stock ideas

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Godrej Consumer Products

Apple Green

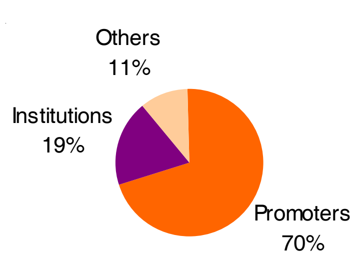
The soap opera

Buy; CMP: Rs145

Company details

Price target:	Rs185
Market cap:	Rs3,727 cr
52-week high/low:	Rs155/94
NSE volume: (No of shares)	79,735
BSE code:	532424
NSE code:	GODREJCP
Sharekhan code:	GODRCON
Free float: (No of shares)	7.8 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	12.4	9.5	39.8	10.5
Relative to Sensex	-1.0	14.8	13.6	58.4

Key points

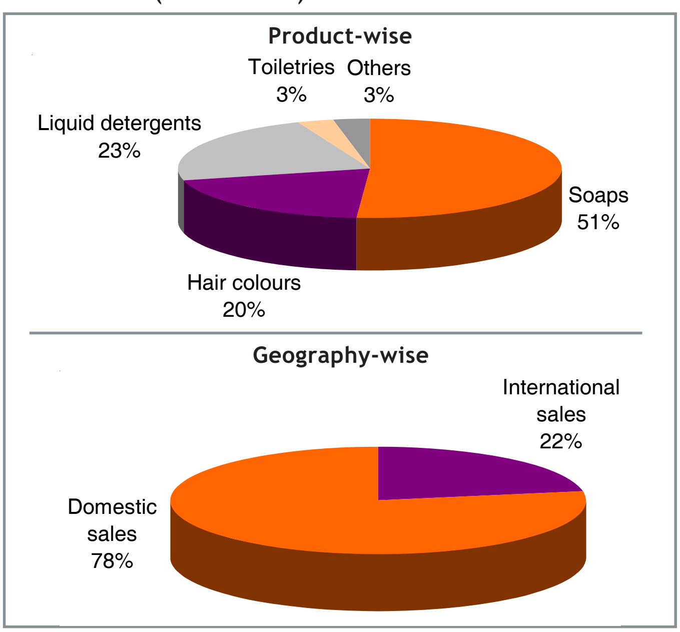
- **Market share expansion in soaps to continue:** Godrej Consumer Products Ltd (GCPL)'s product portfolio is dominated by mass-market brands of soaps and hair colorants. With rural demand remaining strong and the ongoing downturn keeping the demand for FMCG products buoyant at the bottom of the pyramid, GCPL's soap portfolio, which contributes more than half of its annual revenues, will outperform the industry in terms of volume growth. The company will also gain from further downtrading, if any, in the soap category. GCPL, which currently enjoys a market share of 9.9% in the soap category, is targeting a 1% growth in the market share every year for the coming years, which, we believe, is achievable.
- **Margin expansion to lead to hefty growth in earnings:** In FY2009, GCPL's OPM had contracted by 471 basis points due to a sharp increase in its raw material cost led mainly by spiraling palm oil prices. As a result of a sharp correction in palm oil prices in H2FY2009, GCPL's margin is expected to expand substantially in FY2010. We, therefore, expect GCPL's consolidated OPM to grow by 284 basis points yoy, thereby leading to a hefty growth of 35% yoy in its net profit in FY2010.
- **Enough surplus cash to fund inorganic growth:** Inorganic growth remains part of GCPL's core growth strategy. In the past four years the company has acquired companies in the UK and South Africa to expand its overseas operations. As a result, the overseas business now contributes 22% of its total revenues. The strong cash flow generation and the healthy cash on books (~Rs400 crore in March 2009) leave much scope for more inorganic initiatives.
- **Valuation and view:** Even as the double-digit growth in its volume will drive its top line growth going forward, GCPL's bottom line growth will far outperform its top line growth driven by the expected healthy expansion in its margins. We, therefore, expect the company's revenues and profit to grow at a CAGR of 12.5% and of 23.6% respectively over FY2009-11E. Accordingly, we expect GCPL to outperform the industry by far in terms of profit growth. The stock is currently trading at 16x its FY2010E earnings. The valuation is attractive compared with that of its peers considering traction in its profit growth. We, therefore, re-initiate coverage on GCPL with a Buy recommendation and a one-year price target of Rs185 based on 20x its FY2010E earnings.

Key financials	FY2007	FY2008	FY2009	FY2010E	FY2011E
Net sales (Rs cr)	951.5	1,102.6	1,393.0	1,581.0	1,764.3
Adj. net profit (Rs cr)	139.0	159.2	173.3	233.9	264.5
No of shares (cr)	22.6	22.6	25.7	25.7	25.7
EPS (Rs)	6.2	7.1	6.7	9.1	10.3
% y-o-y change	-	*14.6*	*-4.4*	*35.0*	*13.1*
PER (x)	23.6	20.6	21.6	16.0	14.1
Price/BV (x)	26.9	19.1	6.2	5.2	4.3
EV/EBIDTA(x)	19.0	15.9	16.4	11.8	10.2
RoCE (%)	64.5	50.7	28.8	26.8	25.9
RoNW (%)	138.5	108.5	44.6	35.3	33.5
OPM (%)	18.9	19.6	14.8	17.7	17.8

Company background

Promoted by Godrej & Boyce Manufacturing Company, GCPL was formed in November 2000 to take over the consumer products division of Godrej Soaps in keeping with a scheme of demerger. GCPL is a major player in the Indian fast moving consumer goods (FMCG) market with presence in soap, hair dye and hair colour, liquid detergent and toiletries categories. The company is the number one player in the hair dye and hair colour segment and the number two player in the toilet soap segment, and many of its brands like *Cinthol*, *Godrej No1*, *Colour Soft*, *Ezee* and *FairGlow* are household names across the country. Through acquisitions GCPL has also established presence in the hair and hair colour, personal care and toiletries markets of the UK and South Africa. It has five state-of-the-art manufacturing facilities located at Guwahati (Assam), Baddi (Himachal Pradesh), Katha (Himachal Pradesh), Sikkim and Malanpur (Madhya Pradesh). All these facilities except the one at Malanpur enjoy various tax benefits.

Revenue mix (consolidated)



Product portfolio

Categories	Brands
Domestic	
Soaps	Cinthol, FairGlow, Godrej No.1, Shikakai, Evita, Vigil
Hair care	Colour Soft, Renew, Fashion, Kesh Kala, Godrej Kali Mehendi, Nupur, Godrej Powder and Liquid Hair Dye
Liquid detergents	Ezee, Godrej Dish Wash, Glossy
Toiletries	Cinthol talc, Cinthol deo, Godrej shaving cream
International	
Hair care	Adorn hair spray, Inecto, Henara, Touch of Silver, Sofelene
Hair products	Kinky range of products
Personal care	Aapri, Nulon
Absorbents	Tena, Snuggy, Libero, Libresse
Toiletries	Cuticura talc, Erasmic, Inecto

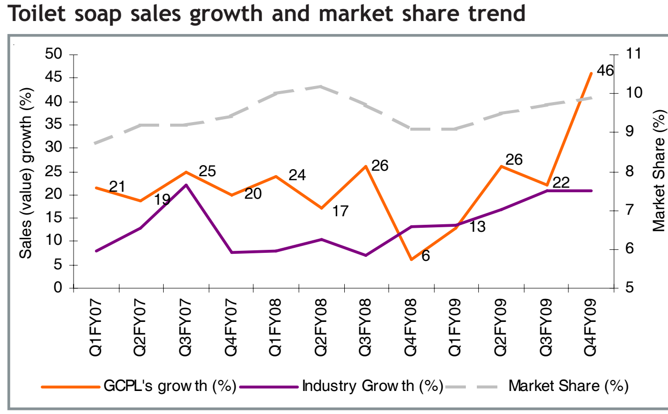
Investment arguments

Gaining market share and volumes in soaps

With a market share of 9.9%, GCPL is the second largest player in the ~Rs7,100-crore domestic toilet soap market after HUL, which enjoys a market share of 49.6%. Toilet soaps are the largest contributor to GCPL's revenues, accounting for 65.6% of its domestic revenues and 51.2% of its consolidated sales. Although the company has brands, such as *FairGlow*, *Cinthol*, *Evita* and *Godrej No.1*, across consumer categories, yet its soap sales are skewed towards the mass brand *Godrej No.1*, which accounts for 60-70% of its total soap sales volumes.

With rural India witnessing buoyancy in demand and FMCG demand likely to remain higher at the bottom of the pyramid (mass categories) in the current economic scenario, we believe GCPL's soap portfolio will outperform the industry volume growth. GCPL will also gain from any further downtrading in the soap category. In the inflationary scenario of FY2009, GCPL's value market share in the toilet soap category had increased by 80 basis points to 9.9%. That was possible because unlike its competitor HUL (which lost 570-basis-point market share to 49.6% since March 2008) GCPL had followed the policy of sacrificing margins for volume growth with far smaller price increases (~5-8% price led growth). As a result, its sales in the soap segment had grown by 25% primarily backed by the strong growth in the volumes. The strong volume growth is expected to continue and GCPL is expected to continue to outperform the toilet soap industry in future.

Toilet soap sales growth and market share trend



Margins to surge on lower raw material cost

Financial year 2009 had seen relentless rise in GCPL's raw material cost because of the spiraling prices of its key inputs, such as palm oil, packaging material and crude derivatives. While its competitors had increased their product prices substantially in a bid to protect their margins, GCPL had effected only small price increases, the strategy being to enhance volume growth and market share while sacrificing profit margins. Thus, the raw material cost as a percentage of its sales had risen sharply by 830 basis points in FY2009, causing the operating profit margin (OPM) to decline by 471 basis points. However, in the second half of FY2009 palm oil prices had corrected sharply (refer chart "Palm oil prices"). GCPL's OPM is expected to expand substantially in FY2010 as a result of this correction. The benefits of the lower raw material prices were already visible in the company's Q4FY2009 performance, which showed a sequential drop of 756 basis points in its raw material cost as a percentage of sales. In FY2010, GCPL's consolidated OPM is expected to expand by 284 basis points year on year (yoy), thereby driving a hefty year-on-year (y-o-y) growth of 35% in its net profit.

Well funded for inorganic growth

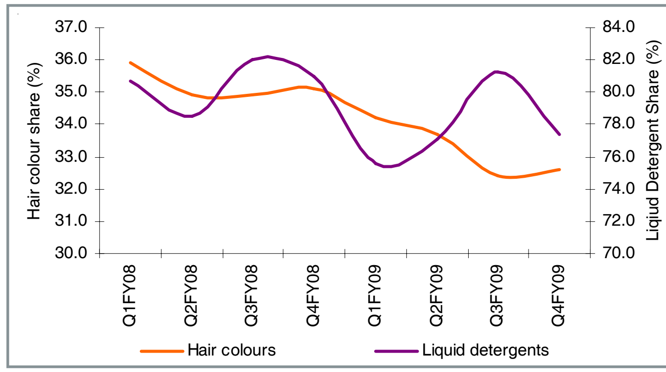
Besides pursuing organic growth, GCPL has been eyeing acquisitions as part of its overall growth strategy. It had acquired Keyline Brands (UK) in 2005-06, and Rapidol and Kinky (South Africa) in 2006-07 and April 2008 respectively. These businesses had accounted for 22% of its total revenues in FY2009. We believe with strong cash flow and healthy cash on books (~Rs400 crore as on March 31, 2009) GCPL is well funded to make more acquisitions.

Risks and concerns

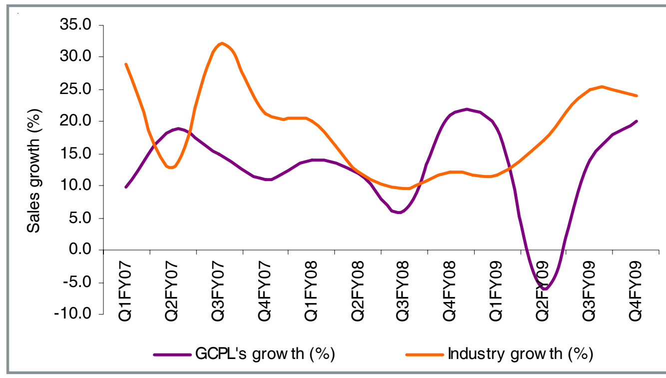
Limited product portfolio, market share loss in hair colours, liquid detergent stagnant

GCPL operates with a limited product portfolio in categories that are either highly penetrated or enjoy a high market share and are thus difficult to grow further. The toilet soap category has a high penetration of 91.5%. Hence, its growth hinges on increase in per capita usage and market share gains, and it has been witnessing mid single-digit volume growth. We believe GCPL's performance in this category will largely depend on its market share gains. GCPL is the leader in the hair colorant and liquid detergent categories in India, with market shares of 32.6% and 77.4% respectively. In the hair colorant category, GCPL continues to be strong in the mass segment products (hair dyes). However, it is facing acute competition from players like L'Oreal and Garnier at the premium end of the hair colour market. As a result, its market share in this category had declined by 250 basis points in FY2009. We believe hair colours rather than hair dyes will drive the growth in the hair colorant category in future and hence we expect GCPL to continue to lag the industry in this market. GCPL has a 77.4% value market share in the liquid detergent segment (via its brand *Ezee*) and its sales have remained almost stagnant in the past four years with the category itself stagnating. To ensure sustainable high growth GCPL needs to create new growth drivers by entering into new product categories.

Market share trend



Hair colour (value) sales



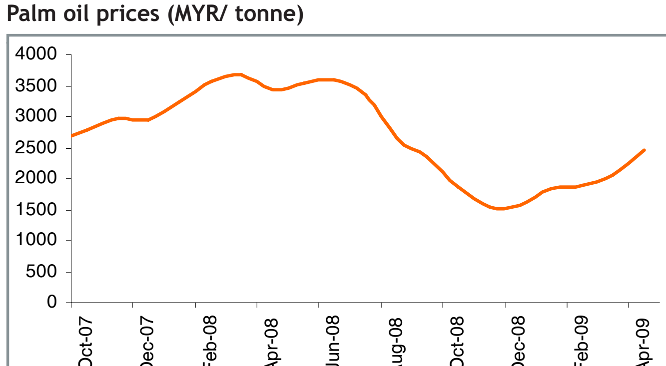
International business may slow down due to recession

Overseas, GCPL operates in the markets of the UK and South Africa. These countries are likely to have been hit hard by the global recession. A downturn in these countries is likely to affect GCPL's operations in these countries. In FY2009, the international business had contributed 22% to GCPL's total revenues; its profit contribution was much smaller at 6.7%.

Palm oil prices begin to rise

Palm oil prices started to show an upward trend from January 2009 and stood at MYR2,465 per tonne in April 2009—that is an increase of 57.9% compared with MYR1,561 per tonne in December 2008. This upward movement, if it continues, along with the depreciating rupee (the company makes payment for palm oil purchases in dollars) could substantially limit the gains expected from the drop in palm oil prices in the later part of FY2010.

Palm oil prices (MYR/ tonne)



Valuation and view

We expect the double-digit growth in GCPL's volumes to drive its top line growth. However, the growth in the bottom line will far outperform the top line growth driven by margin expansion resulting from its falling input cost. Thus, we expect the company's revenues and profit to grow at a compounded annual growth rate (CAGR) of 12.5% and of 23.6% respectively over FY2009-11. Accordingly, we expect GCPL to outperform the industry by a long margin in terms of profit growth. Currently, the stock is trading at 16x its FY2010E earnings. The valuation is attractive compared with that of its peers considering the traction in its profit growth. We, therefore, re-initiate coverage on GCPL with a Buy recommendation and a one-year price target of Rs185 based on 20x its FY2010E earnings.

Financials

Profit & Loss statement (consolidated) Rs (cr)

Particulars	FY07	FY08	FY09	FY10E	FY11E
Net sales	951.5	1102.6	1393.0	1581.0	1764.3
Total operating exp	771.8	888.1	1189.3	1304.8	1454.4
EBIDTA	179.7	215.9	207.4	280.4	314.6
Other income	2.6	2.6	5.1	6.0	6.0
Interest	9.6	12.9	-16.0	-23.6	-29.6
Depreciation	14.2	18.2	19.2	22.9	25.7
PBT	158.5	187.5	209.2	287.0	324.5
Tax	19.5	28.3	36.0	53.1	60.0
Adj. net profit	139.0	159.2	173.3	233.9	264.5
Extraordinary income	5.1	0.0	0.0	0.0	0.0
Reported net profit	144.0	159.2	173.3	233.9	264.5

Balance sheet (consolidated) Rs (cr)

Particulars	FY07	FY08	FY09	FY10E	FY11E
Share capital	22.6	22.6	25.7	25.7	25.7
Reserves and surplus	99.4	149.0	579.9	693.0	836.7
Net worth	122.0	171.6	605.6	718.7	862.4
Total debt	173.6	187.1	130.0	130.0	130.0
Minority interest	0.00	0.00	0.00	0.00	0.00
Deferred tax liabilities	7.98	8.91	8.91	8.91	8.91
Capital employed	303.6	367.6	744.5	857.6	1001.4
Net fixed assets	159.4	168.3	220.7	252.8	267.1
CWIP	39.8	71.6	15.0	0.0	0.0
Goodwill	88.6	95.6	95.6	95.6	95.6
Investments	0.0	0.0	400.0	450.0	550.0
Net current assets	15.8	29.2	13.2	59.3	88.7
Misc exp not w/off	0.0	2.9	0.0	0.0	0.0
Capital deployed	303.6	367.6	744.5	857.6	1001.4

Key ratios (%)

Particulars	FY07	FY08	FY09	FY10E	FY11E
OPM	18.9	19.6	14.8	17.7	17.8
NPM	14.6	14.4	12.4	14.8	15.0
RoCE	64.5	50.7	28.8	26.8	25.9
RoNW	138.5	108.5	44.6	35.3	33.5

Valuation ratios

Particulars	FY07	FY08	FY09	FY10E	FY11E
EPS (Rs)	6.2	7.1	6.7	9.1	10.3
Book value (Rs)	5.4	7.6	23.6	28.0	33.6
PE (x)	23.6	20.6	21.6	16.0	14.1
PBV (x)	26.9	19.1	6.2	5.2	4.3
EV/EBIDTA (x)	19.0	15.9	16.4	11.8	10.2
EV/Sales (x)	3.6	3.1	2.4	2.1	1.8
Market cap/Sales	3.5	3.0	2.7	2.4	2.1

Cash flow statement (consolidated) Rs (cr)

Particulars	FY07	FY08	FY09	FY10E	FY11E
Operating cash flow before working capital changes	153.2	177.4	192.5	256.9	290.2
Changes in working capital	-11.8	-18.2	35.7	-14.0	-3.2
Cash flow from operating activities	141.4	159.2	228.2	242.9	287.0
Cash flow from financing activities	10.6	-98.1	206.5	-120.8	-120.8
Cash flow from investing activities	-130.9	-65.9	-415.0	-90.0	-140.0
Closing cash balance	**47.5**	**42.6**	**62.3**	**94.4**	**120.6**

Peer comparison

Company	CMP	EPS		P/E multiple		EV / EBIDTA		RONW (%)		ROCE (%)	
		FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E	FY2010E	FY2011E
HUL	234.6	11.0	12.5	21.3	18.7	18	15.5	102.6	96.3	124.1	116.9
Marico	68.0	4.0	4.4	17.0	15.5	11	9.5	43.5	35.5	39.4	38.4
ITC	192.3	10.3	11.8	18.7	16.3	11.5	9.6	25.4	24.7	34.2	33.4
Dabur India	104.3	5.5	6.6	18.9	15.7	14.6	12.2	50.7	46.9	43.5	43.4
GCPL	145.4	9.1	10.3	16.0	14.1	11.8	10.2	35.3	33.5	26.8	25.9

The author doesn't hold any investment in any of the companies mentioned in the article.