

Company

15 July 2010 | 10 pages

Colgate Palmolive (India) (COLG.BO)

 Equity
 Target price change
 Estimate change

Sell: Decelerating Volumes, Rising Competition, Rich Valuations

- 1QFY11 ahead of expectations ...** — PAT at Rs1.21bn rose ~19% YoY, 4% ahead of est. of Rs1.16bn. This was driven by ~380bps YoY increase in EBITDA margins to 29.1%. We note that the reported gross margins (64%, +~650bps YoY) and SGA (+31% YoY) aren't comparable with the previous year, given distortions arising from the amalgamation of Professional Oral Care Products.
- ... but volume growth moderates sequentially** — Overall, volume growth of ~10% YoY moderated on a sequential basis, given slower growth in toothbrushes and toothpowders. Over the past five years, revenue CAGR has been 15% CAGR – we forecast nominally lower growth of ~13.5% CAGR over the next three years, as we note that penetration-driven growth will slowly plateau (overall penetration of toothpastes is ~60% today, vs. ~50%, five years ago).
- Revising estimates** — We increase our EPS estimates by 20%/9% over FY11/12E, primarily driven by margin expansion of 180bps in FY11 (and the subsequent impact in FY12), due to the cost savings on amalgamation. We've marginally cut our revenue estimates to reflect moderating volumes.
- We remain sellers** — We think risk reward is not favorable at current valuations of 25x one year forward P/E. Profit growth over the next two years is likely to be impacted by higher tax outgo (effective tax rate is likely to increase to 22-25%), decelerating volume growth and increasing competition from Hindustan Unilever. The risk of P&G's entry – and the subsequent de-rating - is also not adequately priced in, we believe. We thus retain our multiple of 23x – and roll forward to Sept11 from Mar11. Our target price increases to Rs812 (from Rs659 earlier).
- Upside risks** — Key risks to our Sell recommendation include: 1) Ad expenses substantially lower than forecast, and 2) further margin expansion, driven by the amalgamation of CC Healthcare Products.

Sell/Low Risk	3L
Price (15 Jul 10)	Rs844.40
Target price	Rs812.00
	<i>from Rs659.00</i>
Expected share price return	-3.8%
Expected dividend yield	2.6%
Expected total return	-1.2%
Market Cap	Rs114,832M
	US\$2,459M

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)	(%)	(%)
2009A	2,951	21.70	26.8	38.9	53.1	155.9	1.8
2010A	4,233	31.12	43.4	27.1	35.2	156.1	2.4
2011E	4,675	34.38	10.4	24.6	26.2	122.3	2.6
2012E	4,929	36.25	5.4	23.3	20.6	99.2	2.8
2013E	5,311	39.05	7.7	21.6	16.8	85.7	3.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	38.9	27.1	24.6	23.3	21.6
EV/EBITDA adjusted (x)	42.7	26.5	21.1	19.7	18.1
P/BV (x)	53.1	35.2	26.2	20.6	16.8
Dividend yield (%)	1.8	2.4	2.6	2.8	3.0
Per Share Data (Rs)					
EPS adjusted	21.70	31.12	34.38	36.25	39.05
EPS reported	21.34	31.12	34.38	36.25	39.05
BVPS	15.90	23.98	32.21	40.89	50.25
DPS	15.00	20.00	22.34	23.56	25.38
Profit & Loss (RsM)					
Net sales	16,948	19,625	22,532	25,534	28,707
Operating expenses	-14,513	-15,746	-17,587	-20,308	-23,060
EBIT	2,435	3,878	4,945	5,226	5,647
Net interest expense	-11	-15	-16	-16	-16
Non-operating/exceptionals	1,078	985	1,064	1,192	1,450
Pre-tax profit	3,502	4,848	5,993	6,402	7,081
Tax	-551	-615	-1,319	-1,472	-1,770
Extraord./Min.Int./Pref.div.	-49	0	0	0	0
Reported net income	2,902	4,233	4,675	4,929	5,311
Adjusted earnings	2,951	4,233	4,675	4,929	5,311
Adjusted EBITDA	2,665	4,254	5,305	5,626	6,067
Growth Rates (%)					
Sales	15.0	15.8	14.8	13.3	12.4
EBIT adjusted	16.1	59.3	27.5	5.7	8.1
EBITDA adjusted	16.1	59.7	24.7	6.0	7.8
EPS adjusted	26.8	43.4	10.4	5.4	7.7
Cash Flow (RsM)					
Operating cash flow	3,207	5,031	4,436	5,033	5,837
Depreciation/amortization	229	376	360	400	420
Net working capital	-75	424	-598	-296	106
Investing cash flow	272	-931	-193	-150	-150
Capital expenditure	-26	-1,121	-198	-150	-150
Acquisitions/disposals	297	190	5	0	0
Financing cash flow	-2,361	-3,135	-3,555	-3,749	-4,039
Borrowings	0	-1	0	0	0
Dividends paid	-2,381	-3,178	-3,555	-3,749	-4,039
Change in cash	1,069	964	688	1,134	1,648
Balance Sheet (RsM)					
Total assets	7,723	8,822	10,021	11,521	13,354
Cash & cash equivalent	2,511	3,476	4,164	5,298	6,946
Accounts receivable	111	98	112	127	143
Net fixed assets	1,786	2,531	2,369	2,119	1,849
Total liabilities	5,560	5,561	5,640	5,960	6,521
Accounts payable	3,417	3,708	3,776	4,091	4,652
Total Debt	47	46	46	46	46
Shareholders' funds	2,163	3,261	4,381	5,561	6,833
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	15.7	21.7	23.5	22.0	21.1
ROE adjusted	155.9	156.1	122.3	99.2	85.7
ROIC adjusted	nm	nm	nm	nm	nm
Net debt to equity	-113.9	-105.2	-94.0	-94.4	-101.0
Total debt to capital	2.1	1.4	1.0	0.8	0.7

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1QFY11 Results Summary

Colgate revenue growth of 13% was driven by strong growth in volumes (we est. ~10%). Volume growth has moderated on a sequential basis.

Gross margins and other SG&A expenditure was not comparable given distortions arising from the amalgamation of Professional Oral Care Products

EBITDA growth of 30% YoY to Rs1.6bn was ahead of estimates as EBITDA margins expanded ~380bps YoY to 29.1% -ad spends to sales ratio was restricted to 12.6% (+60bps YoY, -300bps QoQ). Sequentially margins expanded 220bps.

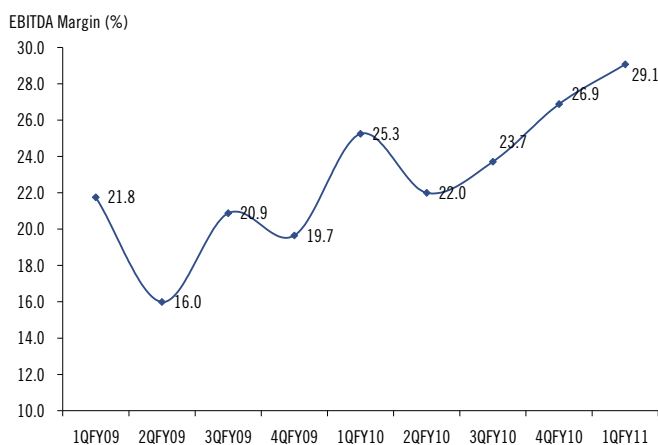
Overall reported PAT growth was 19% YoY – tax rate increased to 22% (as expected).

Figure 1. Colgate Palmolive (India) – 1QFY11 Results Summary

	1QFY10	1QFY11	% Change Y/Y
Net Sales	4,680	5,288	13.0
Other Operating Income	174	209	20.0
Total Revenues	4,854	5,497	13.3
Expenditure	-3,628	-3,899	7.5
EBITDA	1,226	1,598	30.4
<i>EBITDA Margin (%)</i>	<i>25.3</i>	<i>29.1</i>	<i>382 bps</i>
Interest	-5	-3	-24.4
Depreciation & Amortisation	-56	-79	41.0
Other Income	86	54	-37.2
PBT	1,251	1,569	25.5
Tax	-223	-350	57.2
<i>Tax Rate (%)</i>	<i>17.8</i>	<i>22.3</i>	<i>451 bps</i>
PAT	1,028	1,219	18.6
EPS	7.6	9.0	18.6

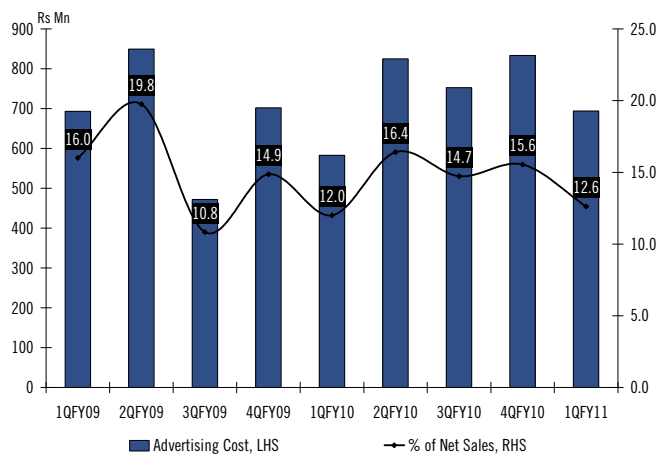
Source: Company Reports

Figure 2. Colgate Palmolive (India) – EBITDA Margin Trends (%)



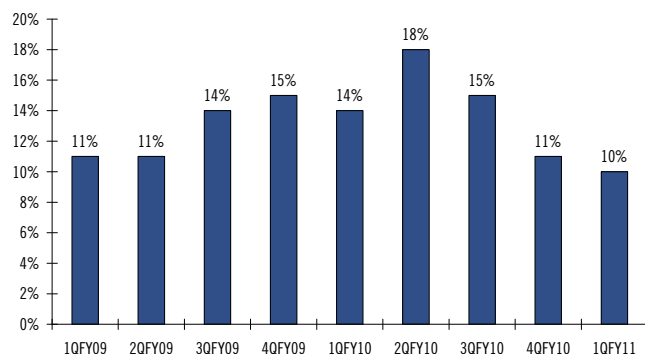
Source: Company Reports

Figure 3. Colgate Palmolive (India) – Advertising Spends Trends (%)



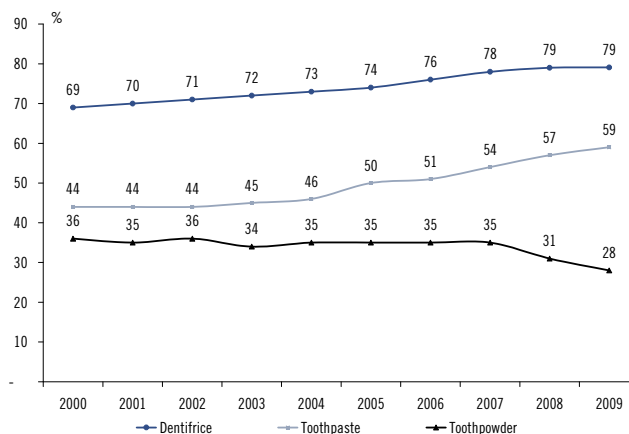
Source: Company Reports

Figure 4. Colgate Palmolive (India) –Volume Growth Trends



Source: Company Reports, CIRA

Figure 5. India Oral Care Market Penetration



Source: IRS, Company Reports

Figure 6. Colgate Palmolive (India) –Distribution Coverage

	2007	2008	2009
Rural	76%	79%	83%
Urban	83%	84%	86%
U+R	80%	81%	84%

Source: Company Reports

Figure 7. Colgate Palmolive (India) –Urban/Rural Contribution to Sales

	2006	2007	2008	2009
Rural	33%	34%	37%	37%
Urban	67%	66%	63%	63%

Source: Company Reports

Revising Earnings, Target price to Rs812

We increase our EPS estimates by 20%/9% over FY11/12E, primarily driven by margin expansion of ~180bps in FY11, driven by cost savings on amalgamation of contract manufacturers. Our revenue estimates have been pared by 1-2% over FY11/12E to reflect moderating volumes. The adverse impact of the rising tax rates in FY11E (mgmt guided to ~22-23%) leads to a muted ~8% EPS CAGR forecast over FY10-12E.

Our target price increases to Rs812 (from Rs659 earlier) as we roll forward to Sept11 from Mar11, maintaining our 23x PE multiple. We think risk reward is not favorable at current valuations of 25x one year forward P/E.

Figure 8. Colgate Palmolive (India) – Earnings Revision Summary

Year to 31-Mar	2011E			2012E		
	Old	New	% Chg	Old	New	% Chg
Sales (Rs Mills.)	22,773	22,532	-1%	26,014	25,534	-2%
EBITDA (Rs Mills.)	4,214	5,305	26%	4,794	5,626	17%
EBITDA Margin (%)	18.5%	23.5%		18.4%	22.0%	
Net Profit (Rs Mills.)	3,894	4,675	20%	4,519	4,929	9%
Diluted EPS (Rs)	28.6	34.4	20%	33.2	36.2	9%
Dividend Per Share (Rs)	20.0	22.3	11%	24.9	23.6	-5%

Source: Citi Investment Research and Analysis estimates

Colgate Palmolive (India)

Company description

Colgate Palmolive (India) has been a leader in India's oral-care market for more than 70 years. The group's portfolio is heavily skewed toward oral-care products, which account for ~90% of sales. Of late it has been exposed to rivalry from Hindustan Unilever, and Dabur, as well as some local competitors. 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 shares as Sell/Low Risk (3L). Colgate is the market leader in the oral-care market with ~51% market share. Over the last three years, Colgate's volume growth and market shares have been rising on the back of double digit growth from rural India. Our Sell rating is predicated on: 1) Stock has outperformed peers and the broad market in the last year; 2) Current valuations imply flawless execution and in our view doesn't price in dual risks of decelerating growth and impact of higher tax rates; 3) Relative P/E to the broad market is at the higher end of the trailing five-year range; and 5) Risks of increasing competition from FMCG majors like HLL and Dabur can't be ruled out, as they aggressively invest behind their oral care portfolio. The risk of P&G's entry – and the subsequent de-rating - is also not adequately priced in.

Valuation

We use a P/E based methodology to value Colgate India because of its steady growth profile. Our target price of Rs812 is based on 23x Sept11E earnings. Our target P/E multiple of 23x is at the higher end of the average trailing three-year historical trading range, which we believe is appropriate given Colgate's strong brand equity, which will likely help it maintain a premium rating despite increasing competition. Over the last five years, the stock has traded in a P/E range of 15x-27x (average 20x). Colgate's relative PE to the broad market is currently at 1.6x, i.e., at the higher end of the last five-year range of 0.8x-1.8x, thus the risk reward at current levels appears unfavorable. At 25x one-year forward P/E, we believe that the stock fully captures the growth expectations (we forecast ~8% EPS CAGR over FY10-FY13E).

Figure 9. Colgate Palmolive (India) – One-Year Forward PE

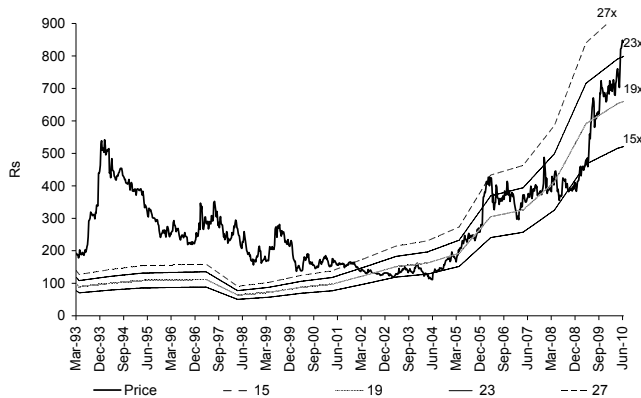


Figure 10. Colgate Palmolive (India) – Relative PE to Sensex



Source: DataStream, Company Reports and Citi Investment Research and Analysis

Source: DataStream, Company Reports and Citi Investment Research and Analysis

Risks

We rate the stock as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks include: 1) Benign input cost environment onwards may provide further buffer to the margin expansion in FY11; 2) Brand building spends remains key towards profitability - Any major cutback in ad spends, due to easing competitive pressures or lack of new product launches, may provide upside risk to our estimates; and 3) higher than forecast margin expansion, driven by amalgamation of the various contract manufacturers.

Appendix A-1

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Colgate Palmolive (India) (COLG.BO)

Ratings and Target Price History Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008

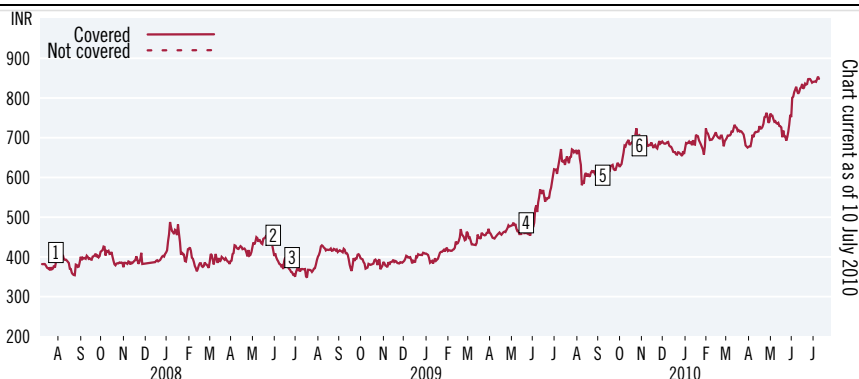


Chart current as of 10 July 2010

Date	Rating	Target Price	Closing Price
1 29-Jul-07	1L	*482.00	373.15
2 30-May-08	1L	*466.00	416.00

Date	Rating	Target Price	Closing Price
3 26-Jun-08	1L	*444.00	361.25
4 22-May-09	1L	*523.00	459.90

Date	Rating	Target Price	Closing Price
5 8-Sep-09	*3L	*585.00	618.00
6 29-Oct-09	3L	*659.00	706.45

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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