8 October 2012

Update | Sector: Consumer

Godrej Consumer Products

BSE SENSEX	S&P CNX
18,709	5,676

CMP: INR693 | TP: INR740 | Neutral

HI-flier in home insecticides; early signs of soaps take-off

Palm oil prices easing; 3-8% EPS upgrade; Rich valuations limit upside

Bloomberg	GCPL IN
Equity Shares (m)	340.3
52-Week Range (INR)	718/370
1,6,12 Rel. Perf. (%)	-1/30/60
M.Cap. (INR b)	235.8
M.Cap. (USD b)	4.5

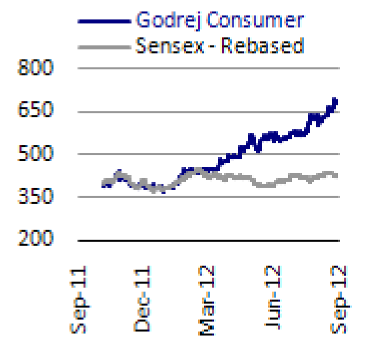
Valuation summary (INR b)

Y/E March	2012	2013E	2014E
Sales	48.5	63.1	78.3
EBITDA	8.6	11.5	14.7
NP	5.5	8.2	10.5
EPS (INR)	15.5	22.4	28.2
EPS Gr. (%)	5.7	44.7	26.1
BV/Sh. (INR)	82.7	97.7	116.3
P/E (x)	44.8	30.9	24.5
P/BV (x)	8.4	7.1	6.0
EV/EBITDA (x)	28.9	21.5	16.6
EV/Sales (x)	5.1	3.9	3.1
RoE (%)	18.7	22.9	24.3
RoCE (%)	20.7	25.4	28.9

Shareholding pattern %

As on	Jun-12	Mar-12	Jun-11
Promoter	64.0	64.0	67.3
Dom. Inst	1.0	1.8	2.2
Foreign	27.2	25.3	19.3
Others	7.8	9.0	11.2

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

- **Our analysis of the recent market share data for Godrej Consumer Products (GCPL) suggests continued momentum in HI (home insecticides) and Soaps.**
- **Softening in palm oil prices also augurs well for near-term earnings performance.**
- **We upgrade our FY13 and FY14 earnings estimates by 3-8% to factor in the above.**
- **Our revised target price of INR740 (26x FY14E EPS) offers only 7% upside. Neutral.**

Momentum continues in HI

GCPL's strong run in HI market in India (44 % of domestic sales) continues unabated. Our analysis of the latest industry data points to continued share gains for GCPL (310bp market share gain during Dec 2011-Aug 2012). It is gaining share in every sub-segment of the HI category and improving its mix. We expect GCPL's outperformance to continue on the back of (1) distribution synergies, (2) innovation, and (3) sustained brand spends.

Soaps market share picks up

GCPL's Soaps market share has remained flat for the last 12 months, but has started to pick up in last four months (Godrej No 1 up 40bp post Apr-12). The recent re-launch of Cinthol (with 10% price hike) should help boost GCPL's Soaps performance, in our view. Channel checks indicate continued momentum in GCPL's Soaps business in 2QFY13.

Raw material situation turning favorable

Softening of palm oil prices (down 23% in last 6 months in INR terms) is a positive for GCPL's gross margins as palm oil is 20% of GCPL's RMC. However, we expect the gains to flow in with a lag of 1-2 quarters, and also part passing-on of the cost savings via promotions. Recent currency appreciation is an additional positive given GCPL's USD 305m debt.

International segment driven by consolidation of acquired businesses

We expect strong momentum to continue in GCPL's international business led by Megasari (50% of international sales) and consolidation of Darling business. GCPL has demonstrated strong execution potential in the integration of its recently acquired businesses. Significant cross pollination potential still exists in categories like Hair Colors and HI, and successful execution of the same will be a key driver in the medium term.

Raising target price; 7% upside; maintain Neutral

We upgrade our FY13 and FY14 earnings estimates by 3-8% to factor in (a) market share gains in Home Insecticides, (b) softening of PFAD prices, and (c) margin improvements in international business in FY14 due to scale economies post integration. We now expect 32% EPS CAGR over FY12-14. Consequently, we revise our target price to INR740 (26x FY14E EPS). Maintain **Neutral**.

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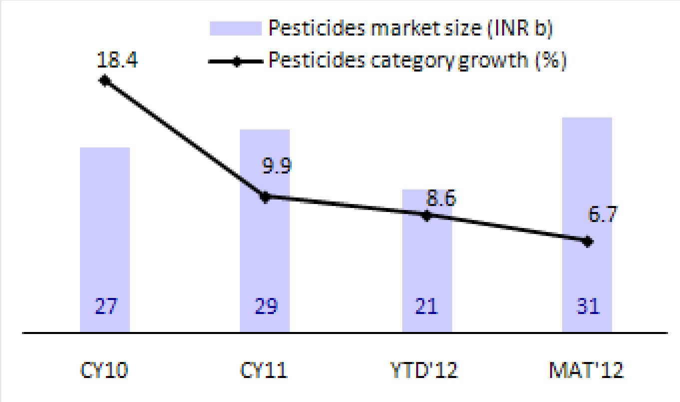
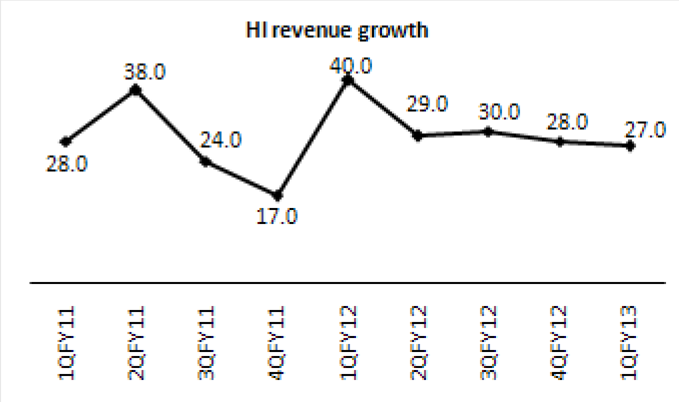
Story in charts Home Insecticides: GCPL's success story

❶ The pesticides category has slowed down ...
❷ ... but GCPL's HI performance stands out ...
❸ ... led by significant, steady gains in market share ...
❹ ... thus, increasing its market share lead over competitors
❺ GCPL has gained market share in HI sub-categories like vaporizers and aerosols ...
❻ ... thus, diversifying its product mix and lowering dependence on mats and coils.

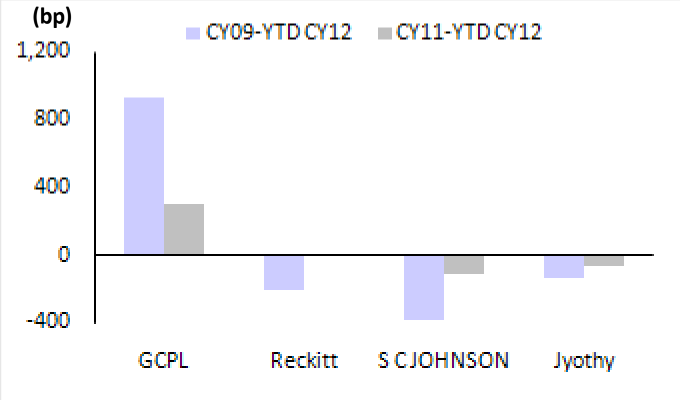
❶ **The pesticides category growth has slowed down....**



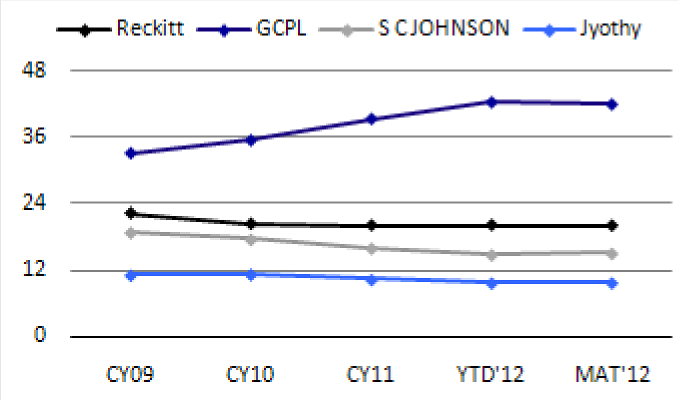
... but GCPL's HI performance stands out (%) ❷



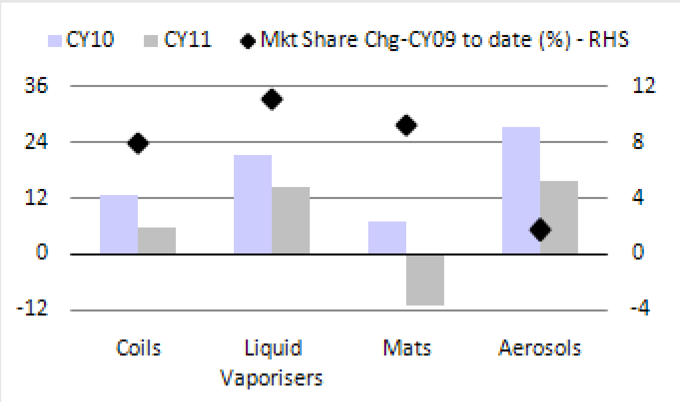
❸ **GCPL has gained significant share even post CY11 ...**



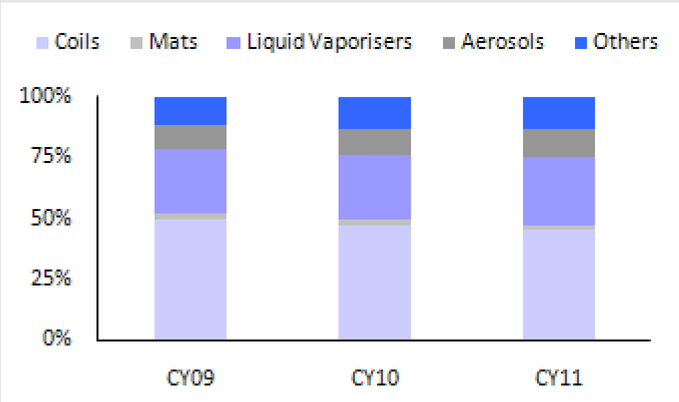
... thus increasing its lead over competitors (%) ❹



❺ **GCPL has gained market share in HI sub-categories like vaporizers and aerosols ...**



... thus, diversifying its product mix and lowering dependence on mats and coils ❻



Source: Company, MOSL

Home insecticides KSFs – synergy, innovation, branding

GCPL's standout performance in HI is a function of –

1) Distribution synergies (post Sara Lee acquisition)
2) Consistent innovation track record and
3) Sustained brand spend in the category.

1. **Distribution synergies:** We see further scope for distribution benefits in HI as all synergies have not been tapped yet. While the magnitude of market share gains will be difficult to replicate, we still see strong 20% + revenue growth in HI. Due to outperformance of high margin sub-categories like aerosols and liquid vaporizer, overall margins have improved for HI. GCPL recently took a ~3% price hike in its HI portfolio.

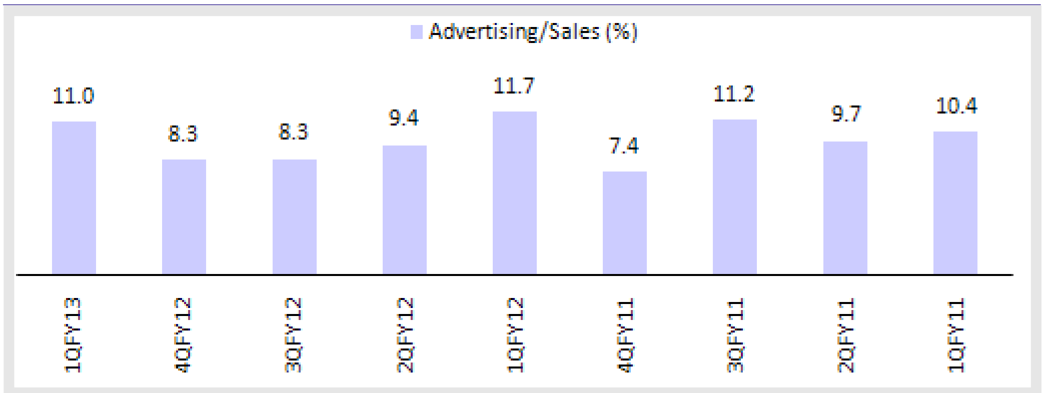
2. **Consistent innovation:** GCPL has demonstrated innovation leadership in HI post the Sara Lee acquisition. It has launched several innovative marketing campaigns in the recent past e.g. *GoodKnight: Dhoondh ke Dikhao Challenge*, *HIT: Kill Malaria*.

   As a part of its overall cross pollination strategy, enunciated at the time of acquisitions, GCPL may launch in India its recent HI innovation in Indonesia – ***Hit Magic*** – a disruptive, paper-format mosquito repellent.

GCPL's Indonesian innovation – paper based HI – may be launched in India

3. **Sustain brand spend:** GCPL has increased ad-spends by 2.6x over past FY10-12 months notwithstanding the 30bps decline in ASP costs in FY12. Bulk of the brand spends was intended to support new launches/renovations in the core HI and Soaps categories, we believe.

Ad spends support new launches/ renovations

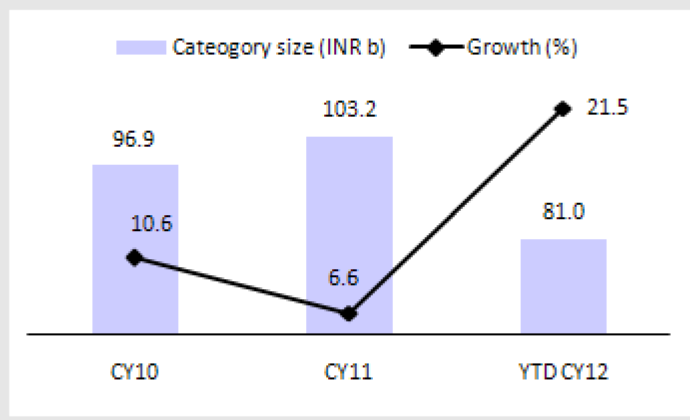


Source: Company, MOSL

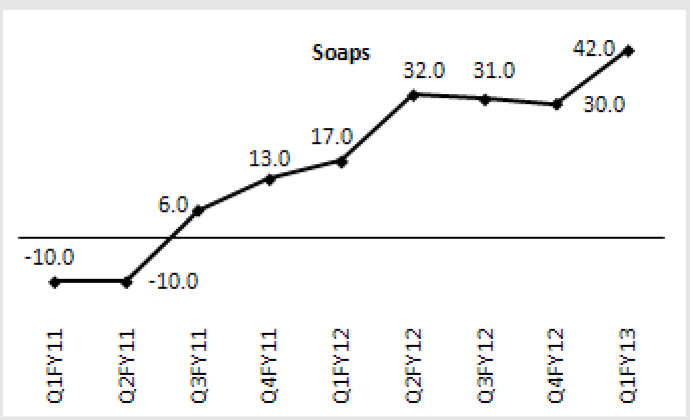
Soaps – modest share gains in Godrej No 1, Cinthol re-launched

GCPL's strong performance in Soaps segment stands at variance with its reported market share gains. GCPL's Soaps revenue has growth at 30%+ for four consecutive quarters, but its market share has stayed flat despite Soaps category (ex liquid soaps) growing just 6.6% in value. However, there is some pick-up in market share for Godrej No1 of late, up ~40bp since April. Also, with the recent Cinthol re-launch and heavy ad spend, we see a possibility of further share gains.

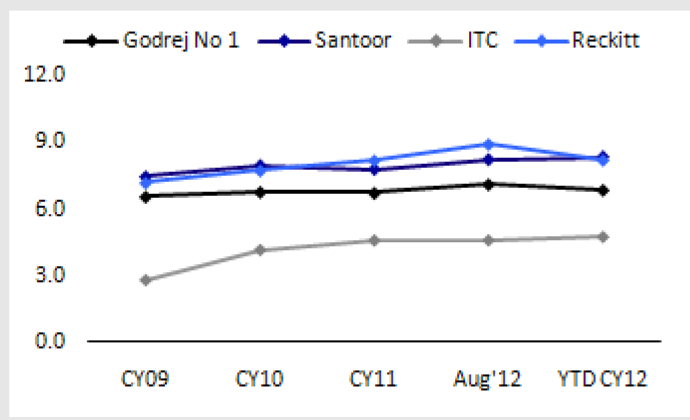
Soaps category growth has picked up in CY12



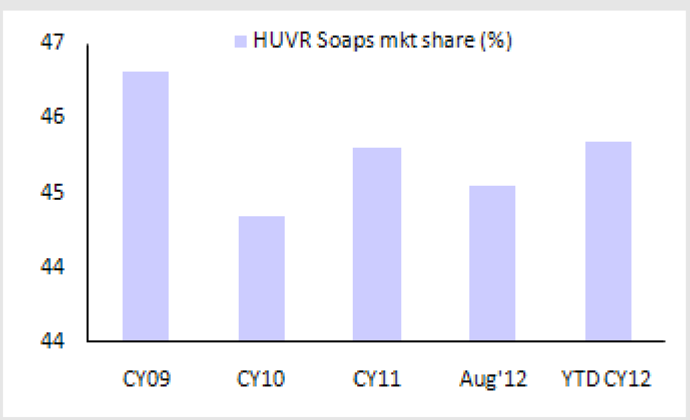
Robust growth in Soaps revenue continues (%)



40bp share gains for GCPL in Godrej No1 since April



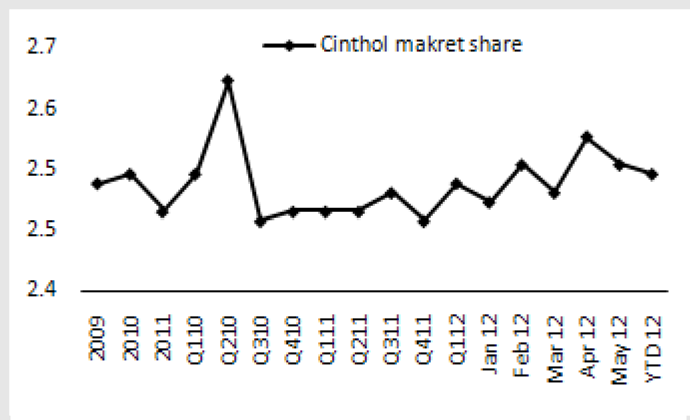
HUL sustaining shares



Source: Company, MOSL

Cinthol re-launched: Cinthol's market share has largely remained flattish. Recent re-launch of Cinthol is intended to contemporize the brand and make it youth centric. GCPL has also implemented price hike of ~10% with the new positioning.

Cinthol market share has remained flat (%)



Cinthol re-launched with a contemporary positioning

Source: Company, MOSL

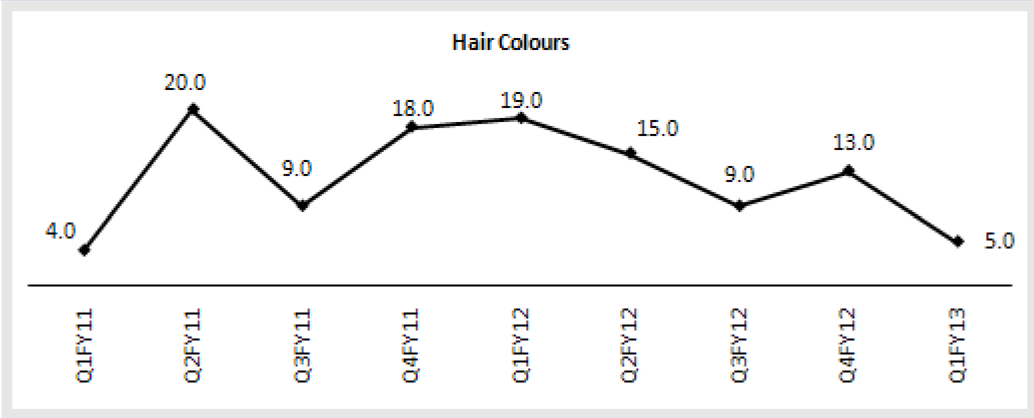
Hair Color: The Achilles heel; corrective actions expected

Hair Color is the only piece in GCPL's domestic portfolio which has not seen any meaningful traction. The main reason is GCPL's low presence in the premium crème-based segment. 85-90% of GCPL's Hair Color business comes from powder hair color, largely a popular/mass segment.

GCPL is now targeting to launch crème-based product to fill the gap between powder hair color and the premium crèmes. If successful, this could help expand margins. GCPL may also cross-pollinate its strength in crème based hair colors in LATAM market and introduce the same here in India.

We don't see any material change in the growth trajectory in this category for GCPL.

Lackluster performance in hair color (%)



Source: Company, MOSL

International business: expect sustained momentum led by Darling consolidation

Africa: Darling consolidation to drive performance

GCPL recently acquired phase II of Darling acquisition and now owns 51% of ~65% of the Darling business. In phase I it had acquired Darling's Nigeria, South Africa and Mozambique business. Phase II includes a) hair extensions business in Kenya, and b) exports to other East Africa geographies.

Phase II consolidation should drive the African portfolio in 2HFY13 and FY14. It also plants to cross leverage its insecticides business prowess in India and Indonesia (Megasari) for Africa. During our recent interaction, management had indicated acquisition of phase III before end-FY14, after which, GCPL will own 51% of overall Darling business.

Indonesia: Steady share gains in core business

Megasari, half of international business, has reported revenue growth of 18% in FY11 and 22% in FY12. We expect it to sustain 18-20% revenue growth in the medium term. This will be driven by the continued benefits from its recent innovations (Hit Magic Paper, MITU Kids range, etc), new product introductions, and reach expansion. Megasari has gained shares in its core insecticides and air freshener categories.

LATAM – Cosmetica Nacional consolidation and new product launches

GCPL's LATAM business reported strong 44% growth in FY12. It has started FY13 with 94% revenue growth in 1Q led by consolidation of Chile business, which we expect to drive growth and margins for the African business for rest of FY13, given its superior margin profile compared to Issue. It has implemented various initiatives in 1QFY13 to drive efficiencies in the business (SAP implementation, restructuring of sales force etc), benefits of which should be visible in subsequent quarters, according to the management.

International business performance (INR m)

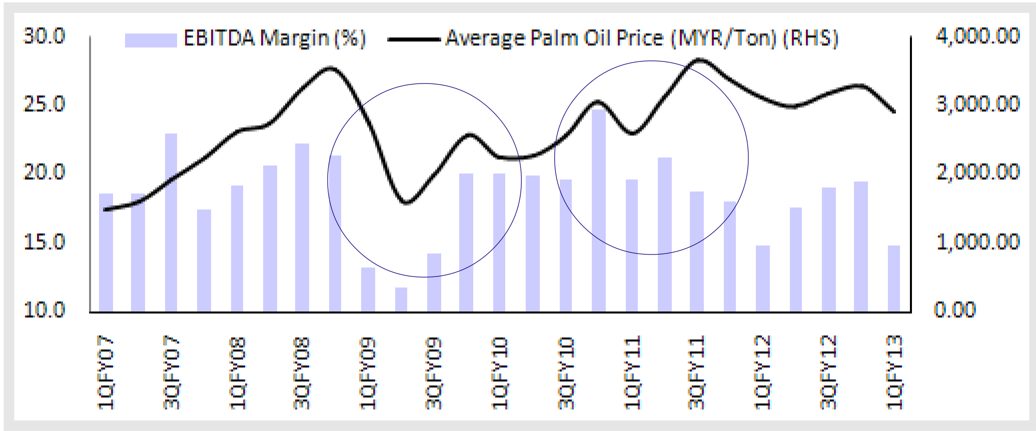
	FY11				FY12				FY13
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Net Sales									
Indian Subcontinent	**4,590**	**6,260**	**6,450**	**6,543**	**6,256**	**7,760**	**7,790**	**7,990**	**7,777**
GCPL (Standalone)	3,174	3,120	3,421	3,033	3,714	3,711	3,717	3,497	4,523
Godrej Home Products	1,416	3,000	3,029	3,510	2,542	3,870	3,938	4,493	3,254
GHPL SL and Bangladesh		140	60			179	135		
International	**1,860**	**3,370**	**3,350**	**3,430**	**3,715**	**4,190**	**5,660**	**5,240**	**6,110**
Africa	340	440	530	450	430	650	1,860	1,280	1,440
Latin America	120	590	630	640	560	650	820	820	1,080
Megasari	830	1,820	1,890	1,950	1,940	2,300	2,500	2,550	2,710
Keyline	570	480	300	390	670	530	430	480	730
Middle East		40			115	60	50	110	150
Total	**6,450**	**9,630**	**9,800**	**9,973**	**9,971**	**11,950**	**13,450**	**13,230**	**13,887**
EBITDA (INR m)									
Indian Subcontinent	**879**	**1,158**	**1,197**	**1,189**	**958**	**1,367**	**1,462**	**1,522**	**1,100**
GCPL (Standalone)	621	618	624	NA	NA	NA	NA	NA	NA
Godrej Home Products	258	540	573	NA	NA	NA	NA	NA	NA
International	**312**	**532**	**479**	**570**	**470**	**722**	**1,191**	**959**	**889**
Africa	60	60	50	50	40	169	577	247	274
Latin America	8	40	60	90	10	48	74	134	32
Megasari	174	382	359	390	330	446	515	528	488
Keyline	70	50	10	40	90	58	26	50	95
Total	**1,191**	**1,690**	**1,676**	**1,778**	**1,427**	**2,088**	**2,653**	**2,481**	**1,988**
EBITDA Margin (%)									
Indian Subcontinent	**19.1**	**18.5**	**18.6**	**18.2**	**15.3**	**17.6**	**18.8**	**19.0**	**14.1**
GCPL (Standalone)	19.6	19.8	18.2	NA	NA	NA	NA	NA	NA
Godrej Home Products	18.2	18.0	18.9	NA	NA	NA	NA	NA	NA
International	**16.8**	**15.8**	**14.3**	**16.6**	**12.6**	**17.2**	**21.0**	**18.3**	**14.5**
Africa	17.6	13.6	9.4	11.1	9.3	26.0	31.0	19.3	19.0
Latin America	7.0	6.8	9.5	14.1	1.8	7.4	9.0	16.3	3.0
Megasari	21.0	21.0	19.0	20.0	17.0	19.4	20.6	20.7	18.0
Keyline	12.3	10.4	3.3	10.3	13.4	11.0	6.0	10.5	13.0
Total	**18.5**	**17.5**	**17.1**	**17.8**	**14.3**	**17.5**	**19.7**	**18.8**	**14.3**

Source: Company, MOSL

Softening in PFAD augurs well for Soaps gross margins

Palm oil prices have fallen ~23% in six months and are expected to correct further owing to rising inventories in Indonesia and Malaysia. Palm oil accounts for 20% of GCPL's RM cost. However, given inventory positions, we expect gains to flow in only post 3Q rather than immediately. Correction in PFAD coupled with recent price increase in Soaps should help expand gross margins for GCPL's Soaps business. This will likely be partly offset by (a) higher promotional spends to pass on the benefits to consumers, and (b) higher brand spends on Cinthol.

Correction in palm oil prices reflects in margins with a lag



Source: Company, MOSL

Valuation and view: 3-8% EPS upgrade; limited upside; Neutral

We upgrade our FY13 and FY14 earnings estimates by 3-8% to factor in (a) market share gains in Home Insecticides, (b) softening of PFAD prices, and (c) margin improvements in international business in FY14 due to scale economies post integration. We now expect 32% EPS CAGR over FY12-14. Consequently, we revise our target price to INR740 (26x FY14E EPS). At CMP, the upside is limited at 7%. **Neutral**.

Revised Forecast (INR m)

	Old		New		Change (%)	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
EBITDA	11,298	13,949	11,527	14,731	2.0	5.6
PAT	7,363	8,962	7,620	9,607	3.5	7.2

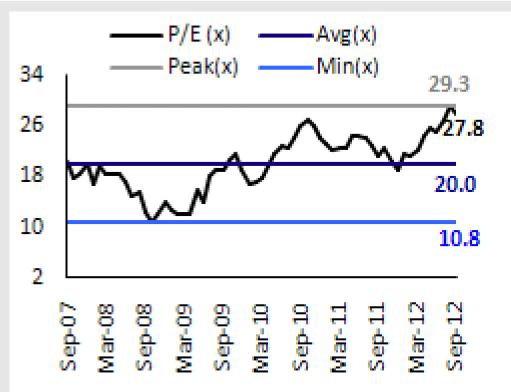
Source: MOSL

We value GCPL at premium to Dabur owing to superior growth dynamics (32% EPS CAGR for FY12-14) and more catalysts for earnings surprise (upsides from acquisition synergies, higher than expected correction in palm oil). In view of only 7% potential upside from current market price, we maintain our **Neutral** rating on the stock.

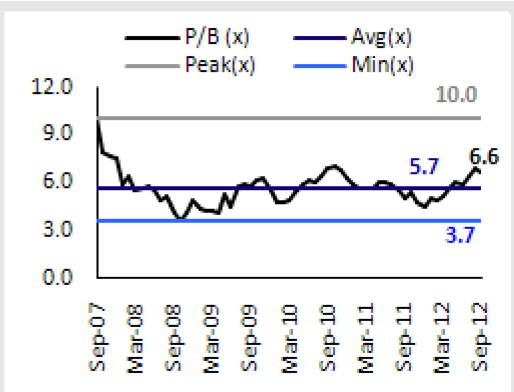
Key positives: (1) Business model with multiple growth drivers, premised on its 3x3 strategy, (2) Sustained momentum in its core HI and Soaps categories, (3) Tailwind benefits from declining raw material costs.

Key risks: (1) Execution risks related to acquisition synergies, (2) Resurgence of unbranded regional players in Soaps due to benign input cost scenario, and (3) Currency related volatility given its USD305m unhedged overseas debt.

GCPL: PE band



GCPL: P/B band



Financials and Valuation

Income Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Net Sales	**20,412**	**36,763**	**48,509**	**63,147**	**78,327**
Change (%)	46.5	80.1	32.0	30.2	24.0
Cost of Goods Sold	9,463	17,072	23,185	29,835	36,668
Gross Profit	10,949	19,691	25,324	33,311	41,660
Margin (%)	53.6	53.6	52.2	52.8	53.2
Total Expenditure	16,329	30,405	39,903	51,619	63,596
EBITDA	**4,083**	**6,358**	**8,607**	**11,527**	**14,731**
Change (%)	100.4	55.7	35.4	33.9	27.8
Depreciation	236	499	644	769	895
Int. and Fin. Charges	111	436	658	744	827
Other Income-rec.	193	643	672	713	818
PBT	**4,199**	**6,118**	**7,771**	**10,728**	**13,828**
Change (%)	100.8	45.7	27.0	38.0	28.9
Tax	796	1,382	2,261	2,452	3,271
Deferred Tax	-8	0	0	-77	-93
Tax Rate (%)	19.1	22.6	29.1	23.6	24.3
PAT	**3,396**	**4,736**	**5,511**	**8,199**	**10,464**
Change (%)	96.8	39.5	16.4	48.8	27.6
Minority interest		0.0	245	579	856
Group Adjusted PAT	3,396	4,736	5,266	7,620	9,607
Non-rec. (Exp.)/Income	0	411	2,002	0	0
Reported PAT	**3,396**	**5,148**	**7,267**	**8,199**	**10,464**

Balance Sheet (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
Share Capital	308	324	340	340	340
Reserves	9,239	16,928	27,796	32,909	39,244
Minority Int			591	1,170	2,027
Networth	**9,547**	**17,252**	**28,136**	**33,249**	**39,584**
Loans	369	20,032	19,030	16,530	15,030
Deferred Liability	66	86	111	187	280
Capital Employed	**9,982**	**37,369**	**47,868**	**51,136**	**56,921**
Gross Block	4,149	19,148	20,403	25,618	29,843
Less: Accum. Depn.	1,531	3,775	4,940	5,708	6,603
Net Fixed Assets	**2,617**	**15,373**	**15,464**	**19,910**	**23,240**
Capital WIP	8	154	158	150	150
Goodwill	3,119	15,404	21,454	21,454	21,454
Currents Assets	**9,095**	**13,774**	**22,606**	**23,436**	**28,604**
Inventory	2,644	4,394	7,839	8,304	10,730
Account Receivables	1,153	3,840	4,725	6,055	7,511
Cash and Bank Balance	3,052	2,269	6,399	4,911	5,597
Loans and Advances	2,189	3,149	3,143	3,565	4,047
Other Current Assets	58	122	500	600	720
Curr. Liab. & Prov.	**5,528**	**7,335**	**11,815**	**13,814**	**16,527**
Account Payables	1,370	3,331	7,702	9,873	12,107
Other Liabilities	4,041	3,915	3,684	3,904	4,371
Provisions	117	89	428	37	49
Net Current Assets	**3,567**	**6,439**	**10,791**	**9,622**	**12,077**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2010	2011	2012	2013E	2014E
Basic (INR)					
EPS	11.0	14.6	15.5	22.4	28.2
Cash EPS	11.8	16.2	17.4	24.6	30.9
BV/Share	31.0	53.3	82.7	97.7	116.3
DPS	4.1	5.0	4.6	8.0	10.0
Payout (%)	37.1	34.4	29.7	35.7	35.4
Valuation (x)					
P/E			44.8	30.9	24.5
Cash P/E			39.9	28.1	22.5
EV/Sales			5.1	3.9	3.1
EV/EBITDA			28.9	21.5	16.6
P/BV			8.4	7.1	6.0
Dividend Yield			0.7	1.2	1.4
Return Ratios (%)					
RoE	35.6	27.5	18.7	22.9	24.3
RoCE	45.2	20.1	20.7	25.4	28.9
Working Capital Ratios					
Debtor (Days)	21	38	36	35	35
Asset Turnover (x)	7.8	2.4	3.1	3.1	3.3
Leverage Ratio					
Debt/Equity (x)	0.0	1.2	0.7	0.5	0.4

Cash Flow Statement (INR Million)

Y/E March	2010	2011	2012	2013E	2014E
OP/(Loss) before Tax	4,083	6,358	8,607	11,527	14,731
Other Income	464	643	672	1,391	1,528
Interest Paid	111	436	658	744	827
Direct Taxes Paid	796	1,382	2,261	2,452	3,271
(Inc)/Dec in WC	270	3,654	223	319	1,770
CF from Operations	**3,369**	**1,528**	**6,138**	**9,404**	**10,392**
Extraordinary Items	0	411	2,002	0	0
Inc in FA	763	15,144	1,260	5,207	4,225
Pur of Investments	595	-670	0	0	0
Goodwill	986	12,285	6,050	0	0
CF from Investments	**-2,344**	**-26,348**	**-5,309**	**-5,207**	**-4,225**
Issue of Shares	51	4,976	6,567	0	0
Inc in Debt	-2,406	19,663	-1,002	-2,500	-1,500
Dividend Paid	1,490	1,966	1,820	3,185	3,982
CF from Fin. Activity	**-1,758**	**24,038**	**3,301**	**-5,684**	**-5,482**
Inc/Dec of Cash	-732	-783	4,130	-1,487	685
Add: Beginning Balance	3,783	3,051	2,269	6,399	4,912
Closing Balance	**3,051**	**2,269**	**6,399**	**4,912**	**5,596**

E: MOSL Estimates

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