

Company Results Review

26 April 2007 | 11 pages

Godrej Consumer Products (GOCP.BO)

Buy: Disappointing Results but Attractive Valuations

 Rating change
 Target price change
 Estimate change

- 4QFY07 below expectations** – GCP’s revenue growth of 26.6% was in-line with our expectation, driven by strong growth in the soaps (20%) and international businesses. Keyline’s revenues grew 80% YoY, contributing 20% to GCP’s consolidated 4QFY07 revenues. GCP’s net income, however, grew just 2.3% on a 214bps YoY decline in EBITDA margins. We fine-tune our estimates down 0.5-3.3% for 2007-09.
- Margin pressure in core categories** – Despite the price hikes taken in both its soaps and personal care businesses, EBIT margins declined 180bps and 680bps, respectively. While the soap price hikes appeared insufficient to mitigate the rise in palm oil prices, margin erosion in personal care was due to lower sales of ‘Ezee’ and a higher contribution from the lower-margin international business.
- Deceleration in hair colors business** – While we were expecting a slowdown in the hair color business, we are surprised by the extent; hair color sales grew just 11% vs. industry growth of 21%. The sales deceleration is even more surprising given the 12.5% price hike taken by GCP in January 2007 in Godrej Hair Dye.
- A price correction would offer an enhanced opportunity to Buy** – While margin pressures still exist, we think the 5-8% price hike taken in soaps in April should be able to arrest the margin decline in soaps to some extent. Trading at a FY08E P/E of 18.7x, GCP’s valuation looks attractive vs. peers in the domestic HPC universe.

Buy/Low Risk	1L
Price (25 Apr 07)	Rs143.80
Target price	Rs194.00
Expected share price return	34.9%
Expected dividend yield	3.5%
Expected total return	38.4%
Market Cap	Rs32,476M US\$799M

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)	(%)	(%)
2005A	896	3.96	43.2	36.3	65.4	194.5	2.1
2006A	1,213	5.37	35.7	26.8	41.3	188.8	2.4
2007E	1,440	6.38	18.7	22.5	25.7	140.6	2.6
2008E	1,740	7.71	20.8	18.7	18.3	114.6	3.3
2009E	1,970	8.72	13.2	16.5	13.5	94.4	3.6

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	36.3	26.8	22.5	18.7	16.5
EV/EBITDA adjusted (x)	32.4	23.2	18.4	14.4	12.7
P/BV (x)	65.4	41.3	25.7	18.3	13.5
Dividend yield (%)	2.1	2.4	2.6	3.3	3.6
Per Share Data (Rs)					
EPS adjusted	3.96	5.37	6.38	7.71	8.72
EPS reported	3.96	5.37	6.38	7.71	8.72
BVPS	2.20	3.48	5.59	7.86	10.62
DPS	3.00	3.50	3.75	4.78	5.23
Profit & Loss (RsM)					
Net sales	5,627	6,997	9,532	11,397	12,328
Operating expenses	-4,729	-5,699	-7,878	-9,297	-9,988
EBIT	898	1,298	1,655	2,100	2,340
Net interest expense	-25	-65	-96	-107	-76
Non-operating/exceptionals	64	88	27	54	54
Pre-tax profit	938	1,321	1,585	2,048	2,318
Tax	-77	-113	-243	-307	-348
Extraord./Min.Int./Pref.div.	35	5	99	0	0
Reported net income	896	1,213	1,440	1,740	1,970
Adjusted earnings	896	1,213	1,440	1,740	1,970
Adjusted EBITDA	1,005	1,413	1,797	2,274	2,519
Growth Rates (%)					
Sales	14.9	24.4	36.2	19.6	8.2
EBIT adjusted	19.9	44.5	27.5	26.9	11.4
EBITDA adjusted	19.2	40.6	27.2	26.6	10.8
EPS adjusted	43.2	35.7	18.7	20.8	13.2
Cash Flow (RsM)					
Operating cash flow	1,029	1,298	1,993	2,097	2,238
Depreciation/amortization	107	115	142	174	179
Net working capital	27	-30	410	182	89
Investing cash flow	-81	-961	-1,132	-775	-675
Capital expenditure	-81	-100	-1,032	-75	-75
Acquisitions/disposals	0	-861	-100	-700	-600
Financing cash flow	-967	-293	2	-1,673	-1,657
Borrowings	-181	626	868	-444	-311
Dividends paid	-771	-901	-965	-1,230	-1,348
Change in cash	-18	43	862	-351	-94
Balance Sheet (RsM)					
Total assets	2,045	3,425	5,652	6,261	6,844
Cash & cash equivalent	90	263	1,027	676	582
Accounts receivable	52	303	405	484	524
Net fixed assets	1,014	850	1,740	1,640	1,536
Total liabilities	1,547	2,638	4,389	4,486	4,445
Accounts payable	1,330	1,787	2,612	3,122	3,377
Total Debt	61	687	1,555	1,111	800
Shareholders' funds	498	787	1,263	1,774	2,399
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	17.9	20.2	18.9	20.0	20.4
ROE adjusted	194.5	188.8	140.6	114.6	94.4
ROIC adjusted	129.4	119.1	86.4	100.9	127.4
Net debt to equity	-5.7	53.9	41.8	24.5	9.1
Total debt to capital	11.0	46.6	55.2	38.5	25.0

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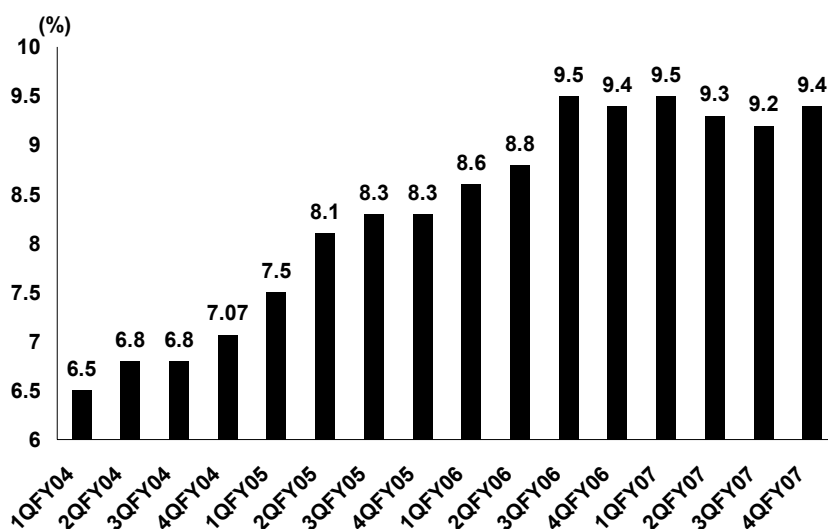


GCP: 4QFY07 Result Overview

Soaps: Market share gains continue, margins remain a concern

GCP's soap revenues grew 20%, outperforming industry growth of 7.7%; market share has consequently increased to 9.4%. Palm oil prices have continued to remain firm and have increased by ~20% in the past six months. As a result, soap EBIT margins, despite the price hike of 5-8% taken in October 2006, have declined by 180bps. The 5% price hike taken in October 2006 seems to have been insufficient to mitigate the palm oil price rise. GCP has taken another 5-8% price hike in April, which we believe will mitigate margin erosion to some extent in the coming quarters.

Figure 1. Soaps: Market share gains continue (%)

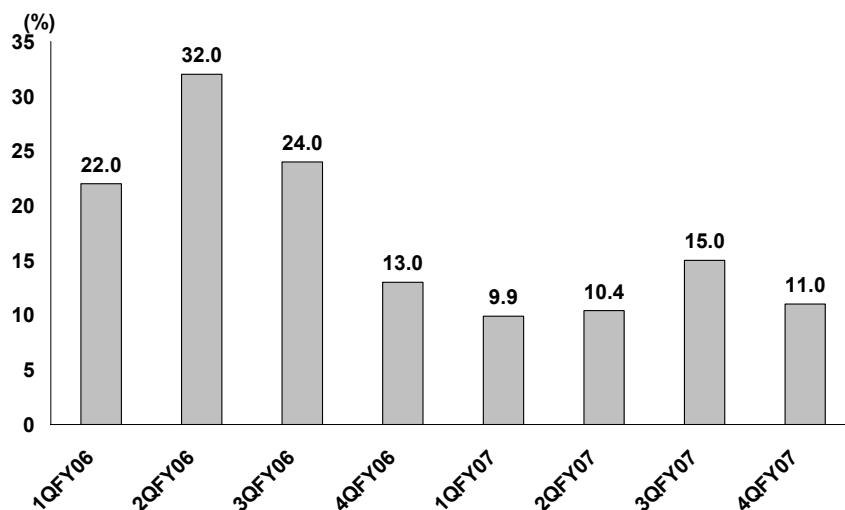


Source: Company Reports and Citigroup Investment Research

Deceleration in hair colors business a concern

While we were expecting a slowdown in the hair color business, we are surprised by the extent of deceleration and margin decline in GCP's hair color category. Hair color revenues grew 11% against industry growth of 21%. The revenue deceleration is even more surprising given the 12.5% price hike taken by GCP in January 2007 in Godrej Hair Dye. We await more clarity from management on this issue.

Figure 2. Hair Color Sales Growth Trend (%)



Source: Company Reports and Citigroup Investment Research

Personal Care: Liquid Detergents pull down the margin

Personal care margins declined 681bps as a result of: (1) Lower sales of 'Ezee', GCP's high margin product due to a mild winter; and (2) increasing contribution from GCP's international businesses, namely Keyline and Rapidol, which have a lower margin profile than GCP's core domestic personal care business.

'Snuggly' sold to JV with SCA

'Snuggly', which is GCP's Rs70m baby diaper brand, has been sold to a JV between GCP and SCA Hygiene. GCP and SCA have formed a 50:50 JV to produce and market baby care and feminine hygiene products in India, Nepal and Bhutan. Snuggly, which was imported in the past, will now be manufactured in the JV's new facility in North India and will be marketed and sold in India.

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Figure 3. Godrej Consumer: Consolidated 4QFY07 Profit and Loss Summary (Rupees in Millions, Percent)

	4QFY06	4QFY07	Growth %
Net Sales	1,915.2	2,424.2	26.6
Expenditure	-1,533.9	-1,993.4	30.0
Gross Profit	1,055.6	1,303.2	23.5
<i>Gross Profit (%)</i>	<i>55.1</i>	<i>53.8</i>	<i>-136 bps</i>
EBITDA	381.3	430.8	13.0
<i>EBITDA Margin (%)</i>	<i>19.9</i>	<i>17.8</i>	<i>-214 bps</i>
Interest	-21.4	-20.0	-6.5
Depreciation	-31.3	-45.0	43.8
Other Income	6.6	6.3	-4.5
Profit Before Tax	335.2	372.1	11.0
Tax	-34.3	-64.2	87.2
<i>Tax Rate (%)</i>	<i>10.2</i>	<i>17.3</i>	<i>702 bps</i>
Profit After Tax	300.9	307.9	2.3
Extraordinary Items		50.7	nm
Prior period tax	5.0	35.0	600.0
Net Profit After Extraordinary Items	305.9	393.6	28.7

Source: Company

Figure 4. Godrej Consumer: Consolidated 4QFY07 Cost Details (Rupees in Millions, Percent)

	4QFY06	4QFY07	Growth %
(Increase)/decrease in stock in trade	-130.5	-264.8	102.9
Consumption of raw material and purchase of goods	990.1	1,385.8	40.0
Total Raw Materials	859.6	1,121.0	30.4
<i>-As a % of sales</i>	<i>44.9</i>	<i>46.2</i>	<i>136 bps</i>
Staff cost	146.4	127.8	-12.7
<i>-As a % of sales</i>	<i>7.6</i>	<i>5.3</i>	<i>-237 bps</i>
Advertisement and Publicity	185.9	216.8	16.6
<i>-As a % of sales</i>	<i>9.7</i>	<i>8.9</i>	<i>-76 bps</i>
Other expenditure	342.0	527.8	54.3
<i>-As a % of sales</i>	<i>17.9</i>	<i>21.8</i>	<i>391 bps</i>

Source: Company

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Figure 5. Godrej Consumer: Consolidated 4QFY07 Segmental Details (Rupees in Millions, Percent)

	4QFY06	4QFY07	Growth %
Revenues			
Soap	1,016.4	1,212.9	19.3
Personal Care	898.8	1,211.3	34.8
Total	1,915.2	2,424.2	26.6
EBIT			
Soap	131.5	135.0	2.7
Personal Care	288.9	306.8	6.2
Total	420.4	441.8	5.1
Less: Interest (net)	21.4	20.0	-6.5
Less: Other unallocated expenses net of unallocated income	63.8	49.7	-22.1
PBT	335.2	372.1	11.0
EBIT Margin (%)			
Soap	12.9	11.1	-181 bps
Personal Care	32.1	25.3	-681 bps
Total	22.0	18.2	-373 bps
Godrej Brands Sales Breakup			
Soaps	985.4	1,179.1	19.7
Hair Colours	430.2	541.3	25.8
Toiletries	417.9	612.2	46.5
Liquid Detergents	44.4	53.0	19.4
Total Godrej Brands	1,877.9	2,385.6	27.0
By-Products	37.3	38.6	3.5
Total	1,915.2	2,424.2	26.6

Source: Company

Figure 6. Godrej Consumer: Consolidated FY07 Profit and Loss Summary (Rupees in Millions, Percent)

	FY06	FY07	Growth %
Net Sales	6,997.2	9,532.3	36.2
Expenditure	-5,584.6	-7,735.4	38.5
Gross Profit	3,735.4	4,910.7	31.5
<i>Gross Profit (%)</i>	<i>53.4</i>	<i>51.5</i>	<i>-187 bps</i>
EBITDA	1,412.6	1,796.9	27.2
<i>EBITDA Margin (%)</i>	<i>20.2</i>	<i>18.9</i>	<i>-134 bps</i>
Interest	-64.7	-96.3	48.8
Depreciation	-114.8	-142.1	23.8
Other Income	87.7	26.5	-69.8
Profit Before Tax	1,320.8	1,585.0	20.0
Tax	-112.8	-243.4	115.8
<i>Tax Rate (%)</i>	<i>8.9</i>	<i>14.1</i>	<i>515 bps</i>
Profit After Tax	1,208.0	1,341.6	11.1
Extraordinary Items	0.0	50.7	nm
Prior period tax	5.0	48.1	862.0
Net Profit After Extraordinary Items	1,213.0	1,440.4	18.7

Source: Company Reports

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Figure 7. Keyline Brands Limited: Profit and Loss Summary (Rupees in Millions, Percent)

	4QFY06	4QFY07	% Change	FY07
Sales	274.0	493.0	79.9	1,674.8
PBIT	20.0	77.0	285.0	237.4
<i>PBIT Margin</i>	<i>7.3%</i>	<i>15.6%</i>		<i>14.2%</i>
Interest	9.0	9.0	0.0	38.7
PBT	11.0	68.0	518.2	198.7
Tax	6.0	19.0	216.7	59.3
PAT	5.0	49.0	880.0	139.4

Source: Company

Figure 8. Rapidol International: Profit and Loss Summary (Rupees in Millions, Percent)

	4QFY07	FY07
Sales	101.0	276.0
PBIT	9.0	42.0
<i>PBIT Margin</i>	<i>8.9%</i>	<i>15.2%</i>
Interest	(1.0)	(1.0)
PBT	10.0	43.0
Tax	3.0	13.0
PAT	7.0	30.0

Source: Company

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 a dominant 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 8 decades of manufacturing experience in soaps and personal-care products.

Investment thesis

We rate GCP as Buy/Low Risk (1L). The company has a dominant 38% 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, GCP 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.

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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 Rs194 is based on about 25x FY08E EPS, pegged at an 8-10% discount to sector leader HLL. Our target multiple is reasonable, in our view, given our positive stance on GCP's core domestic business and its recent international acquisitions. We forecast a 16.5% consolidated earnings CAGR for FY06-09, and believe the stock will continue to trade at a historical c.60% premium to the Sensex.

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) Slowdown in consumer demand; (4) Integration issues after recent acquisitions, and slower-than-expected growth in the UK and South Africa; and (4) Considering that 18.5% of the consolidated entity's revenues would be from international markets, earnings growth is exposed to forex risks.

Appendix A-1

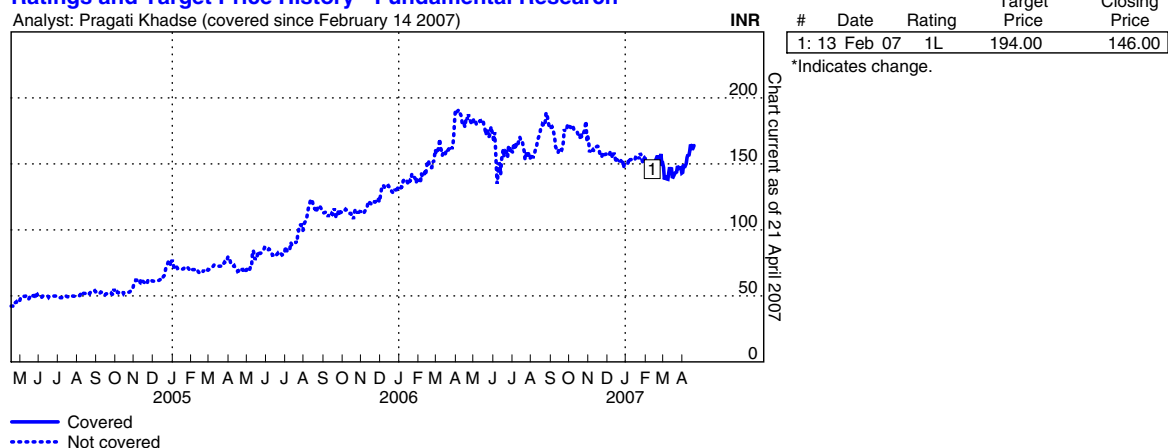
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Analyst: Pragati Khadse (covered since February 14 2007)



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