

Colgate-Palmolive

Q1FY12/ Rating Change

25 July 2011

Sell

Target Price: Rs883

CMP: Rs992*

Downside: 11%

*as on 22 July 2011

Higher expenses impact profit

Colgate-Palmolive reported revenue of Rs6,294mn (up 14.5% YoY and 4.7% QoQ) in Q1FY12 on the back of 12% YoY volume growth. Its toothpaste category grew 14%, though market share declined 10bps. High COGS and increased A&P spend and royalty payout impacted operating margins, while a high tax rate hurt profitability which declined 17.7% YoY. We downgrade to Sell on account of expensive valuations.

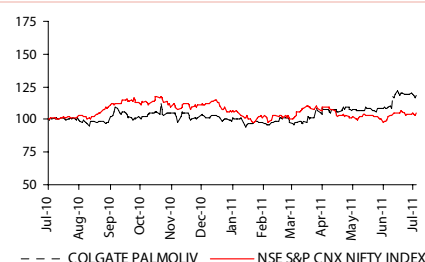
- **Robust volume growth boosts revenue:** Colgate posted 12% volume growth in Q1FY12 despite high food inflation. Net sales grew 15.6% on the back of 14% growth in the toothpaste category, which included strong traction in new products for sensitive tooth such as "Colgate Sensitive Pro-Relief".
- **Increased expenses hit margins:** Operating profit declined 15% YoY on account of higher expenses. A&P costs increased 42.3%, COGS a percentage of sales grew 343bps to 39.2%, while other expenditure increased by 24%. As a result, operating margin contracted 755bps YoY and 247bps QoQ to 21.5%. Net profit declined 17.7% YoY to Rs1,004mn due to a higher tax rate of 27.3%.
- **Downgrade to Sell:** We have marginally lowered our FY12 and FY13 estimates. The company recently hiked prices by 3-4% across product categories. This, combined with declining A&P spend (as ad rates ease), and reduced pressure on COGS would help improve margins, going forward. At current valuations of 28.6x FY12E EPS of Rs34.7 and 25.8x FY13E EPS of Rs38.4, we believe the stock is expensive hence we downgrade to SELL from HOLD. We value the stock at 23x FY13E EPS to arrive at a price target of Rs883.

Key Data

Bloomberg Code	CLGT IN
Reuters Code	COLG.BO
Current Shares O/S (mn)	136.0
Diluted Shares O/S(mn)	136.0
Mkt Cap (Rsbn/USDbn)	135.1/3
52 Wk H / L (Rs)	1033/716
Daily Vol. (3M NSE Avg.)	76,518
Face Value (Rs)	1

1 USD = Rs44.4

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Colgate-Palm	8.1	17.8	17.4
NIFTY	2.9	(1.0)	3.3

Source: Bloomberg, Centrum Research
*as on 22 July 2011

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Y/E March (Rsmn)	Q1FY12	Q1FY11	YoY (%)	Q4FY11	QoQ (%)	Q1FY12E	Variance (%)
Net sales	6,294	5,497	14.5	6,012	4.7	6,229	1.0
Total Expenditure	4,938	3,898	26.7	4,569	8.1	4,779	3.3
Employee Cost	498	444	12.3	432		469	6.2
as % of sales	7.9	8.1		7.2		7.5	
COGS	2,467	1,966	25.5	2,393	3.1	2,400	2.8
as % of sales	39.2	35.8		39.8		38.5	
A&P spend	988	694	42.3	804	22.9	950	4.0
as % of sales	15.7	12.6		13.4		15.3	
Other expenditure	985	795	24.0	940	4.8	960	2.6
as % of sales	15.7	14.5		15.6		15.4	
EBIDTA	1,356	1,599	(15.2)	1,444	(6.1)	1,450	(6.5)
% margin	21.5	29.1		24.0		23.3	
Depreciation	88	79		88		90	
EBIT	1,268	1,520		1,356		1,360	
Interest	6	3		4		5	
EBT	1,262	1,516		1,351		1,355	
Other Income	120	54		78		85	
Exceptional item	0	0		0		0	
PBT	1,381	1,570	(12.0)	1,429	(3.3)	1,440	(4.0)
Tax	377	350		288		364	
% Tax	27.3	22.3		20.2		25.3	
PAT	1,004	1,220	(17.7)	1,141	(11.9)	1,076	(6.6)

Source: Company, Centrum Research Estimates

Y/E Mar (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY10	19,625	15.8	4,254	21.7	4,233	45.8	31.1	156.1	140.6	31.9	30.9
FY11	22,206	13.2	4,507	20.3	4,026	(4.9)	29.6	113.4	116.5	33.5	29.0
FY12E	25,575	15.2	5,425	21.2	4,713	17.1	34.7	114.2	121.9	28.6	23.7
FY13E	29,238	14.3	6,238	21.3	5,226	10.9	38.4	110.7	123.5	25.8	20.4
FY14E	33,432	14.3	6,807	20.4	5,688	8.8	41.8	105.2	117.7	23.7	18.5

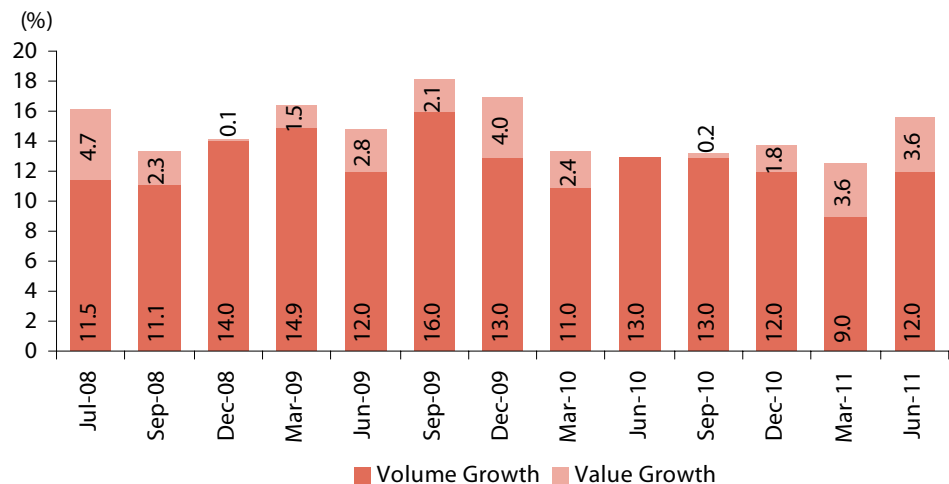
Source: Company, Centrum Research Estimates

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Robust volume growth boosts revenue

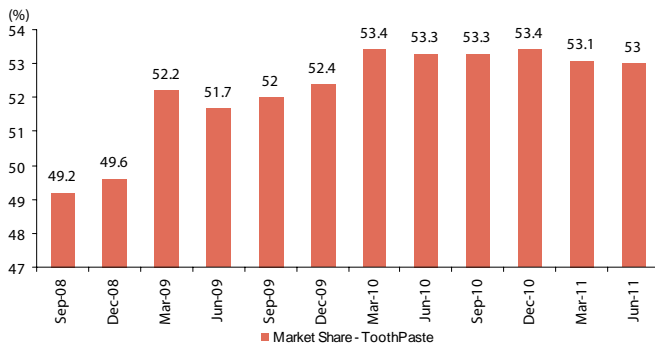
Colgate posted 12% volume growth in Q1FY12 despite high food inflation. Net sales grew 15.6% YoY on the back of 14% growth in the toothpaste category which included strong traction in new products for sensitive tooth such as "Colgate Sensitive Pro-Relief". Company's toothpaste volume market share decreased marginally by 10bps from 53.1% to 53% During May-June 2011 due to heightened competitive intensity. Volume market share in the toothbrush category stood at 40%, while in the emerging mouthwash category, market share increased sequentially to 24% from 22%.

Exhibit 1: Robust volume growth



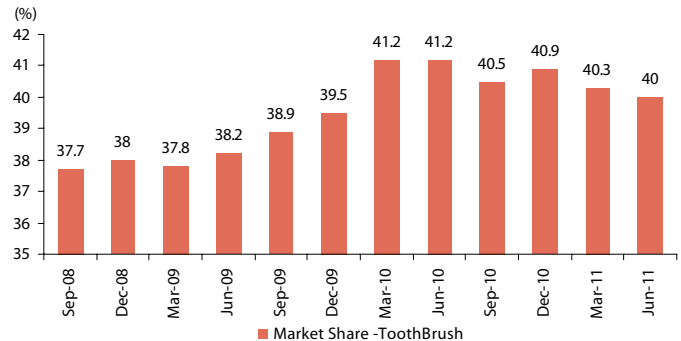
Source: Company, Centrum Research

Exhibit 2: Toothpaste market share



Source: Centrum Research, Company

Exhibit 3: Toothbrush market share

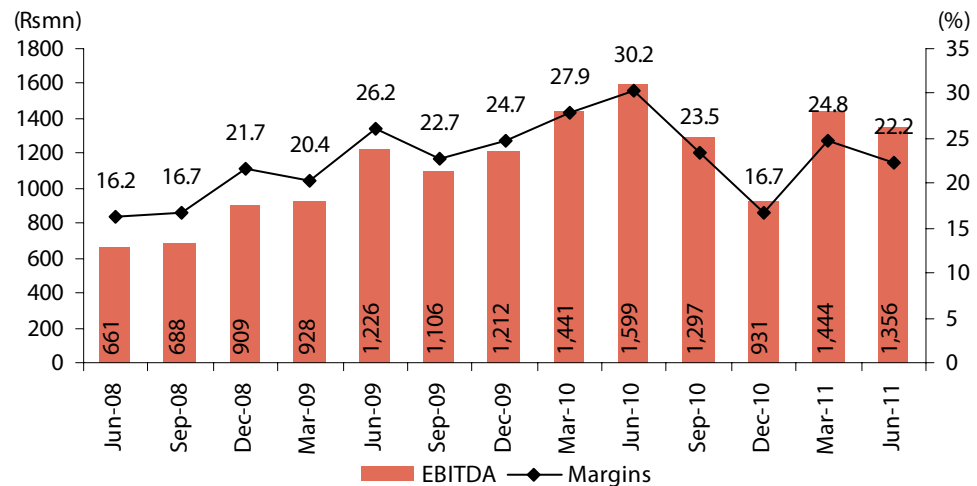


Source: Centrum Research, Company

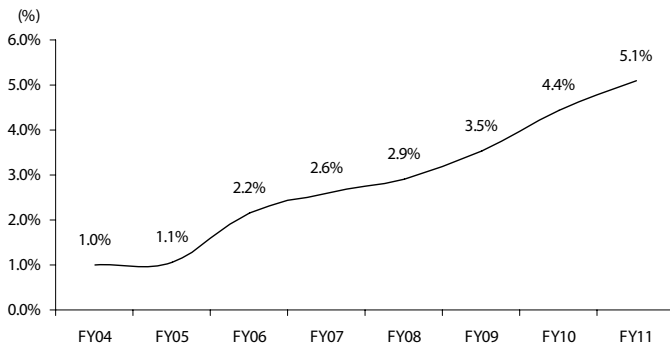
High costs impact operating margin

Operating profit declined 15% YoY and 6.1% QoQ to Rs1,356mn on back of the 42.3% increase in the A&P spend to 15.7% of sales. COGS as a percentage of sales increased 343bps YoY to 39.2% while other expenditure increased 24% YoY. The investment in new launches and brand-building along with increase in raw material costs impacted operating profits.

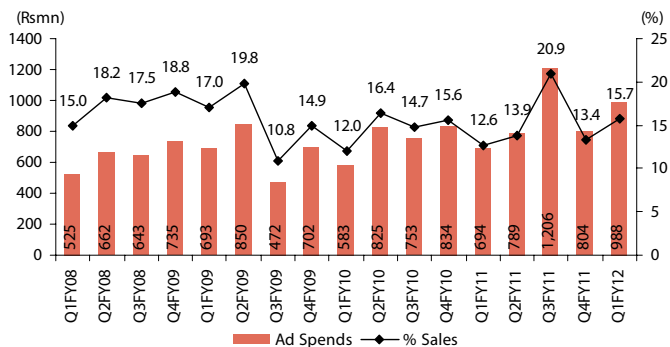
The company also increased its royal outgo to 5.1% of sales in FY11 from 4.4% in FY10. As a result, operating margins declined 755bps YoY and 247bps QoQ to 21.5%. Net profit declined 17.7% YoY to Rs1,004mn (6.6% below our estimate) on the back of high tax outgo. Tax rate increased to 27.3% during the quarter due to reduced tax incentives from the Baddi plant.

Exhibit 4: Lower operating profit impacted margins


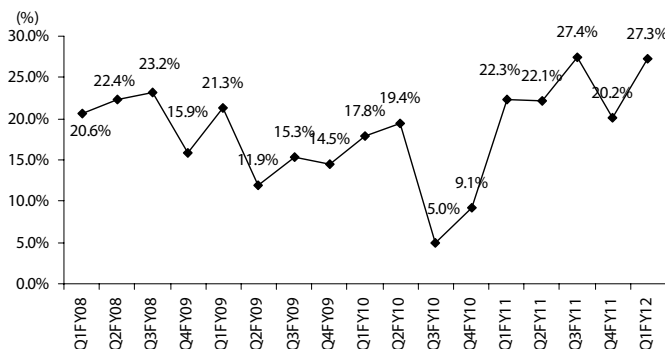
Source: Company, Centrum Research

Exhibit 5: High royalty payout


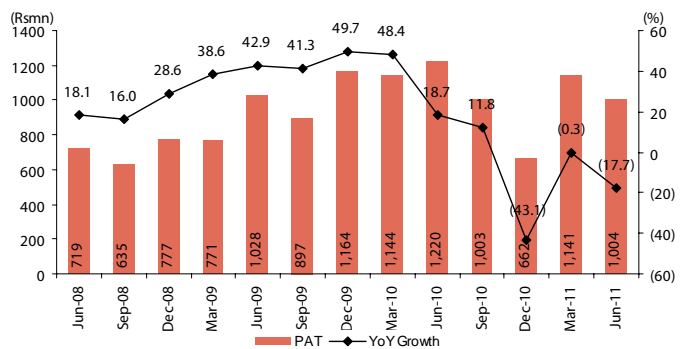
Source: Centrum Research, Company

Exhibit 6: Ad spending as percentage of sales increases


Source: Centrum Research, Company

Exhibit 7: High tax rate


Source: Centrum Research, Company

Exhibit 8: Declining profitability


Source: Centrum Research, Company

Downgrade to Sell

We have marginally lowered our FY12 and FY13 estimates. The company recently hiked prices by 3-4% across product categories. This, combined with declining A&P spend (as ad rates ease), and reduced pressure on COGS would help improve margins, going forward. At current valuations of 28.6x FY12E EPS of Rs34.7 and 25.8x FY13E EPS of Rs38.4, we believe the stock is expensive and hence downgrade to Sell. We value the stock at 23x FY13E EPS to arrive at a price target of Rs883.

Financials

Exhibit 9: Income Statement

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales	19,625	22,206	25,575	29,238	33,432
Growth (%)	15.8	13.2	15.2	14.3	14.3
Employee Cost	1,591	1,932	2,222	2,533	2,888
%of Sales	8.1	8.7	8.7	8.7	8.6
Cost of Goods Sold	7,768	8,720	9,718	11,169	13,038
% of sales	39.6	39.3	38.0	38.2	39.0
Advertising Expenses	2,994	3,493	4,143	4,678	5,349
% of sales	15.3	15.7	16.2	16.0	16.0
Admin & other expenses	3,017	3,554	4,066	4,620	5,349
% of sales	15.4	16.0	15.9	15.8	16.0
EBIDTA	4,254	4,507	5,425	6,238	6,807
EBIDTA Margins (%)	21.7	20.3	21.2	21.3	20.4
Depreciation	376	342	391	405	442
Interest expenses	15	33	15	15	15
PBT for operations	3,863	4,131	5,019	5,819	6,351
Other non operating income	985	1,068	1,350	1,440	1,550
Exceptional item	0	0	0	0	0
PBT	4,848	5,199	6,369	7,259	7,901
Provision for tax	615	1,174	1,656	2,032	2,212
Effective tax rate (%)	12.7	22.6	26.0	28.0	28.0
Net Profit	4,233	4,026	4,713	5,226	5,688
Adj Net Profit	4,233	4,026	4,713	5,226	5,688

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Share Capital	136	136	136	136	136
Reserves & Surplus	3,125	3,705	4,281	4,893	5,649
Total Shareholders Funds	3,261	3,841	4,417	5,029	5,785
Secured Loans	0	0	0	0	0
Unsecured Loans	46	1	1	1	1
Loan Funds	46	1	1	1	1
Total Capital Employed	3,307	3,841	4,417	5,029	5,785
Fixed Asset					
Gross Block	5,345	5,798	5,925	6,055	6,459
Less:- Accumulated Depreciation	2,876	3,248	3,639	4,043	4,486
Net Block	2,469	2,550	2,286	2,011	1,973
Capital WIP	62	123	123	123	123
Total fixed assets	2,531	2,673	2,409	2,134	2,096
Investments	210	387	387	387	387
Deferred Tax Asset	179	168	168	168	168
Inventory	1,106	1,537	1,464	1,683	1,965
Debtors	98	430	210	240	275
Loans & advances	1,167	1,048	1,151	1,316	1,504
Cash & bank balances	3,476	3,956	5,775	7,178	8,560
Interest Accrued on Deposits	55	73	73	73	73
Total current assets	5,901	7,044	8,673	10,491	12,377
Current liabilities and provisions	5,515	6,432	7,221	8,151	9,244
Net current assets	387	612	1,453	2,339	3,133
Total	3,307	3,841	4,417	5,029	5,785

Source: Company, Centrum Research Estimates

Exhibit 11: Cash flow

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
CF from operations					
Profit before tax	4,848	5,199	6,369	7,259	7,901
Depreciation & amortisation	376	342	391	405	442
Others	(276)	(324)	(1,335)	(1,425)	(1,535)
CF before WC changes	4,948	5,218	5,425	6,238	6,807
Working capital changes	(209)	(322)	978	517	588
Cash inflow from operations	4,739	4,896	6,403	6,755	7,396
Income tax paid	(765)	(1,042)	(1,656)	(2,032)	(2,212)
Cash from Operations	3,974	3,854	4,747	4,723	5,183
Cash from investing					
Capex	(310)	(409)	(126)	(130)	(405)
Investments	119	(192)	0	0	0
Other Income	536	456	1,350	1,440	1,550
Cash from investing	345	(145)	1,224	1,310	1,145
Cash from financing					
Borrowings/ repayments	(1)	(45)	0	0	0
Dividend paid	(3,359)	(3,168)	(4,137)	(4,614)	(4,932)
Interest paid	(15)	(16)	(15)	(15)	(15)
Others	0	0	0	0	0
Cash from financing	(3,375)	(3,230)	(4,152)	(4,629)	(4,947)
Net change in cash	944	479	1,818	1,404	1,381

Source: Company, Centrum Research Estimates

Exhibit 12: Key Ratios

Y/E March	FY10	FY11	FY12E	FY13E	FY14E
Margin ratios (%)					
EBIDTA Margins	21.7	20.3	21.2	21.3	20.4
PBIT Margins	19.8	18.8	19.7	20.0	19.0
PBT Margins	24.7	23.4	24.9	24.8	23.6
PAT Margins	21.6	18.1	18.4	17.9	17.0
Growth ratios (%)					
Revenues	15.8	13.2	15.2	14.3	14.3
EBIDTA	62.6	5.9	20.4	15.0	9.1
Adj Net Profit	45.8	-4.9	17.1	10.9	8.8
Return Ratios (%)					
ROCE	141	117	122	124	118
RoNW	156	113	114	111	105
Turnover Ratios					
Inventory period (days)	45	55	56	51	51
Average collection period(days)	2	4	5	3	3
Average payment period (days)	98	93	93	94	93
Working Capital Cycle (days)	(50)	(33)	(32)	(40)	(39)
Per Share (Rs)					
EPS	31.1	29.6	34.7	38.4	41.8
CEPS	33.9	32.1	37.5	41.4	45.1
Book Value	24.0	28.2	32.5	37.0	42.5
Dividend	20.0	22.0	26.0	29.0	31.0
Valuations (x)					
PER	31.9	33.5	28.6	25.8	23.7
P/BV	41.4	35.1	30.5	26.8	23.3
EV/EBIDTA	30.9	29.0	23.7	20.4	18.5
EV/Sales	6.7	5.9	5.0	4.4	3.8
M-cap/Sales	6.9	6.1	5.3	4.6	4.0

Source: Company, Centrum Research Estimates

Appendix A

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