



Colgate Palmolive

| | |
|--------------------|--------------|
| STOCK INFO. | BLOOMBERG |
| BSE SENSEX: 13,033 | CLGT IN |
| | REUTERS CODE |
| S&P CNX: 3,767 | COLG.BO |

1 November 2006

Neutral

Previous Recommendation: Neutral

Rs409

| | |
|-----------------------|----------|
| Equity Shares (m) | 136.0 |
| 52-Week Range (Rs) | 464/230 |
| 1,6,12 Rel. Perf. (%) | 9/-12/11 |
| M.Cap. (Rs b) | 55.6 |
| M.Cap. (US\$ B) | 1.2 |

| YEAR | NET SALES | PAT | EPS | EPS | P/E | P/BV | ROE | ROCE | EV/ | EV/ |
|--------|-----------|--------|------|------------|------|------|------|------|-------|--------|
| END | (RS M) | (RS M) | (RS) | GROWTH (%) | (X) | (X) | (%) | (%) | SALES | EBITDA |
| 03/06A | 11,242 | 1,548 | 11.4 | 37.7 | 35.9 | 20.5 | 48.6 | 58.6 | 4.7 | 25.0 |
| 03/07E | 13,281 | 1,896 | 13.9 | 22.5 | 29.3 | 18.3 | 53.8 | 65.2 | 4.0 | 21.8 |
| 03/08E | 15,287 | 2,230 | 16.4 | 17.6 | 24.9 | 15.9 | 53.7 | 67.6 | 3.4 | 18.5 |

- Colgate's 2QFY07 results were above our expectations with 63.7% adjusted PAT growth versus our estimates of 32.4% growth. Sales growth at 15% was below our estimates of 22% growth on YoY basis.
- Gross margin improved by 330bp, partly aided by 4.4% price increase undertaken in June 2006. EBITDA margin expanded by 350bps even as the other expenditure increased by 63%, mainly due to 19.6% decline in the advertising expense. Royalty and freight cost increases from the Baddi unit were key contributors to the increase in other expenses.
- Toothpaste volumes grew by 10% while Toothpowder and Toothbrush volumes were up 9% and 26% respectively. Volume growth was broadbased with all the leading brands contributing to growth.
- Colgate has closed down its higher cost Sewri unit in Mumbai where the entire staff was offered VRS at a cost of Rs588m. We expect the company to improve profitability as the operational costs at Sewri were very high due to manpower and octroi charges.
- We are revising our EPS estimates for FY07 by 4.8% to Rs13.9 and for FY08 by 5.1% to Rs16.4 respectively from our earlier estimates of Rs13.3 (FY07) and Rs15.7 (FY08) respectively. The stock is currently trading at 29.3x FY07E and 24.9x FY08E earnings, which fully factors in the benefits of improved margins and steady growth prospects. We maintain **Neutral**.

QUARTERLY PERFORMANCE

| Y/E MARCH | (Rs Million) | | | | | | | | | |
|------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| | FY06 | | | | FY07E | | | | FY06 | FY07E |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2QE | 3QE | 4QE | | |
| Net Sales | 2,583 | 2,781 | 2,857 | 3,021 | 3,096 | 3,200 | 3,390 | 3,595 | 11,242 | 13,281 |
| YoY Change (%) | 6.4 | 13.2 | 21.2 | 25.8 | 19.9 | 15.1 | 18.7 | 19.0 | 16.6 | 18.1 |
| Total Exp | -2,201 | -2,396 | -2,143 | -2,564 | -2,695 | -2,642 | -2,650 | -2,867 | -9,113 | -10,854 |
| EBITDA | 382 | 385 | 714 | 457 | 401 | 558 | 740 | 727 | 2,128 | 2,426 |
| Margins (%) | 14.8 | 13.9 | 25.0 | 15.1 | 12.9 | 17.4 | 21.8 | 20.2 | 18.9 | 18.3 |
| Depreciation | -26 | -39 | -47 | -37 | -37 | -36 | -50 | -51 | -260 | -173 |
| Interest | -2 | -1 | -1 | -2 | -2 | -2 | -2 | 1 | -6 | -6 |
| Other Income | 140 | 98 | 49 | 50 | 148 | 122 | 50 | -40 | 187 | 280 |
| PBT | 494 | 443 | 715 | 467 | 509 | 643 | 738 | 637 | 2,050 | 2,527 |
| Tax | -140 | -134 | -132 | -97 | -149 | -137 | -170 | -179 | -503 | -635 |
| Rate (%) | 28.2 | 30.2 | 18.5 | 20.8 | 29.2 | 21.4 | 23.0 | 28.1 | 24.5 | 25.1 |
| Adjusted PAT | 355 | 309 | 583 | 370 | 361 | 505 | 568 | 458 | 1,548 | 1,892 |
| YoY Change (%) | 39 | 14 | 69 | 11 | 1.6 | 63.7 | -2.5 | 23.8 | 28.5 | 22.3 |
| Extraordinary Expenses | -75 | 0 | -165 | 0 | 0 | -274 | 0 | 0 | -172 | -274 |
| Reported PAT | 280 | 309 | 417 | 370 | 361 | 232 | 568 | 458 | 1,376 | 1,618 |
| YoY Change (%) | 10 | 14 | 46 | 14 | 29 | -25 | 36 | 24 | 142 | 18 |

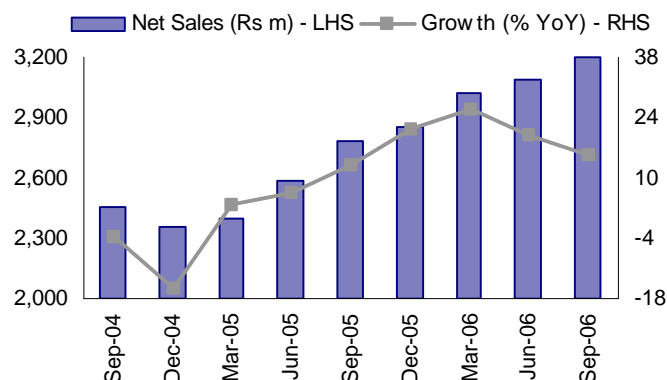
E: MOST Estimates

Steady volume growth

Colgate reported yet another quarter of double-digit volume growth with Toothpaste volumes growing by 10%. Toothbrushes were the star performers with more than 26% volume growth. Toothpowder reported 9% volume growth. Toothpaste category reported broadbased growth with all the leading brands and past year launches such as Colgate Advanced Whitening, Colgate Active Salt and Colgate MaxFresh Gel reporting steady growth. Colgate had a share of 47.6% in Toothpaste, and 43.8% in Toothpowder and 34.3% in Toothbrushes, clearly maintaining its dominance in the oral care market.

Long term demand potential remains intact with product penetration being around 51%. The demand potential is huge as per capita usage in China and Malaysia is 2.5-3 times that of India. In addition only 7% of the population in India has the habit of brushing the teeth twice, indicating healthy long term demand growth potential.

TREND IN NET SALES



Source: Company/ Motilal Oswal Securities

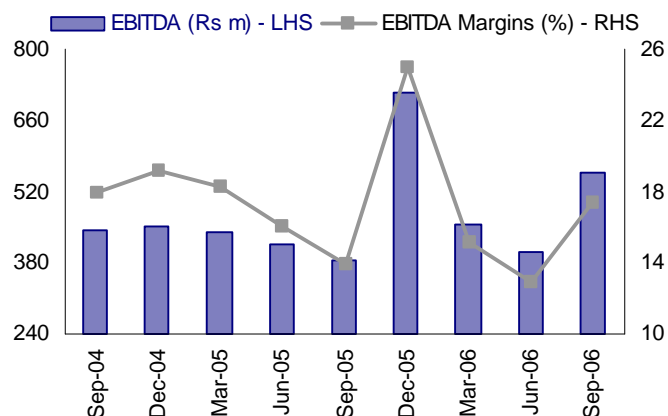
Decline in advertising cost boosts EBITDA margins

Colgate's gross margins jumped by 330bp due to a 4.4% price increase undertaken by the company during June 2006. EBITDA margin expanded by 350bp even as other expenditure increased by 63%, mainly due to 19.6% decline in advertising expenses. Royalty and freight cost increases at the Baddi unit were the key contributors to increase in

other expenses. The decline in advertising expenses appears strange as all competing companies have been advertising aggressively in the recent past.

Colgate's royalty payments to its parent have risen by Rs29.5m during 2QFY07, on a YoY basis. Colgate pays 5% royalty to the parent, which is linked to the sales value realized from the products manufactured inhouse. We expect the EBITDA margins to remain steady in the coming quarters although Q3FY07 margins might show a decline on a YoY basis, as Q3FY06 margins had jumped by 600bp.

TREND IN EBITDA MARGIN



Source: Company/ Motilal Oswal Securities

Revising estimates by 5% for FY07 and FY08

We are revising FY07 and FY08 adjusted PAT estimates by 4.8% and 5% respectively. This follows from lower advertising and operational costs and higher other income. We have also lowered tax rates by 100bp to 25%.

Valuation and view

We are revising our EPS estimates for FY07 by 4.8% to Rs. 13.9 and for FY08 by 5.1% to Rs16.4 respectively from our earlier estimates of Rs13.3 (FY07) and Rs15.7 (FY08) respectively. The stock is currently trading at 29.3x FY07E and 24.9x FY08E earnings, which fully factors in the benefits of improved margins and steady growth prospects. We maintain **Neutral**.

Colgate Palmolive: an investment profile

Company description

Colgate is a market leader in the toothpaste segment with a market share of 50%. With the relaunch of Cibaca Top in early CY04 the company has captured 38% of low price segment. Oral care is one of the most underpenetrated segments of the FMCG market with a penetration of 32%. Colgate has invested Rs700m in a toothpaste facility at Baddi in Himachal Pradesh which will accrue fiscal benefits.

Key investment arguments

- Colgate has regained its leadership position in the oral care market. In FY05, it grew 14% in volumes compared to 9% industry growth.
- Pricing environment has improved as is evident by the latest price hikes. This would aid margin improvement.

Key investment risks

- P&G's entry in the oral care market with its Crest brand, at a lower price point than Colgate.
- Higher input cost prices could affect margins.

Recent developments

- Announced the launch of its innovative new product – “New Colgate Max Fresh”, a unique gel based toothpaste with dissolvable cooling crystals.
- Colgate raised prices across its toothpaste brands by approximately 5% with effect from April 2005.
- Launched Colgate Active Salt, claimed to be the first toothpaste in India to contain salt.

Valuation and view

- The stock is currently trading at 29.3x FY07E and 24.9x FY08E earnings, which fully factors in the benefits of improved margins and steady growth prospects. We maintain **Neutral**.

Sector view

- We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- Companies with low competitive pressures and brought product portfolios will be able to better withstand any slowdown in a particular segment.
- Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

| | | COLGATE | HLL | NESTLE |
|---------------|-------|---------|------|--------|
| P/E (x) | FY07E | 29.3 | 31.6 | 27.1 |
| | FY08E | 24.9 | 25.4 | 22.0 |
| EV/EBITDA (x) | FY07E | 21.8 | 26.9 | 16.5 |
| | FY08E | 18.5 | 21.5 | 13.7 |
| EV/Sales (x) | FY07E | 4.0 | 3.9 | 3.6 |
| | FY08E | 3.4 | 3.4 | 3.2 |
| P/BV (x) | FY07E | 18.3 | 18.5 | 25.4 |
| | FY08E | 15.9 | 15.7 | 21.6 |

SHAREHOLDING PATTERN (%)

| | SEP.06 | JUN.06 | SEP.06 |
|---------------|--------|--------|--------|
| Promoter | 51.0 | 51.0 | 51.0 |
| Domestic Inst | 10.7 | 11.6 | 13.7 |
| Foreign | 10.8 | 10.2 | 5.4 |
| Others | 27.5 | 27.2 | 29.9 |

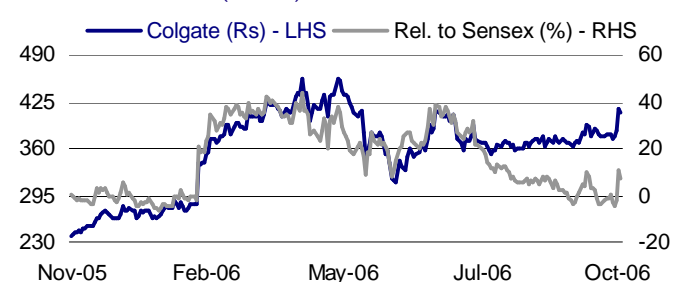
EPS: MOST FORECAST VS CONSENSUS (RS)

| | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| FY07 | 13.9 | 13.7 | 1.8 |
| FY08 | 16.4 | 15.8 | 4.0 |

TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|---------|
| 409 | 350 | -14.4 | Neutral |

STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT | | (RS MILLION) | | | | |
|----------------------------|--------------|---------------|---------------|---------------|---------------|--|
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E | |
| Net Sales | 9,642 | 11,242 | 13,281 | 15,287 | 17,119 | |
| Change (%) | 2.7 | 16.6 | 18.1 | 15.1 | 12.0 | |
| Total Expenditure | -7,968 | -9,113 | -10,854 | -12,455 | -13,808 | |
| EBITDA | 1,674 | 2,128 | 2,426 | 2,831 | 3,311 | |
| Change (%) | 14.4 | 27.1 | 14.0 | 16.7 | 16.9 | |
| Margin (%) | 17.4 | 18.9 | 18.3 | 18.5 | 19.3 | |
| Depreciation | -224 | -260 | -173 | -179 | -184 | |
| Int. and Fin. Charges | -12 | -6 | -6 | -6 | -6 | |
| Other Income | 342 | 16 | 6 | 326 | 400 | |
| Profit before Taxes | 1,781 | 1,879 | 2,253 | 2,973 | 3,522 | |
| Change (%) | 17.6 | 5.5 | 19.9 | 31.9 | 18.5 | |
| Margin (%) | 18.5 | 16.7 | 17.0 | 19.4 | 20.6 | |
| Tax | -700 | -529 | -667 | -783 | -955 | |
| Deferred Tax | 52 | 26 | 32 | 37 | 46 | |
| Tax Rate (%) | -36.4 | -26.8 | -28.2 | -25.1 | -25.8 | |
| Adjusted PAT | 1,124 | 1,548 | 1,896 | 2,230 | 2,606 | |
| Change (%) | 4.1 | 37.7 | 22.5 | 17.6 | 16.9 | |
| Margin (%) | 11.7 | 13.8 | 14.3 | 14.6 | 15.2 | |
| Reported PAT | 1,133 | 1,376 | 1,622 | 2,230 | 2,606 | |

| BALANCE SHEET | | (RS MILLION) | | | | |
|------------------------------|--------------|--------------|--------------|---------------|---------------|--|
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E | |
| Share Capital | 1,360 | 1,360 | 1,360 | 1,360 | 1,360 | |
| Reserves | 1,138 | 1,351 | 1,678 | 2,129 | 2,655 | |
| Net Worth | 2,498 | 2,711 | 3,038 | 3,489 | 4,015 | |
| Loans | 40 | 44 | 44 | 44 | 44 | |
| Deferred Liability | -86 | -76 | -108 | -145 | -191 | |
| Capital Employed | 2,452 | 2,678 | 2,974 | 3,387 | 3,868 | |
| Gross Block | 3,244 | 4,035 | 4,335 | 4,465 | 4,599 | |
| Less: Accum. Depn. | -2,447 | -2,435 | -2,609 | -2,787 | -2,971 | |
| Net Fixed Assets | 797 | 1,600 | 1,727 | 1,678 | 1,628 | |
| Capital WIP | 675 | 91 | 91 | 91 | 91 | |
| Investments | 1,608 | 1,483 | 2,000 | 3,000 | 3,600 | |
| Curr. Assets, L&A | 2,493 | 3,014 | 2,993 | 2,815 | 3,047 | |
| Inventory | 745 | 744 | 863 | 951 | 1,004 | |
| Account Receivables | 174 | 74 | 110 | 126 | 141 | |
| Cash and Bank Balance | 561 | 879 | 670 | 352 | 478 | |
| Others | 1,014 | 1,317 | 1,351 | 1,386 | 1,423 | |
| Curr. Liab. and Prov. | 3,122 | 3,511 | 3,837 | 4,197 | 4,498 | |
| Account Payables | 2,024 | 2,425 | 2,941 | 3,253 | 3,500 | |
| Other Liabilities | 126 | 399 | 163 | 168 | 174 | |
| Provisions | 971 | 687 | 733 | 776 | 824 | |
| Net Current Assets | -628 | -497 | -844 | -1,382 | -1,451 | |
| Application of Funds | 2,452 | 2,678 | 2,974 | 3,387 | 3,868 | |

E: M O S t Estimates

| RATIOS | | | | | | |
|-------------------------------|------------|-------------|-------------|-------------|-------------|--|
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E | |
| Basic (Rs) | | | | | | |
| EPS | 8.3 | 11.4 | 13.9 | 16.4 | 19.2 | |
| Cash EPS | 9.9 | 13.3 | 15.2 | 17.7 | 20.5 | |
| BV/Share | 18.4 | 19.9 | 22.3 | 25.7 | 29.5 | |
| DPS | 7.0 | 7.5 | 8.3 | 11.5 | 13.4 | |
| Payout % | 84.7 | 65.9 | 70.0 | 70.0 | 70.0 | |
| Valuation (x) | | | | | | |
| P/E | 49.5 | 35.9 | 29.3 | 24.9 | 21.3 | |
| Cash P/E | 412 | 30.8 | 26.9 | 23.1 | 19.9 | |
| EV/Sales | 5.5 | 4.7 | 4.0 | 3.4 | 3.0 | |
| EV/EBITDA | 319 | 25.0 | 218 | 18.5 | 15.6 | |
| P/BV | 22.2 | 20.5 | 18.3 | 15.9 | 13.8 | |
| Dividend Yield (%) | 17 | 18 | 2.0 | 2.8 | 3.3 | |
| Return Ratios (%) | | | | | | |
| RoE | 37.3 | 48.6 | 53.8 | 53.7 | 54.4 | |
| RoCE | 45.2 | 58.6 | 65.2 | 67.6 | 68.8 | |
| Working Capital Ratios | | | | | | |
| Debtor (Days) | 6 | 2 | 3 | 3 | 3 | |
| Asset Turnover (x) | 57.0 | 10.2 | 15.0 | 516 | 96.7 | |
| Leverage Ratio | | | | | | |
| Debt/Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |

| CASH FLOW STATEMENT | | (RS MILLION) | | | | |
|------------------------------|---------------|---------------|---------------|---------------|---------------|--|
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E | |
| OP/(loss) before Tax | 1,506 | 1,909 | 2,301 | 2,705 | 3,183 | |
| Int./Div. Received | 278 | 147 | 232 | 274 | 344 | |
| Interest Paid | 12 | 6 | 6 | 6 | 6 | |
| Direct Taxes Paid | -700 | -469 | -600 | -706 | -870 | |
| (Incr)/Decr in WC | -278 | -186 | -137 | -221 | -195 | |
| CF from Operations | 817 | 1,407 | 1,801 | 2,058 | 2,468 | |
| (Incr)/Decr in FA | -751 | -197 | -332 | -167 | -180 | |
| (Pur)/Sale of Investments | -449 | 124 | -517 | -1,000 | -600 | |
| CF from Invest. | -1,200 | -73 | -848 | -1,167 | -780 | |
| Issue of Shares | 0 | 0 | 0 | 0 | 0 | |
| (Incr)/Decr in Debt | -17 | -4 | 0 | 0 | 0 | |
| Dividend Paid | -1,078 | -1,163 | -1,294 | -1,779 | -2,080 | |
| Others | 759 | 151 | 131 | 571 | 517 | |
| CF from Fin. Activity | -336 | -1,016 | -1,163 | -1,208 | -1,563 | |
| Incr/Decr of Cash | -719 | 318 | -210 | -317 | 126 | |
| Add: Opening Balance | 1,280 | 561 | 879 | 670 | 352 | |
| Closing Balance | 561 | 880 | 670 | 352 | 478 | |

E: M O S t Estimates

N O T E S

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| Disclosure of Interest Statement | Colgate Palmolive |
|---|--------------------------|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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