

# Colgate-Palmolive (India)

25 October 2019

Reuters: COLG.BO; Bloomberg: CLGT IN

## Higher ad spends put pressure on margins

Colgate-Palmolive India (CLGT) reported a topline growth of 4.6% YoY to Rs12.2bn in 2QFY20 (vs. our est. 5% growth to Rs12.3bn). Domestic growth stood at 5% YoY, led by a 4% YoY growth in toothpaste volume, which was just slightly above our expectation of 3% YoY growth. No major improvement in volume during the quarter despite investing heavily on advertising and brand building activities (absolute ad spends up 26.5% YoY) clearly indicates pressure in overall demand environment. Management indicated that the category continued to witness headwinds during the quarter, especially in the rural markets, along with liquidity crunch. EBITDA was down 2% YoY to Rs3.2bn (vs. our est. 3.1% growth to Rs3.4bn). Adj. PAT grew by 24.3% to Rs2.4bn (our est. 16.1% to Rs2.3bn) largely due to lower tax rate of 12.2% (our est. 25.2%) vs. 34.2% in base quarter. Gross margin remained flattish YoY at 64.7%. EBITDA margin contracted 180bps YoY to 26.4% (our est. 27.7%) due to continued strong investment in advertising & brand building activities and also on strengthening distribution. We expect the advertising and promotions intensity to remain in the coming quarter given management's resolve to regain market share. We believe that the company may be able to gradually gain market share but at the cost of margins. Hence, we expect margin expansion to remain modest because of these concerns. We have retained our Accumulate rating on CLGT, with an unchanged target price (TP) of Rs1,500 based on a P/E multiple of ~38x (based on Sep'21 EPS).

**No major uptick in volumes:** CLGT delivered a 4.6% YoY growth in topline, which was largely led by toothpaste volume (+4% YoY). Our concerns about volume growth persist as CLGT will find it difficult to grow volume in a subdued environment without investing heavily in advertising & promotions to gain market share.

**High ad spends hurt operating margin:** Gross margin remained flattish YoY at 64.7%. While EBITDA margin contracted 180bps YoY to 26.4% (vs. our est. 27.7%) due to increase in ad spends as a % of sales (+250bps YoY to 14.4%; absolute ad spends up sharply 26.5% YoY to Rs1.8bn) and higher staff costs as a % of sales (+20bps YoY to 6.7%), which was partially offset by lower other operating costs as a % of sales (-90bps YoY).

**1HFY20 Performance:** Sales, EBITDA and Adj. PAT growth stood at 4.4%, 1.9% and 13.7% YoY, respectively. Toothpaste volume growth stood at ~4% YoY in the same period. Overall EBITDA margin contracted 70bps YoY to 27%.

**Outlook and valuation:** We lower our estimates slightly for FY20 to bake in lower margins during the quarter and higher depreciation. There is no material change to our FY21/FY22E EPS. Management's decision to place primacy on volume-led sales growth will likely restrict near-term margin expansion in our view. We have retained our Accumulate rating on CLGT with an unchanged TP of Rs1,500 based on a P/E multiple of 38x (based on Sep'21 EPS), implying downside of 4% from the current market price (CMP).

## ACCUMULATE

**Sector:** FMCG

**CMP:** Rs1,565

**Target Price:** Rs1,500

**Downside:** 4%

**Vishal Punmiya**

Research Analyst

vishal.punmiya@nirmalbang.com

+91-22-6273 8064

**Ayush Chaturvedi**

Research Associate

ayush.chaturvedi@nirmalbang.com

+91-22-6273 8244

### Key Data

Current Shares O/S (mn)	272.0
Mkt Cap (Rsbm/US\$bn)	425.4/6.0
52 Wk H / L (Rs)	1,590/1,075
Daily Vol. (3M NSE Avg.)	552,504

### Price Performance (%)

	1 M	6 M	1 Yr
Colgate-Palmolive (India)	3.0	29.6	41.2
Nifty Index	(0.0)	(1.2)	13.3

Source: Bloomberg

Y/E march (Rsmn)	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	1HFY19	1HFY20	YoY (%)
Net sales	11,680	10,849	12,218	4.6	12.6	22,093	22,674	2.6
COGS	4,115	3,704	4,308	4.7	16.3	7,665	8,011	4.5
% of sales	35.2	34.1	35.3	0.0	1.1	34.7	35.3	(150bps)
Gross margin %	64.8	65.9	64.7	(10bps)	(110bps)	65.3	64.7	150bps
Employee costs	764	835	819	7.2	(1.9)	1,513	1,654	9.3
% of sales	6.5	7.7	6.7	20bps	(100bps)	6.8	7.3	10bps
Advertising costs	1,389	1,513	1,758	26.5	16.2	2,825	3,271	15.8
% of sales	11.9	13.9	14.4	250bps	40bps	12.8	14.4	(30bps)
Other expenses	2,116	1,799	2,104	(0.6)	16.9	3,979	3,903	(1.9)
% of sales	18.1	16.6	17.2	(90bps)	60bps	18.0	17.2	(110bps)
EBITDA	3,296	2,998	3,230	(2.0)	7.7	6,111	5,835	(4.5)
EBITDA margin %	28.2	27.6	26.4	(180bps)	(120bps)	27.7	25.7	280bps
Depreciation	398	499	504	26.6	1.1	792	1,003	26.6
EBIT	2,897	2,500	2,726	(5.9)	9.0	5,319	4,832	(9.2)
EBIT margin %	24.8	23.0	22.3	(250bps)	(70bps)	24.1	21.3	250bps
Interest expenses	-	23	24	-	-	-	47	0.0
Other income	86	152	86	(0.1)	(43.1)	178	238	33.7
Exceptional items	-	-	-	0.0	0.0	225	-	0.0
PBT	2,984	2,628	2,788	(6.6)	6.1	5,497	5,416	(1.5)
Tax	1,020	937	347	(66.0)	(63.0)	1,864	1,284	(31.1)
Effective tax rate %	34.2	35.7	12.4	(2180bps)	(2320bps)	33.9	23.7	(110bps)
Adj. PAT	1,964	1,691	2,441	24.3	44.3	3,634	4,132	13.7
Adj. PAT margin %	16.7	15.4	19.8	320bps	450bps	16.3	18.0	190bps
EPS	7.2	6.2	9.0	24.3	44.3	13.4	15.2	13.7

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19E	FY20E	FY21E	FY22E
Net sales	41,880	44,624	48,063	53,574	59,053
YoY growth (%)	5.3	6.6	7.7	11.5	10.2
EBITDA	11,124	12,361	13,106	15,128	16,888
EBITDA margin (%)	26.6	27.7	27.3	28.2	28.6
Reported PAT	6,734	7,756	8,551	10,106	11,314
Adjusted PAT	6,850	7,451	8,551	10,106	11,314
EPS	25.2	27.4	31.4	37.2	41.6
YoY change (%)	18.6	8.8	14.8	18.2	12.0
RoCE (%)	47.9	47.9	56.6	71.1	88.1
RoE (%)	49.0	50.1	60.5	76.5	95.7
P/E (x)	62.1	57.1	49.8	42.1	37.6
P/BV (x)	27.9	29.4	30.9	33.7	38.6
EV/EBITDA (x)	37.8	34.1	32.2	27.9	25.0

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Our estimates versus actual performance

Y/E March (Rsmn)	2QFY19	1QFY20	2QFY20	YoY (%)	QoQ (%)	NBIE Estimates	Deviation (%)
Net sales	11,680	10,849	12,218	4.6	12.6	12,268	(0.4)
EBITDA	3,296	2,998	3,230	(2.0)	7.7	3,399	(0.5)
EBITDA (%)	28.2	27.6	26.4	-180bps	-120bps	27.7	130bps
Adj. PAT	1,964	1,691	2,441	24.3	44.3	2,280	7

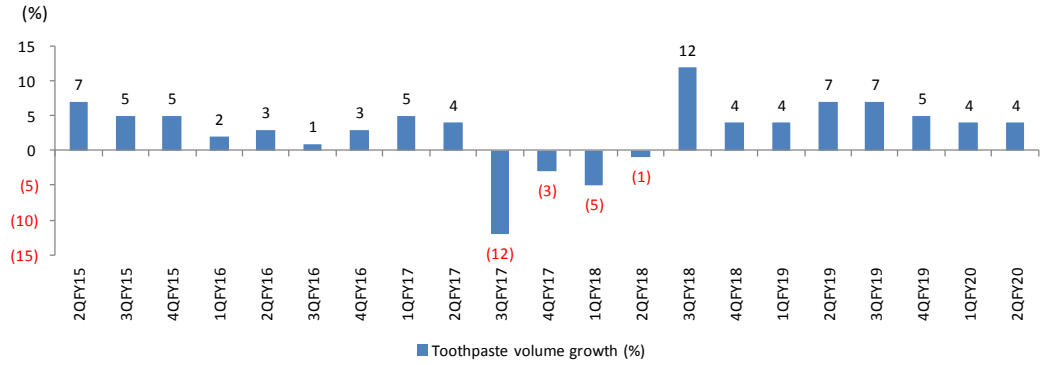
Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 3: Change in our estimates

Y/E March (Rsmn)	Old estimates			New estimates			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Net sales	48,063	53,574	59,053	48,063	53,574	59,053	0.0	0.0	0.0
EBITDA	13,206	15,133	16,893	13,106	15,128	16,888	(0.8)	0.0	0.0
EBITDA (%)	27.5	28.2	28.6	27.3	28.2	28.6	(0.2)	0.0	0.0
PAT	8,802	10,117	11,335	8,551	10,106	11,314	(2.8)	(0.1)	(0.2)

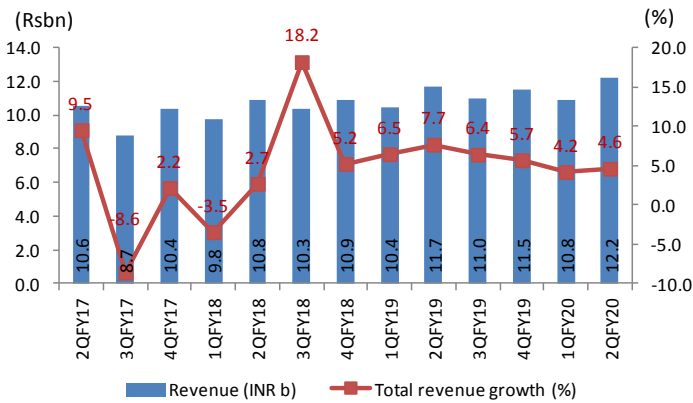
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Volume growth trend**



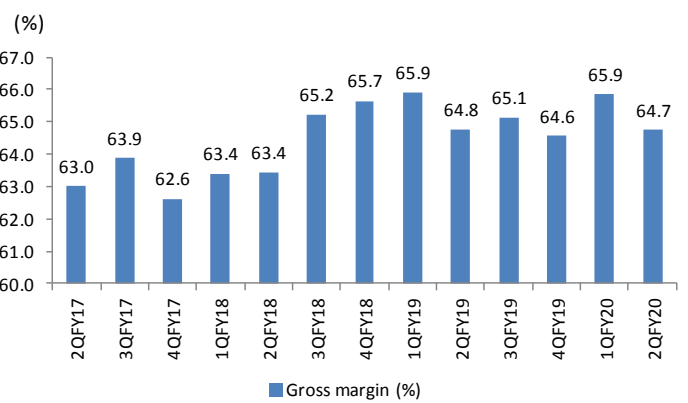
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 5: Top-line growth trend**



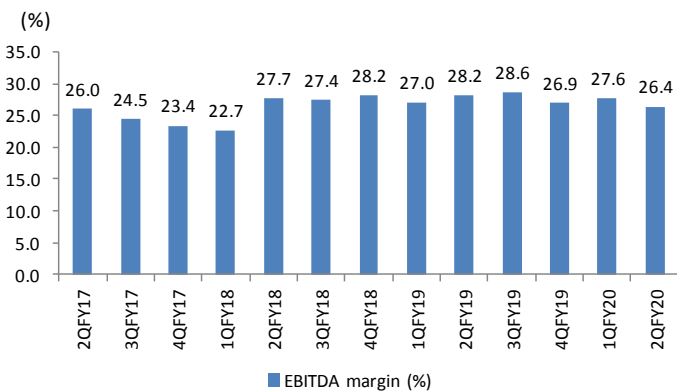
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: Gross margin trend**



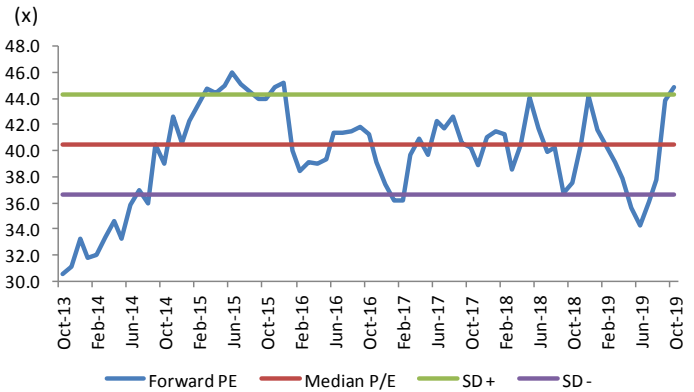
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: Operating margin trend**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 8: One-year forward P/E chart**



Source: Company, Nirmal Bang Institutional Equities Research

## Financials

### Exhibit 9: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Gross sales	42,999	44,324	47,733	53,211	58,654
Less: excise duty	1,405	0	0	0	0
Net Sales	41,880	44,624	48,063	53,574	59,053
<b>% Growth</b>	<b>5.3</b>	<b>6.6</b>	<b>7.7</b>	<b>11.5</b>	<b>10.2</b>
COGS	14,901	15,586	16,748	18,468	20,213
Staff costs	3,059	2,959	3,246	3,618	3,988
Advertising costs	5,268	5,647	6,181	6,811	7,508
Other expenses	7,528	8,072	8,782	9,549	10,456
Total expenses	30,756	32,264	34,958	38,446	42,165
EBITDA	11,124	12,361	13,106	15,128	16,888
<b>% growth</b>	<b>17.9</b>	<b>11.1</b>	<b>6.0</b>	<b>15.4</b>	<b>11.6</b>
EBITDA margin (%)	26.6	27.7	27.3	28.2	28.6
Other income	388	377	383	332	266
Interest costs	0	25	80	80	80
Depreciation	1,565	1,592	1,982	1,873	1,953
Profit before tax (before exceptional items)	9,947	11,121	11,427	13,506	15,120
Exceptional items	-117	305	0	0	0
Tax	3,097	3,670	2,876	3,399	3,806
PAT	6,850	7,451	8,551	10,106	11,314
PAT margin (%)	16.2	16.6	17.7	18.7	19.1
<b>% Growth</b>	<b>18.6</b>	<b>8.8</b>	<b>14.8</b>	<b>18.2</b>	<b>12.0</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 11: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	272	272	272	272	272
Reserves	14,974	14,196	13,522	12,349	10,756
Net worth	15,246	14,468	13,794	12,621	11,028
Total debt	0	777.1	777.1	777.1	777.1
Deferred tax liability	355	309	309	309	309
<b>Total liabilities</b>	<b>15,246</b>	<b>15,245</b>	<b>14,571</b>	<b>13,398</b>	<b>11,805</b>
Gross block	19,077	21,118	22,918	23,918	24,918
Depreciation	7,617	9,209	11,191	13,064	15,018
Net block	11,459	11,909	11,727	10,853	9,900
Capital work-in-progress	1586	1987	1987	1987	1987
Investments	312	312	312	312	312
Inventories	2,267	2,486	2,696	2,962	3,231
Debtors	2,010	2,098	2,354	2,333	2,571
Cash	4,562	3,994	4,508	3,934	3,490
Loans & advances	2303	1385	1495	1615	1744
Other current assets	1140	2096	2096	2096	2096
Total current assets	12,282	12,058	13,149	12,940	13,133
Creditors	6,145	6,132	7,660	7,642	8,362
Other current liabilities & provisions	12,282	12,058	13,149	12,940	13,133
Total current liabilities	10,037	10,712	12,295	12,385	13,218
Net current assets	2,245	1,346	854	555	-85
<b>Total assets</b>	<b>15,246</b>	<b>15,245</b>	<b>14,571</b>	<b>13,398</b>	<b>11,805</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 10: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
PAT	9,947	11,121	11,427	13,506	15,120
Depreciation	1,565	1,592	1,982	1,873	1,953
Other income	(209)	(352)	(303)	(252)	(186)
(Inc.)/dec. in working capital	(889)	330	1,007	(274)	196
<b>Cash flow from operations</b>	<b>6,940</b>	<b>8,974</b>	<b>11,236</b>	<b>11,455</b>	<b>13,279</b>
Capital expenditure (-)	(1,793)	(2,151)	(1,148)	(349)	(349)
<b>Net cash after capex</b>	<b>5,147</b>	<b>6,823</b>	<b>10,088</b>	<b>11,106</b>	<b>12,930</b>
Dividends paid (-)	(2,986)	(7,757)	(9,225)	(11,279)	(12,908)
Inc./dec. in total borrowings	0	777	0	0	0
Inc./dec. in investments	0	0	0	0	0
<b>Cash from financial activities</b>	<b>(3,798)</b>	<b>(7,767)</b>	<b>(9,957)</b>	<b>(12,011)</b>	<b>(13,640)</b>
Others	-	-	-	-	-
Opening cash balance	2,943	4,562	3,994	4,508	3,935
Closing cash balance	4,562	3,994	4,508	3,935	3,491
Change in cash balance	1,619	(568)	514	(573)	(444)

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 12: Key ratios

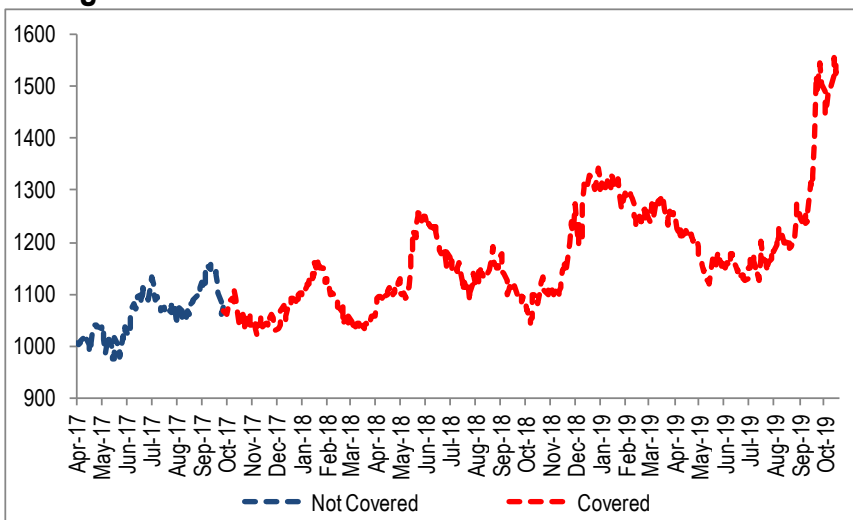
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
<b>Per share (Rs)</b>					
EPS	25.2	27.4	31.4	37.2	41.6
Book value	56.1	53.2	50.7	46.4	40.5
DPS	24.0	23.0	27.4	33.4	38.3
<b>Valuation (x)</b>					
P/Sales	7.5	7.2	6.3	5.9	5.5
EV/sales	10.0	9.5	8.8	7.9	7.2
EV/EBITDA	37.8	34.1	32.2	27.9	25.0
P/E	62.1	57.1	49.8	42.1	37.6
P/BV	27.9	29.4	30.9	33.7	38.6
<b>Return ratios (%)</b>					
RoCE	47.9	47.9	56.6	71.1	88.1
RoE	49.0	50.1	60.5	76.5	95.7
<b>Profitability ratios (%)</b>					
Gross margin	64.4	65.1	65.2	65.5	65.8
EBITDA margin	26.6	27.7	27.3	28.2	28.6
EBIT margin	22.8	24.1	23.1	24.7	25.3
PAT margin	16.4	16.7	17.8	18.9	19.2
<b>Liquidity ratios (%)</b>					
Current ratio	1.2	1.1	1.1	1.0	1.0
Quick ratio	1.0	0.9	0.9	0.8	0.7
<b>Solvency ratio (%)</b>					
Debt-to-equity ratio	0.0	0.1	0.1	0.1	0.1
<b>Turnover ratios</b>					
Total asset turnover ratio (x)	3.1	3.4	3.8	4.7	6.0
Fixed asset turnover ratio (x)	3.7	3.7	4.1	4.9	6.0
Debtor days	17	17	18	16	16
Inventory days	56	58	59	59	58
Creditor days	147	156	159	151	113

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
29 September 2017	Accumulate	1,055	1,100
17 October 2017	Accumulate	1,063	1,100
6 February 2018	Accumulate	1,121	1,200
22 May 2018	Accumulate	1,208	1,260
27 July 2018	Accumulate	1,085	1,200
30 October 2018	Accumulate	1,102	1,220
28 January 2019	Accumulate	1,287	1,300
9 April 2019	Accumulate	1,228	1,370
28 May 2019	Accumulate	1,180	1,320
19 July 2019	Accumulate	1,203	1,320
25 October 2019	Accumulate	1,564	1,500

## Rating chart



## DISCLOSURES

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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 6273 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

## Nirmal Bang Equities Pvt. Ltd.

### Correspondence Address

B-2, 301/302, Marathon Innova,  
 Nr. Peninsula Corporate Park,  
 Lower Parel (W), Mumbai-400013.

Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010