

## Company Flash

26 October 2007 | 6 pages

# Colgate Palmolive (India) (COLG.BO)

## 2Q FY08: Higher Ad Spend Pares Margins, But Volumes Robust

- Below expectations** — Colgate's 2Q FY08 results were significantly below our estimates. Net profit fell 33.2% yoy, mainly on account of a 349bp EBITDA margin contraction and a higher tax rate. Colgate's expenditure on advertising in 2Q was significantly higher (up 518bps), which depressed margins.
- Volume growth remains robust** — The positive side of the 2Q performance was continued strong growth in volumes. Net sales increased 13.7% yoy, with underlying oral-care volumes growing 9% thanks to strong contribution from all oral-care brands.
- Looking beyond toothpastes** — Colgate recently launched new products in the tooth brush and personal-care segments. While still small, Colgate is increasing its non-toothpaste product portfolio and trying to create a second line of growth drivers, which bodes well for longer-term growth prospects.
- Further savings on tax and excise** — Despite disappointing 2Q results, we are maintaining our FY08 EPS estimates. Colgate is ramping up its capacities for its facilities in tax-free areas, which will contribute to further excise and tax savings going forward. We also expect contribution from new products to enhance Colgate's growth profile.
- Valuations look attractive** — The stock is currently trading at 14.5x FY08E P/E, towards the lower end of its historical trading multiples (average 23x), and we believe provides a good buying opportunity.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (26 Oct 07)	Rs385.95
Target price	Rs482.00
Expected share price return	24.9%
Expected dividend yield	3.1%
<b>Expected total return</b>	<b>28.0%</b>
Market Cap	Rs52,486M US\$1,333M

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



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,376	10.12	18.4	38.1	19.4	52.8	2.3
2007A	2,182	16.04	58.6	24.1	18.7	79.1	2.5
2008E	2,649	19.48	21.4	19.8	14.5	82.6	3.1
2009E	3,041	22.36	14.8	17.3	11.6	74.9	3.6
2010E	3,506	25.78	15.3	15.0	9.4	69.7	4.1

Source: Powered by dataCentral

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## 2Q FY08 Results Tables

Figure 1. Colgate 2Q FY08 Results Summary (Rupees in Million; Percent)

	2QFY07	2QFY08	% yoy
<b>Net Sales</b>	<b>3,200.1</b>	<b>3,638.7</b>	<b>13.7</b>
Expenditure	-2,592.0	-3,074.4	18.6
<b>EBITDA</b>	<b>608.1</b>	<b>564.3</b>	<b>-7.2</b>
<i>EBITDA Margin (%)</i>	<i>19.0</i>	<i>15.5</i>	<i>-349 bps</i>
Interest	-2.2	-5.5	150.0
Depreciation & Amortisation	-35.6	-49.3	38.5
Other Income	182.4	195.8	7.3
<b>PBT</b>	<b>752.7</b>	<b>705.3</b>	<b>-6.3</b>
Tax	67.1	-157.9	-335.3
<i>Tax Rate (%)</i>	<i>-8.9</i>	<i>22.4</i>	<i>nm</i>
<b>PAT</b>	<b>819.8</b>	<b>547.4</b>	<b>-33.2</b>
Exceptional items	-588.0	0.0	nm
<b>PAT after Exceptionals</b>	<b>231.8</b>	<b>547.4</b>	<b>136.2</b>

Source: Company Reports

Figure 2. Colgate 2Q FY08 Key Costs (Rupees in Million, Percent)

	2QFY07	2QFY08	% yoy
Net Sales	3200.1	3638.7	13.7
Total Raw Material Cost	1,392.2	1,552	11.5
<i>% of Sales</i>	<i>43.5</i>	<i>42.6</i>	<i>-86 bps</i>
Employee/Staff Cost	297.8	308	3.4
<i>% of Sales</i>	<i>9.3</i>	<i>8.5</i>	<i>-84 bps</i>
Advertising Cost	416.6	662	59.0
<i>% of Sales</i>	<i>13.0</i>	<i>18.2</i>	<i>518 bps</i>
Other Expenditure	485.4	553	13.8
<i>% of Sales</i>	<i>15.2</i>	<i>15.2</i>	<i>2 bps</i>

Source: Company and Citi Investment Research

## Colgate Palmolive (India)

### Company description

Palmolive has been a leader in India's oral-care market for more than 30 years. The group's portfolio is heavily skewed toward oral-care products, which account for more than 90% of sales. Of late it has been exposed to rivalry from Hindustan Lever and others. The company has a presence in the personal-care category through its Palmolive brand in products such as shaving creams and soaps, as well as higher-end shower gels and hand washes. Colgate Inc. has a 51% stake in the company.

### Investment strategy

We rate Colgate as Buy/Low Risk. Colgate is the market leader in the oral-care market with more than 49% market share. The company has invested significantly in its brands and, even with its strong leadership position, has

been growing ahead of the market. In the past two years, it has gained market share in the semi-urban/rural markets by pushing its 'Cibaca' brand. It has also launched innovative variants catering to the urban markets, which has significantly enhanced its growth profile. The company has kept its ad-budgets fairly high in the past two years, and we believe that it is now in a position to scale these back; and hence unlock brand value and enhance margins.

## Valuation

Our price target of Rs482 is based on a P/E of 23x mid FY09E, which is benchmarked off Colgate's mid-end historical P/E trading range over the last ten-year period. We use the mid-end of the trading range to reflect the improving sales growth environment, although we continue to monitor competitive risks, especially if P&G were to enter the oral-care market. Our target price is also based on about 14x one-year forward EV/EBITDA, a premium to the market and the sector average. We believe Colgate's brand equity is strong and will likely help the company maintain its premium rating.

## Risks

We rate the stock as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to the stock reaching our target price include: 1) The biggest risk to Colgate emanates from increased competition by HLL and/or entry of a third large player such as PG; 2) The oral-care market has seen all major players introduce discount brands but only some have been successful. In case there is cannibalization of the flagship brands, there is a threat that although volumes may not decline, the overall size (value) of the oral care market may not increase but rather contract if the brands and the perceived value equation are not communicated in an effective manner; and 3) If rural demand slackens (on sub-normal monsoon), volume growth could slow.

# Appendix A-1

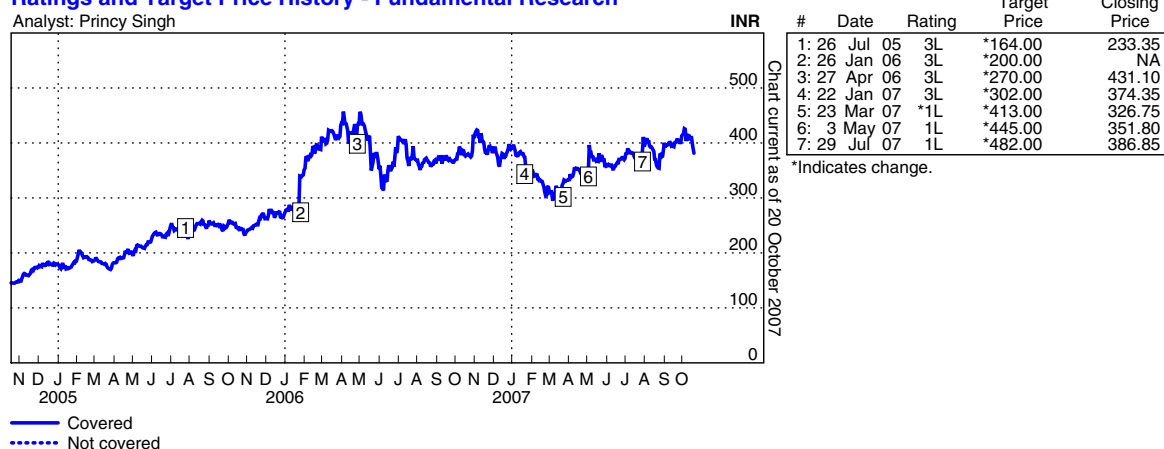
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Analyst: Princy Singh



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