

BSE Code: 500830
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Innovations: A reason to cheer

Colgate-Palmolive (India) Ltd, or CPIL, is a 51% subsidiary of Colgate-Palmolive Company, USA. It is the market leader in Indian oral care market. In FY15, it commanded 57.8% & 42.1% volume market share in toothpaste & toothbrush category respectively. CPIL has maintained its position as the undisputed leader for more than a decade.

Investment Rationale

Undisputed market leader with a strong brand recall: In Indian oral care market, CPIL dominates, enjoying a 57.6% market share (September 2015) in toothpaste category. The company also has a significant market share of 43.3% in the toothbrush category. Toothbrush and toothpaste (along with toothpowder) accounted for 95.3% of its FY15 revenues. In India, CPIL ranks No.1 in top of the mind recall in many consumer surveys.

Increase in the consumption of oral care products: Availability of wide variety of products, increasing health awareness and rising income levels are some factors which have led to higher consumption of oral care products. Interestingly, the per capita consumption of toothpaste is about 146 gms-one of the lowest in the world. Taking this into consideration, CPIL has expanded its dominance in India's toothpaste category, aided by its presence across premium, popular and mass categories. CPIL's market share in toothpaste has increased from 54.5% in CY12 to 57.8% in 2015 (YTD April 2015). Further, with new launches both in the premium and economy segments maintaining their pace, we expect toothpaste segment to grow at a CAGR of 11.3% over FY15-18E.

Innovations to drive growth ahead: CPIL continuously focused on expanding its product portfolio through new launches and variants (innovations). In FY16, CPIL introduced Colgate Total Charcoal Deep Clean, Colgate Active Salt Neem, Colgate 360 toothbrush range & Palmolive liquid hand soap with new range of liquid and foam. These introductions would help the company in tapping the urban market where lifestyles are fast changing and demand for innovative products is rising. Over the years, this strategy (innovations) has aided CPIL in improving its market share. It has also improved its product mix through higher sales of value-added products and better realizations. Interestingly, the average selling price of premium products like Colgate Total Charcoal, Colgate Sensitive Pro Relief, Colgate Visible White is over 2x the base product. Hence, the impact on realisation growth and gross margin is tremendous.

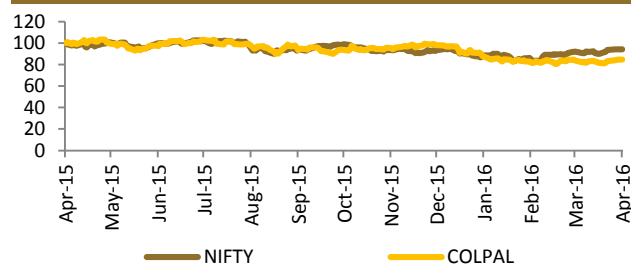
Valuation: CPIL is better placed than peers given its strong parentage, pricing power, leadership position and distribution reach in the oral care market. We expect revenue and PAT to grow at a CAGR of 9.6% and 11.4% over FY15-FY18E. Further, we rate the stock as 'BUY' assigning a forward P/E of 33x arriving at a target price of Rs. 937 which implies potential upside of ~10% for next 12 months.

Market Data

Rating	BUY
CMP (Rs.)	850
Target (Rs.)	937
Potential Upside (%)	~10
Duration	Long Term
Face Value (Rs.)	1
52 week H/L (Rs.)	1,057/790
Adj. all time High (Rs.)	1,099
Decline from 52WH (%)	19.6
Rise from 52WL (%)	7.6
Beta	0.4
Mkt. Cap (Rs.Cr)	23,119

Fiscal Year Ended

Y/E	FY15	FY16E	FY17E	FY18E
Revenue (Rs.Cr)	3,982	4,134	4,615	5,238
Adj. Profit (Rs.Cr)	559	604	672	772
EPS (Rs.)	41.1	22.2	24.7	28.4
P/E (x)	49.0	38.3	34.4	29.9
P/BV (x)	35.6	22.7	18.2	14.8
ROE (%)	81.6	67.6	58.7	54.6

One year Price Chart

Shareholding Pattern

Shareholding Pattern	Mar-16	Dec-15	Change
Promoters (%)	51.0	51.0	0.0
FII (%)	6.0	5.1	1.0
DII (%)	18.3	19.4	(1.1)
Others (%)	24.7	24.6	0.1

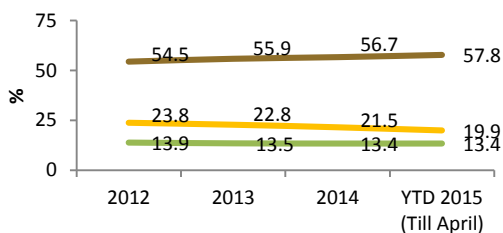
CPIL is the market leader in Indian oral care market.

CPIL: Undisputed market leader in oral care category

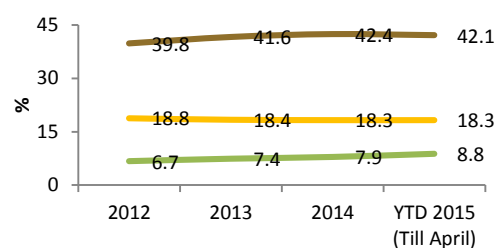
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Colgate offers oral care products including toothpaste, toothbrushes, mouth rinses, dental floss and pharmaceutical products for oral health professionals. Other products include personal care products like shower gels, shower creams, toilet soaps, liquid handwashes and shaving creams mostly under Palmolive brand. In the household segment, Colgate markets dish-washing soaps under the brand name Axion. Colgate's most recognizable products are in oral care and contribute over 90% to its revenue.

Toothpaste volume market share



Toothbrush volume market share

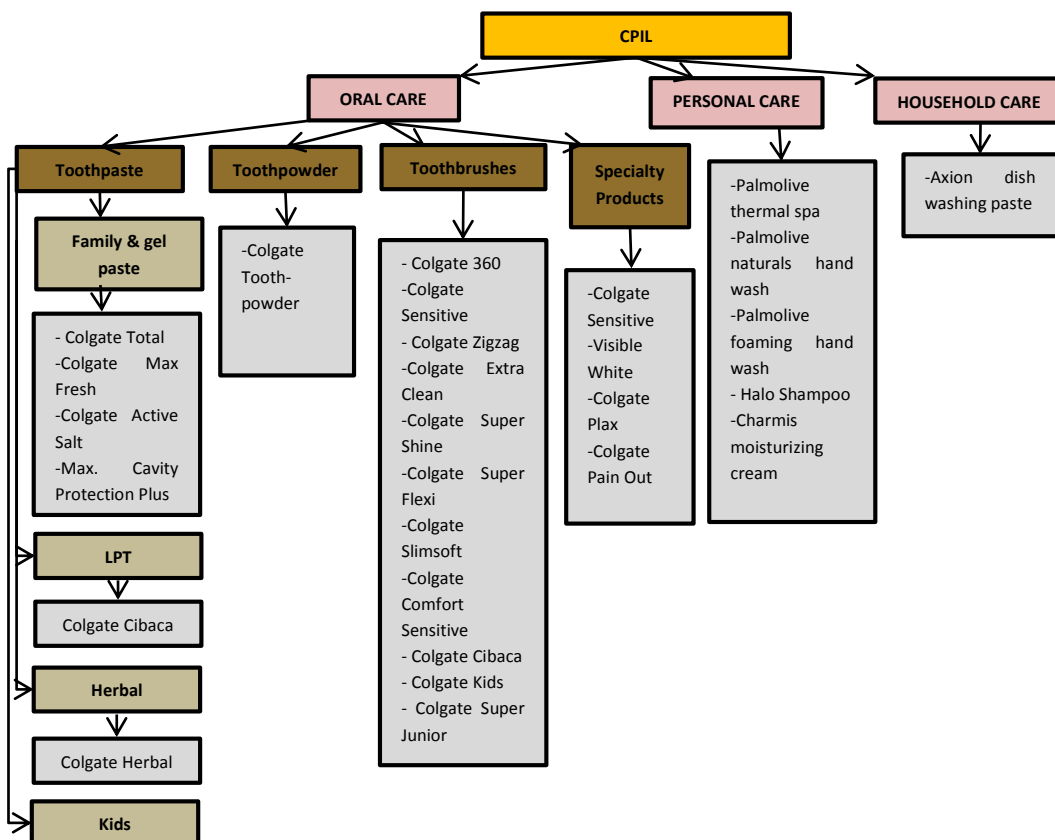


— Colgate — Competitor 1 — Competitor 2

Source: Company, In-house research

Oral care category contributes over 90% to the total revenues of CPIL.

Product Portfolio of CPIL

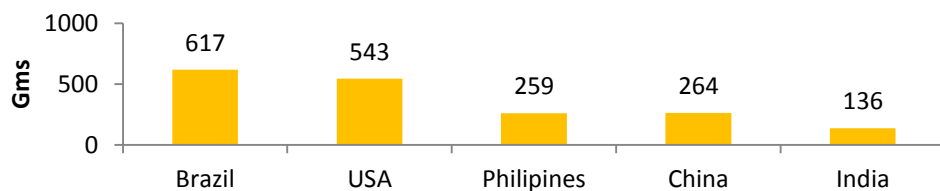


Source: Company, In-house research

Under-penetrated category provides significant headroom for growth

The Indian oral care industry, which is characterized by low penetration and low per capita usage, offers a huge potential to industry players to grow. Almost one-third of the Indian population does not have access to modern oral care. Though urban penetration is higher at 92.3% (2014), rural penetration lags behind at 74.1% (2014). Further, the overall per capita consumption of toothpaste in India is significantly lower at 136 gm (2014) compared to other developing nations, China at 264 gm, Philippines at 259 gm and Brazil at 617 gm, providing enough room for CPIL to boost its volume growth. We believe increase in volume growth & per capita consumption would come through increasing awareness on oral hygiene, change in consumer habits (brushing twice daily) and increasing penetration.

Per capita consumption of toothpaste in India is among the lowest in the world



Source: Company, In-house research

Dominance to prevail in oral care category

The company has expanded its dominance in India's toothpaste category, aided by its presence across premium, popular and mass categories and having SKUs across variants (regular, sensitive, herbal, whitening, gum care, freshness), CPIL's market share in toothpaste has strengthened from 54.5% in CY12 to 57.8% in 2015 (YTD April 2015). Further, with new launches both in the premium and economy segments maintaining their pace, we expect toothpaste segment to grow at a CAGR of 11.3% over FY15-18E. Likewise, CPIL's market share in toothbrush has strengthened from 39.8% in CY12 to 42.1% in 2015 (YTD April 2015). The company's brand strength has enabled it to grab market share of unbranded players. Further, CPIL's nearest competitor, P&G, with brand Oral-B, continues to maintain a distant No.2 position in the segment. We believe that with the upgrading consumer needs in rural markets and upgrading demand by urban consumer, CPIL's revenues from the toothbrush segment would continue to grow at 14.3% CAGR (FY15-18E).

Innovations to drive growth ahead

CPIL continuously focused on expanding its product portfolio through new launches and variants (innovations). In FY15, it launched toothpastes (Visible White Plus Shine, Sensitive Pro-Relief Enamel Repair, Sugar Acid Neutralizer) and two varieties of toothbrushes (Slimsoft Charcoal, Zig Zag Black). Likewise, in FY16, CPIL introduced Colgate Total Charcoal Deep Clean, Colgate Active Salt Neem, Colgate 360 toothbrush range & Palmolive liquid hand soap with new range of liquid and foam. These introductions would help the company in tapping the urban market where lifestyles are fast changing and demand for innovative products is rising. Over the years, this strategy (innovations) has aided CPIL in improving its market share. It has also improved its product mix through higher sales of value-added products and better realizations. Interestingly, the average selling price of premium products like Colgate Total Charcoal, Colgate Sensitive Pro Relief, Colgate Visible White is over 2x the base product. Hence, the impact on realisation growth and gross margin is tremendous. More importantly, the parent company has a wide product portfolio, not just in the oral care segment but also in non-oral care as well. CPIL has been adding substantially to its product portfolio with the help of its parent (CPIL pays a royalty of around 5.5% of its revenues). Interestingly, a lot of these products are at the premium end, thereby aiding overall profitability as well.

History of innovations over the last two years

FY15	Q1	Q2	Q3	Q4
	Colgate Maximum Cavity Protection Plus SAN toothpaste, Colgate Visible White teeth whitening treatment, Colgate Slim Soft Charcoal toothbrush	Colgate Visible White Plus Shine toothpaste	Colgate Plax Active Salt mouthwash	Colgate Sensitive Pro-Relief (CSPR) Enamel Repair toothpaste, Colgate Zig Zag black toothbrush
FY16	Q1	Q2	Q3	
	Colgate Total Charcoal Deep Clean toothpaste, Colgate Active Salt Neem toothpaste	Colgate Total Charcoal Deep Clean toothpaste, Colgate Active Salt Neem toothpaste, Colgate 360 toothbrush range	Palmolive Handwash – 4 variants	

Source: Company, In-house research

Diverse portfolio offering

Colgate has an oral care portfolio spread across different price points with each product having a different value offering. While Colgate toothpowder is strong in the rural market, the company has an entry level offering in Colgate Cibaca which helps convert consumers from toothpowder to toothpaste usage. From there, the company has several offerings like Colgate Dental Cream, Max Gel and Advance Whitening which caters to consumers as they upgrade. The company also has niche offerings like Colgate Sensitive for people who have sensitive teeth. More importantly, CPIL is gradually expanding its herbal offerings (Active Salt Neem). The management perceives tremendous potential in this segment and intends to do a lot more innovation in this space.

Strong distribution network in India

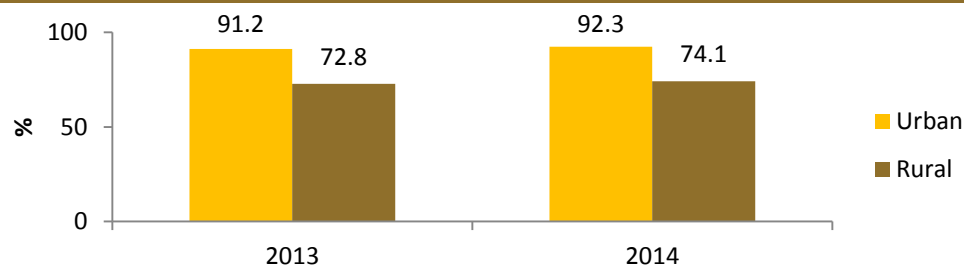
CPIL has one of the widest distribution networks in India, which spans across ~5 million outlets across the country. Going forward, the increasing distribution network would help in enhancing the volume growth of the company. The company has also tied up with e-Choupal and Disha.

Increasing presence in rural market

Colgate has increased its reach in rural areas by converting non-users to users through various sales promotion measures such as small volume low priced sachets, distribution of free toothbrushes, Rural Van Programmes etc. Number of rural vans has increased from 801 in 2013 to 951 in 2014 (there were 340 rural vans in 2012).

The pressure on the rural segment is likely to continue in the near term. However, going forward, we expect rural demand to revive as IMD predicts above-normal monsoon in 2016 (after two consecutive years of poor monsoon). Besides, government has recently taken several initiatives (crop insurance, enhanced allocation for NREGA in Union Budget) to support rural consumption.

Rural penetration still lower than urban



Source: Company, In-house research

Well equipped to battle competition

The company has been spending substantial amount in brand building to retain its first position as India's most trusted brand in oral care (in the last two years, ad spends as % of sales has hovered in the range of 18-19%). The oral care segment is dominated by two players, Colgate and Hindustan Lever. However, a host of brands exist: Dabur, P&G and Patanjali. The company has a good past track record to battle competition (Close-Up in 80s, Pepsodent in late 90s, local players like Balsara, Anchor etc. over 2002-05 and P&G in 2013). Moreover, innovation, higher A&P spends, pricing realignment in select sub-brands and potential acquisition are likely tools which might be possibly used by CPIL to tackle Patanjali Ayurved (It has become a strong force in the toothpaste category with its Dant Kanti brand).

EBITDA margin to rise to 23.1% by FY18E owing to better product mix

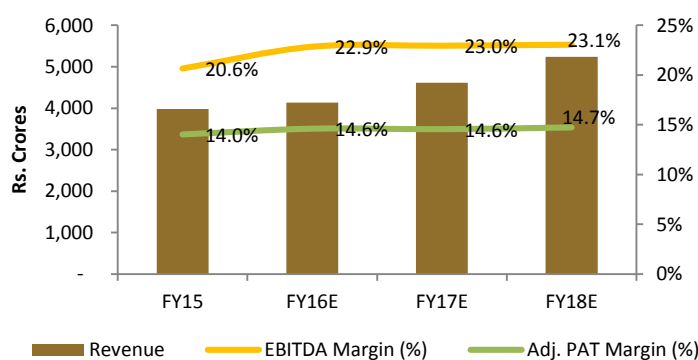
Strong pricing power in oral care industry and increasing revenue contribution of premium products would lead to higher margins going forward. We believe with the revival in consumption demand, EBITDA margins would improve to 23.1% by FY18E. The company has consistently shown strength in efficiently managing its costs and ad spends in order to maintain the margins. Besides, we believe CPIL would continue to launch new products from its parent's product portfolio, while continuing to leverage its existing brand equity.

Revenue and PAT to grow at a CAGR of 9.6% and 11.4% respectively over FY15-18E

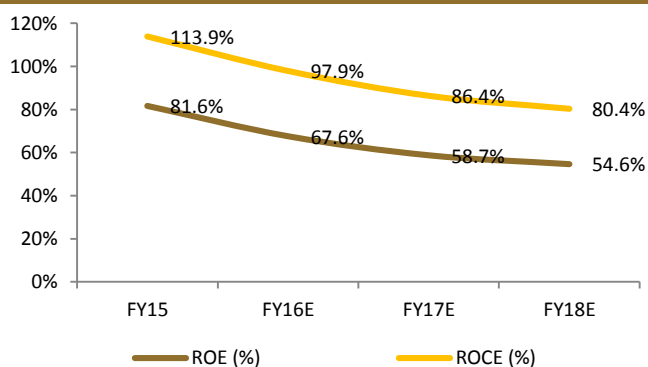
Marred by a near-term slowdown coupled with the impact of phase out of excise and tax exemptions at Baddi unit would result in low revenue growth in FY16. However, we expect better show on earnings performance post FY16. During FY15-FY18E, we expect the top-line of the company to grow at a CAGR of 9.6%. This growth is expected to be driven by strong pricing power along with improvement in product mix. Further, we estimate 11.4% CAGR in Adjusted PAT over FY15-18E mainly on account of EBITDA margin expansion. However, return ratios are expected to moderate over the next two years due to recent increasing investments in new facilities (ROCE expected to fall from 113.9% in FY15 to 80.4% by FY18E and ROE expected to fall from 81.6% in FY15 to 54.6% in FY18E). Going forward, return ratios would improve once the profitability accelerates.

We expect top-line of the company to grow at a CAGR of 9.6% over FY15-FY18E.

Revenue to grow at a CAGR of 9.6% over FY15-FY18E



Return ratios trend



Source: Company, In-house research

Key Risks:

- 1 Down trading by consumers due to slowdown in rural economy.
- 2 Any weakness in INR could increase cost of imported chemicals.
- 3 Increase in competition from new and existing players could affect the revenues.

Profit & Loss Account

Y/E (Rs.Cr)	FY15	FY16E	FY17E	FY18E
Total operating Income	3,982	4,134	4,615	5,238
Raw Material cost	1,468	1,492	1,671	1,896
Employee Cost	259	269	300	340
Other operating expenses	1,433	1,428	1,585	1,793
EBITDA	822	945	1,060	1,208
Depreciation	75	108	122	137
EBIT	747	837	937	1,071
Interest cost	-	-	-	-
Other income	33	38	51	64
Profit before tax	780	876	989	1,136
Tax	221	271	316	363
Profit after tax	559	604	672	772
Minority Interests	-	-	-	-
P/L from Associates	-	-	-	-
Adjusted PAT	559	604	672	772
E/oincome/ (Expense)	-	(31)	-	-
Reported Profit	559	573	672	772

Balance Sheet

Y/E (Rs.Cr)	FY15	FY16	FY17E	FY18E
Paid up capital	14	27	27	27
Reserves and Surplus	757	991	1,243	1,530
Net worth	770	1,019	1,270	1,557
Minority Interest	-	-	-	-
Total Debt	-	-	-	-
Other non-current liabilities	62	69	76	83
Total Liabilities	833	1,087	1,346	1,640
Total fixed assets (inc CWIP)	896	988	1,066	1,129
Goodwill	27	27	27	27
Investments	37	37	37	37
Deferred tax assets	(3)	(3)	(3)	(3)
Net Current assets	(184)	(27)	147	370
Other non-current assets	59	65	72	79
Total Assets	833	1,087	1,346	1,640

Cash Flow Statement

Y/E (Rs.Cr)	FY15	FY16E	FY17E	FY18E
Pretax profit	780	876	989	1,136
Depreciation	75	108	122	137
Chg in Working Capital	5	23	46	54
Others	(17)	(38)	(51)	(64)
Tax paid	(206)	(271)	(316)	(363)
Cash flow from operating activities	638	697	789	899
Capital expenditure	(300)	(200)	(200)	(200)
Chg in investments	-	-	-	-
Other investing cashflow	28	38	51	64
Cash flow from investing activities	(272)	(162)	(149)	(136)
Equity raised/(repaid)	-	-	-	-
Debt raised/(repaid)	-	-	-	-
Dividend paid	(339)	(356)	(421)	(485)
Other financing activities	(46)	-	-	-
Cash flow from financing activities	(385)	(356)	(421)	(485)
Net chg in cash	(18)	180	220	278

Key Ratios

Y/E	FY15	FY16E	FY17E	FY18E
Valuation (x)				
P/E	49.0	38.3	34.4	29.9
EV/EBITDA	33.0	24.0	21.2	18.4
EV/Net Sales	6.8	5.5	4.9	4.2
P/B	35.6	22.7	18.2	14.8
Per share data (Rs.)				
EPS	41.1	22.2	24.7	28.4
DPS	24.0	11.0	13.0	15.0
BVPS	56.6	37.4	46.7	57.2
Growth (%)				
Net Sales	11.3	3.8	11.6	13.5
EBITDA	23.8	14.9	12.1	14.0
Net Profit	17.6	8.1	11.2	14.9
Operating Ratios (%)				
EBITDA Margin	20.6	22.9	23.0	23.1
EBIT Margin	18.8	20.3	20.3	20.5
PAT Margin	14.0	14.6	14.6	14.7
Return Ratios (%)				
RoE	81.6	67.6	58.7	54.6
RoCE	113.9	97.9	86.4	80.4
Turnover Ratios (x)				
Sales/Total Assets	2.5	2.2	2.1	2.0
Sales/Working Capital	(8.9)	(9.2)	(9.5)	(9.8)
Liquidity&Solvency Ratios (x)				
Current Ratio	0.8	1.0	1.1	1.3
Net Debt/Equity	(0.3)	(0.4)	(0.5)	(0.6)

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* CPIL is a large-cap company

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