

GODREJ CONSUMER



Increasing scale, reasonable valuation

Following are key takeaways from our interaction with MD of GCPL, Mr Mahendran:

- Soaps underperformance in near term will be offset by other businesses**
 GCPL is expecting near term slowdown in soaps following high food inflation, base effect and competitive intensity from ITC and HUL. Soaps contribution to sales is now just ~30% (was ~60% 2 years back), thus company does not see any major risk to the group's profitability. Moreover, Godrej Household Products (erstwhile Godrej Sara Lee) portfolio offers better and stable margins which will offset dip in group margins. Household insecticide (including Megasari) is ~40% of sales which was handled by Mr Mahendran earlier.
- M&A integration plans on track; QIP successful; bridge loan paid off**
 GCPL has retained most of the existing management teams and has an acquisition integration team headed by Naveen Gupta. Company is sticking to its previous guidance of INR 600 mn PAT (post interest costs for these acquisitions) from these international acquisitions, excluding any synergies. Company expects the bigger synergy benefits to flow in from FY12 onwards. GCPL has raised INR 5.3 bn through QIP; USD denominated funding rate is at $\text{libor} + 150\text{-}175 \text{ bps}$.
- 3 Sara Lee brands to go gradually, likely positive surprise from Kiwi**
 While *Ambipur* has been sold to P&G globally and *Brylcreem* has been lapped up by Unilever, nothing has been finalised for the *Kiwi* brand thus far. Overall, these 3 brands constitute ~12-13% of Godrej Sara Lee sales. According to unconfirmed media reports, GCPL is expecting ~INR 2.35 bn from sale of *Ambipur* to P&G. We expect GCPL to benefit from likely participation in Kiwi's licensing rights in South Africa; Indonesia and UK.
- Outlook and valuations: Valuations attractive; maintain 'BUY'**
 Looking at past successes of acquisition integration, we are confident of management's capabilities to derive synergy benefits. Although there would be near term pressure on soap volumes, valuations are attractive at these levels. We have revised up our FY11 and FY12 EPS estimates to INR 14.5 and INR 17.5, respectively, to factor recent acquisitions. We maintain '**BUY**' recommendation on the stock, and rate it '**Sector Performer**' on a relative return basis.

July 14, 2010

Reuters: GOCPL.BO Bloomberg: GCPL IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 350
52-week range (INR)	:	373 / 166
Share in issue (mn)	:	308.2
M cap (INR bn/USD mn)	:	114 / 2,440
Avg. Daily Vol. BSE/NSE ('000):	:	262.5

SHARE HOLDING PATTERN (%)

Promoters*	:	71.4
MFs, FIs & Banks	:	0.8
FIIIs	:	18.9
Others	:	8.9
* Promoters pledged shares (% of share in issue)	:	3.2

PRICE PERFORMANCE (%)

	Stock	Nifty	EW FMCG Index
1 month	(0.0)	5.5	6.0
3 months	19.3	1.5	15.3
12 months	111.4	35.9	40.5

Financials

Year to March	FY09	FY10	FY11E	FY12E
Revenues (INR mn)	13,930	20,412	34,829	41,178
Rev. growth (%)	26.3	46.5	70.6	18.2
EBITDA (INR mn)	2,071	4,073	6,013	7,535
Net profit (INR mn)	1,733	3,395	4,697	5,674
Shares outstanding (mn)	257	308	323	323
Diluted EPS (INR)	6.7	11.0	14.5	17.5
EPS growth (%)	(4.7)	64.1	31.7	20.8
Diluted P/E (x)	52.1	31.7	24.1	19.9
EV/EBITDA (x)	42.9	25.6	21.3	17.0
ROAE (%)	46.6	44.5	34.8	29.7

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GCPL's MD A. Mahendran

Other takeaways

▪ Soaps:

- This business contributes ~30% to the top line, post acquisitions. 2 years ago, soaps contributed ~60% of the group's top line. Contribution to profitability is ~20%.
- Company expects the soaps volumes to be under pressure in the near term following higher food inflation.
- Company is, however, confident of recovery in growth in the medium term.
- GCPL won't take any price increase for the time being in soaps. Depending on the raw material movement, there can be slight pressure on margins in the near term. Company will reduce below the line promotional spending if margin pressure comes into play. Company believes FY12 can see good opportunities for price increase, if the monsoon is good this year.
- Palm Oil prices are currently between the higher and lower end seen in the recent past. Company is not unduly worried about these price levels.
- Though market share gain is an important matrix for performance evaluation for GCPL, it won't capture market share at unprofitable terms.
- Company believes in sustainable advertising and sales promotion (A&P) spend to compete for market share gains in the longer term.
- Soaps contribution to profitability is just ~20%, thus company does not see any major risk to the group's profitability from ITC and other competitors.
- Current inventory levels are at normal levels.

▪ Hair Colour:

- This business contributes ~30% to the top line, post acquisitions.
- This business offers stable, higher margins than other businesses of the group.
- GCPL is market leader in 19 countries in this category.
- Since only ~5% of the business comes from premium end of hair colour, GCPL is not unduly worried by competitive intensity from L'Oreal.
- ~35% revenues come from mid-premium segment while the rest from the mass end of the hair colour market.
- Company will benefit from the synergy of Issue group products (sachet based hair colours).

▪ Household Insecticides (HI):

- This business contributes ~40% to the top line, post acquisitions.
- GCPL is currently market leader in this category.
- Margins are better than soaps, but lower than Hair colour.
- Business is growing at ~20%, mostly led by volumes.

▪ International Acquisitions:

- International businesses now contribute ~30% of the group turnover.
- GCPL has formed a task force in Mumbai headed by Naveen Gupta to integrate the recent acquisitions.
- Company has retained management teams in most of these acquisitions.

- GCPL is not planning any more acquisitions in the near term. Company is, however, open to other opportunities.
- GCPL expects the synergy benefits to flow in from FY12 onwards. Household Insecticides (HI) will be introduced in Africa and LatAm at some point in future.
- African market will be the highest growth market while Latin America will also grow faster.

Table 1: Indicative EBITDA margins (%)

Megasari	~20
Tura	~13-15
Latin American businesses (Issue + Argencos)	~13-15
GCPL	~20
GHPL	~18

Source: Company, Edelweiss research

Table 2: Overview of recent acquisitions

Transaction	Value	(INR mn)
100% acq of Megasari Group (USD)	252	11,844
51% stake in Godrej Household Products (EUR)	185	10,545
Argentine hair colour (Issue+Argencos) (USD)	43	2,021
Tura (USD)	15	705
Total		25,115

Funding	Value	(INR mn)
Debt (USD)	350	16,450
Equity (INR)	5,300	5,300
Cash with GCPL and GHPL (INR)	3,365	3,365
Total		25,115

Source: Company, Edelweiss research

Annexure I: GCPL vs. ITC soap portfolio

Table 1: GCPL

Fragrance	Pack size	Each unit		
		Weight (gm)	(INR)	INR/gm
Godrej No 1 Papaya	100G*3	100	29	0.096
Godrej No 1 Papaya	125*3	125	47	0.125
Godrej No.1 San 100G*4	100*4	100	40	0.100

Source: Company, Edelweiss research

Table 2: ITC

Fragrance	Pack size	Each unit		
		Weight (gm)	INR	INR/gm
Superia Soap 100G Fra Flower	100G	100	9	0.090
Superia Soap 100G*3 Fragrant	100*3	100	29	0.096
Superia Soap 100G*3 Sandal	100*3	100	29	0.096

Source: Company, Edelweiss research

- Superia sandal is priced for INR 9.66 for 100 gm, where as godrej no1 sandal is priced at INR 10 for 100gm.
- Individual soap of 100 gm cost INR 10 for both (Superia & Godrej)
- Both the brands have launched around 6-8 fragrance and with different pack size (100gm*4 & 100gm*3 & 100gm*1)

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Gross revenues	11,330	14,352	20,818	35,563	42,045
Excise duties	305	423	406	734	868
Net revenue	11,026	13,930	20,412	34,829	41,178
Materials costs	5,184	7,668	9,472	16,718	19,436
Gross profit	5,842	6,262	10,940	18,111	21,742
Employee costs	725	865	1,518	2,680	3,210
Other expenses	1,662	1,947	3,334	4,890	5,644
Advertisement & sales costs	1,310	1,379	2,015	4,528	5,353
EBITDA	2,145	2,071	4,073	6,013	7,535
Depreciation & Amortization	182	192	236	240	245
EBIT	1,963	1,879	3,837	5,773	7,291
Other income	40	402	473	474	474
EBIT incl. other income	2,004	2,281	4,310	6,247	7,764
Interest expenses	129	189	111	225	490
Profit before tax	1,875	2,092	4,199	6,022	7,274
Provision for tax	283	366	803	1,325	1,600
Core profit	1,592	1,726	3,395	4,697	5,674
Prior period adjustments (net)	-	6	-	-	-
Profit after tax	1,592	1,733	3,395	4,697	5,674
Profit after minority interest	1,592	1,733	3,395	4,697	5,674
Basic shares outstanding (mn)	226	257	308	323	323
Basic EPS (INR)	7.1	6.7	11.0	14.5	17.5
Diluted equity shares (mn)	226	257	308	323	323
Diluted EPS (INR)	7.1	6.7	11.0	14.5	17.5
CEPS (INR)	7.9	7.6	11.8	15.3	18.3
Dividend per share (INR)	4.1	4.0	4.1	5.4	6.5
Dividend payout (%)	60.2	62.9	35.5	31.7	36.3

Common size metrics					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Materials costs	47.0	55.0	46.4	48.0	47.2
Employee expenses	6.6	6.2	7.4	7.7	7.8
Advertising & sales costs	11.9	9.9	9.9	13.0	13.0
Other expenses	15.1	14.0	16.3	14.0	13.7
Depreciation	1.6	1.4	1.2	0.7	0.6
Interest expenditure	1.2	1.4	0.5	0.6	1.2
EBITDA margins	19.5	14.9	20.0	17.3	18.3
EBIT margins	17.8	13.5	18.8	16.6	17.7
Net profit margins	14.4	12.4	16.6	13.5	13.8

Growth ratios (%)					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	15.7	26.3	46.5	70.6	18.2
EBITDA	19.4	(3.4)	96.6	47.6	25.3
PBT	18.3	11.6	100.7	43.4	20.8
Net profit	18.7	8.4	96.7	38.3	20.8
EPS	18.7	(4.7)	64.1	31.7	20.8

Balance sheet					(INR mn)
As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	226	257	308	324	324
Reserves & surplus	1,490	5,458	9,239	17,173	20,358
Shareholders funds	1,716	5,715	9,547	17,497	20,681
Secured loans	921	2,296	369	16,369	16,369
Unsecured loans	950	480	-	-	-
Borrowings	1,871	2,776	369	16,369	16,369
Deferred tax (net)	89	42	66	66	66
Sources of funds	3,676	8,533	9,981	33,931	37,116
Gross block	2,937	3,370	4,149	7,949	8,778
Depreciation	1,253	1,098	1,532	1,968	2,411
Net block	1,683	2,272	2,617	5,981	6,367
Capital work in progress	716	25	8	8	8
Intangible assets	956	2,132	3,119	25,119	25,119
Investments	-	75	670	670	670
Inventories	1,916	1,675	2,644	5,183	7,199
Sundry debtors	510	602	1,153	2,084	3,004
Cash and equivalents	426	3,783	3,052	882	1,039
Loans and advances	668	1,268	2,247	3,589	3,989
Total current assets	3,519	7,327	9,095	11,739	15,231
Sundry creditors and others	2,904	2,919	5,326	9,394	10,087
Provisions	323	380	202	202	202
Total current liabilities & provisions	3,228	3,299	5,528	9,595	10,289
Net current assets	291	4,029	3,567	2,143	4,942
Miscellaneous expenditure	29	-	-	10	10
Uses of funds	3,676	8,533	9,981	33,931	37,116
Book value per share (INR)	7.6	22.2	31.0	54.1	64.0

Free cash flow					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	1,592	1,733	3,395	4,697	5,674
Depreciation	182	192	236	240	245
Deferred tax	9	34	8	-	-
Others	(105)	26	(69)	9	9
Gross cash flow	1,678	1,985	3,571	4,946	5,928
Less: Changes in WC	182	380	270	746	2,642
Operating cash flow	1,497	1,605	3,301	4,200	3,286
Less: Capex	271	781	581	3,603	631
Free cash flow	1,225	824	2,719	597	2,655

Cash flow metrics					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	1,497	1,605	3,301	4,200	3,286
Investing cash flow	(638)	(1,415)	(339)	(25,521)	(605)
Financing cash flow	(908)	3,168	(2,748)	19,152	(2,525)
Net cash flow	(49)	3,357	215	(2,170)	157
Capex	(271)	(781)	(581)	(3,603)	(631)
Dividends paid	(841)	(1,002)	(1,259)	(1,741)	(2,103)
Share issuance/(buyback)	-	3,816	1,926	5,313	-

Profitability & efficiency ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	109.6	46.6	44.5	34.8	29.7
ROACE (%)	58.5	31.0	43.2	27.1	20.9
Inventory day	115	85	83	85	116
Debtors days	16	15	16	17	23
Payable days	206	155	170	165	187
Cash conversion cycle (days)	(74)	(55)	(71)	(63)	(48)
Current ratio	1.1	2.2	1.6	1.2	1.5
Debt/EBITDA	0.9	1.3	0.1	2.7	2.2
Debt/Equity	1.1	0.5	-	0.9	0.8
Adjusted debt/equity	1.1	0.5	-	0.9	0.8
Interest coverage	15.3	10.0	34.6	25.7	14.9

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	3.3	2.3	2.2	1.6	1.2
Fixed asset turnover	6.7	7.0	8.4	8.1	6.7
Equity turnover	7.5	3.7	2.7	2.6	2.2

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	14.4	12.4	16.6	13.5	13.8
Total assets turnover	3.3	2.3	2.2	1.6	1.2
Leverage multiplier	2.3	1.6	1.2	1.6	1.9
ROAE (%)	109.6	46.6	44.5	34.8	29.7

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	7.1	6.7	11.0	14.5	17.5
Y-o-Y growth (%)	18.7	(4.7)	64.1	31.7	20.8
CEPS (INR)	7.9	7.6	11.8	15.3	18.3
Diluted PE (x)	49.7	52.1	31.8	24.1	20.0
Price/BV (x)	46.1	15.7	11.3	6.5	5.5
EV/Sales (x)	7.3	6.4	5.1	3.7	3.1
EV/EBITDA (x)	37.5	42.9	25.7	21.3	17.0
Dividend yield (%)	1.2	1.1	1.2	1.5	1.9



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Asian Paints	BUY	SO	M	Colgate	HOLD	SO	M
Dabur	BUY	SO	M	Godrej Consumer	BUY	SO	H
Hindustan Lever	BUY	SP	L	ITC	BUY	SO	L
Marico	BUY	SP	M	Nestle Ltd	HOLD	SU	L
United Spirits	BUY	SP	H	Emami	Buy	SO	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect



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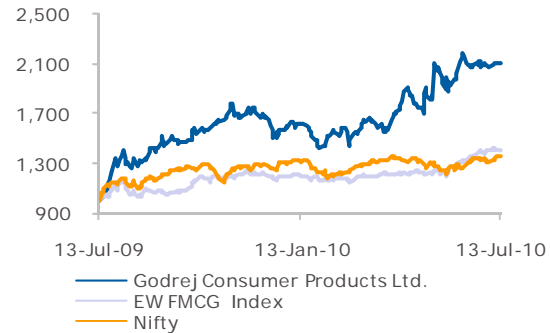
Coverage group(s) of stocks by primary analyst(s): FMCG

Asian Paints, Colgate, Dabur, Godrej Consumer, Hindustan Lever, ITC, Marico, Nestle Ltd, United Spirits

Godrej Consumer



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	109	52	12	177
* 4 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	108	54	15	

Recent Research

Date	Company	Title	Price (INR)	Recos
23-Jun-10	FMCG	FIFTEEN KEY THEMES; Sector Update		
10-Jun-10	Emami	Set to reap summer's bonanza; Visit Note		Buy
10-Jun-10	ITC	Robust outlook; cigarettes a key monitorable; Initiating Coverage	280	Buy

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