

Colgate Palmolive (India) Ltd

Profitability hit as A&P expenses shoot up

Colgate Palmolive (Colgate) reported weak numbers for Q3FY11, with EBITDA margins disappointing hugely. The company reported sales/EBITDA/PAT growth of 13%/(26)%/(43.1)% as against our expectation of 13.5%/0%/(22)% for the quarter. However, a key negative surprise was a 720bps YoY contraction in the EBITDA margin. While we expected a sequential increase in A&P expenses by 300 bps, a 730 bps QoQ increase in A&P expenses (21.6% of sales) for the quarter were above the trend, and we expect it to moderate to 16–17% levels in Q4 and FY12. Revenue growth was in line at 13%, driven by a growth of 13%/24% in the toothpaste/toothbrush categories. Overall volume growth remained at 12%, in line with historic growth rates.

We have pared our earnings estimates for FY11/FY12/FY13 by 10%/5%/7% to factor in the higher A&P expenses, thus revising our Sep '11 price target downwards to Rs 800 (from Rs 860 earlier) while maintaining our SELL rating on the stock. Likely upward pressure on A&P expenses due to the possible entry of P&G and HUVR getting aggressive in the oral care segment remains as the key risk for the stock.

Sales growth remains steady: Colgate's Q3FY11 revenues increased by 13.8% YoY to Rs 5.6bn, in line with our estimates. The company clocked a volume growth of 12% for the quarter, with the **toothpaste category** reporting 13% higher volumes. Volume market share in the toothpaste category improved to 53.4% in the Jan–Nov '10 period compared to 52.4% in Jan–Nov '09. All flagship brands, *Colgate Dental Cream, Active Salt, Max fresh, Sensitive* and *Total* contributed to the volume growth. In the **toothbrush category**, volumes grew by 24%, with the volume market share improving by 40.5% (Jan–Nov 10) vs. 39.5% (Jan–Nov 09). However, Colgate's volume market share in the **toothpowder category** at 47.3% (Jan–Nov '10) was slightly lower than in the same period last year. In the **mouthwash category**, *Plax* mouthwash improved its share to 17.3% (Jan–Nov 10) from 6.6% (Jan–Nov 09).

Margins below estimates: EBITDA slumped by 26% YoY to Rs 746mn, with operating margins at 13.4%—a contraction of 720bps YoY. Gross profit margins improved by 410bps YoY while other expenses increased by 390bps YoY. However, A&P expenses, which jumped 630bps YoY to 21.6%, were the biggest drag on profitability. Adjusting for these expenses, margins would have only declined by 100bps YoY for the quarter. Adjusted PAT fell by 43.1% YoY to Rs 662mn and adj. PAT margins by 1,190bps YoY to 11.9%.

Price target revised to Rs 800; maintain SELL: We reduce our FY11/FY12/FY13 earnings estimates by 10%/5%/7% to account for the higher A&P expenses. Our revised Sep '11 price target works out to Rs 800 (as against Rs 860 earlier) based on 23x Sep '12 earnings. We maintain our SELL rating on the stock.

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	19,625	22,348	25,347	28,715
Growth (%)	15.8	13.9	13.4	13.3
Adj net income	4,232	3,939	4,522	5,006
Growth (%)	45.8	(6.9)	14.8	10.7
FDEPS (Rs)	31.1	29.0	33.3	36.8
Growth (%)	45.8	(6.9)	14.8	10.7

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	21.7	20.1	20.5	20.5
EBIT margin	19.8	18.5	19.0	19.0
Adj PAT margin	21.6	17.6	17.8	17.4
ROE	156.1	116.3	123.6	126.3
ROIC	295.4	246.5	260.9	307.8
ROCE	153.9	115.6	122.6	125.4

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 824	Rs 800	SELL	LOW

BSE	NSE	BLOOMBERG
500830	COLPAL	CLGT IN

Company data

Market cap (Rs mn / US\$ mn)	112,058 / 2,441
Outstanding equity shares (mn)	136
Free float (%)	49
Dividend yield (%)	2.8
52-week high/low (Rs)	1005 / 665
2-month average daily volume	92,216

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Colgate	824	(5.3)	(6.4)	(2.3)
BSE FMCG	3,366	(8.6)	(6.6)	4.2
Sensex	18,328	(10.6)	(8.5)	2.6

Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	26.5	28.4	24.8	22.4
P/E @ Target	25.7	27.6	24.1	21.7
EV/EBITDA @ CMP	25.5	24.1	20.9	18.4





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Revenue	5,582	5,789	(3.6)
EBITDA	746	909	(17.9)
Adj net income	662	940	(29.5)
FDEPS (Rs)	4.87	6.92	(29.5)

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Net Sales	5,582	4,906	13.8	5,518	1.2
Cost of revenues	2,160	2,100	2.9	2,201	(1.9)
Gross profit	3,422	2,806	21.9	3,316	3.2
A&P spends	1,206	753	60.2	789	52.8
Staff costs	524	406	28.9	533	(1.8)
Other operating expenses	947	639	48.1	872	8.5
Operating profit	746	1,008	(26.0)	1,122	(33.5)
Depreciation & Amortization	91	56	63.3	84	8.5
Other income	277	278	(0.4)	256	8.0
Interest	19	5	265.4	6	211.5
PBT	913	1,225	(25.5)	1,288	(29.1)
Income taxes	250	61	309.2	285	(12.0)
Adj. PAT	662	1,164	(43.1)	1,003	(34.0)
EBITDA margin (%)	13.4	20.6	(720 bps)	20.3	(700 bps)
EPS (Rs)	4.9	8.6	(43.1)	7.4	(34.0)

Source: Company, RCML Research

Sales growth in line, margins hit by higher A&P expenses

Net sales growth largely led by volumes

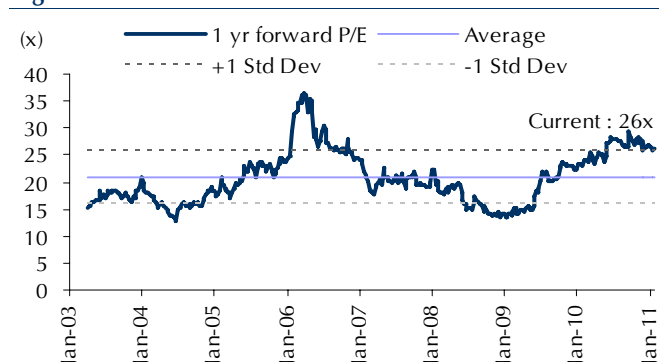
Operating margins contract 720bps YoY on account of higher A&P expenses

Fig 3 - Revised estimates

Key parameters	FY11E			FY12E			FY13E		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
Revenue (Rs mn)	22,348	22,348	(0.0)	25,347	25,347	0.0	28,715	28,715	(0.0)
EBITDA (Rs mn)	5,013	4,499	(10.23)	5,446	5,192	(4.7)	6,319	5,888	(6.8)
EBITDA margin (%)	22.4	20.1	(230 bps)	21.5	20.5	(100 bps)	22.0	20.5	(150 bps)
Net profit (Rs mn)	4,405	3,939	(10.6)	4,780	4,522	(5.4)	5,397	5,006	(7.2)
EPS (Rs)	32.40	28.96	(10.6)	35.14	33.25	(5.4)	39.68	36.81	(7.2)

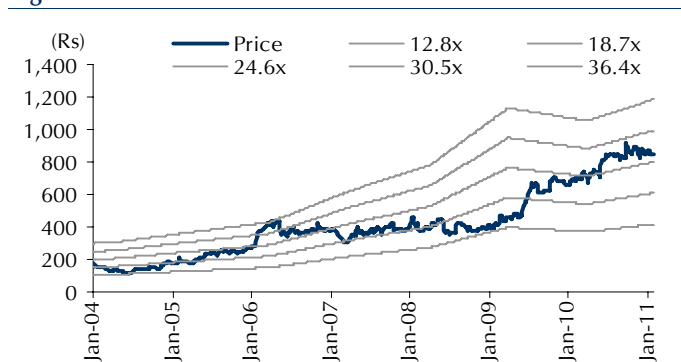
Source: RCML Research

Fig 4 - 1Yr fwd P/E



Source: RCML Research

Fig 5 - 1Yr fwd P/E bands



Source: RCML Research



Standalone financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	19,625	22,348	25,347	28,715
<i>Growth (%)</i>	15.8	13.9	13.4	13.3
EBITDA	4,254	4,499	5,192	5,888
<i>Growth (%)</i>	62.6	5.8	15.4	13.4
Depreciation & amortisation	376	358	385	436
EBIT	2,386	3,878	4,141	4,807
<i>Growth (%)</i>	-	62.5	6.8	16.1
Interest	15	41	23	26
Other income	985	1,083	1,245	1,432
EBT	4,848	5,183	6,029	6,857
Income taxes	615	1,244	1,507	1,851
Effective tax rate (%)	12.7	24.0	25.0	27.0
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	4,232	3,939	4,522	5,006
Adjustments	-	-	-	-
Adjusted net income	4,232	3,939	4,522	5,006
<i>Growth (%)</i>	45.8	(6.9)	14.8	10.7
Shares outstanding (mn)	136.0	136.0	136.0	136.0
FDEPS (Rs) (adj)	31.1	29.0	33.3	36.8
<i>Growth (%)</i>	45.8	(6.9)	14.8	10.7
DPS (Rs)	20.0	23.2	26.6	29.4

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	4,608	4,296	4,907	5,442
Non-cash adjustments	(425)	210	76	78
Changes in working capital	(209)	(341)	287	331
Cash flow from operations	3,974	4,166	5,270	5,852
Capital expenditure	(310)	31	(346)	(640)
Change in investments	119	-	-	-
Other investing cash flow	536	-	-	-
Cash flow from investing	345	31	(346)	(640)
Issue of equity	-	-	-	-
Issue/repay debt	(1)	-	-	-
Dividends paid	(3,359)	(2,955)	(4,002)	(4,460)
Other financing cash flow	(15)	(41)	(23)	(26)
Change in cash & cash eq	944	1,200	899	726
Closing cash & cash eq	3,476	4,676	5,575	6,300

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	3,476	4,676	5,575	6,300
Accounts receivable	98	144	163	185
Inventories	1,106	1,081	1,263	1,439
Other current assets	1,222	2,571	2,923	3,301
Investments	210	210	210	210
Gross fixed assets	4,439	4,470	4,816	5,456
Net fixed assets	1,563	1,236	1,197	1,401
CWIP	62	-	-	-
Intangible assets	907	907	907	907
Deferred tax assets, net	179	179	179	179
Other assets	-	-	-	-
Total assets	8,822	11,004	12,417	13,922
Accounts payable	3,708	4,218	4,827	5,496
Other current liabilities	559	635	727	828
Provisions	1,248	2,591	3,015	3,429
Debt funds	46	46	46	46
Other liabilities	-	-	-	-
Equity capital	136	136	136	136
Reserves & surplus	3,125	3,377	3,667	3,987
Shareholder's funds	3,261	3,513	3,803	4,123
Total liabilities	8,822	11,004	12,417	13,922
BVPS (Rs)	25.0	26.8	29.0	31.3

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	21.7	20.1	20.5	20.5
EBIT margin	19.8	18.5	19.0	19.0
Net profit margin	21.6	17.6	17.8	17.4
ROE	156.1	116.3	123.6	126.3
ROCE	153.9	115.6	122.6	125.4
Working Capital & Liquidity ratios				
Receivables (days)	2	2	2	2
Inventory (days)	45	44	42	42
Payables (days)	167	160	162	161
Current ratio (x)	1.4	1.7	1.8	1.8
Quick ratio (x)	0.8	1.0	1.0	1.0
Turnover & Leverage ratios (x)				
Gross asset turnover	5.0	5.0	5.5	5.6
Total asset turnover	2.4	2.3	2.2	2.2
Interest coverage ratio	257.8	100.3	209.6	206.3
Adjusted debt/equity	0.0	0.0	0.0	0.0
Valuation ratios (x)				
EV/Sales	5.5	4.9	4.3	3.8
EV/EBITDA	25.5	24.1	20.9	18.4
P/E	26.5	28.4	24.8	22.4
P/BV	33.0	30.7	28.5	26.3



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	4,906	5,166	5,288	5,518	5,582
YoY growth (%)	17.0	13.4	13.0	13.2	13.8
QoQ growth (%)	0.7	5.3	2.4	4.3	1.2
EBITDA (Rs mn)	1,008	1,247	1,390	1,122	746
EBITDA margin (%)	20.6	24.1	26.3	20.3	13.4
Adj net income (Rs mn)	1,164	1,144	1,220	1,003	662
YoY growth (%)	49.7	48.4	18.7	11.8	(43.1)
QoQ growth (%)	29.8	(1.7)	6.6	(17.8)	(34.0)

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	84.0	87.3	76.0	75.0	73.0
Interest burden (PBT/EBIT)	144.7	125.0	125.2	125.4	125.8
EBIT margin (EBIT/Revenues)	14.1	19.8	18.5	19.0	19.0
Asset turnover (Revenues/Avg TA)	230.1	237.2	225.4	216.5	218.0
Leverage (Avg TA/Avg equity)	389.3	305.0	292.7	320.1	332.3
Return on equity	153.4	156.1	116.3	123.6	126.3

Company profile

Colgate earns 96% of its revenues from the oral care business, while its personal care and home care segments contribute a mere 4%. Colgate currently commands a market share of over 50% in the toothpaste category (which accounts for 65% of the total oral care segment). It also remains the market leader in the Toothbrush and Toothpowder category.

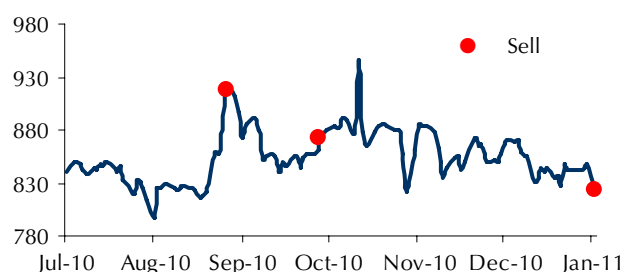
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	51.0	51.0	51.0
FIs	16.0	16.2	17.4
Banks & FIs	7.7	7.8	7.0
Public	25.3	25.0	24.6

Recommendation history

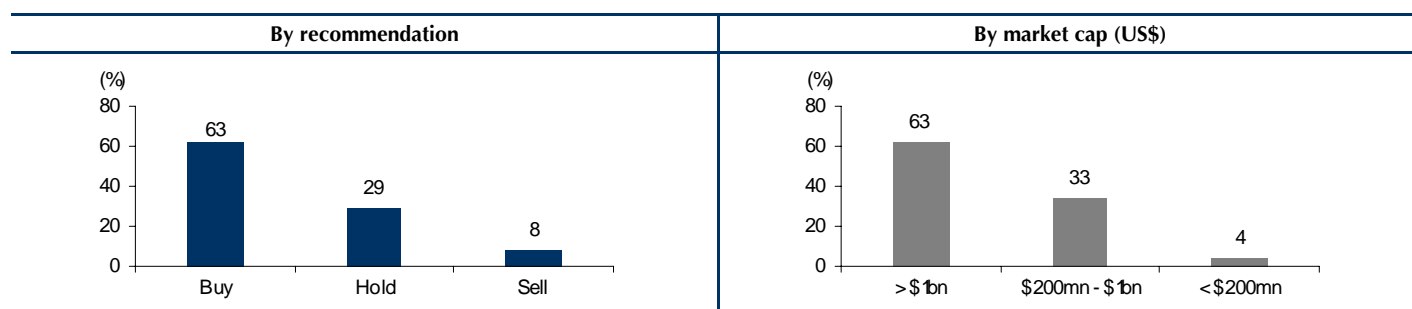
Date	Event	Reco price	Tgt price	Reco
27-Sep-10	Initiating Coverage	919	850	Sell
28-Oct-10	Results Review	876	860	Sell
31-Jan-11	Results Review	824	800	Sell

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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