PICK OF THE WEEK

November 26, 2007

IDBI capital

Colgate Palmolive India Ltd.

Rs.394 | Buy

Smiling bright

Nifty: 5732; Sensex: 19248

Key Stock Data

Sector	FMCG – Personal Care
Bloomberg/Reuters	CLGT@IN/COLG.BO
Shares o/s (m)	136
Market cap (Rs m)	53,581
Market cap (US$ m)	1,350
3-m daily average vol.	87,944

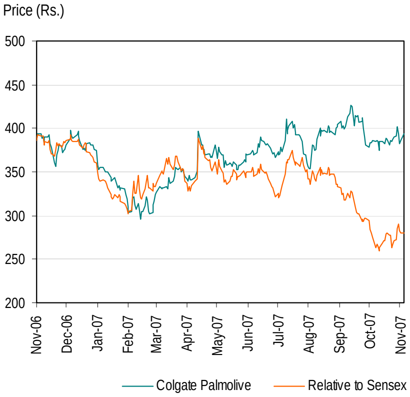
Price Performance

52-week high/low			Rs434/291
	-1m	-3m	-12m
Absolute (%)	0.9	9.1	0.0
Rel to Sensex (%)	(1.0)	(24.0)	(37.8)

Shareholding Pattern (%)

Promoters	51.00
FIIs/NRIs/OCBs/GDR	11.19
MFs/Banks/FIs	11.21
Non Promoter Corporate	2.38
Public & Others	24.21

Stock vs Relative to Sensex



Source: Capitaline

Summary

Colgate Palmolive India Ltd. (Colgate) is the leader in oral care market. Over the decades it has maintained its dominant position with 40% market share. With 90% revenues coming from oral care, the product portfolio also include personal care products. Over the last 2-years the revenues have grown by CAGR 16 %.

Going forward, we believe that the oral care market in India is expected to exhibit double digit growth. Colgate with its dominant position in Indian markets is well poised to capture industry growth. At current price, Colgate is trading at attractive P/E of 21.5x on FY08E and 18.1x on FY09E earnings. We recommend 'Buy' with price target of Rs.457 (16% upside) over the year.

Investment highlights

- **Dominant position aided by steady growth**

  We believe that Colgate will maintain its steady growth in revenues and market leadership position. With its presence in all price segment, brand positioning and wide distribution in rural and urban India, we estimate Colgate should be able to report a revenue growth of 15%+ CAGR over the next 2-years.

- **Industry has a huge room to grow**

  The rural penetration levels of toothpaste at 38%, offers opportunity for growth. In urban areas there is scope for increasing per capita consumption, with only 7% of current users brushing twice a day. Toothpaste consumption in India is a low 92gm /month as against 285gm in Malaysia and 219gm in China.

- **Margins to expand with fiscal benefits**

  Over the last 2-years EBITDA margins of the company have volatile due to ad spends fluctuations and extra ordinary expenses but going forward we believe the EBITDA margins will expand due to fiscal benefits. Colgate's Baddi plant enjoys the 100% excise benefits for the first 10-years where company is expected to shift its entire toothpaste production. Colgate has expanded its Baddi capacity in FY07 to 40,000 MT from 24,000 MT. So also it has income tax breaks to tune of 100% exemption for the first 5-years and 30% exemption for next 5-years. These benefits will help to boost the margins with lower income tax and excise duty. (~ 500bps over the next 2-years.)

- **Wide distribution**

  Colgate has been largest distributed oral care brand in India supported by robust country wide distribution network. It is also trying to improve its rural reach by tying up with e-Choupal and Disha. The network has helped the company to successfully launch the new products and gain the market share.

- **Capital reduction to improve return ratios**

  Colgate has recently announced the capital reduction wherein company will return Rs.9/share to the shareholders taking the face value to Re.1/share and total share capital to Rs.136m. It involves total outlay of Rs.1,432m including dividend and dividend tax. Strong performance coupled with high free cash flows and minimum capex requirements, the capital reduction with improve the return ratios like RoCE and RoE will improve significantly during this period.

Table 1: Financial snapshot (Rs. m)

Year-end: March	FY05	FY06	FY07	FY08E	FY09E
Total revenues	9,984	11,703	13,621	15,757	17,940
EBITDA	1,674	1,838	1,509	2,457	2,933
PAT	1,133	1,476	1,602	2,489	2,964
EPS (Rs)	8.3	10.1	11.8	18.3	21.8
P/E (x)	20.8	34.1	27.8	21.5	18.1

Source: Company reports; IDBI Capital Market Services

Investment positives

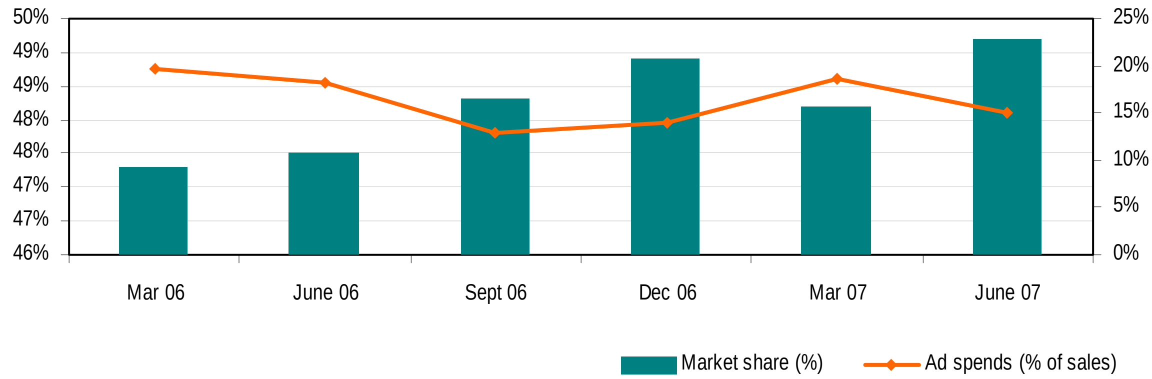
Colgate – Continued dominance with steady growth

Undisputed leader in Indian oral care market

Colgate is undisputed leader in Indian oral care market since decades. It has been recognized as the 'Most Trusted Brands' in India with the strong brand equity associated with Colgate brands. Company's presence in both premium and value segments aids the growth of the company. The revival during the last year in oral care market will benefit the market leader Colgate with strong brand presence in urban markets and also in rural market through *Cibaca* brand.

Along with undisputed dominance Colgate's strong distribution network had a key role to beef up the performance in rural as well in urban regions. Further the company has been spending (18% as compared to 12-13% of industry average) of the substantial amount in brand building and has been able to retain its first position as India's most trusted brand by Brand Equity since 2003.

Figure 1: Market share vs. ad spend



Source: Company reports; IDBI Capital Market Services

Presence in all price points to benefit

The company has the product portfolio across segments gel toothpastes, family toothpaste, Low Price toothpaste and toothpowders. While family toothpaste and toothpowders are expected to catch un-penetrated rural markets while higher end toothpaste are expected to the urban markets. Having presence in all segments will benefit Colgate by catching untapped rural consumers and upgrading product in urban consumers.

In urban area its closet competitor is Hindustan Unilever Ltd. (HUL) who have 30% market share and in rural area *Cibaca* is competing with *Dabur* and other regional player like *Ajanta* and *Amar*.

Table 2: Segmentwise competitive scenario

Gels	Family toothpaste	LPT	Toothpowder
Colgate	Colgate	Colgate	Colgate
HUL	HUL	-	-
-	Dabur	Dabur	Dabur
-	-	Anchor	Anchor

Source: Company reports; IDBI Capital Market Services

With the revenue drivers in place we believe that the revenues of Colgate will grow at the CAGR of 15% over the next 2-years with robust volume growth of 11 % in FY08 and 10 % in FY09. The innovations helped the company to garner market share recently. The company's recent launches have been well received by the market. The new launches supported by the category growth of (15 %) added 5% in market share to the company.

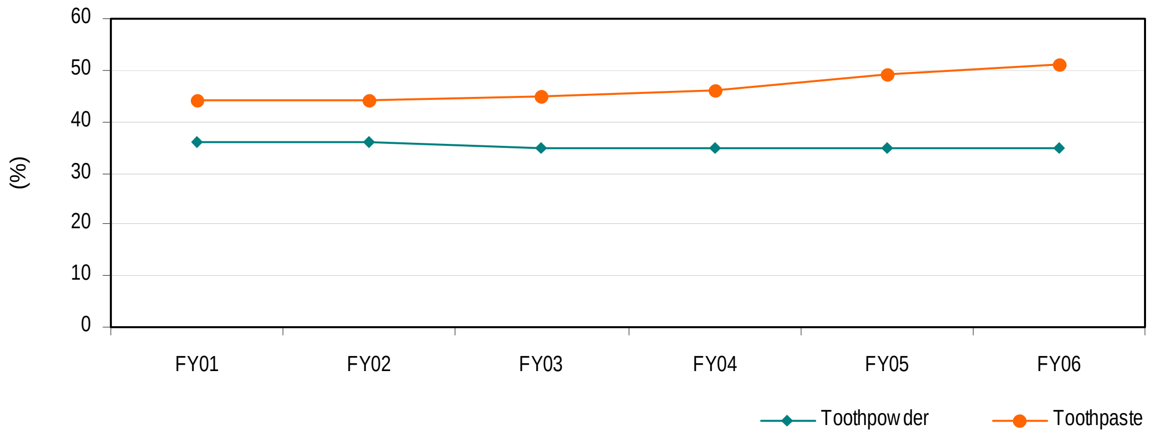
Low category penetration and low per capita consumption – huge room to grow

Low category penetration and lower per capita consumption – Enough scope for growth

Rs.24bn Indian oral care market have revived with the strongly after the dismal growth of 3% and 5% in FY05 and FY06 respectively. Industry has witnessed strong growth of 16% in toothpaste category in FY07.

The industry which is characterized by low penetration and low per capita usage offers a huge potential to industry players to grow. Toothpaste penetration (%) has been low in India especially in rural India. Urban penetration levels are higher to 75% compared to 38 % penetration in rural India. Overall penetration has increased to 51% by the end of 2006 as compared to 45% in 2003.

Figure 2: Penetration – Toothpowder and toothpaste



Source: Company reports; IDBI Capital Market Services

Along with the low penetration, per capita usage is very low to 92gm as compared to 285gm in Malaysia and 219gm in China. Only 50% people use toothpaste and 75% of the tooth brush users brushes only ones a day, this keeps the per capita usage to these low levels.

Table 3: Per capita consumption of toothpaste

	Per capita consumption (Grams/Month)	% of brushing twice a day
China	219	61
Malaysia	285	86
India - Urban	92	7

Source: Company reports; IDBI Capital Market Services

Increased penetration with increasing awareness about the oral care products will drive the demand in rural areas. The shift from datun, salt and other traditional methods to toothpowder or toothpaste will increase penetration in rural areas. Urban demand growth is the factor of increased per capita usage by urban consumers as a result of more and more people turning to brushing twice a day. Colgate undertakes various programmes in association with dentists all over India to increase awareness about oral care and educate the people.

Wide distribution

Strong distribution has been the formidable strength of the company. Colgate has been largest distributed oral care brand in India supported by robust country wide distribution network. It is also trying to improve its rural reach by tying up with e-Choupal and Disha. The network has helped the company to successfully launch the new products and gain the market share.

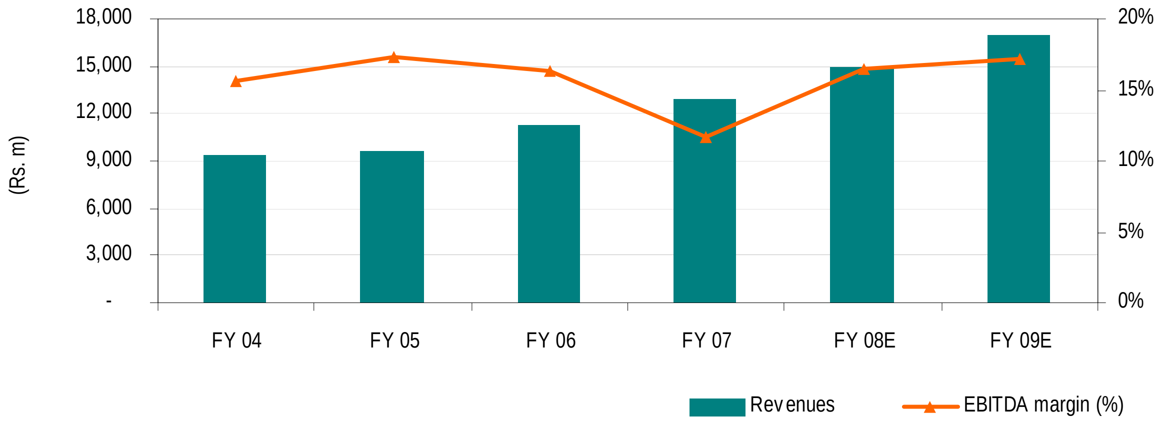
Tax exemption will boost profit margins

- **Profit margins to expand**

Colgate has expanded its Baddi capacity in FY07 to 40,000MT from 24,000MT. This plant enjoys the 100% excise benefits for the first 10-years. So also it has income tax breaks to tune of 100% exemption for the first 5-years and 30% exemption for next 5-years. This plant expansion along with Sewri plant closure will lead to substantial saving to the company. We estimate 95% capacity utilization at Baddi plant which would bring down effective tax rates to ~ 20% in FY08 from 28% in FY07.

Further Colgate will rake up the capacity utilization at baddi plant to take benefits of tax breaks by increasing inhouse sourcing inturn reducing the effective cost for the company. We believe, fiscal benefits, in-house sourcing, along with the staff cost saving due to closure of Sewri plant will lead to margin improvement over the next two years. We estimate 16.7% and 17.4 % net profit margin in FY08 and FY09.

Figure 3: Revenues and margins



Source: Company reports; IDBI Capital Market Services

Concerns

- **No diversity in products**

Colgate earns more than 90% of its revenues from oral care. Unlike Colgate, its parent company earns only 38% of its revenues from oral care. Colgate internationally concentrates on personal care as well.

Colgate has still diversified in India much even after having such a strong brand name. Its time Colgate started looking at personal care segment as well. Having most of its revenues come from only one segment can limit Colgate's future prospects. Limited product portfolio thus is one of the major constraints to the companies' progress.

- **Competition by big players**

Colgate is the market leader in oral care since decades. But it has been exposed to competition from other players. Its major competitors are Hindustan Unilever Ltd. and Dabur India Ltd.These are major FMCG players and have a varied range of products other than oral care. Dabur has recently acquired a market share of around 10.4% thus making it the third largest player in oral care in India. Dabur has successfully acquired Balsara and is now catering to the lower ends of the market. Colgate in competition has its variants under the *Cibaca* brand but still there is price war where the rural consumer will shift to the product priced lower. Currently HUL is not present in the lower price category of toothpastes; its entry in this segment can impact Colgate's revenues from rural and semi-urban areas.

Valuation

Toothpaste is one of the least penetrated category in FMCG we see a sustainable oral care industry growth. Colgate will sustain double digit growth in medium term with its dominant position in oral care industry having presence in premium and lower price segment.

We have applied a DCF based valuation method for Colgate. We have arrived at a fair value of Rs.457/share of the company. This implies a return of 16% from the current price of Rs.394.

Table 4: DCF

	FY08E	FY09E	FY10-FY17E
EBIT (1-T)	2,501	2,976	35,777
Free cash flow to firm	2,118	3,001	41,597
NPV			
Discounted terminal value	34,399		
Discounted cash flows	26,256		
EV	60,655		
Net debt	(1,430)		
Value per share (discounted to present)	457		

Ke 11.7; Terminal value @ 3% growth, B= 0.65 Rf.10 year yield = 7.8%; Risk pr 6%
s/o: 136 m

Source: Company data; IDBI Capital Market Services

DCF sensitivity analysis prices

Table 5: DCF sensitivity analysis prices

	Cost of capital			
Terminal growth rate (%)	10%	11%	13%	15%
2	511.4	427.2	358.1	296.8
3	556.9	456.2	376.2	308.1
4	617.6	493.2	399.4	321.5
5	702.5	541.7	427.7	337.5

Source: Company data; IDBI Capital Market Services

Valuation based on EV/EBITDA

We have also valued stock on EV/EBITDA method. We have applied 20x EV/EBITDA to FY09 EBITDA of Rs.2,933m compared to peers. Value works out to be Rs.459/share with potential upside of 19.3%.

Table 6: Valuation (EV/EBITDA)

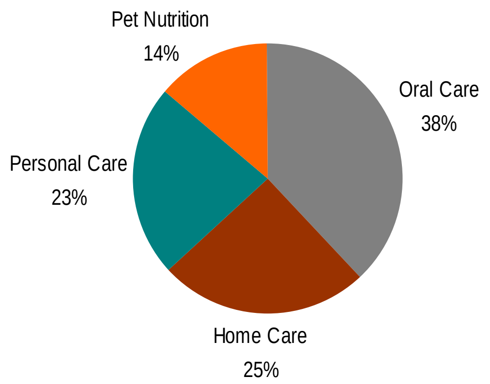
	FY09E
EBITDA	2,933
Applied EV/EBITDA	20
EV	58,667
Net debt	(3,785)
Market cap	62,452
No. of shares	136
Stock value	459

Source: Company data; IDBI Capital Market Services

Business profile

Colgate is market leader in oral care market since decades. Colgate is 51% subsidiary of Colgate Inc. Colgate Inc has worldwide presence with market leader in 53 of the 71 largest toothpaste markets in the world. The oral care revenue contributes 38% to the total revenues of the parent company. Colgate India has almost ~ 7% contribution to the worldwide oral care sales.

Figure 4: Bifurcation of revenue – Parent company



Source: Company data; IDBI Capital Market Services

The parent company's product portfolio contains various products in its portfolio which is not launched in India. These products include Colgate *Luminous*, Colgate *Tarter Control*, Colgate *Ultra Brite* etc.

Colgate has a product portfolio which is dominated by oral care products which contributes ~ 90% to total revenues. Other products include personal care products like shower gels, shower creams, toilet soaps, liquid handwashes, and shaving creams mostly under *Palmolive* brand.

It markets toothpastes under two main brands *Colgate* and *Cibaca*, aimed at the premium and lower price segments, respectively. It commands 49% market share in oral care segment.

■ Oral care brand portfolio – Colgate/HUL/Dabur

Table 7: Product portfolio – Colgate/HUL/Dabur

Colgate	HUL	Dabur
Family and gel paste		
Colgate Dental Cream	*Pepsodent Cumcare*	*Meswak*
Colgate Total	*Pepsodent 2 in 1*	*Dabur Lal*
Colgate Max Fresh	*Pepsodent complete*	
Colgate Kids toothpaste	*Pepsodent Whitening*	
Colgate Herbal	*Closeup Vitamin Fluoride System*	
Colgate Advance Whitening	*Closeup Lemon Mint*	
Colgate Active Salt	*Closeup Milk Calcium*	
Low price toothpaste		
Colgate Cibaca		*Babool*
Promise		
Toothpowder		
Colgate toothpowder		*Dabur Lal Dant Manjan*

Source: Company reports; IDBI Capital Market Services

Financials

Capital reduction to improve return ratios

Colgate has recently announced the capital reduction wherein company will return Rs.9/share to the shareholders taking the face value to Re.1/share and total share capital to Rs.1,36m. It involves total outlay of Rs.1,432m including dividend and dividend tax. Strong performance coupled with high free cash flows and minimum capex requirements, the capital reduction will improve the return ratios like RoCE and RoE significantly going forward.

Q2FY08 quarter performance

Company reported net sales of Rs.3,834m in Q2FY08, up 13.7% from Rs.3,382m in Q2FY07 and the net profit grew by 136% to Rs. 547.4m during the quarter.

The sales growth was mainly driven by the 9% volume growth in toothpaste. The performance of the new products boosted the volumes. This helped the company to marginally increase its market share to 49.1% from 48.2% in FY07.

EBIDTA margin declined by 350bps from 19% to 15.5% due to increase in advertising cost which rose to 18.2% of sales during the quarter as against 13% in Q2FY08. Staff cost declined YoY to Rs.307m due closure of Sewri plant. The net profit profit has increased by 136% YoY, but excluding the impact of extraordinary expenses in Q2FY07, it shows the improvement of 10%.

Table 8: Quarterly performance (Rs. m)

Year-end: March	Q2FY07	Q2FY08	YoY (%)	Q3FY07	Q4FY07	Q1FY08
Net total revenues	3,200	3,639	14	3,223	3,433	3,507
QoQ growth (%)	*3.4*	*3.8*		*0.7*	*7*	*2.2*
Other income	182	196		166	174	210
Total revenues	3,383	3,835	13	3,389	3,606	3,717
Total operating expenses	(3,180)	(3,074)	(3.3)	(2,678)	(2,889)	(2,902)
QoQ growth (%)	*18*	*7*		*(16)*	*8*	*0*
Operating profit	202.5	760	275	711	717	814
QoQ growth (%)	*(63)*	*(9)*		*251*	*1*	*13*
Depreciation	(37)	(49)		(44)	(37)	(44)
EBIT	167	711	326	667	680	770
QoQ growth (%)	*(67)*	*(10)*		*300*	*1.9*	*13*
Interest	(2.2)	(5.5)		(2.9)	(2.5)	(3.3)
Pre-tax profits	(165)	705	328	664	678	767
QoQ growth (%)	*(68)*	*(10)*		*303*	*2*	*13*
Reported net profit	232	547	136	503	506	609
QoQ growth (%)	*(36)*	*(13)*		*117*	*0.5*	*20*

Source: Company reports; IDBI Capital Market Services

Financial summary

Profit and loss account

(Rs. m)

Particulars	FY05	FY06	FY07	FY08E	FY09E
Income					
Sales	10,725	12,175	13,854	14,134	16,013
Excise duty	(1,083)	(933)	(902)	(800)	(906)
Soaps, cosmetics and toilet preparations	8,706	10,095	11,662	13,334	15,107
Toothbrushes and shave brushes	919	1,126	1,271	1,571	1,861
Others	17	21	18	31	37
Net sales	9,642	11,242	12,951	14,936	17,005
Other income	342	461	670	821	935
Total revenue	9,984	11,703	13,621	15,757	17,940
Expenditure					
Cost of goods sold	(4,833)	(5,054)	(5,764)	(6,609)	(7,440)
Employees cost	(747)	(969)	(1,119)	(1,270)	(1,403)
Advertisement and sales promotion	(1,368)	(1,978)	(2,075)	(2,390)	(2,763)
Other expenses	(1,019)	(1,403)	(1,905)	(2,210)	(2,466)
	(7,968)	(9,403)	(10,863)	(12,479)	(14,072)
Extraordinary item			(580)		
EBITDA	1,674	1,838	1,509	2,457	2,933
Depreciation/Amortisation/Impairment	(224)	(314)	(153)	(210)	(217)
EBIT	1,793	1,985	2,026	3,069	3,652
Interest	(12)	(6)	(10)	(15)	(15)
Profit before tax	1,781	1,979	2,016	3,054	3,637
Current tax	(700)	(469)	(540)		
Deferred tax	51.6	25.8	167.4		
Fringe benefit tax		(60)	(42)		
Total tax	(648)	(503)	(414)	(565)	(673)
Profit after tax before prior period item	1,133	1,476	1602	2,489	2,964
Prior period items					
Net profit	1,133	1,476	1602	2,489	2,964
EPS (Rs.)	8.3	10.1	11.8	18.3	21.8
DPS (Rs.)	7.0	7.5	9.5	10.0	11.5

Source: Company reports; IDBI Capital Market Services

Balance sheet

(Rs. m)

Particulars	FY05	FY06	FY07	FY08E	FY09E
Sources of funds					
Shareholders' funds	2,498	2,711	2,805	3,112	4,997
Share capital	1,360	1,360	1,360	136	136
Reserves and surplus	1,138	1,351	1,445	2,976	4,861
Loan funds	40	44	43	43	43
Unsecured loans	40	44	43	43	43
Total	2,538	2,754	2,848	3,155	5,040
Application of funds	-	-	-	-	-
Fixed assets	-	-	-	-	
Gross block	3,244	4,035	4,115	4,365	4,565
Less: Depreciation/Amortisation/Impairment	2,447	2,435	2,438	2,647	2,864
Net block	797	1,600	1,677	1,717	1,701
Capital work-in-progress and advances for capital expenditure	675	91	243	243	243
	1,472	1,691	1,920	1,961	1,944
Pre-operative expenses pending allocation/Capitalisation	36	-	-	-	-
Investments	1,608	1,483	1,333	1,333	1,333
Deferred tax asset (Net)	50	76	257	257	257
Current assets, loans and advances	2,493	3,015	3,564	4,098	6,654
Inventories	745	744	803	971	1,156
Sundry debtors	174	74	93	105	119
Cash and bank balances	561	880	1,117	1,472	3,828
Interest accrued on Investments/Deposits	55	42	39	39	39
Loans and advances	959	1,275	1,512	1,512	1,512
Less: Current liabilities and provisions	3,122	3,511	4,226	4,494	5,148
Liabilities	2,151	2,824	3,157	3,503	3,958
Provisions	971	687	1,069	991	1,190
Net current assets	(628)	(496)	(662)	(396)	1,506
Total	2,538	2,754	2,848	3,155	5,040

Source: Company reports; IDBI Capital Market Services

Ratio analysis

Particulars	FY05	FY06	FY07	FY08E	FY09E
Growth ratios (YoY) (%)					
Revenue growth	2.7	16.6	15.2	15.3	13.9
EBIDTA growth	14.4	9.8	(17.9)	62.9	19.4
EBT growth	17.6	11.1	1.9	51.5	19.1
Net profit growth	4.9	30.3	8.5	55.4	19.1
Profitability ratios (%)					
EBIDTA margin	17.4	16.4	11.6	16.5	17.3
PBT margin	18.5	17.6	15.6	20.4	21.4
PAT margin	11.7	13.1	12.4	16.7	17.4
Return ratios (%)					
RoE	45.4	54.5	57.1	80.0	59.3
RoCE	45.1	53.8	56.6	79.4	59.1
RoNW	11.5	14.2	14.5	80.0	59.3
Liquidity ratios (x)					
Current ratio	0.80	0.86	0.84	0.91	1.29
Debt/Equity	0.02	0.02	0.02	0.01	0.01
Valuation ratios (x)					
P/E	20.8	34.1	27.8	21.5	18.1
EV/EBITDA	13.8	25.1	20.8	21.2	17.0
P/B	9.5	17.3	15.9	17.2	10.7
EV/Sales	2.4	4.1	3.4	3.5	2.9

Source: Company reports; IDBI Capital Market Services

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   "Investment Advice in publicly accessible media -

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   (b) In case, an employee of the stock broker is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice."

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