

**Colgate Palmolive (India) – A Shiny Idea**Date: 25th May 2020

CMP: Rs 1,313

Large Cap – Mkt Cap Rs. 35,700, Industry: Consumer - FMCG

Valuation: P/E at 37.3

Advise: BUY



Overview: Colgate Palmolive (India) is the leader in India's oral care market with a 49% share. Their range includes toothpastes, toothpowder, toothbrushes, mouthwashes and personal care products under the Colgate and Palmolive brands. FY20 revenues were ₹ 4,574 crores, and profits ₹ 816 cr. CPL today has one of the widest distribution networks in India - a logistical marvel with 61 lakh retail outlets. Most of the products of CPL were part of the 'Essential products' that were allowed to be distributed even during lockdown. Also by May 4th, all CPL plants were allowed to open. Given all this, we feel that CPL will be less disrupted than most consumer firms through Q1 and Q2 FY21 due to the lockdown.

Key Risks: 1) Covid 19 lockdown in Q1FY20 will impact both mfg. and the demand as supply chains as well as outlets have been closed 2) strong competition 3) Indian preferences for natural and ayurvedic products

Advice: BUY with a May 2022 target of ₹ 1,555, a 18.5% gain

Description and Profile

- Colgate Palmolive India Ltd. (CPL), located in Mumbai caters to the personal care products.
- FY20 revenues were ₹ 4,574 crores, and profits ₹ 816 cr. It was incorporated in 1937. It is 83 years presence in India so is accepted as a MNC with strong Indian roots.
- CPL makes products such as Soaps, Cosmetics and Toilet Preparations.
- They have over 2,305 employees and CPL today has one of the widest distribution networks in India - a logistical marvel with 61 lakh retail outlets across the country.
- Colgate-Palmolive Co. U.S.A. is the parent company with revenues of \$16.16 b. (₹ 1,21,000 cr.)
- CPL has grown to a ₹ 4,500 cr. plus organization with a good record of enhancing value for its shareholders. CPL leads the ₹ 10,000 crore plus Indian toothpaste market.
- CPL makes 3 product categories - Toothpaste, Toothbrush and Mouthwash. The products include toothpowder, kids' products like 'Colgate Barbie Toothpaste' and speciality products like 'Colgate Pain Out'. Palmolive has liquid hand wash as a product category and the range available is 'foaming hand wash' and 'naturals'. See Fig 1 for products.
- Management has Mr. I. Bachaalani as MD.
- Shareholders are: Promoters 51%, MFs 5.97%; FIIs 15.37%, Individuals 18.72% and others 8.94%.

Business Model, News and Updates

- Colgate ranked as India's Most Trusted Oral Hygiene Brand for the 9th consecutive year in TRA's Brand Trust India Study Report 2019.

- Colgate operates in the Personal Care business, which accounts for more than 50% of FMCG sales in India. This includes Oral Care that contributes 90% of CPL sales. Within Oral Care, CPL has a leadership position in Toothpaste and Toothbrush categories.



Fig 1 - CPL products

- CPL reported Net Sales of ₹ 1,062.4 cr. for Q4FY20, a decrease of 7.4% over the same quarter YoY with volume decline at 8% mainly impacted due to COVID. CIL launched Palmolive Hand Sanitizers responding fast to the opportunity and displaying agility, resilience and creativity. In 4QFY20 CPL also relaunched Colgate Strong Teeth, and other new launches were Kids toothpaste (premium), Charcoal clean, Bamboo toothbrush, Colgate ZigZag, Colgate Superflexi Charcoal, Colgate ZigZag Charcoal, Battery brushes and Palmolive Hand Sanitizer, bodywash & shampoo.
- CPL has recently launched several new sub brands, such as Colgate Cibaca Vedshakti, herbal products like Active Salt Neem and sensitive Clove toothpaste, and Swarna Vedshakti, as well as Colgate Charcoal Clean. It has become aggressive and taken back share from Patanjali.
- CPL's key financial ratios are healthy. The RoNW in FY19 increased to 52% from 48% YoY driven by improvement in Profits. CPL advertising spent was up 8.86% in Q4 FY19. See Fig 2b.
- CPL is the first company in India to receive TRUE Zero Waste Platinum certification. All the four mfg. plants of CPL - in Baddi (HP), Goa, Sanand (Gujarat), and Sricity (AP), have achieved TRUE Zero Waste Platinum certification. Most of CPL's plants are situated close to the suppliers of raw material and packaging material suppliers, reducing transportation and carbon emission.
- CPL has invested in a Solar Power plant of 1,284 KW capacity for captive consumption to ensure commitment towards green power, sustainability and saving initiatives. Installation and commissioning of 1,284KW Solar Power in the plant achieved an annual savings of 1,872 MWh.
- Online presence: Colgate products are widely available on popular eCommerce sites and this business has grown by 18 X in 2018 over the year 2015.

Effect of Covid19 and lockdown

- The new CPL CEO stated that India and China were the firm's worst-affected markets in the March quarter, reporting sales decline on account of Covid-19. There were supply chain disruptions, including on stock going into retail stores.
- However by 5th May, CPL reported that it had been allowed to resume operations at reduced capacity at all of its manufacturing plants. And CPL products were part of the Essential products allowed to be sold in the lockdown. So barring a few weeks, we feel the sale of the products would not have stopped. The Supply chain, raw material supply and transportation issues however would have taken longer to solve as the country moved from lockdown 1.0 to 2.0, 3.0 and 4.0. Factories in the red zones in the country are even now not able to open in many states.

- By May 23rd, the company was working at 70-80% of its overall capacity.
- We are expecting weakness in Q1FY21, but a return to normalcy by Q2FY21 due to lockdown.

Industry Outlook

- India oral care market has shown growth in the last few years. Rise in awareness of oral hygiene has created a demand for premium and innovative products in metros and urban cities.
- The market was mainly driven by change in lifestyle of Indian consumers, demand for premium products, rising disposable incomes and awareness regarding hygiene and sanitation.
- Global oral care players like CPL, Hindustan Unilever, Gillette India (P&G), GSK Consumer Healthcare and Johnson & Johnson have strong presence in India. Dabur India and Patanjali Ayurved are the only two strong domestic players in the market. See market shares in Fig 2a.

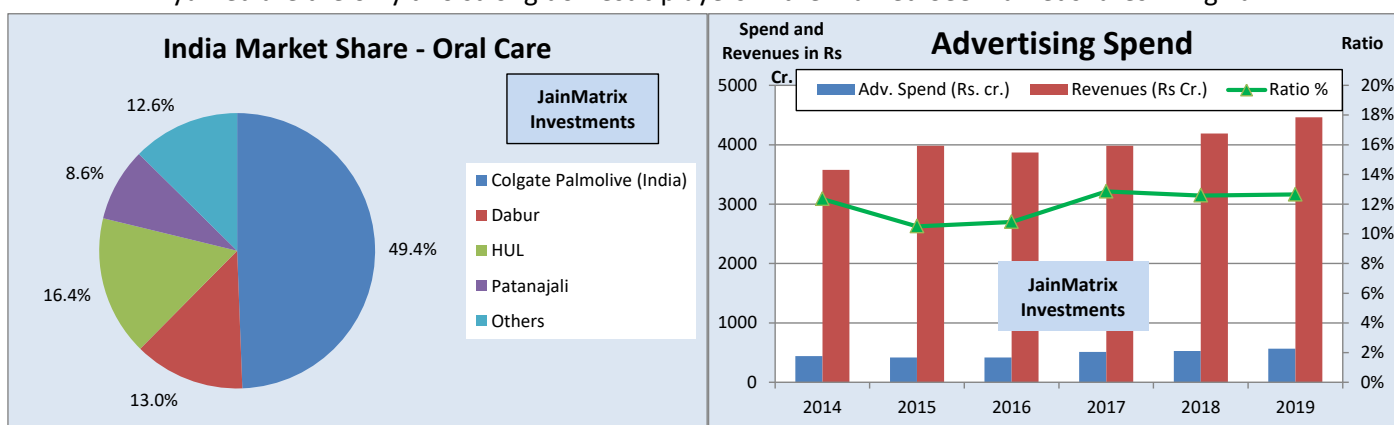


Fig. 2a - Market Share and 2b – Advertising Spends to Revenues

- Penetration level of oral care products in urban area is high as compare to that of rural area. This poses a latent opportunity for global as well as domestic players to grow the presence of their oral care products in India. As a result, players are now focusing more in areas. Rural Indian consumers have started shifting to toothpaste & toothbrush from toothpowder.
- The Indian market is growing at a fast pace, but from a low base. The per capita consumption of toothpaste in India is lower than other countries like Brazil (603 gm), U.S (458), Philippines (312), and China (212) compared to India (158).

Stock Evaluation, Performance and Returns

- CPL's price history is detailed in Fig 3; it rose from ₹787 in May'16 to a high of ₹1,643 in Nov'19.
- Dividend yield is currently at 1.69%. The return on equity (ROE) for the stock stood at 53.6 %.
- The Beta value stood at 0.52, indicating lower volatility in relation to the market.

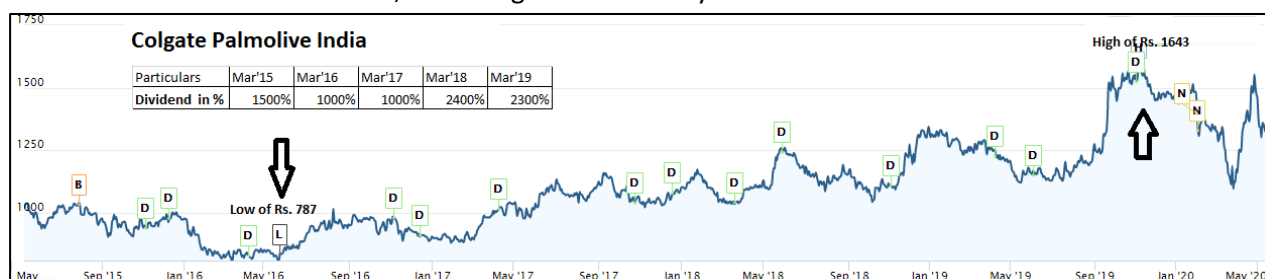


Fig 3 - Price History

- CPL's Revenues, EBITDA and PAT have grown by 4%, 9.8% and 7.1% CAGR over 7 years. See Fig 4.
- The Price and PE chart Fig 5a indicates that the historical average PE has been 45 times over 7 years. The fall in PE to the current at 37.3 thus makes the share Undervalued at these levels.

- In Fig 5b we can see that EPS has been ascending quite steadily over the years, indicating a safe stock. The EPS is rising in the indicated channel.

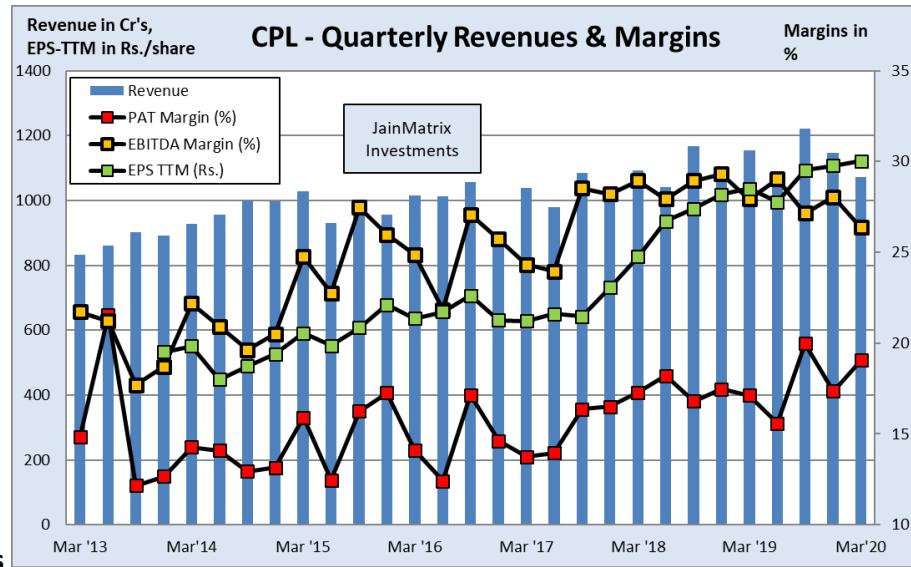


Fig 4 - CPL Financials

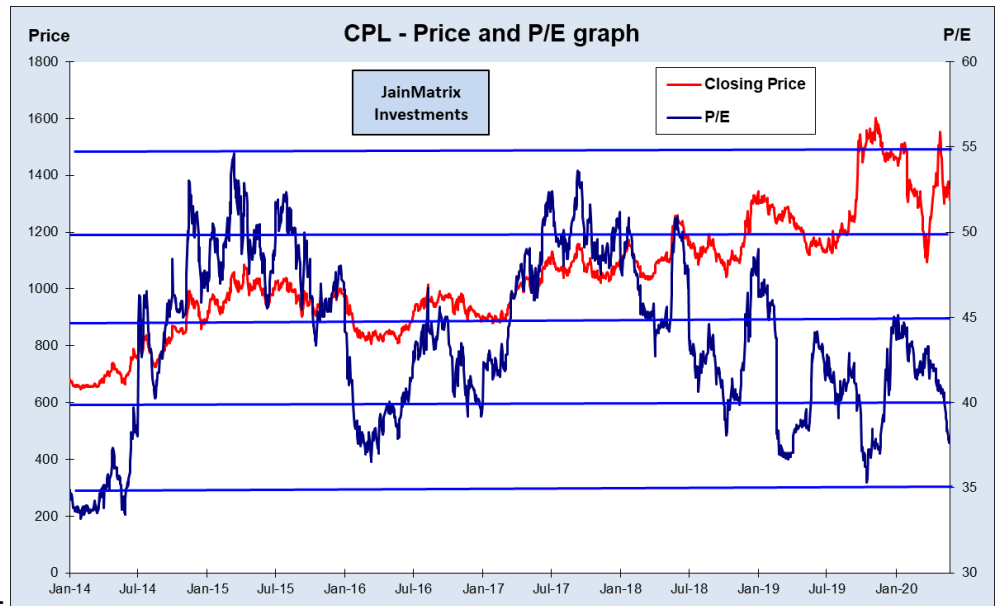


Fig 5a – Price and PE Chart

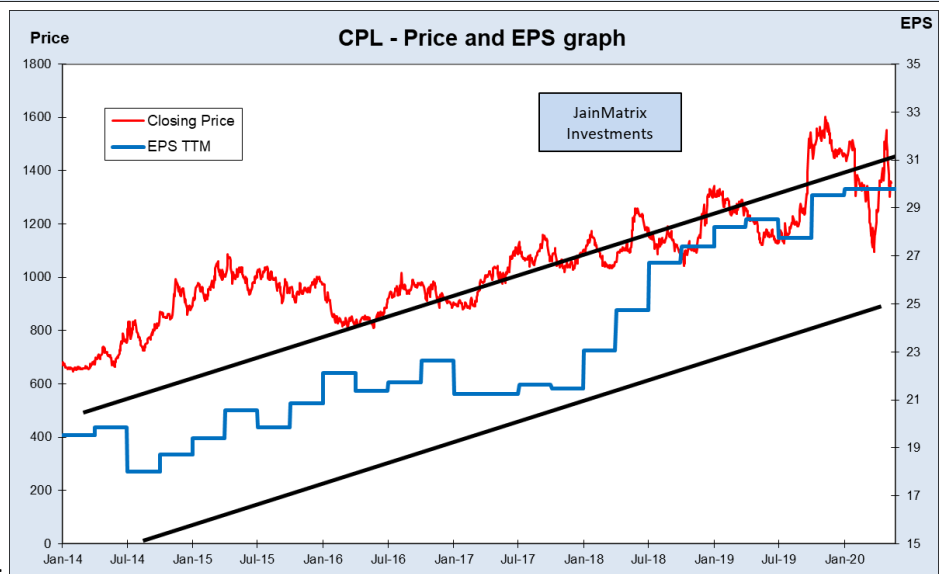


Fig 5b – Price and EPS Chart

- Cash flow data (Fig 6) shows that CPL has been generating positive and growing CFO while also investing in its facilities & businesses. Even so, the net Free Cash Flow is positive.
- Dividend payout is good, so dividend yield is 1.75%.

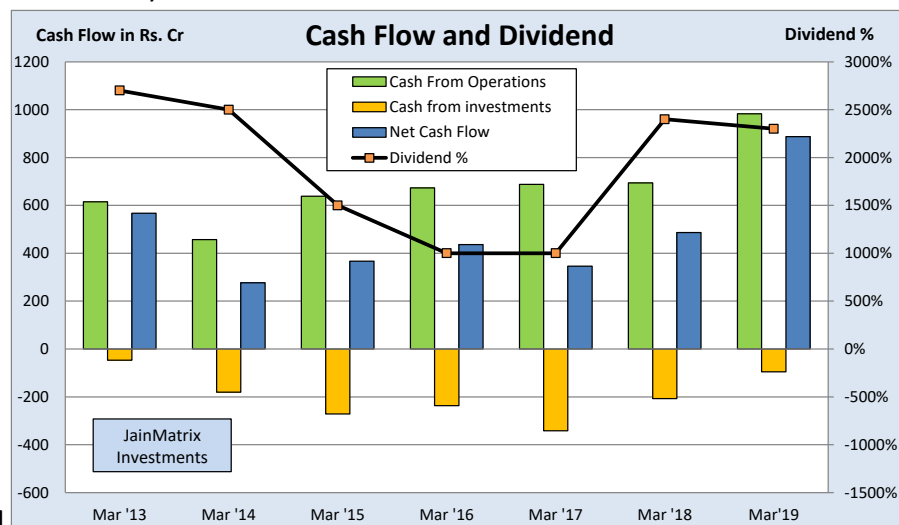


Fig 6 - Cash Flow, Dividend

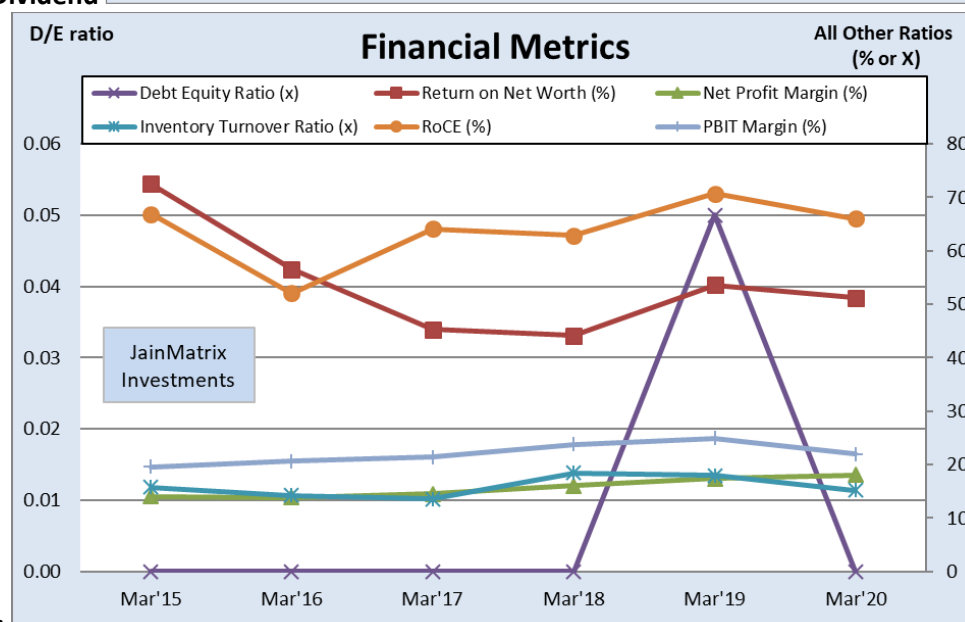


Fig 7 - Financial Metrics

The Fig 7 displays some of the key financial ratios.

- The firm has used its good cash flows to reduce debt, and become a debt free company again, as we can see in the DE ratio.
- CPL has a very high RoCE and RoNW, this is good. The Profit and Operating Margins are consistent over the years.
- The company's inventory turnover ratio has improved over the years, and is high indicating good productivity and efficient factory operations.
- CPL has not changed its equity capital in the last 5 years, a sign of good stability.

Benchmarking and Financial Projections

A benchmarking exercise compares Colgate Palmolive (India) Limited with peers in the FMCG industry. See Table 8.

- The PE of CPL is average, not expensive.
- The dividend yield (%) is in the lines of the industry and is one of the better paced companies.

- Sales and profit have been steady, but low.
- CPL is a leader in terms of returns, both ROCE and ROE, among the peers.
- CPL has the best ITR, a sign of high efficiency and productivity.

Particulars	CPL	HUL	Dabur	Marico	God Con	ITC
Revenue's (Rs. In Cr's.) FY19	4,462	39,719	6,587	5,955	5,717	47,379
EBITDA (Rs. In Cr's.)	1,304	9,202	1,961	1,383	2,494	20,618
PAT (Rs. In Cr's.)	776	6,207	1,497	1,113	2,134	12,667
Market Cap (Rs. In Cr's.)	36,854	481,606	78,899	39,073	53,089	195,569
PE (x)	39.30	71.15	47.88	37.15	23.04	12.90
Price to Book Value (x)	23.13	59.49	12.83	12.82	6.73	3.33
Dividend Yield (%)	1.69	1.10	0.62	2.00	2.00	3.62
3 Yr CAGR Sales (%)	4.88	6.89	2.67	9.68	6.98	7.25
3 Yr CAGR Profit (%)	7.78	14.11	6.79	16.96	26.12	10.53
Return on Capital Employed (%)	73.98	90.93	27.24	41.22	19.11	34.26
Return on Equity (%)	52.50	80.01	25.51	40.96	31.55	22.99
Debt to Equity Ratio (x)	0.03	0.01	0.14	0.12	0.51	0.00
Inventory Turnover Ratio (x)	18.78	15.46	6.68	5.43	6.58	6.49

Table 8 – B'marking

The 3 year financial projections for CPL are in Table 9:

	Mar '18	Mar '19	Mar '20	Mar '21	Mar '22
Sales Turnover - crores	4,188	4,462	4,525	4,299	4,978
EBITDA - crores	1,151	1,274	1,251	1,325	1,394
Net Profit - crores	673	776	816	799	846
EPS - Rs/share	24.8	28.5	30.0	29.4	31.1
PE (at current Price)			43.7	44.7	42.2

Table 9 – Projections

- The key assumptions for these projections are 5% revenue fall in FY21, then recovery to 10% growth in FY22 and 23. There will be some fall in margins in FY21, then recovery in FY22 and 23.

Strengths

- Colgate is a brand which has enjoyed enormous success and high customer goodwill. It is such a strong brand that it is a generic term for toothpaste in many parts of India. Colgate has been ranked as India's #1 Most Trusted Oral Care Brand for eight consecutive years.
- CPL has a strong balance sheet and good cash generation from core business - Improving Cash Flow over the last 2 years. The returns ratios are among the highest in the country.
- CPL is a company with Zero Promoter Pledge and low debt.
- CPL has been a market share leader in Oral care products for decades.
- In terms of productivity and efficiency, CPL scores high.
- In terms of marketing and branding, India gets many inputs from Colgate USA. At the same time, several products have been launched which are India specific, catering to local needs.
- Annual Net Profits and Sales have been improving for last 3 years.
- CPL is promoting Oral Health consciousness. It received a Guinness World Record for most people brushing simultaneously at a single venue in Nov, 2019, when 26,382 people took part.
- Quite unlike the competitors, CPL owns their manufacturing facilities and makes locally all their products. The company owns 4 such facilities in India.
- The recent fall in CPL share price gives investors a good opportunity to enter.

Risks and Challenges

- The personal care line under Palmolive struggles to match up to the leaders like HUL and P&G.
- In general CPL scores low on innovation, new categories and new product development. It is restricted in its addressable product categories by global HO directives.

- Customers are apprehensive about the presence of chemicals and artificial ingredients in these products and this is shifting their choice to organic or ayurvedic products. This is a trend which can threaten Colgate Palmolive in both oral care and personal care segments. Patanjali set off this trend of natural products, but CPL has launched their natural lines which are doing well.
- Retailing in India is changing from small kirana store domination to growth of Retail chains such as Reliance Fresh, DMart and Big Bazaar, as well as eCommerce. The retail chains also develop their own in house products and brands, and this could be a challenge for CPL.

Opinion, Outlook and Recommendation

- India has a low penetration of Oral care products. We are going to see decades of high growth here as consumers upgrade from cheap home remedies to these products. The Indian market will soon cater simultaneously to a small group of international travellers and foreigners, many affluent Indians, and a mass of middle class and low income consumers.
- With a 50% market share in oral products, CPL has a strong grip on this market and among the best distribution chains in India. The Colgate brand is very strong with high recall, being almost a generic name. Financially CPL is well managed with strong balance sheet, good free cash flow, investments in capacity expansions and low debt.
- The key risks for CPL investments are: 1) Covid 19 lockdown in Q1FY20 will impact both mfg. and the demand as supply chains as well as outlets have been closed 2) strong competition 3) Indian preferences for natural and ayurvedic products
- Today priced at ₹ 1,313, CPL has a PE of 37.3 times, which makes it undervalued.
- CPL is seen by us a safe stock, a good bet in times of economic stress like now. Its strong brands and solid distribution will ensure that CPL will at least retain market share over next 2 quarters.
- The May 2022 target for CPL is Rs 1,555, a 18.5% gain over today's share price. CPL is a BUY.

Disclaimer, Disclosures and Assumptions

- The target price has been arrived at basis the financial projections for CPL in Table 9, management commentary, capex plans shared publicly and a PE target of 50 by May 2022 based on analyst judgement.
- Punit Jain has no holding in CPL. In addition, JM and its promoters/ employees have no financial interest in CPL and no known material conflict of interest as on date of publication of this report.
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