

## Colgate Palmolive

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,742	CLGT IN
	REUTERS CODE
S&P CNX: 3,156	COLG.BO

27 July 2006

**Neutral**
*Previous Recommendation: Buy*
**Rs374**

		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
Equity Shares (m)	136.0	03/06A	11,242	1,548	11.4	37.7	32.9	18.8	48.6	58.6	4.3	22.8
52-Week Range (Rs)	464/223	03/07E	13,500	1,805	13.3	16.6	28.2	16.5	50.0	61.7	3.6	19.8
1,6,12 Rel. Perf. (%)	-2/2/18	03/08E	15,348	2,140	15.7	19.3	23.8	14.5	51.6	64.3	3.1	17.0
M.Cap. (Rs b)	50.9											
M.Cap. (US\$ B)	1.1											

- Colgate's 1QFY07 results were below our expectations with 1.6% Adjusted PAT growth despite robust revenue growth of 19.9% YoY, due to 24.3% and 82.4% jump in advertisement and other expenses. Increase in freight cost, overheads at new Baddi unit, royalty, and higher than expected tax rate were the key reasons for slack profit growth.
- Volume growth continued to be robust at 11% while Toothbrushes grew by 53%. New launches in both Toothpaste (Advanced Whitening, Active Salt and Max fresh Gel) and Toothbrush (Colgate 360') were the key volume drivers.
- Colgate expedited new product launches as Colgate 360 Toothbrush, Vitality shower Gel and new Toothpowder formulation (anti caries ingredient) were launched in 1QFY07.
- We are increasing our FY07 and FY08 sales estimates by 4.7% and 6% respectively. Despite our bullish outlook on the sales volume front we are downgrading our Adjusted EPS estimates by 12.5% and 12.8% for FY07 and FY08 to Rs13.3 and Rs15.7 respectively. The stock is currently quoted at 28.2x FY07E and 23.8x FY08E earnings, which fully factors in the expected improvement in profitability due to recent price increase (4.4%) and benefits of ramp up at Baddi facility. We downgrade the stock to **Neutral**.

**QUARTERLY PERFORMANCE**

(Rs Million)

Y/E MARCH	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
<b>Net Sales</b>	<b>2,583</b>	<b>2,781</b>	<b>2,857</b>	<b>3,021</b>	<b>3,096</b>	<b>3,350</b>	<b>3,500</b>	<b>3,554</b>	<b>11,242</b>	<b>13,500</b>
YoY Change (%)	6.4	13.2	21.2	25.8	19.9	20.5	22.5	17.7	16.6	20.1
Total Exp	-2,201	-2,350	-2,143	-2,564	-2,695	-2,750	-2,700	-2,922	-9,113	-11,067
<b>EBITDA</b>	<b>382</b>	<b>432</b>	<b>714</b>	<b>457</b>	<b>401</b>	<b>600</b>	<b>800</b>	<b>632</b>	<b>2,128</b>	<b>2,433</b>
Margins (%)	14.8	15.5	25.0	15.1	12.9	17.9	22.9	17.8	18.9	18.0
Depreciation	-26	-39	-47	-37	-37	-45	-60	-79	-260	-221
Interest	-2	-1	-1	-2	-2	-1	-2	-1	-6	-6
Other Income	140	51	49	50	148	55	50	14	187	267
<b>PBT</b>	<b>494</b>	<b>443</b>	<b>715</b>	<b>467</b>	<b>509</b>	<b>609</b>	<b>788</b>	<b>566</b>	<b>2,050</b>	<b>2,472</b>
Tax	-140	-134	-132	-97	-149	-180	-190	-149	-503	-668
Rate (%)	28.2	30.2	18.5	20.8	29.2	29.6	24.1	26.4	24.5	27.0
<b>Adjusted PAT</b>	<b>355</b>	<b>309</b>	<b>583</b>	<b>370</b>	<b>361</b>	<b>429</b>	<b>598</b>	<b>416</b>	<b>1,548</b>	<b>1,804</b>
YoY Change (%)	39	14	69	11	1.6	38.9	2.6	12.5	28.5	16.6
Extraordinary Expenses	-75	0	-165	0	0	0	0	0	-172	0
<b>Reported PAT</b>	<b>280</b>	<b>309</b>	<b>417</b>	<b>370</b>	<b>361</b>	<b>429</b>	<b>598</b>	<b>416</b>	<b>1,376</b>	<b>1,804</b>
YoY Change (%)	10	14	46	14	29	39	43	13	130	31

E: MOSt Estimates

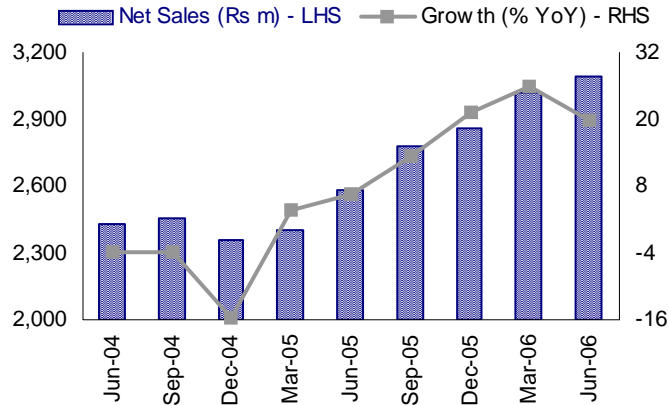
Note: In the interest of timeliness, this report has not been edited.

**Strong volume growth across segments**

Colgate reported yet another quarter of strong double digit volume growth with overall volumes growing by 11%. Toothbrushes were the star performers with more than 53% volume growth. Toothpaste category growth was lead by three new launches of last year i.e. Colgate Advanced Whitening, Colgate Active Salt and Colgate MaxFresh Gel. Toothbrush volume growth was driven by Colgate 360' a new launch.

We are increasing FY07 and FY08 sales growth estimates by 4.7% and 6% respectively due to higher anticipated growth in Toothbrushes and improved pricing environment in toothpastes. We believe that Colgate is best placed to exploit the huge untapped opportunity in the oral care space in India. Strong product innovation and brands will continue to provide competitive edge to the company.

QUARTERLY SALES AND SALES GROWTH



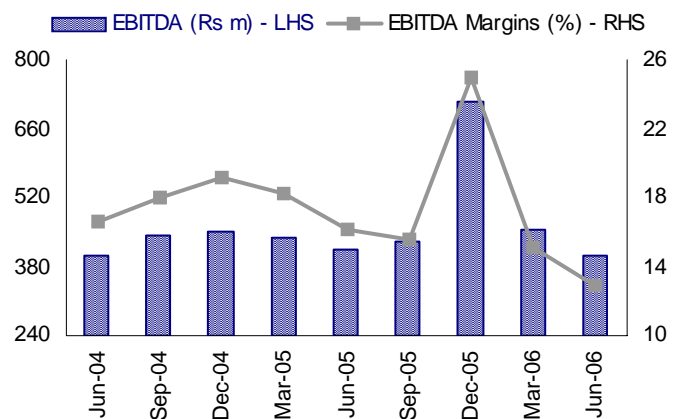
Source: Company/ Motilal Oswal Securities

**EBITDA Margins; lowest in recent times**

Colgate's EBITDA margins declined to a new low even as the company has displayed one of the best growth phases in its history. EBITDA margins declined by 185bp as other expenses, advertising costs and staff costs increased by 82%, 24% and 21% respectively. While advertising cost has been due to aggressive brand building and new launches, increase in staff costs is due to new Baddi facility and general increase in salary levels. Other expenses have gone up primarily due to higher freight costs due to Baddi facility, rising overheads and royalty.

Colgate's Royalty payments to its parent have risen by Rs70m during 1QFY07, on YoY basis. Colgate pays 5% royalty to the parent which is linked to the sales value realized from the products manufactured in-house. The royalty payment had increased from Rs103m in FY05 to Rs243m in FY06 due to production from Baddi facility and consequent reduction in outsourcing. We believe that higher freight costs, overheads and royalty have negated the benefits of the Baddi facility significantly.

EBITDA AND EBITDA MARGINS



Source: Company/ Motilal Oswal Securities

**Downgrading profit estimates; price hike to restore margins**

Colgate has undertaken an average 4.4% price increase in its toothpaste portfolio from July, which is fully factored in our realization growth estimates. We have increased out toothbrush growth estimates looking at strong 53% volume growth during the quarter. We are increasing royalty, freight and advertising expenses as also the expected tax provision. Our estimates reveal that while the production from Baddi facility is accretive on Gross margin front, as outsourced product total price is added up in the material costs. But higher overheads, freight and royalty payments make the impact on EBITDA margin seems far lower. We expect the company to report better margins in the coming quarters due to recent price increase in Colgate brand toothpastes. We are reducing the FY07 and FY08 PAT and EPS estimates by 12.5% and 12.8% respectively.

**Valuation and view**

We are increasing our FY07 and FY08 sales estimates by 4.7% and 6% respectively. Despite our bullish outlook on the sales volume front we are downgrading our Adjusted EPS estimates by 12.5% and 12.8% for FY07 and FY08 to

Rs13.3 and Rs15.7 respectively. The stock is currently quoted at 28.2x FY07E and 23.8x FY08E earnings, which fully factors in the expected improvement in profitability due to recent price increase (4.4%) and benefits of ramp up at Baddi facility. We downgrade the stock to **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 valued at 28.2x FY07E and 23.8x FY08E earnings. We downgrade the stock to **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	28.2	31.9	27.7
	FY08E	23.8	25.3	22.5
EV/EBITDA (x)	FY07E	19.8	27.5	16.9
	FY08E	17.0	21.3	14.0
EV/Sales (x)	FY07E	3.6	4.2	3.7
	FY08E	3.1	3.6	3.2
P/BV (x)	FY07E	16.5	23.1	25.9
	FY08E	14.5	20.0	22.0

#### SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.06
Promoters	51.0	51.0	51.0
Domestic Institutions	11.6	10.6	13.3
FIs/FDIs	10.2	10.3	5.1
Others	27.2	28.1	30.6

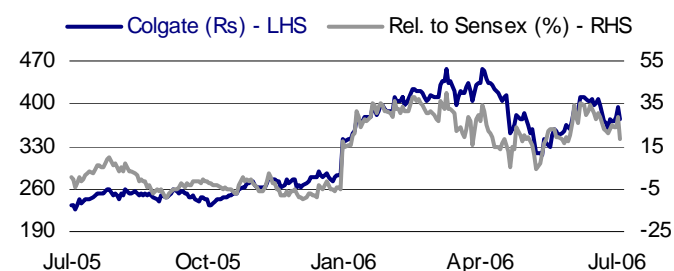
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	13.3	14.8	-10.3
FY08	15.7	17.5	-10.4

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
374	360	-3.7	Neutral

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Net Sales</b>	<b>9,392</b>	<b>9,642</b>	<b>11,242</b>	<b>13,500</b>	<b>15,348</b>	
Change (%)	-0.9	2.7	16.6	20.1	13.7	
Total Expenditure	-7,928	-7,968	-9,113	-11,067	-12,552	
<b>EBITDA</b>	<b>1,464</b>	<b>1,674</b>	<b>2,128</b>	<b>2,433</b>	<b>2,796</b>	
Change (%)	2.3	14.4	27.1	14.3	14.9	
Margin (%)	15.6	17.4	18.9	18.0	18.2	
Depreciation	-243	-224	-260	-221	-228	
Int. and Fin. Charges	-6	-12	-6	-6	-6	
Other Income	299	342	16	267	330	
<b>Profit before Taxes</b>	<b>1,515</b>	<b>1,781</b>	<b>1,879</b>	<b>2,472</b>	<b>2,892</b>	
Change (%)	3.4	17.6	5.5	31.6	17.0	
Margin (%)	16.1	18.5	16.7	18.3	18.8	
Tax	-590	-700	-529	-702	-791	
Deferred Tax	155	52	26	33	38	
Tax Rate (%)	-28.7	-36.4	-26.8	-27.0	-26.1	
<b>Adjusted PAT</b>	<b>1,080</b>	<b>1,124</b>	<b>1,548</b>	<b>1,805</b>	<b>2,140</b>	
Change (%)	2.19	4.1	37.7	16.6	18.6	
Margin (%)	11.5	11.7	13.8	13.4	13.9	
<b>Reported PAT</b>	<b>1,080</b>	<b>1,133</b>	<b>1,376</b>	<b>1,805</b>	<b>2,140</b>	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Share Capital	1,360	1,360	1,360	1,360	1,360	
Reserves	1,083	1,138	1,351	1,715	2,148	
<b>Net Worth</b>	<b>2,443</b>	<b>2,498</b>	<b>2,711</b>	<b>3,075</b>	<b>3,508</b>	
Loans	22	40	44	44	44	
Deferred Liability	1	-86	-76	-110	-147	
<b>Capital Employed</b>	<b>2,466</b>	<b>2,452</b>	<b>2,678</b>	<b>3,009</b>	<b>3,404</b>	
Gross Block	3,212	3,244	4,035	4,335	4,465	
Less: Accum. Depn.	-2,314	-2,447	-2,435	-2,656	-2,884	
<b>Net Fixed Assets</b>	<b>898</b>	<b>797</b>	<b>1,600</b>	<b>1,679</b>	<b>1,581</b>	
Capital WIP	42	675	91	91	91	
Investments	1,159	1,608	1,483	2,000	3,000	
<b>Curr. Assets, L&amp;A</b>	<b>3,300</b>	<b>2,493</b>	<b>3,014</b>	<b>3,098</b>	<b>2,927</b>	
Inventory	617	745	744	867	951	
Account Receivables	326	174	74	111	127	
Cash and Bank Balance	1,280	561	879	769	463	
Others	1,077	1,014	1,317	1,351	1,386	
<b>Curr. Liab. and Prov.</b>	<b>2,932</b>	<b>3,122</b>	<b>3,511</b>	<b>3,859</b>	<b>4,196</b>	
Account Payables	1,789	2,024	2,425	2,961	3,251	
Other Liabilities	196	126	399	163	168	
Provisions	946	971	687	735	777	
<b>Net Current Assets</b>	<b>368</b>	<b>-628</b>	<b>-497</b>	<b>-761</b>	<b>-1,268</b>	
<b>Application of Funds</b>	<b>2,466</b>	<b>2,452</b>	<b>2,678</b>	<b>3,009</b>	<b>3,404</b>	

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>7.9</b>	<b>8.3</b>	<b>11.4</b>	<b>13.3</b>	<b>15.7</b>	
Cash EPS	9.7	9.9	13.3	14.9	17.4	
BV/Share	18.0	18.4	19.9	22.6	25.8	
DPS	6.0	7.0	7.5	9.3	11.0	
Payout %	75.5	84.7	65.9	70.0	70.0	
<b>Valuation (x)</b>						
P/E		45.3	32.9	28.2	23.8	
Cash P/E		37.8	28.1	25.1	21.5	
EV/Sales		5.1	4.3	3.6	3.1	
EV/EBITDA		29.1	22.8	19.8	17.0	
P/BV		20.4	18.8	16.5	14.5	
Dividend Yield (%)		19	2.0	2.5	2.9	
<b>Return Ratios (%)</b>						
RoE	35.3	37.3	48.6	50.0	51.6	
RoCE	41.4	45.2	58.6	61.7	64.3	
<b>Working Capital Ratios</b>						
Debtor (Days)	11	6	2	3	3	
Asset Turnover (x)	7.4	57.0	10.2	14.7	49.0	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
OP/(loss) before Tax	1,326	1,506	1,909	2,260	2,620	
Int./Div. Received	195	278	147	218	278	
Interest Paid	6	12	6	6	6	
Direct Taxes Paid	-590	-700	-469	-634	-714	
(Incr)/Decr in WC	-222	-278	-186	-154	-202	
<b>CF from Operations</b>	<b>715</b>	<b>817</b>	<b>1,407</b>	<b>1,696</b>	<b>1,987</b>	
(Incr)/Decr in FA	72	-751	-197	-333	-168	
(Pur)/Sale of Investments	-107	-449	124	-517	-1,000	
<b>CF from Invest.</b>	<b>-35</b>	<b>-1,200</b>	<b>-73</b>	<b>-850</b>	<b>-1,168</b>	
Issue of Shares	0	0	0	0	0	
(Incr)/Decr in Debt	264	-17	-4	0	0	
Dividend Paid	-920	-1,078	-1,163	-1,440	-1,708	
Others	272	759	151	483	583	
<b>CF from Fin. Activity</b>	<b>-384</b>	<b>-336</b>	<b>-1,016</b>	<b>-957</b>	<b>-1,125</b>	
<b>Incr/Decr of Cash</b>	<b>295</b>	<b>-719</b>	<b>318</b>	<b>-111</b>	<b>-305</b>	
Add: Opening Balance	985	1,280	561	879	769	
<b>Closing Balance</b>	<b>1,280</b>	<b>561</b>	<b>880</b>	<b>769</b>	<b>464</b>	



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**Colgate Palmolive**

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|---|----|
| 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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