' rating on HUVR and Colgate, respectively.

Key financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Revenues (Rs m)	16,948	19,753	22,788	26,285
Growth (%)	15.0%	16.6%	15.4%	15.3%
EBITDA (Rs m)	2,616	3,879	4,247	4,681
PAT (Rs m)	2,902	3,904	4,120	4,669
EPS (Rs)	21.3	28.7	30.3	34.3
Growth (%)	25.3%	34.5%	5.5%	13.3%
Net DPS (Rs)	17.5	25.2	26.6	30.1

Source: Company Data; PL Research

Profitability & valuation	FY09	FY10E	FY11E	FY12E
EBITDA margin (%)	15.4%	19.6%	18.6%	17.8%
RoE (%)	153.3	162.5	142.4	136.0
RoCE (%)	178.6	195.4	186.8	177.7
EV / sales (x)	5.6	4.8	4.2	3.6
EV / EBITDA (x)	36.5	24.6	22.5	20.4
PE (x)	33.2	24.7	23.4	20.6
P / BV (x)	44.5	36.5	30.6	25.9
Net dividend yield (%)	2.5	3.6	3.8	4.3

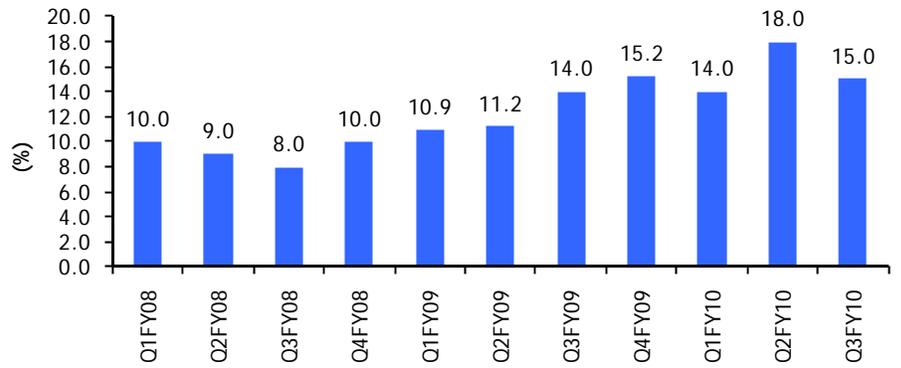
Source: Company Data; PL Research

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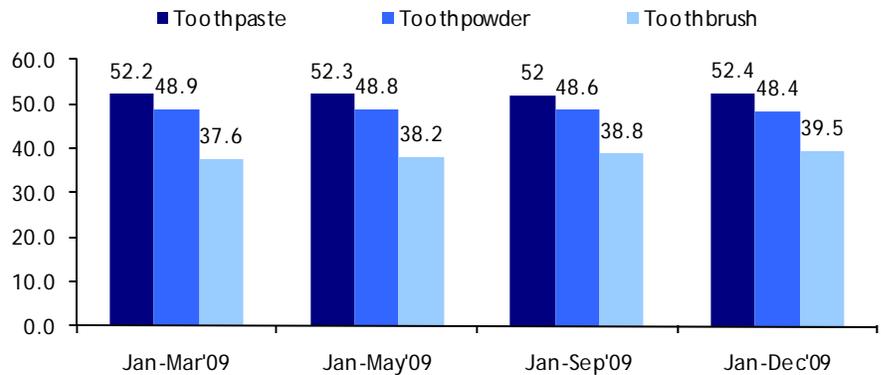
Pressure on incumbent’s market shares and margins: As and when P&G introduces *Crest* in India, it will entail price competition as well as heavy brand investment in the category from all the players, in our view. It will put the market share and margins of incumbent market leader, Colgate, under pressure. Colgate will need to sustain its higher-than-industry ad-spends to protect its turf in Oral care. Recognition of the risk of being a single category company will get highlighted if the competitive intensity sees a step jump in the Oral care category.

Colgate has reported robust volume growth in the recent past...



Source: Company Data, PL Research

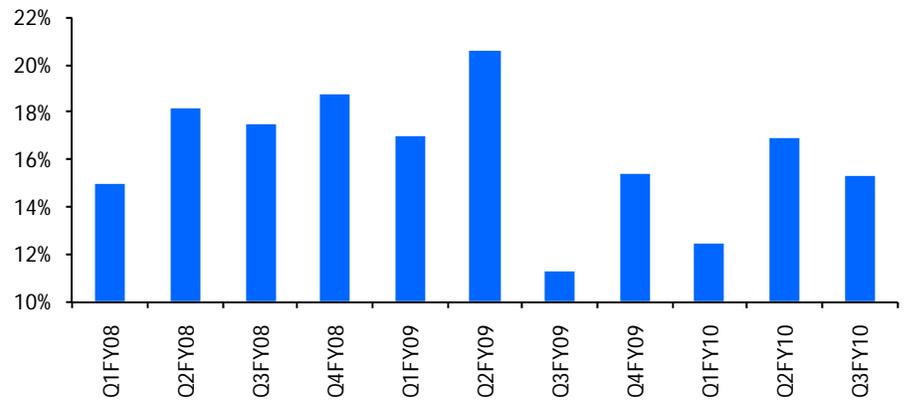
...with improvement in market shares



Source: Company Data, PL Research

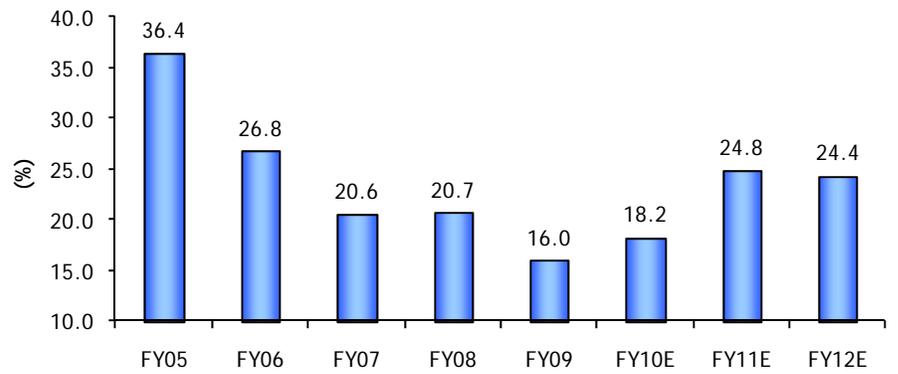


ASP ratio for Colgate to come back to 16-17% levels



Source: Company Data, PL Research

Phasing out of income tax exemption at Baddi in FY11E

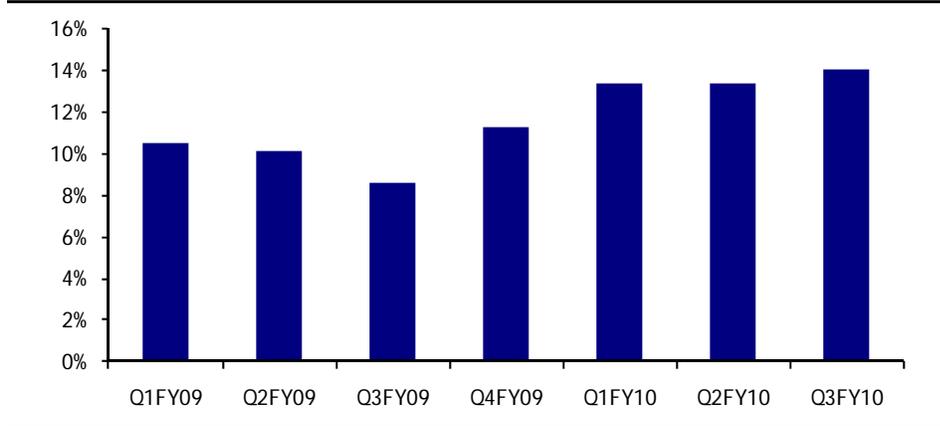


Source: Company Data, PL Research



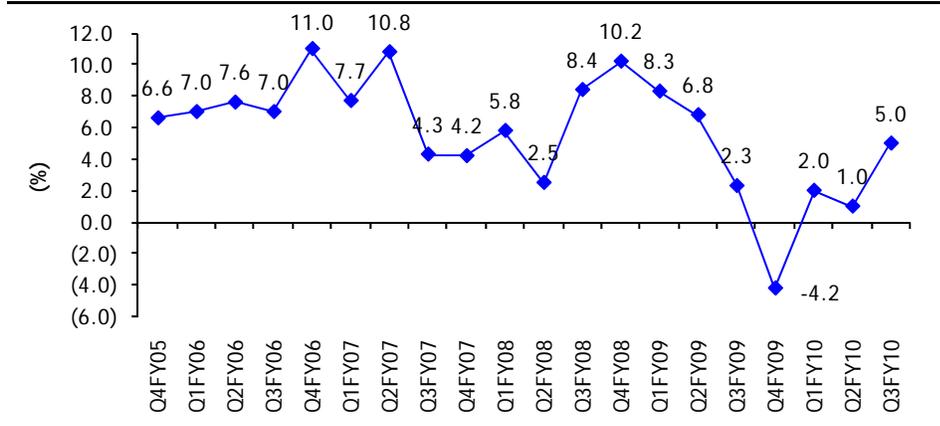
P&G's rising India ambition to put pressure on incumbents: As detailed in our initiation report, *The Rising Tide*, P&G's rising India ambition is playing out as per our expectations; recent detergent price war between HUVR and P&G being an example. With better appreciation of P&G's India plans (HUVR's consensus earnings estimates have been revised 10-12% downwards for FY11E and FY12E in last one month, we are still below 8-10% from consensus estimates) and its consequent deleterious impact on incumbent's financials, we expect HUVR and Colgate to remain under pressure.

HUVR's market share recovery will be gradual and expensive



Source: Company Data, PL Research

We expect volumes to bounce-back in Q4FY10E



Source: Company Data, PL Research



Valuation

Colgate Palmolive (India)

At 23.1X FY11E and 20.4X FY12E, we believe all the positives (sustained volume growth, retention of market leadership) are factored in. However, multiple risks viz. rising competitive threat from P&G, high input costs and down-trading risks owing to sustained high food inflation are not amply reflected in current valuations. Maintain 'Reduce'.

Hindustan Unilever

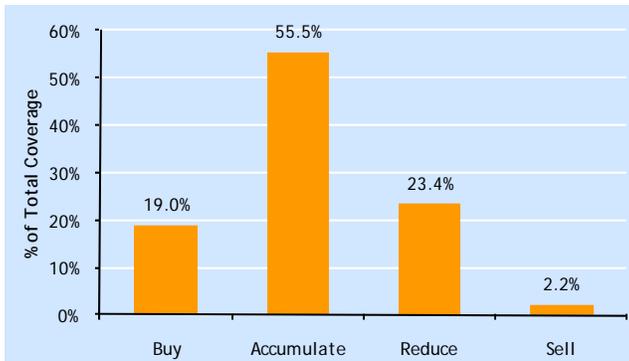
At 23.1X FY11E and 20.5X FY12E, HUVR continues to look expensive to us, given the deteriorating operating and earnings prospects. Increasing competitive intensity is putting defensive characteristics of the business at risk in the medium term in our view and hence, we believe any premium is unjustified. Spread of price war in other categories (Skin care, Shampoo) is our major concern in the near term. Abrupt end in price war, sustainable recovery in market shares and respite from rising input costs constitute key risk to our estimates and rating.

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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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