

## Company Focus

18 January 2008 | 10 pages

# Godrej Consumer Products (GOCP.BO)

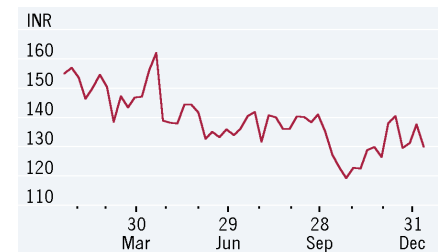
 Target price change 

## Buy: 3QFY08 Results - No Surprises; Revising TP to Rs168

- 3QFY08 in-line with expectations** – Net profit for the quarter came at Rs430m, up 8.7% YoY driven by a 14.6% sales growth. On the EBITDA margin, GCP did well to absorb increased raw material costs.
- Soap revenues up 26%** – The soaps division outperformed the industry yet again this quarter driven by a 5-6% price hike and strong volume growth.
- International business** – Keyline, GCP's UK business recovered after a poor performance last quarter, posting a 6.6% sales growth and 20% growth in net profit. Rapidol, GCP's subsidiary in South Africa showed flat growth, impacted adversely by the rupee appreciation.
- Raising funds for further expansion** – GCP has sought SEBI approval for raising up to Rs4bn through a rights issue. Though the terms of the issue are yet to be decided, the capital raised is likely to be used to retire part of Rs1.7bn debt on GCP's books, and to fund new capex and new acquisitions.
- Target price revision** – Our new target price is Rs168 as we roll forward our target multiple to FY09E earnings (FY08E earlier). This is based on our new target multiple of 21x, adjusted downwards from 25x earlier, to capture increasing competitive intensity and cost pressures in the core domestic hair color and soap businesses, respectively, and slower-than-expected growth in its international businesses. In our opinion, GCP has been de-rated excessively in last 6M, underperforming the Sensex by 28%. At 15.8x FY09E P/E, it is the cheapest stock in our HPC coverage. We rate the stock Buy/Low Risk (1L).

<b>Buy/Low Risk</b>	<b>1L</b>
Price (17 Jan 08)	Rs127.30
Target price	Rs168.00
	<i>from Rs172.00</i>
Expected share price return	32.0%
Expected dividend yield	3.4%
<b>Expected total return</b>	<b>35.3%</b>
Market Cap	Rs28,750M
	US\$733M

### Price Performance (RIC: GOCP.BO, BB: GCPL IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,213	5.37	35.7	23.7	36.5	188.8	2.7
2007A	1,342	5.94	10.6	21.4	23.6	133.7	2.9
2008E	1,556	6.89	16.0	18.5	17.1	107.5	3.4
2009E	1,818	8.05	16.8	15.8	12.8	92.6	3.8
2010E	2,052	9.09	12.9	14.0	9.5	77.9	3.9

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	23.7	21.4	18.5	15.8	14.0
EV/EBITDA adjusted (x)	20.3	16.5	13.9	11.8	10.4
P/BV (x)	36.5	23.6	17.1	12.8	9.5
Dividend yield (%)	2.7	2.9	3.4	3.8	3.9
<b>Per Share Data (Rs)</b>					
EPS adjusted	5.37	5.94	6.89	8.05	9.09
EPS reported	5.37	6.38	6.89	8.05	9.09
BVPS	3.48	5.40	7.42	9.97	13.35
DPS	3.50	3.75	4.27	4.83	5.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	6,997	9,532	11,600	13,459	15,510
Operating expenses	-5,685	-7,877	-9,650	-11,241	-13,044
<b>EBIT</b>	<b>1,313</b>	<b>1,655</b>	<b>1,950</b>	<b>2,218</b>	<b>2,465</b>
Net interest expense	-65	-96	-121	-79	-50
Non-operating/exceptionals	73	26	50	53	55
<b>Pre-tax profit</b>	<b>1,321</b>	<b>1,585</b>	<b>1,879</b>	<b>2,191</b>	<b>2,470</b>
Tax	-113	-243	-323	-373	-418
Extraord./Min.Int./Pref.div.	5	99	0	0	0
<b>Reported net income</b>	<b>1,213</b>	<b>1,440</b>	<b>1,556</b>	<b>1,818</b>	<b>2,052</b>
Adjusted earnings	1,213	1,342	1,556	1,818	2,052
Adjusted EBITDA	1,427	1,797	2,117	2,389	2,642
<b>Growth Rates (%)</b>					
Sales	24.4	36.2	21.7	16.0	15.2
EBIT adjusted	46.1	26.1	17.8	13.7	11.2
EBITDA adjusted	42.1	25.9	17.8	12.9	10.6
EPS adjusted	35.7	10.6	16.0	16.8	12.9
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>1,284</b>	<b>1,479</b>	<b>2,323</b>	<b>2,115</b>	<b>2,084</b>
Depreciation/amortization	115	142	167	172	177
Net working capital	-30	-118	600	126	-145
<b>Investing cash flow</b>	<b>-812</b>	<b>-1,309</b>	<b>-477</b>	<b>-675</b>	<b>-200</b>
Capital expenditure	0	-1,285	0	-75	-100
Acquisitions/disposals	-861	-24	-800	-600	-100
<b>Financing cash flow</b>	<b>-293</b>	<b>140</b>	<b>-1,732</b>	<b>-1,584</b>	<b>-1,627</b>
Borrowings	626	1,049	-633	-340	-340
Dividends paid	-901	-974	-1,100	-1,244	-1,287
<b>Change in cash</b>	<b>179</b>	<b>310</b>	<b>114</b>	<b>-144</b>	<b>257</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>3,425</b>	<b>5,653</b>	<b>6,229</b>	<b>7,002</b>	<b>7,908</b>
Cash & cash equivalent	263	475	589	445	701
Accounts receivable	303	483	493	572	714
Net fixed assets	850	1,992	1,502	1,406	1,329
<b>Total liabilities</b>	<b>2,638</b>	<b>4,433</b>	<b>4,552</b>	<b>4,752</b>	<b>4,892</b>
Accounts payable	1,787	2,520	3,178	3,687	4,207
Total Debt	687	1,736	1,103	763	423
<b>Shareholders' funds</b>	<b>787</b>	<b>1,220</b>	<b>1,677</b>	<b>2,251</b>	<b>3,016</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	20.4	18.9	18.2	17.8	17.0
ROE adjusted	188.8	133.7	107.5	92.6	77.9
ROIC adjusted	120.6	70.2	75.3	117.8	137.9
Net debt to equity	53.9	103.4	30.7	14.2	-9.2
Total debt to capital	46.6	58.7	39.7	25.3	12.3

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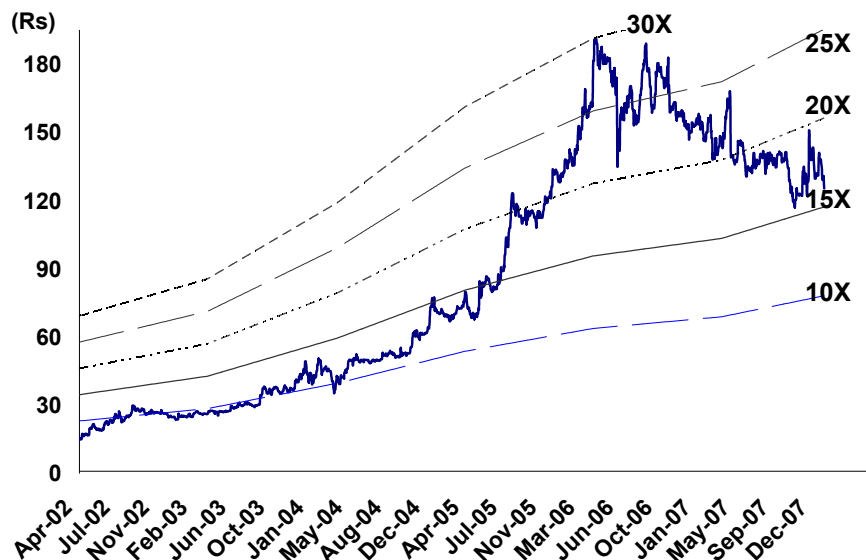
# Excessive De-Rating

In our opinion, GCP has de-rated excessively in the last year, underperforming the Sensex by 41%.

While the concerns on palm oil price inflation and weakening competitive position in hair colors are not unfounded, at current valuations, we believe they are clearly overdone. We believe management's steps to address the above concerns have succeeded as was evident in last few quarters. Consistent price hikes have helped GCP tide over the palm oil cost pressure. This quarter, GCP enforced a 5-6% price hike driving 26% growth in soap revenues. EBITDA margins have remained stable over the last two quarters. The company has arrested market share declines in hair colors through introduction of new product variants and new SKUs.

We are positive on the steps taken by management to address the issues highlighted above. At 15.8x FY09E P/E, which is the lowest among our HPC universe and 3.5% dividend yield, in our opinion, the stock is attractive.

Figure 1. GCP P/E Band Chart



Source: Citigroup Investment Research estimates

## 3QFY08 results review

GCPL reported net profit of Rs430m, up 8.7% yoy in line with our expectation. Sales grew by 14.6% driven by a 26% growth in the soaps business and moderate growth in hair colors and toiletries. Margins have largely been maintained despite pressure on palm oil costs due to consistent price hikes and strong volume growth.

Figure 2. 3QFY08 and 9MFY08 Results Summary

	3QFY07	3QFY08	% Change	9MFY07	9MFY08	% Change
<b>Net Sales</b>	<b>2,380.2</b>	<b>2,727.5</b>	<b>14.6</b>	<b>7,074.8</b>	<b>8,330.6</b>	<b>17.8</b>
Expenditure	-1,864.9	-2,159.2	15.8	-5,741.9	-6,749.5	17.5
<b>EBITDA</b>	<b>515.3</b>	<b>568.3</b>	<b>10.3</b>	<b>1,332.9</b>	<b>1,581.1</b>	<b>18.6</b>
<i>EBITDA Margin (%)</i>	<i>21.6</i>	<i>20.8</i>	<i>-81 bps</i>	<i>18.8</i>	<i>19.0</i>	<i>14 bps</i>
Interest	-33.0	-28.6	-13.3	-76.3	-95.1	24.6
Depreciation	-35.9	-48.0	33.7	-97.1	-138.3	42.4
Other Income	17.1	14.7	-14.0	53.5	40.8	-23.7
Profit Before Tax	463.5	506.4	9.3	1,213.0	1,388.5	14.5
Tax	-67.9	-76.2	12.2	-179.2	-201.3	12.3
<i>Tax Rate (%)</i>	<i>14.6</i>	<i>15.0</i>	<i>40 bps</i>	<i>14.77</i>	<i>14.50</i>	<i>-28 bps</i>
Profit After Tax	395.6	430.2	8.7	1,033.8	1,187.2	14.8
<b>Net Profit</b>	<b>395.6</b>	<b>430.2</b>	<b>8.7</b>	<b>1,046.9</b>	<b>1,187.2</b>	<b>13.4</b>
<b>Cost Details</b>						
Total Raw Materials	1,128.7	1,218.4	7.9	3,483.8	4,024.6	15.5
<i>-As a % of sales</i>	<i>47.4</i>	<i>44.7</i>	<i>-275 bps</i>	<i>49.2</i>	<i>48.3</i>	<i>-93 bps</i>
Staff cost	149.8	182.0	21.5	416.1	542.0	30.3
<i>-As a % of sales</i>	<i>6.3</i>	<i>6.7</i>	<i>38 bps</i>	<i>5.9</i>	<i>6.5</i>	<i>62 bps</i>
Advertisement and Publicity	148.8	212.4	42.7	553.9	653.3	17.9
<i>-As a % of sales</i>	<i>6.3</i>	<i>7.8</i>	<i>154 bps</i>	<i>7.8</i>	<i>7.8</i>	<i>1 bps</i>
Other expenditure	437.6	546.4	24.9	1,288.1	1,529.6	18.7
<i>-As a % of sales</i>	<i>18.4</i>	<i>20.0</i>	<i>165 bps</i>	<i>18.2</i>	<i>18.4</i>	<i>15 bps</i>

Source: Company reports

## Segmental performance

Soaps revenue grew by 26% in 3QFY08 driven by a 5-6% price hike. GCP's margins have stabilized in soaps and its brands and strong product offering ensured that its volume growth in this sector remained robust.

In hair colors, management is expanding its product offering to higher end of the market. It is launching new variants and carrying out innovations in its existing products, which we believe should help arrest market share declines as was evident in this quarter. Four newly launched variants of Renew hair color in powder form and new SKUs in Godrej expert hair dye sachets have contributed to the 6% growth in hair colors this quarter. It has maintained its market share at 34.9%.

Figure 3. 3QFY08 Segmental Breakdown

	3QFY07	3QFY08	% Change
Soaps	1066.5	1348.3	26.4
Hair Colours	616.8	656.2	6.4
Toiletries	368.2	390.4	6.0
Liquid Detergents	286.5	278.8	-2.7
Total Godrej Brands	2338.0	2673.7	14.4
By-Products	42.2	53.8	27.5
<b>Total</b>	<b>2380.2</b>	<b>2727.5</b>	<b>14.6</b>

Source: Company reports

## International business impacted by unfavorable exchange rate environment

Keyline's profits rose by 20% in 3QFY08 driven by 6.6% sales growth and a 158bps expansion in EBIT margin. Keyline's profitability was impacted last quarter due to poor off-take on account of adverse weather conditions. Rapidol, GCP's subsidiary in South Africa, posted flat growth, with the adverse impact of the rupee's appreciation. While growth in the international businesses has been much slower than expected, we expect these businesses to start showing growth once the new strategies implemented by GCP have had some time to deliver.

**Figure 4. Keyline Profit and Loss Summary (Rupees in Millions, Percent)**

	3QFY07	3QFY08	% YoY
Total Income	258.0	275.0	6.6
PBIT	25.0	31.0	24.0
<i>EBIT Margin (%)</i>	<i>9.7</i>	<i>11.3</i>	<i>158 bps</i>
Interest	(10.0)	(11.0)	10.0
PBT	15.0	20.0	33.3
TAX	(5.0)	(8.0)	60.0
PAT	10.0	12.0	20.0

Source: Company reports

**Figure 5. Rapidol Profit and Loss Summary (Rupees in Millions, Percent)**

	3QFY07	3QFY08	% YoY
Total Income	145	146	0.7
PBIT	27	25	(7.4)
Interest	0	0	Nm
PBT	27	25	(7.4)
TAX	-8	-6	(25.0)
PAT	19.0	19.0	0.0

Source: Company reports

## Raising funds for further expansion

GCP has sought SEBI approval for raising up to Rs4bn through a rights issue. Though the terms of the issue are yet to be decided, the capital raised is likely to be used to retire part of Rs1.7bn debt on GCP's books, and to fund new capex and new acquisitions.

**Figure 6. Objects of the Proposed Rights Issue**

	FY09	FY10	Total
Funding of Capital Expenditure	760	375	1,135
Investment in our Joint Venture, Godrej SCA Hygiene Limited	205	-	205
Prepayment / Repayment of certain debt	840	-	840
Investment in our Subsidiary, Godrej Netherlands B.V	464	-	464
Finance acquisitions & strategic initiatives & general corporate expenses	x	x	x
Total	2,269	375	2,644

Source: Company reports

## Godrej Consumer Products

### Company description

GCP is one of the fastest growing companies in India's FMCG sector, with leadership in the hair-color market and the No.2 position in soaps. Its product portfolio also includes toiletries, and household-, baby- and personal-care products. GCP acquired Keyline Products, a manufacturer of cosmetic products and toiletries in the UK, in October 2005. In September 2006, it acquired Rapidol International, a market leader in the South African ethnic hair-color market. GCP came into being in April 2001 when the consumer division of Godrej Soaps was de-merged. Godrej Soaps then became Godrej Industries and retained the industrial chemicals, medical diagnostics and estate operations. The group has close to eight decades of manufacturing experience in soaps and personal-care products.

### Investment strategy

We rate GCP as Buy/Low Risk (1L). The company has a 35% share of India's hair-color market and is the second largest in the soaps segment. GCP's overseas acquisitions complement its product portfolio and give it access to high-growth markets such as South Africa and the UK. The hair-color market is under-penetrated in India, and therefore offers GCP scope for further growth. In soaps, it continues to enlarge market share through innovations and value-for-money products. The stock is among the cheapest in our India household and personal care universe.

### Valuation

We use P/E as our primary valuation method because GCP's earnings growth has been steady, and the company is unlikely to face cyclical earnings. Our target price of Rs168 is based on 21x FY09E EPS, pegged at a 25% discount to sector leader HUL. Our target multiple is reasonable, in our view, given the growth potential of GCP's core domestic business and its recent international acquisitions. We ascribe a discount to HUL in valuing GCP owing to its presence in a limited number of product categories vis-à-vis HUL, to capture its market positioning and the competitive intensity in its existing markets. We value it at a 15% discount to comparable HPC peers like Marico owing to slower earnings potential.

### Risks

We rate GCP as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility, and because the company operates in branded consumer segments. Risks that could impede the stock from reaching our target price include: 1) intense competition in the hair-color segment, which is undergoing a gradual shift from traditional hair colors to the premium segment, in which GCP has a weak presence; (2) price inflation in key raw materials such as palm oil; 3) a slowdown in consumer demand, 4)

integration issues after the recent acquisitions, and slower-than-expected growth in the UK and South Africa, and 4) considering that c20% of the consolidated entity's revenues is likely to be from international markets, earnings growth is exposed to forex risks.

# Appendix A-1

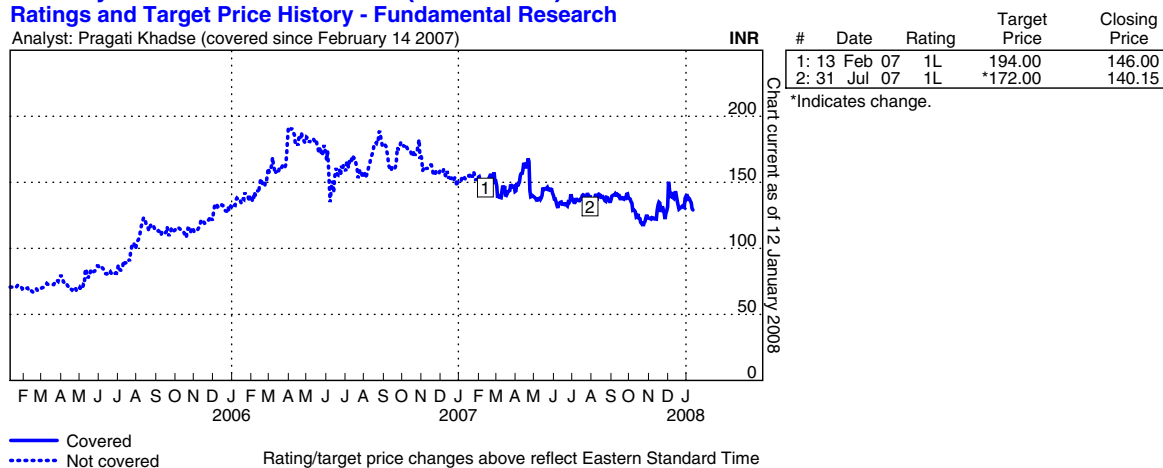
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Analyst: Pragati Khadse (covered since February 14 2007)



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Data current as of 31 December 2007

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