

Colgate-Palmolive India (CLGT IN)

Member of quant-based [HTI Portfolios](#): Quality

Target Price **Rs1,170**
 Current Price **Rs980.1**
 % Upside **19%**

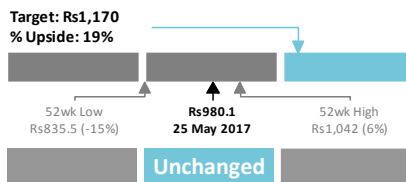
Volume Growth Recovery To Be Key Focus in FY3/18

Household & Personal Care

India

26 May 2017

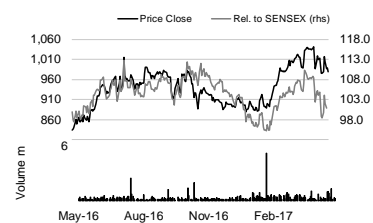
BUY



Basic Share Information

Market cap	Rs266.6b / US\$4.12b
Daily traded value (3mth)	US\$6.14m
Shares outstanding	272.0m
Free float	49%
Net debt-to-equity	-23.1%
1 yr high	Rs1,042
1 yr low	Rs835.5
Foreign Shareholding	67.3%
Share price date	25 May 17

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-5.8%	9.7%	17.4%
Absolute USD	-6.3%	13.2%	22.9%
Relative to SENSEX	-7.2%	4.6%	0.1%



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Launches in Natural Segment to Drive Volume Growth

Summary: For Colgate (CLGT), FY3/17 was a sluggish year with total income and NP growing 2.9% and -1%, respectively, and volumes sliding by 2% YoY. The lackluster show was largely on account of drop in market share in the toothpaste category due to consumer shift towards nature-based offerings leading to market share gains for Patanjali (unlisted) and Dabur (DABUR IN) as well as the impact of demonetization hitting rural India. However, given CLGT's robust brand strength, innovation ability and capacity to invest in high advertising & promotion (A&P), FY3/18 should see market share stabilize in the toothpaste category. This would be driven by strong consumer response to its nature-based offering *Cibaca Vedshakti* and new product launches around natural/Ayurveda platform. We estimate average volume growth of 7.5% over FY3/18-19 led by market share gains and low base. Additionally, recent aggressive price increases across its portfolio, premiumization and operating leverage should aid gross margin and EBITDA margin improvement of 190bps and 230bps over FY3/18-19. We build in revenue and NP CAGR of 15% and 20.4% over FY3/18-19. Maintain BUY.

Target Price and Catalyst: Our target price of Rs1,170 is based on a PER of 38x our FY3/19 EPS estimate of Rs30.8. Key catalyst would be improvement in volume growth backed by market share gains and expansion in margins driven by positive operating leverage.

Earnings: With a low base in FY3/17, management's renewed focus on regaining its lost market share through more new product launches especially around the natural/Ayurveda platform and high marketing spend, we anticipate a recovery in sales volumes. We forecast a recovery in volume growth to an average 7.5% over FY3/18-19. Additionally, with recent price hikes being more than inflation in raw material prices, we estimate revenue CAGR of around 15% over FY3/18-19. We forecast EBITDA margin rising from 23.7% in FY3/17 to 26% in FY3/19. CLGT's NP CAGR over FY3/18-19 should be 20.4% up from the low of 1.6% CAGR over FY3/16-17.

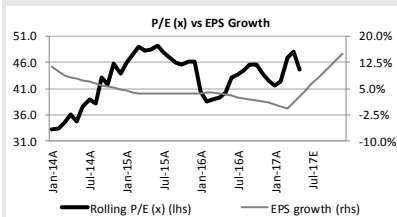
Valuation: We maintain our BUY rating on CLGT with a target price of Rs1,170, valued at 38x in-line with its 5-year historical average applied to our FY3/19 earnings. Our forecasts are 2.3-6.5% higher than Bloomberg consensus estimates over FY3/18-19. The main risks to our recommendation and target price are 1) increased competitive intensity in natural segment of toothpastes leading to lower market share gains for CLGT than we currently estimate, 2) above-expected increase in raw material prices and A&P spends making our margin estimates appear optimistic and 3) destocking of products across trade channels on account of goods and services tax (GST) implementation in FY3/18 could lead to lower volume growth than we currently estimate.

	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Trend
Total turnover (Rsm)	39,819	38,682	39,819	45,584	52,654	■
Operating profit (Rsm)	7,472	8,271	8,117	9,809	11,846	■
Pre-tax profit (Rsm)	7,804	8,353	8,515	10,262	12,354	■
Net income to ord equity (Rsm)	5,590	5,812	5,775	6,957	8,376	■
Adjusted net profit (Rsm)	5,590	6,125	5,775	6,957	8,376	■
Net profit growth	3.5%	4.0%	(0.6%)	20.5%	20.4%	■
P/E (x)	47.69	45.87	46.16	38.31	31.82	■
Adj P/E (x)	47.69	43.52	46.16	38.31	31.82	■
Adj EV/EBITDA (x)	30.55	27.24	27.21	21.18	15.98	■
P/B (x)	34.61	25.85	20.93	16.79	13.46	■
ROE	81.6%	64.5%	50.1%	48.6%	47.0%	■
Dividend yield	1.2%	1.0%	1.0%	1.2%	1.4%	■
EPS HTI old (Rs)	20.55	21.37	21.23	25.67	30.80	■
EPS HTI New (Rs)	20.55	21.37	21.23	25.58	30.80	■
Adj EPS (Rs)	20.55	22.52	21.23	25.58	30.80	■
Consensus EPS (Rs)	20.66	22.41	21.78	24.85	28.78	■
HTI EPS vs Consensus	(0.5%)	(4.6%)	(2.5%)	2.9%	7.0%	■

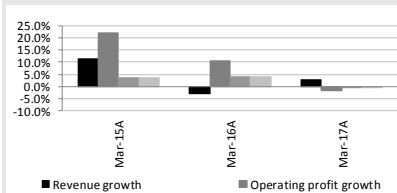
Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

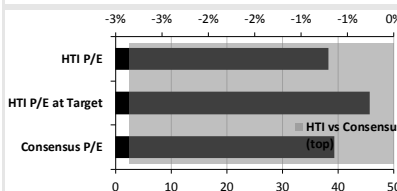
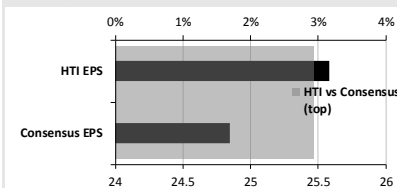
Valuation



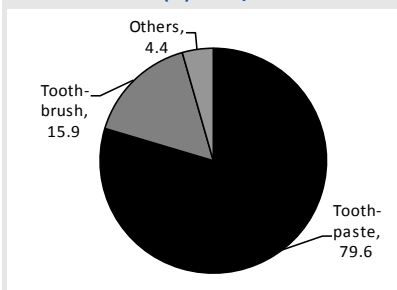
Earnings Trends



Earnings: HTI vs Consensus



Sales Breakdown (%) – FY3/16



Investment Thesis

Buy

► Natural/Ayurveda toothpaste offering such as *Cibaca Vedshakti* and other new launches in the segment should help CLGT counter competition from players such as Patanjali and Dabur. Also, this offering would help the company arrest and stabilize its volume market share in the toothpaste category.

► We estimate volume recovery over FY3/18–19 driven by low base in FY3/17, new product launches in natural segment and uptick in consumer spending.

► Aggressive price hike over the last three months should help the company counter increase in raw material prices and cause its gross margin to expand. This would assist in maintaining its high A&P spends, which should drive consumer offtake and revival in volume growth.

► We expect the premiumization trend playing out in urban markets to assist CLGT's EBITDA margin improvement.

► We have set our FY3/18 target price of Rs1,170 based on 38x our FY3/19 EPS estimate.

► The main risks to our rating and target price are higher inflation in key raw material prices than we currently expect, (which would make our EBITDA margin forecast too optimistic), and sluggish consumer demand would lead to the company delivering lower volume growth than we forecast. Destocking on account of GST would be a key overhang.

Company Snapshot

CLGT is dominant market leader in oral care segment in India with toothpaste, toothbrush market shares of 55.6%, 47.3%, respectively, in FY3/16. Its oral care product offering includes toothpastes, toothbrushes, mouthwash, and tooth powder under the *Colgate* brand. The company also provides a range of personal care products under the *Palmolive* brand name. CLGT garners about 95.5% of its revenue from the oral segment with toothpaste and toothbrushes contributing approximately 79.6% and 15.9% of total revenue, respectively, in FY3/16. The moat of the *Colgate* brand was demonstrated last year through it being voted the 'Most Trusted Brand' in 2016 in India in the Economic Times Brand Equity Survey for the sixth consecutive year.

Key Investment Metrics

Revenue Growth

Low Medium High

We forecast revenue CAGR of 15% over FY3/18–19 driven by an average volume growth of 7.5% and price improvement of approximately 6.5% over the same period.

Profit Margins

Low Medium High

We estimate operating leverage and improvements in the product mix would drive a rise in gross margin and EBITDA margin of approximately 190bps and 230bps, respectively, over FY3/18–19 to 64.8% and 26%, respectively, in FY3/19.

Shareholder Returns

Low Medium High

We estimate a net profit CAGR of 20.4% over FY3/18–19 with ROE largely remaining robust at above 46% over our forecast period.

Balance Sheet Risks

High Medium Low

With strong free cash flow generation and zero debt on the balance sheet of the company the company's balance sheet should remain strong.

Barriers to Entry

Low Medium High

With low up-front capital requirements and minimal regulatory requirements, the barriers to entry in the toothpaste and toothbrush markets are low. As a result, there are numerous global, domestic and regional players in these markets. However, once a company has created strong brand loyalty it becomes difficult for competitors to capture market share from them.

International Exposure/Breakdown

High Medium Low

Colgate Palmolive (India) is largely focused on the Indian market with limited revenue from exports. In FY3/16, the company generated approximately Rs1.1bn (approximately 2.6% of its total income) in revenue from exports.

FX Exposure

High Medium Low

The company has a little foreign currency exposure mainly related to its import of some raw materials and small export operations.

Corporate Governance

Low Medium High

To enhance and protect stakeholder value, the company has a board of directors that we regard as strong, comprising three full-time directors (a managing director and two executive directors) and seven non-executive directors including the chairman of the board. Additionally, six of the seven non-executive directors are independent directors. In our view, the company has among the best corporate governance practices in India.

Our Model Assumptions

We estimate 15% revenue CAGR over FY3/18–19 driven by average volume growth of 7.5% over the same period

We forecasts EBITDA margin improving from 23.7% in FY3/17 to 26% in FY3/19

Profit & Loss (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Total turnover	39,819	38,682	39,819	45,584	52,654
Cost of sales	(14,677)	(14,763)	(14,763)	(16,432)	(18,519)
Gross profit	25,142	23,919	25,055	29,152	34,135
Total operating costs	(17,670)	(15,648)	(16,939)	(19,342)	(22,289)
Operating profit	7,472	8,271	8,117	9,809	11,846
Operating EBITDA	8,222	9,385	9,449	11,414	13,699
Depreciation and amortisation	(750)	(1,114)	(1,332)	(1,605)	(1,853)
Other recurring income	332	395	398	452	508
Exceptional income - net	-	(313)	-	-	-
Pre-tax profit	7,804	8,353	8,515	10,262	12,354
Taxation	(2,214)	(2,541)	(2,740)	(3,304)	(3,978)
Net income to ord equity	5,590	5,812	5,775	6,957	8,376

Source: Company, HTI estimates

Note: FY15 Financials on IGAAP basis; FY16-19 Financials on IND AS basis

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✓ **Key P/L Takeaway**

Driven by volume-led revenue CAGR of 15% over FY3/18–19, we estimate a CAGR for NP of 20.4% over the same period

With our expectation of recovery in rural markets, which in turn should drive improvement in CLGT's sales volume growth, and the trend of premiumization playing out in urban markets, which should enhance the product mix, we estimate a CAGR for revenue of 15% and for NP of 20.4% over FY3/18–19, which compares favorably to the CAGR of 1.6% CLGT posted over FY3/16–17.

Our Model Assumptions

CLGT boasts of strong free cash flow historically and we expect the company to maintain a healthy cash balance over FY3/18-19

Balance Sheet (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Total cash and equivalents	2,545	2,887	2,943	2,834	3,082
Inventories	2,522	2,915	2,926	3,077	3,447
Accounts receivable	696	1,015	1,299	1,404	1,615
Other current assets	1,657	2,035	3,008	3,054	3,159
Total current assets	7,420	8,852	10,175	10,368	11,303
Tangible fixed assets	8,321	9,958	11,840	13,094	14,352
Intangible assets	907	907	907	907	907
Total investments	371	312	312	1,312	3,312
Total other assets	(26)	(97)	(275)	(275)	(275)
Total non-current assets	9,573	11,080	12,784	15,038	18,295
Total assets	16,993	19,932	22,959	25,406	29,599
Accounts payable	5,144	5,519	6,012	5,463	5,509
Other current liabilities	2,874	3,438	3,394	3,084	3,109
Total current liabilities	8,018	8,958	9,406	8,547	8,618
Other liabilities	1,272	664	816	983	1,183
Total non-current liabilities	1,272	664	816	983	1,183
Total liabilities	9,290	9,622	10,221	9,530	9,801
Common stocks	136	272	272	272	272
Other reserves	7,567	10,038	12,466	15,605	19,526
Shareholders' equity	7,703	10,310	12,738	15,877	19,798
Total equity	7,703	10,310	12,738	15,877	19,798
Total liabilities & shareholders' equity	16,993	19,932	22,959	25,406	29,599

Source: Company, HTI estimates

Note: FY15 Financials on IGAAP basis; FY16-19 Financials on IND AS basis

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✓ **Key B/S Takeaway**

We believe CLGT's balance sheet should remain healthy supported by its strong free cash flow generation

With negative capital requirement coupled with our expectation of spend only on maintenance capex over our forecast period, we believe CLGT should be able to generate strong free cash flow through FY3/19, which should strengthen its balance sheet over this period.

Our Model Assumptions

We forecast capex in the Rs2.9–3.1bn range over FY3/18–19, to be used primarily for maintenance activities

We project a CAGR for free cash flow of 28.8% CAGR over FY3/18–19

✓ **Key Cash Flow Takeaway**
We expect the company to continue generating strong free cash flow over our forecast period and see management increasing the dividend per share from Rs10 in FY3/17 to Rs14 in FY3/19

Cash Flow (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Operating profit	7,472	8,271	8,117	9,809	11,846
Depreciation and amortisation	750	1,114	1,332	1,605	1,853
Changes in working capital	(299)	(150)	(819)	(1,161)	(616)
Other operating cash flow	469	(35)	169	187	(979)
Operating cash flow	8,392	9,200	8,799	10,440	12,105
Tax paid	(2,010)	(2,470)	(2,562)	(3,304)	(3,978)
Cash flow from operations	6,381	6,729	6,237	7,135	8,127
Capex	(3,000)	(2,727)	(3,214)	(2,859)	(3,111)
Other new investments	(142)	-	-	(1,000)	(2,000)
Other investing cash flow	284	361	381	433	487
Cash flow from investing activities	(2,858)	(2,366)	(2,834)	(3,426)	(4,624)
Dividends paid to ordinary shareholders	(3,264)	(2,720)	(2,720)	(3,264)	(3,808)
Proceeds from issue of shares	(622)	(484)	(627)	-	-
Other financing cash flow	38	(554)	83	(555)	(647)
Cash flow from financing activities	(3,848)	(3,758)	(3,264)	(3,819)	(4,455)
Cash at beginning of period	2,870	2,545	2,887	2,943	2,834
Total cash generated	(325)	605	140	(109)	(952)
Forex effects		(263)	(83)		1,200
Implied cash at end of period	2,545	2,887	2,943	2,834	3,082
Free cash flow	3,381	4,002	3,023	4,277	5,016

Source: Company, HTI estimates

Note: FY15 Financials on IGAAP basis; FY16-19 Financials on IND AS basis

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We expect the company to continue generating strong free cash flow over our forecast period with capex requirement in the range of Rs2.9–3.1bn annually during FY3/18–19. We see the dividend per share increasing from Rs10 in FY3/17 to Rs14 in FY3/19.

Our Model Assumptions

We expect sales volume growth and improvement in the product mix to drive a revenue CAGR of 15% over FY3/18–19

We see price hikes, positive operating leverage and an improved product mix driving EBITDA margin expansion from 23.7% in FY3/17 to 26% in FY3/19

✓ **Key Driver Takeaway**
Volume growth revival and premiumization in the product mix should support a revenue CAGR of 15% during FY3/18–19

Per Share Data	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
EPS (Rs)	20.55	21.37	21.23	25.58	30.80
Adj EPS (Rs)	20.55	22.52	21.23	25.58	30.80
FDEPS (Rs)	20.55	21.37	21.23	25.58	30.80
Revenue per share (Rs)	146.4	142.2	146.4	167.6	193.6
Operating EBITDA per share (Rs)	30.23	34.51	34.74	41.97	50.37
BVPS (Rs)	28.32	37.91	46.83	58.37	72.79
DPS (Rs)	12.00	10.00	10.00	12.00	14.00
Recurrent cash flow per share (Rs)	23.46	24.74	22.93	26.23	29.88
Shares in issue (million)	272.0	272.0	272.0	272.0	272.0
Year end adjusted shares in issue (m)	272.0	272.0	272.0	272.0	272.0
Key Ratios	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Valuation Measures					
P/Sales (x)	6.69	6.89	6.69	5.85	5.06
P/E (x)	47.69	45.87	46.16	38.31	31.82
Adj P/E (x)	47.69	43.52	46.16	38.31	31.82
P/CF (x)	41.77	39.61	42.74	37.36	32.80
P/B (x)	34.61	25.85	20.93	16.79	13.46
Adj EV/EBITDA (x)	30.55	27.24	27.21	21.18	15.98
Dividend yield	1.2%	1.0%	1.0%	1.2%	1.4%
Growth					
Revenue growth	11.3%	(2.9%)	2.9%	14.5%	15.5%
Operating profit growth	21.8%	10.7%	(1.9%)	20.9%	20.8%
Net profit growth	3.5%	4.0%	(0.6%)	20.5%	20.4%
Margins					
Gross margin	63.1%	61.8%	62.9%	64.0%	64.8%
Operating EBITDA margin	20.6%	24.3%	23.7%	25.0%	26.0%
Operating margin	18.8%	21.4%	20.4%	21.5%	22.5%
Pretax profit margin	19.6%	21.6%	21.4%	22.5%	23.5%
Tax rate	28.4%	30.4%	32.2%	32.2%	32.2%
Net profit margin	14.0%	15.0%	14.5%	15.3%	15.9%
Key Ratios					
ROE	81.6%	64.5%	50.1%	48.6%	47.0%
ROA	35.1%	31.5%	26.9%	28.8%	30.5%
Capex/revenue	7.5%	7.0%	8.1%	6.3%	5.9%
Current ratio (x)	0.93	0.99	1.08	1.21	1.31
Creditor days	127.9	136.8	148.6	121.3	108.6
Debtor days	6.38	9.61	11.91	11.24	11.19
Inventory days	62.72	72.28	72.33	68.34	67.94
Sales/avg assets	2.50	2.10	1.86	1.88	1.91
Credit analysis					
Net debt to equity	(33.0%)	(28.0%)	(23.1%)	(17.9%)	(15.6%)

Source: Company, HTI estimates

Note: FY15 Financials on IGAAP basis; FY16-19 Financials on IND AS basis

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We estimate average volume growth of 7.5% over FY3/18–19 following relatively low base of volume decline of 2% YoY in FY3/17. We expect a recovery in volume growth and premiumization to support revenue CAGR of 15% over FY3/18–19. We see EBITDA margin improving from 23.7% in FY3/17 to 26% in FY3/19 accompanied by a rise in gross margin. We estimate a CAGR for NP of 20.4% over FY3/18–19.

Company Outline and Operational Review

FY3/17 Performance Marred By Market Share Loss In Toothpaste Category

FY3/17 was a sluggish year for CLGT with revenue growth of 2.9% YoY largely on account of pressure on volumes, which declined 2% YoY. The volume decline in the year was largely due to increased shift of consumers towards natural/Ayurvedic offerings across FMCG categories. Similar trend was witnessed in the toothpaste category where consumer shift was seen towards Ayurvedic offerings of Patanjali (unlisted) through its product *Dant Kanti* and Dabur (DABUR IN) through its products *Dabur Red* and *Meswak*. Toothpaste division contributed ~80% of revenues in FY3/16 for CLGT.

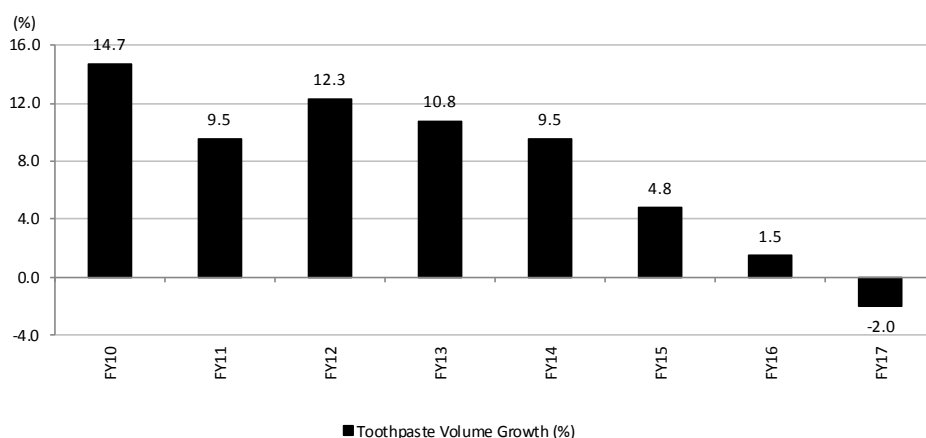
The trend (Please refer toothpaste volume market trend table below) was authenticated by toothpaste volume market share data where the market leader CLGT saw volume market share loss of 180bps YoY to 55.6% in the toothpaste category while *Ayurvedic* players such as *Patanjali* and *Dabur* gaining market share by 150/140bps YoY to 15.3%/2.8% respectively.

Toothpaste Volume Market Share (%) Trend - India

Toothpaste Volume Market Share (%)	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16
Colgate Palmolive (India)	48.8	49.4	52.2	53.3	52.7	54.5	56.1	57.0	57.4	55.6
Hindustan Unilever	25.1	24.6	22.8	22.6	23.3	23.5	22.8	21.3	19.6	19.1
Dabur India	11.9	12.2	12.9	13.7	14.8	14.0	13.4	13.4	13.9	15.3
Patanjali					0.0	0.1	0.4	0.6	1.3	2.8

Source: Company Annual FY17 presentation

CLGT: Toothpaste Volume Growth (%) Trend



Source: Company data

...While Volume Market Share Gains Continue In Toothbrush Category

In the Toothbrush category, CLGT continue to witness strong volume market share gains driven by new product launches supported by high A&P spends. In FY3/16, CLGT gained volume market share of 290bps YoY to 47.3% in the toothbrush category. Over the same period, Procter and Gamble's (PG IN) strategy of focusing on profitability has led to volume market share loss of 280bps YoY to 14.6% in FY3/16 while Hindustan Unilever (HUVR IN) market share gain of 140bps YoY to 10.7%. Over last five years, CLGT's strong brand equity in oral care segment, strong innovation ability and high A&P spends have enabled the company gain substantial volume market share (around 750bps) and improve its volume market share standing from 39.8% in FY3/12 to 47.3% in FY3/16. CLGT's toothbrush division contributed about 16% of total revenues in FY3/16.

Consumer shift towards Ayurvedic toothpaste led to loss of volume market share for CLGT

New product launches in the toothbrush category have enabled the company gain volume market share

Toothbrush Volume Market Share (%) Trend - India

Toothbrush Volume Market Share (%)	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16
Colgate Palmolive (India)	33.4	38.4	38	35.9	39.8	42.3	42.8	44.4	47.3
Procter and Gamble (P&G)	11.4	11.9	14.8	17.8	18.8	18.4	18.2	17.4	14.6
Hindustan Unilever	5.9	6.4	7.2	7.2	6.7	7.5	7.9	9.3	10.7

Source: Company Annual FY17 presentation

New product launches have been one of the key strengths of the company. It has deployed launches to defend and at the same time gain market from competition. In FY3/17, the company launched four new toothbrushes namely *Colgate SuperFlexi Black*, *Colgate A1*, *Colgate Slimsoft Advanced* and *Colgate Star* with the latter being an entry level toothbrush at a price point of Rs12 to tap the “Bottom of Pyramid “ consumers.

CLGT: New Product Innovation in Toothbrush Category

FY13	FY14	FY15	FY16	FY17
3600, a battery operated toothbrush	Colgate® Slim Soft	Colgate SlimSoft Charcoal Toothbrush	Colgate 360 Toothbrush range	Colgate SuperFlexi Black
MaxFresh toothbrush	Colgate Wave Gum Comfort Toothbrush	Colgate ZigZag Black Toothbrush	Colgate ZigZag Black Toothbrush	Colgate A1
	Relaunch of Colgate Super Flexi Toothbrush			Colgate Star
				Colgate Slim soft Advanced

Source: Company data

FY3/18 to Witness Market Share Stabilization Led by CLGT's Natural Product Offerings

The shift in consumers towards Ayurvedic toothpaste led by increased awareness about benefits of Ayurveda along with attractive pricing had led to volume market share loss for CLGT in FY3/16. However, in FY3/18, we believe the company should see stabilization in volume market share led by CLGT's natural offering in toothpaste segment in the form of *Colgate Cibaca Vedshakti* and other expected new launches in the natural segment along with continued focus on the existing key brands.

According to the management, post the launch of *Cibaca Vedshakti* in FY3/17, the product has received good response from the consumer and has already gained 0.5% market share at national level at the end of FY3/16 while at specific states level, market share hovers around approximately 1%. Management further plans to introduce new products in natural segment which should help the company compete against Ayurvedic offerings of Patanjali and Dabur. Additionally, the company's strong brand strength in the oral care segment supported by marketing spends, would assist the company in arresting its fall of volume market share in the toothpaste segment from FY3/18 onwards.

Recent Price Hikes To Assist Gross Margin

Over the last three months, the company has been quite aggressive on price hikes across its product portfolio. According to our calculations, the company has taken a weighted average price hike of about 6% across its toothpaste portfolio which is slightly aggressive than its average price increase of around 5% YoY over FY3/12–16. We believe this was taken largely to mitigate the impact of inflation in raw material prices as well as a precursor to GST implementation. Over the last one year, according to our calculation, the Company has seen raw material price inflation of 2.9% YoY.

Volume market share in toothpaste category should stabilize led by *Cibaca Vedshakti* and new product launches in natural segment

In Q4 FY3/17, despite volume declining by 3% YoY, aggressive price hike taken by the company assisted gross margin expansion of 140bps YoY to 62.6%. Therefore, with price hikes leading raw material price inflation, we have built in gross margin expansion over FY3/18 and FY3/19. However, we need to get clarity on whether the price hike taken in the prior three months by the company need to be passed on to consumer post implementation of GST to adhere to “anti-profiteering” clause (clause states that the all Companies have to compulsorily pass on the entire benefits received on account lower indirect tax in GST regime) as well as the benefit arising out of a lower GST rate as compared to the current taxes paid by the company.

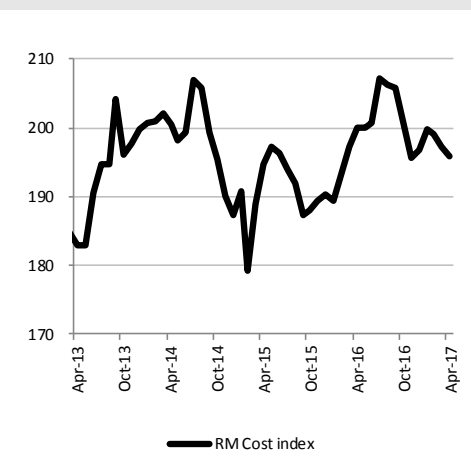
Company

Company	Product	SKU Tracked	Normalised weight	Apr-17	1M Ch (%)	3M Ch (%)	6M Ch (%)	1Yr Ch (%)
Colgate Palmolive (India)	Colgate Dental Cream	100 gm	100 gm	52.0	0.0%	8.3%	8.3%	13.0%
Colgate Palmolive (India)	Cibaca	175 gm	100 gm	27.4	0.0%	0.0%	2.1%	2.1%
Colgate Palmolive (India)	Colgate Max Fresh	80 gm	100 gm	65.0	0.0%	0.0%	6.1%	6.1%
Colgate Palmolive (India)	Colgate Active Salt	100 gm	100 gm	55.0	0.0%	5.8%	10.0%	10.0%
Colgate Palmolive (India)	Colgate Active Salt Neem	100 gm	100 gm	58.0	0.0%	5.5%	7.4%	7.4%
Colgate Palmolive (India)	Colgate - Total Charcoal	140 gm	100 gm	82.1	0.0%	0.0%	2.7%	2.7%
Colgate Palmolive (India)	Colgate Visible White	100 gm	100 gm	95.0	3.3%	3.3%	3.3%	9.2%
Colgate Palmolive (India)	Sensitive pro-relief	70 gm	100 gm	164.3	0.0%	0.0%	0.1%	4.6%
Colgate Palmolive (India)	Sensitive Original	80 gm	100 gm	131.3	0.0%	0.0%	0.0%	0.0%
Colgate Palmolive (India)	Colgate Cibaca Vedshakti	175gm	100 gm	28.6	0.0%	0.0%	0.0%	--
Dabur India	Babool	Pack of 2	100 gm	23.8	0.0%	0.0%	0.0%	4.8%
Dabur India	Dabur Red	200 gm	100 gm	45.0	0.0%	2.3%	2.3%	2.3%
Dabur India	Dabur Meswak	200 gm	100 gm	46.0	0.0%	2.2%	2.2%	2.2%
GSK Consumer	Sensodyne	70 gm	100 gm	142.9	0.0%	-4.8%	-4.8%	0.0%
Himalaya	Himalaya Sensitive	100 gm	100 gm	98.0	1.0%	2.1%	3.2%	3.2%
Hindustan Unilever	Close-Up	80 gm	100 gm	60.0	0.0%	0.0%	2.1%	6.7%
Hindustan Unilever	Pepsodent Germicheck	80 gm	100 gm	50.0	6.4%	13.6%	13.6%	13.6%
Hindustan Unilever	Pepsodent expert protect	70 gm	100 gm	90.0	0.0%	0.0%	0.0%	16.1%
Hindustan Unilever	Pepsodent 2 in 1	80 gms	100 gm	61.3	0.0%	2.1%	4.3%	4.3%
Hindustan Unilever	Pepsodent Whitening	80 gms	100 gm	63.0	0.0%	7.2%	9.6%	12.0%
Hindustan Unilever	Pepsodent Sensitive	80 gm	100 gm	100.0	0.0%	0.0%	0.0%	0.0%
Patanjali Ayurveda	Patanjali Dant Kanti	200gm	100 gm	37.5	0.0%	0.0%	0.0%	0.0%

Source: Company data

The company has taken aggressive price increases across its toothpaste product portfolio in last three months

CLGT's RM Cost Index Trend



Source: Company data, Bloomberg

CLGT's raw material index has seen inflation of 2.9% YoY in the last one year (after couple of years of flattish to slightly declining RM costs)

Change in RM Cost Index

Period	RM Cost Index Change (%)
1M Change	(0.7)
3M Change	(1.9)
6M Change	(2.4)
1Yr Change	2.9
3Yr Change	2.4
5Yr Change	16.4

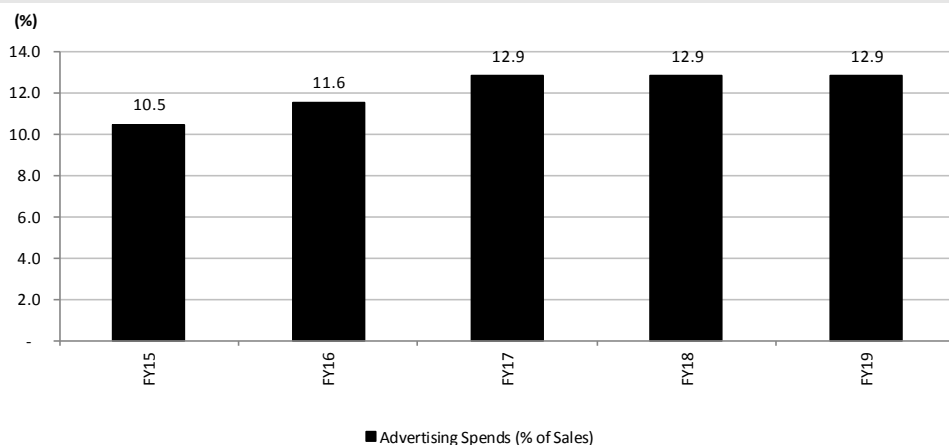
Source: Company data, Bloomberg

We estimate maintaining of advertising spends at elevated levels

Expansion In Gross Margin To Enable Company To Maintain Higher A&P Spends

With strong new product launch pipeline in FY3/18 especially in the natural segment and expansion in gross margin over FY3/18–19, we believe CLGT is likely to continue its high spends on advertising. According to IND AS, we expect the company to maintain its expenditure of around 13% of total sales on advertising over FY3/18–19 in line with FY3/17. This should help the company is consumer awareness about launches and should lead to increased off take.

Advertising Spends (% of Sales)

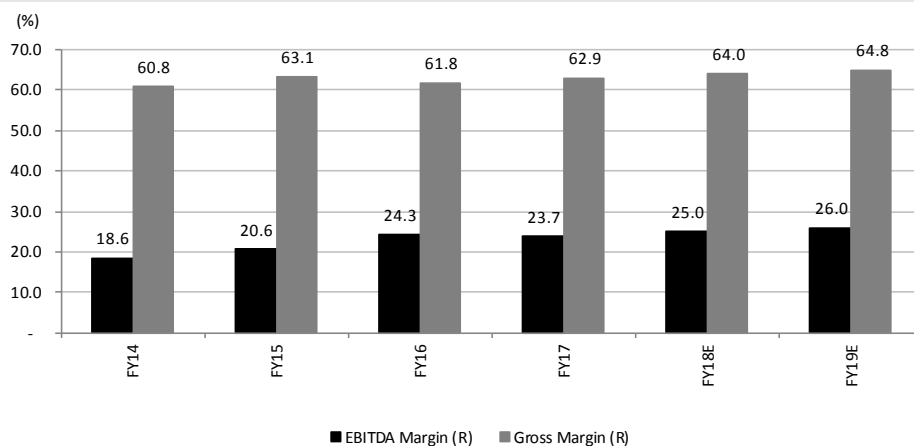


Source: Company data, HTI estimates

EBITDA Margin To Expand Assisted By Operating Leverage

Our estimate of volume growth recovery over FY3/18–19 is based on expectation of new product launches and uptick in consumer demand especially in rural market post Indian Metrological Department (IMD) prediction of normal monsoon in FY3/18. This coupled with aggressive price hikes taken by the company and the trend of premiumization playing out in urban markets, we estimate gross margin expansion of 190bps over FY3/18–19. Despite the company continuing on its strategy of high advertising spends to support its new launches, we forecast EBITDA margin to expand by 230bps over FY3/18–19 driven by positive operating leverage driven by high single-digit volume growth over the same period. We believe this would help the company to post NP CAGR of 20.4% over FY3/18–19 as compared to the lackluster NP CAGR of 1.6% over FY3/16–17.

CLGT Gross and EBITDA Margin (%) Trend



Source: Company data; HTI estimates; Note: FY14–15 Financial based on IGAAP while FY16–19 Financial based on IND AS

Volume growth recovery and recent aggressive price hikes should aid gross and EBITDA margin expansion of 190 and 230bps, respectively, over FY3/18-19

Lower GST rate on toothpaste should aid in better consumer offtake through lower pricing

We value CLGT at 38x applied to our FY3/19 EPS, which yields a target price of Rs1,170

Lower Indirect Taxation on Toothpaste in GST To Aid Consume Offtakes

The government has come out with GST rate for toothpaste at 18%, which is lower than the current total indirect taxation (excise duty + Value added tax) borne by the company at approximately 24%. We believe benefits of lower tax rate will be passed on the consumers which would help CLGT to improve its competitive position. We believe lower pricing will aid CLGT in improving its competitive position and driving volume growth which would help in arresting further volume market loss in the toothpaste segment.

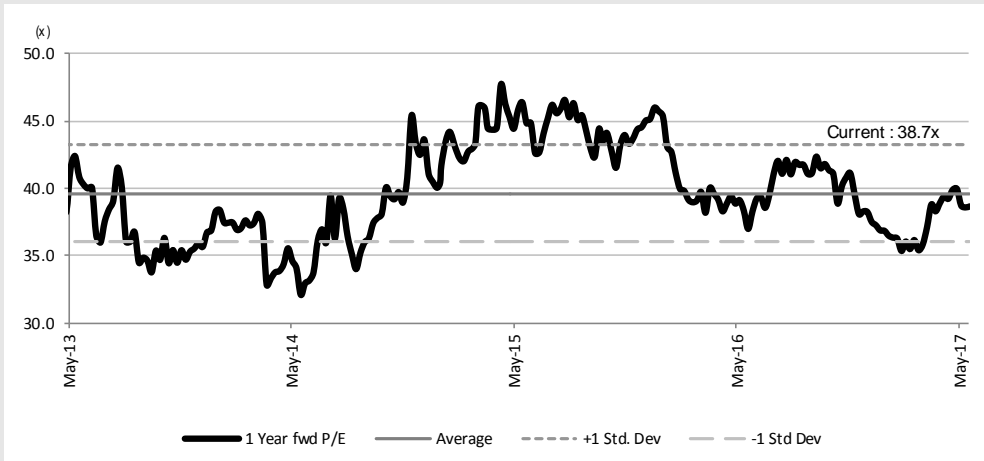
Valuation

We estimate recovery in volume and revenue growth from FY3/18 onwards, which should drive topline growth of approximately 15% over FY3/18–19. Gross margin and EBITDA margin should expand by approximately 190bps and 230bps, respectively, which in turn should drive NP CAGR of 20.4% over FY3/18–19. Compared with Bloomberg consensus EPS, our estimates are higher by 2.3-6.5% over FY3/18–19, as we are slightly ahead on EBITDA margin estimates. We value the company on a P/E multiple of 38x FY3/19 EPS, in line with its 5-year average of 38x, which yields a target price of Rs1,170.

PER Valuation

We use PER as the primary valuation methodology given the stable nature of earnings. Our target PER takes into consideration the business model's competitive matrix, long-term sustainable revenue growth, sustainable margin trends, and return ratios. We value consumer companies on a relative basis in the sector.

CLGT: One-Year Forward PER Trend



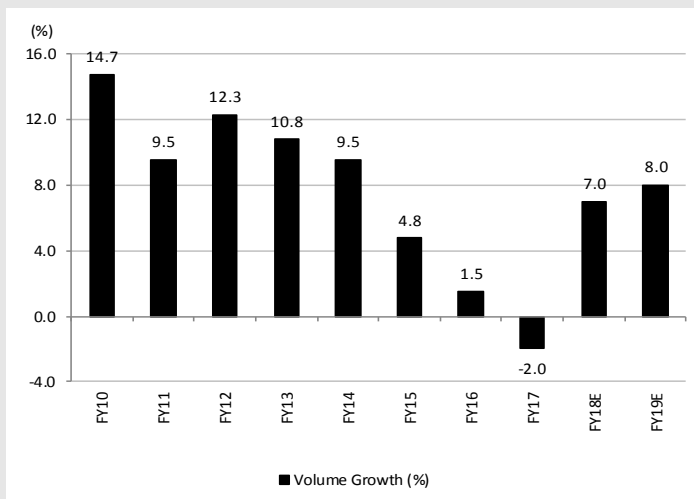
Source: Company data, Bloomberg, HTI estimates

Key Risks to Our Rating and Target Price

- 1) Slower recovery than we currently expect in consumer spending resulting in subdued volume growth as compared to our estimates.
- 2) Higher increase in key raw material costs than we currently expect could put at risk our expectation of gross margin improvement.
- 3) Higher promotional costs versus our current expectations, specifically on account of increase in competitive intensity from Patanjali and HUL as well as a relaunch by P&G in toothpaste category could put at risk our revenue and margins estimates.
- 4) Implementation of GST in FY3/18 could lead to destocking across trade channels which could lead to volume growth for the company lower than we currently estimate.

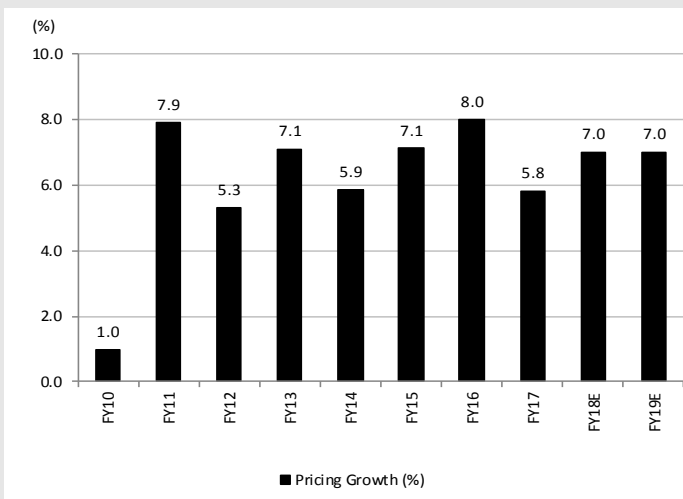
Financial Outlook (Note: FY10-15 according to Indian GAAP; FY16-19 according to IND AS)

Volume Growth (% YoY) Trend



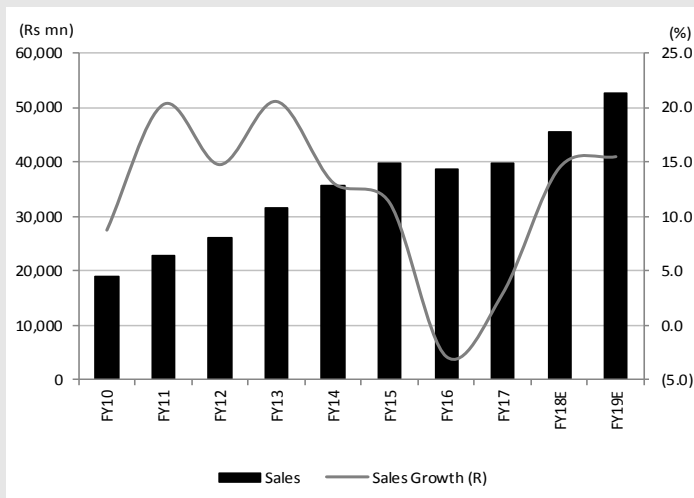
Source: Company data, HTI estimates

Pricing Growth (% YoY) Trend



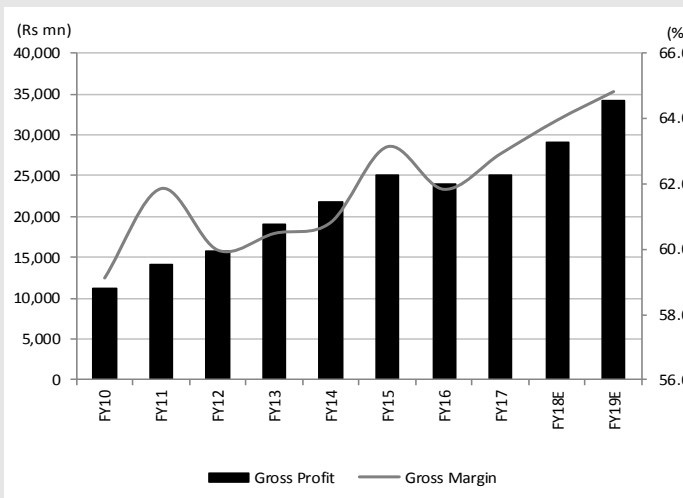
Source: Company data, HTI estimates

Sales and Sales Growth (%) Trend



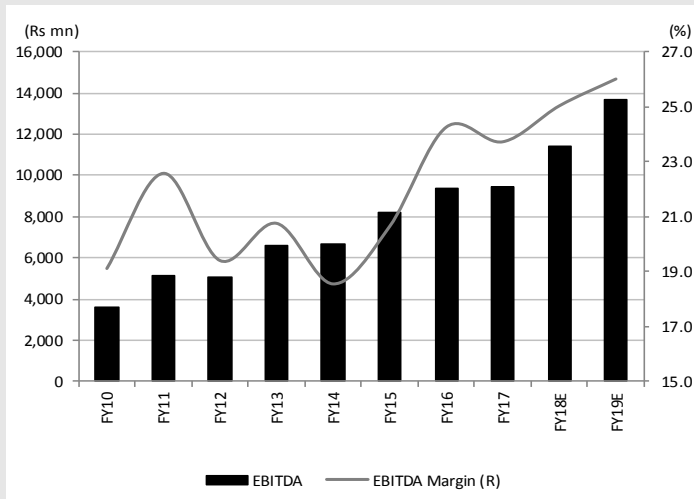
Source: Company data, HTI estimates

Gross Profit and Margin (%) Trend



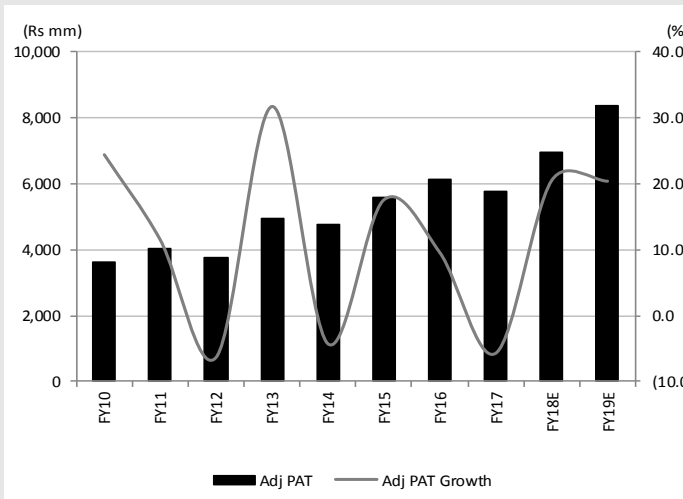
Source: Company data, HTI estimates

EBITDA and EBITDA Margin (%) Trend



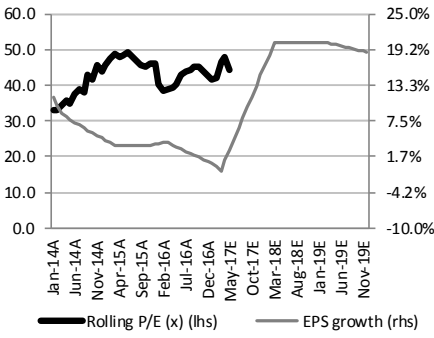
Source: Company data, HTI estimates

NP and NP Growth (%) Trend



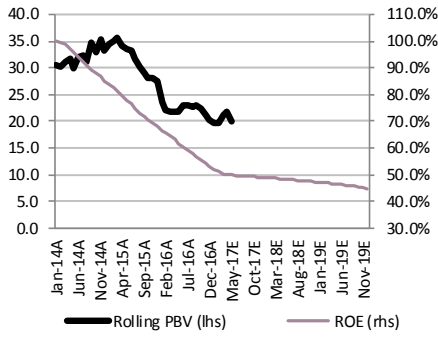
Source: Company data, HTI estimates

P/E (x) vs EPS Growth (%)



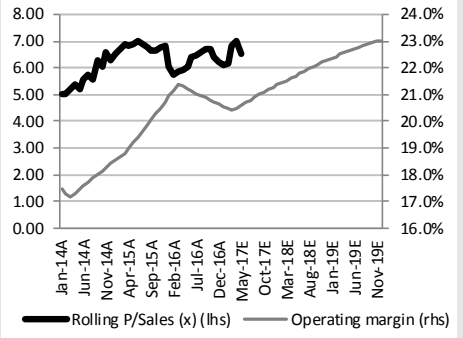
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



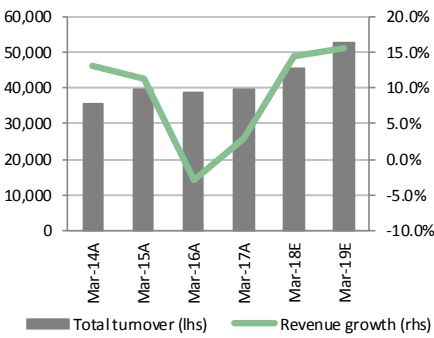
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



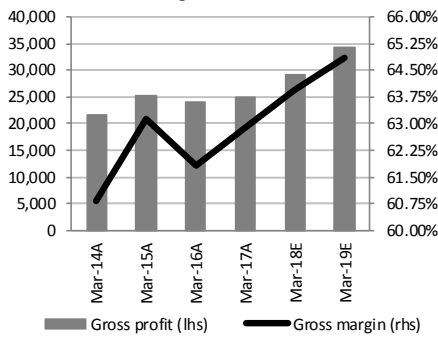
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



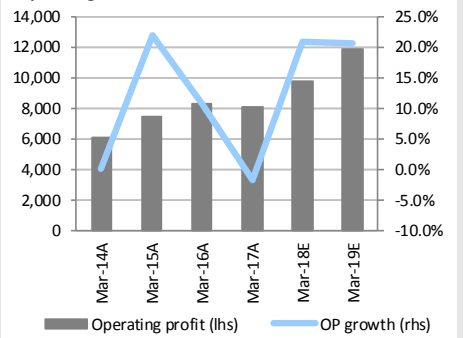
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



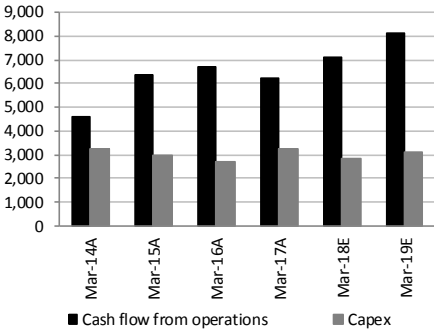
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



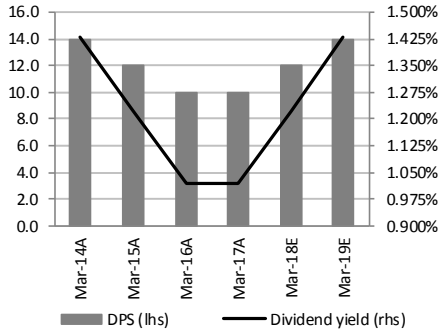
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



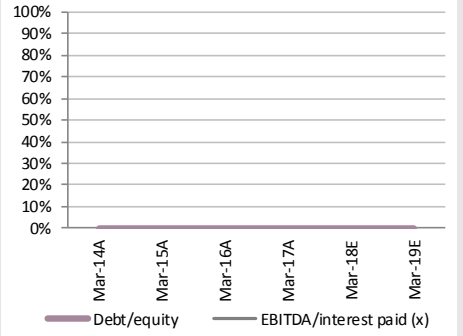
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



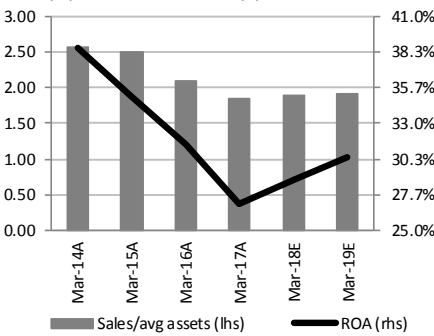
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



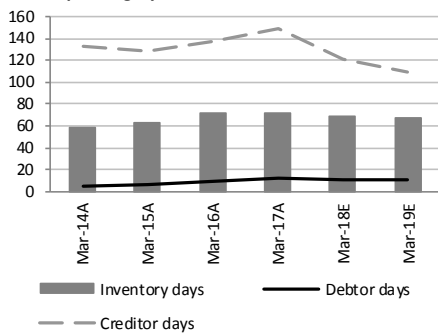
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



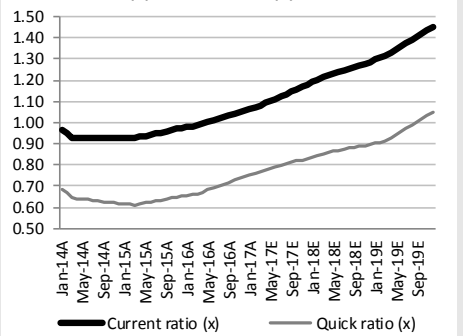
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

Revenue Growth

We forecast revenue CAGR of 15% over FY3/18–19 driven by an average volume growth of 7.5% and price improvement of approximately 6.5% over the same period.

Profit Margins

We estimate operating leverage and improvements in the product mix would drive a rise in gross margin and EBITDA margin of approximately 190bps and 230bps, respectively, over FY3/18–19 to 64.8% and 26%, respectively, in FY3/19.

Shareholder Returns

We estimate a net profit CAGR of 20.4% over FY3/18–19 with ROE largely remaining robust at above 46% over our forecast period.

Balance Sheet Risks

With strong free cash flow generation and zero debt on the balance sheet of the company the company's balance sheet should remain strong.



Key Takeaway

Volume growth revival and premiumization in the product mix should support a revenue and NP CAGR of 15% and 20.4%, respectively, over FY3/18–19

Investment Thesis – Target Price – Share Price Catalysts

CLGT's sluggish performance in FY3/17 was largely on account of drop in market share in the toothpaste category due to consumer shift in toothpaste category towards natural offerings leading to market share gains for Patanjali and Dabur. However, we believe given the company's robust brand strength, innovation ability and capacity to invest in high A&P spends, FY3/18 fiscal would be highlighted by market share stabilization in the toothpaste category. This would be driven by strong consumer response to its first natural offering *Cibaca Vedshakti* and new product launches around natural/ayurveda platform. We therefore estimate average volume growth of 7.5% over FY3/18–19 led by market share gains and low base. Additionally, recent aggressive price increase across its portfolio, premiumization and operating leverage should assist gross margin and EBITDA margin improvement of 190bps and 230bps, respectively, over FY3/18–19. We build in revenue and NP CAGR of 15% and 20.4%, respectively, over FY3/18–19. We maintain our BUY rating with TP of Rs1,170. Key catalyst would be improvement in volume growth backed by market share gains and above our estimated rise in margins driven by a positive operating leverage led by higher than anticipated volume growth.

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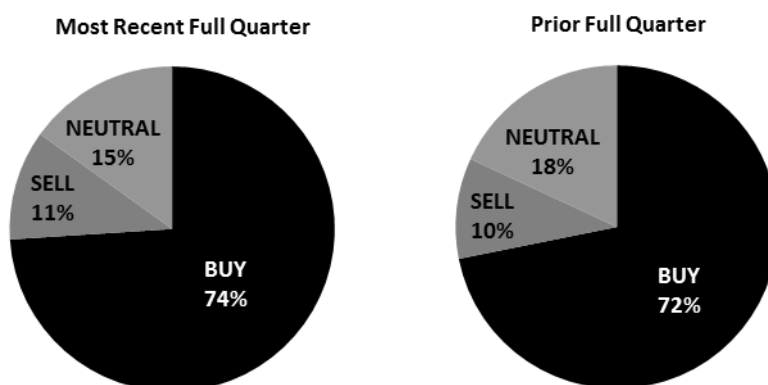
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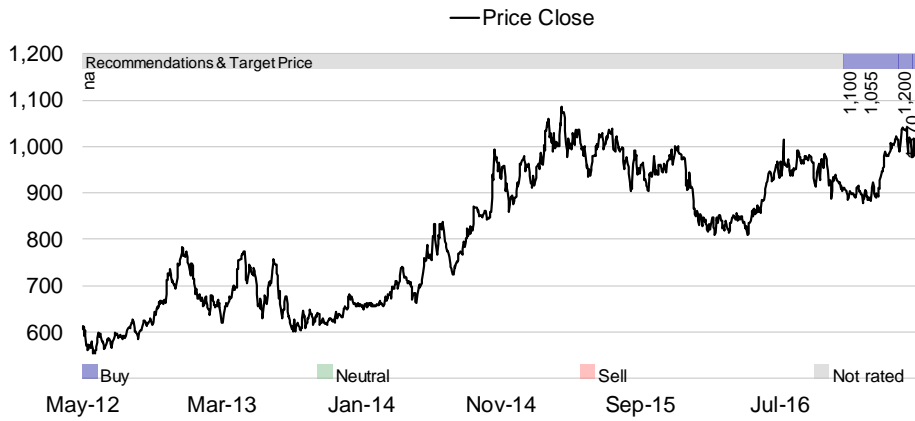
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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2017-05-16	Buy	1,170	977
2017-04-14	Buy	1,200	1,015
2017-01-30	Buy	1,055	886
2016-12-15	Buy	1,100	910

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity