



research@impetusadvisors.com

**India Research - FMCG**

**07 Feb 2006**

For Private Circulation Only  
Important disclosure on the last page

## Godrej Consumer Products Ltd

www.godrejcp.com

Godrej Consumer Products Ltd (GCPL) has been consistently outperforming the industry. With the FMCG sector showing signs of growth acceleration, GCPL is all set to grow at a very healthy pace. GCPL has shown decent growth in revenues and profits for the first half of this fiscal and is likely to sustain such growth going forward too. Double digit growth across all segments in which it operates, strong cash flows, recent acquisition of UK-based Keyline Brands Ltd, and acquisitions-in-pipeline make it an attractive investment.

**DCF Value Rs.1053**

**Price Rs.547**

**+93%**

The stock currently trades at 21.3 times and 18 times the estimated EPS for FY07 and FY08 respectively. We expect the EPS to grow by 23% and 18% in FY07 & FY08. We estimate one-year out DCF value at around Rs.1053 (CoE 10.2%, WACC 10.2%). GCPL has consistently maintained high ROCE and ROE of around 100%. Its profits do not capture its strong cash flow generation.

### Key Data

Market Cap	Rs.30.9bn US\$702mn
Shares Outstanding	56.5 mn
52 week High-Low	Rs.599 / Rs.260
Average Daily Volume	No. of shares
BSE+NSE 365 days	32,330
BSE+NSE 30 days	24,000
BSE Scrip Code	532424
BSE Group	A

### Shareholding %

**31 Dec 05**

Promoters	68.2
Institutions	19.8
Others	12.0

### Multiple Valuation

**YE Mar-07E**

EV/EBITDA	18.0x
EV/ EBIT	19.2x
Market Cap/Sales	3.8x
P/E	21.3x

### Main Products & Brands

Hair Colours	Renew, ColourSoft, Godrej Liquid & Powder Hair Dye, Nupur Mehandi, Fashion Hair Colour
Soaps	Cinthol, Fairglow, Godrej No.1, Crowning Glory, Nimin, Shikakai
Fabric Care	Ezee Liquid Detergent
Baby Care	Snuggly Diapers
Home Care	Godrej Dish Wash Liquid
Toiletries	Godrej Shaving Cream, Cinthol Talc, Sanitizer, Deodorant

### Key Investment Points

- GCPL, a market leader in powder hair dyes, has been growing at a scorching pace in hair colours, a product category that holds immense growth & profit potential.
- Its soap business has been outperforming the industry & managed to consistently improve market share.
- It set up plants in Himachal Pradesh & Assam and is setting up two more plants in these states to take advantage of excise and income tax exemptions there.
- A highly capital efficient company, it has been repaying all surplus cash to shareholders via maximum possible dividends & share buybacks. It continues to surprise us with its ability to generate cash.
- Improved purchasing power in under-penetrated rural areas due to benevolent rains last year will likely convert into strong growth for consumer goods.

### Value Kickers

- It recently acquired UK based Keyline Brands Ltd, which owns a number of well known brands. The acquisition will enable it to expand its sales globally and also outsource production of certain products to India. Upside from Keyline, UK acquisition not considered in projections & valuation.
- More acquisitions of brands or companies in similar businesses. Entry into new products or categories.

### Points of Concern

- Price fluctuations in vegetable oil, a key input for soaps
- Intense competition in the high end hair color segment
- Rural consumption is dependent on monsoon.



## Introduction

Godrej Consumer Products Ltd. (GCPL) is a major player in the Indian FMCG market with leadership in the personal care, hair care and the fabric care categories. It is also India's second largest toilet soaps player by value with leading brands such as *Cinthol*, *Godrej Fairglow* and *Godrej No.1*. The Company has state-of-the-art manufacturing facilities at Malanpur (M.P.), Baddi (Himachal Pradesh), Guwahati (Assam) and Silvassa. It is now setting up a plant in Sikkim for hair colors and another plant in Himachal Pradesh for Soaps.

A major portion of GCPL's sales comes from soap segment, followed by hair color, toiletries and liquid detergents. While the hair color division comprises of around 24% of sales, it enjoys huge margins, robust growth, and contributes more than half of the company's profits. The major brands of the soap segment are *Cinthol*, *Fair Glow* and *Godrej No 1*. In the hair color segment, its products range from powder hair dyes, herbal mehendi to the high end cream hair colors (Godrej *Renew* & Godrej *Colorsoft*). The toiletries division includes products like *Godrej Shaving cream*, *Cinthol Talc*, *Snuggly* (baby diapers), etc. In the liquid detergent segment, its *Ezee* brand is an undisputed leader. The table below shows break-up of sales.

### Annual Revenue Breakup (Net of excise)

Rs Mn	FY04	FY05	FY06E	FY07E	FY08E
Soaps	2984	3541	3902	4542	5450
Hair Color	1148	1335	1704	2131	2652
Toiletries	261	245	314	392	488
Liquid detergents	356	365	405	442	478
Others	147	140	154	180	216
<b>Total Sales</b>	<b>4896</b>	<b>5627</b>	<b>6479</b>	<b>7687</b>	<b>9284</b>
<b>Proportion %</b>					
Soaps	61.0	62.9	60.2	59.1	58.7
Hair Color	23.4	23.7	26.3	27.7	28.6
Toiletries	5.3	4.4	4.8	5.1	5.2
Liquid detergents	7.3	6.5	6.2	5.7	5.1
By-products & others	3.0	2.5	2.4	2.3	2.3
<b>Total Sales</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Growth %</b>					
Soaps	10.1	18.7	21.5	19.5	17.3
Hair Color	-2.2	16.3	30.0	28.0	27.5
Toiletries	-8.1	-6.0	55.4	45.8	27.5
Liquid detergents	3.3	2.6	5.6	5.6	5.1
By-products & others	-21.8	-4.7	10.2	16.4	20.0
<b>Total Sales</b>	<b>4.1</b>	<b>14.9</b>	<b>24.0</b>	<b>22.3</b>	<b>20.1</b>



---

## Key Investment Arguments

### High quality at reasonable prices to fuel growth in the soap segment

GCPL has followed a strategy of introducing high quality soaps at reasonable prices, thereby helping them consistently garner market share in the highly competitive soap segment. Their major brands in the toilet soap segment are *Godrej No 1* in the sub popular category, *Fair Glow* in the niche fairness soap segment, and *Cinthol* in the premium soap segment. Good growth across all these categories has helped it consistently outperform the industry and improve its market share. GCPL's market share in the soap segment stood at 9.5% in Q3FY06, which was a 120 basis points gain on a yoy basis. Its market share increased from 5.8% in FY02 to 9.5% in Q3FY06. It significantly outgrew the industry, which showed lackluster growth. For example, Industry grew only 3% (ORG MARG) in Q3FY06 and GCPL's Soap sales grew 12% in the same period.

Increased urban spending and higher rural purchasing power promise good growth for the FMCG sector over next few years. GCPL's strong positioning in the toilet soap segment makes it a major beneficiary of any uptrend in the sector. GCPL's soap segment has grown by a healthy 20% on a yoy basis during the first half of this fiscal. Going forward too, we expect its soap segment to continue on the growth path, given the positive outlook for the FMCG industry as a whole and GCPL's strategy of gaining market share to fuel growth. We expect GCPL's soap volume and value to grow at an average rate of 17.6% during FY07-FY10.

### Hair colour segment to be a key growth driver going forward

GCPL has a strong presence in the hair colour segment with products ranging from powder hair dyes, liquid hair dye to high end cream hair colour range. The hair colour segment has been attracting increased buying interest lately. Given the increasing awareness and usage of hair dyes and hair colours, we expect this segment to grow rapidly in the next few years. GCPL is the market leader in the hair color segment with a market share of 40.5% in value terms in Q3FY06. The hair care segment constitutes 23% of GCPL's total sales. However, we expect this proportion to increase in the next few years on account of rapid growth in this segment.

The hair color segment has grown by a robust 27% yoy during the first half of this fiscal. It reported 24.2% growth in Q3FY06 on account of the price increase it took early this year. Going forward too, we expect the hair color segment to continue on the growth path and report a healthy growth of around 24% over FY07-FY10. Moreover, given the high margins that this segment enjoys, we expect it to contribute greatly towards GCPL's profits.

### Traditional powder hair dye segment- GCPL's main strength

GCPL is an undisputed leader in the powder hair dye segment, which has been growing at a rapid rate. The powder hair dye segment is seeing increased spending from the rural areas, where GCPL has a dominant presence. Rural spending accounts for around 30% of the total hair color sales. GCPL has witnessed higher sales from rural areas than urban areas in the recent past and expects this trend to continue going forward. The powder hair dye segment accounts for around 70% of GCPL's hair colour sales. Moreover, GCPL had increased the prices of its powder hair dye sachets by Re 1, resulting in better realizations and margins. GCPL has been able to consistently improve sales of this segment owing to a very good distribution network. Their powder hair dye sachet is distributed to more than 2 million retail outlets, making it the biggest distributed hair colour in India. Moreover, the powder hair dye segment does not face the threat of intense competition as is witnessed in the high end cream hair color segment.

Hair colors can be classified as those for cover-ups (to cover up grey hairs) and those for color-ups (to color hair other than black to make a fashion statement). At present, cover-ups account for 90-



---

95% of the hair color market in India. Color-ups, though account for just 5-10% of the market (even lower for GCPL) is growing faster than cover-ups.

Globally hair color category is ten times the soap category in value terms. In India, it's only twice the soap category. We are making a comparison with soap, as soap has 100% penetration in India. This indicates the immense growth potential in hair color category in India. Mind you, we have taken into account the relative purchasing power of India vis-à-vis global purchasing power here, as we are assessing the potential market as a multiple of soap sales in India.

GCPL recently acquired UK based Keyline Brands , an FMCG company with leading brands like *Inecto*, *Erasmic*, *Cuticura* etc. Through this acquisition, GCPL plans to tap the large Diaspora of Indian consumers in the UK and other European & Middle East countries. We feel that the powder hair dye segment may see a further boost in sales from this move over the next 2-3 years.

### **Toiletries segment also on growth path**

GCPL's toiletries segment has also registered good growth during the first half of this fiscal. The toiletries segment has grown by a robust 47% yoy during the first nine months of this fiscal. This growth has mainly been on account of the "1 on 1" (1 pack free with purchase of 1) offer on *Cinthol Talc*. This move has resulted in strong sales of the *Cinthol talc* without adversely affecting the margins as GCPL still enjoys very good margins in the toiletries segment. Even other products like *Godrej Shaving cream* and *Godrej Snuggy* in the toiletries segment have seen a pick up in sales. Given the low base effect for the toiletries segment and the strong surge in demand, we expect this segment to continue reporting strong sales going forward.

### **Income tax likely to be at MAT levels for next few years**

GCPL has set up plants at Assam and Himachal Pradesh, and this helps the company enjoy huge excise and income tax benefits. The Assam plant, which was set up in FY02, enjoys 100% excise duty exemption and 100% income tax exemption (on profits earned from the plant) for a period of 10 years. Similarly, GCPL set up a soap facility in Baddi, HP in FY04, where it enjoys similar benefits. The Baddi plant will be totally exempt from excise duty for 10 years and income tax on profits from the plant for 5 years. For the next 5 years, it shall receive 30% deduction on profits made from the plant. As a result of setting up plants at these locations, GCPL's excise and income tax has seen a steady decrease. Currently, GCPL's income tax is at MAT levels as both the plants in Assam and HP are fully operational. We expect GCPL to remain at MAT levels for the next few years as these plants are quite recent in origin and will enjoy tax benefits for the years to come. Further, in order to enjoy more tax benefits going forward, GCPL plans to set up a hair colour facility at Sikkim and another soap plant in HP. The Sikkim plant is likely to be completed by FY07 and will ensure further tax benefits to GCPL.

### **Keyline Brands acquisition- a strategic move for GCPL**

GCPL recently acquired UK based Keyline Brands Ltd, a fast growing FMCG company with a number of famous brands like *Cuticura*, *Inecto*, *Erasmic*, *Nulon* etc. Keyline Brands is a profit making and debt free company with a good distribution network in the UK. It reported revenues of GBP 16.7mn (Rs.1303mn at current exchange rate) and PBT (profit before tax) of GBP 2.2mn (Rs.172mn at current exchange rate) in CY04. It has a strong customer base in UK through various super market chains, pharmacies and discount chain stores. Some of the major stores where it enjoys good customer base are Boots, ASDA (Wal-Mart subsidiary), Sainsbury, Tesco, Superdrug, Savers etc.

**Potential to tap huge Indian Diaspora in UK & Europe-** This acquisition marks GCPL's plans to become a known name in the international FMCG market. Apart from enhancing GCPL's consolidated topline and bottomline, this acquisition will help GCPL increase its geographical presence. Given the strong presence that Keyline Brands enjoys with major super stores, GCPL can use this platform to



---

market its range of hair color and other personal care products to the large Diaspora of Indian consumers in the UK, other European & Middle East countries.

**Outsourcing potential-** Keyline Brands manufactures few products on its own while the remaining are outsourced from specialist UK contract manufacturers. Through this acquisition, GCPL can use its high quality low cost manufacturing skills to transition the production of some of Keyline's products to India.

**Acquisition at reasonable valuations to help GCPL benefit right from the beginning-** GCPL acquired Keyline Brands at reasonable valuations of 8 times its CY05E earnings. GCPL expects Keyline Brands to contribute 15-17% to GCPL's consolidated topline and around 5-7% to its consolidated profits. GCPL has acquired a profit making company with zero debt and huge cash in its books at reasonable valuations, thereby ensuring good returns on its investment right from the time of its acquisition itself.

GCPL is looking at acquiring more brands in the UK through Keyline Brands Ltd.

## **Risks / Concerns**

### **Wide fluctuations in vegetable oil prices may impact margins**

GCPL depends on import of non-edible vegetable oils, a key raw material for soaps. The vegetable oil prices are subject to wide fluctuations, and this impacts its margins in soaps. While the company feels that it will be able to pass any abnormal hike in raw material prices to the end consumer by raising the prices of soaps, we feel that the same may be subject to market conditions prevailing then. According to the company, since the soap industry already operates on considerably lower margins, the scope for further price cuts, discounts or freebies by competition is limited.

Price of Palm Kernel Oil, which can be used as a ballpark benchmark for ascertaining the price trend of the vegetable oil that GCPL imports, has been softening this fiscal, resulting in better margins for GCPL's soap segment. However, it is difficult to predict future price trend with any degree of confidence, thereby resulting in uncertainty over future prices of vegetable oils. GCPL generally has 3 month forward contracts for procurement of vegetable oils, though this differs occasionally depending on its outlook for vegetable oil prices.

### **Intense competition in the high-end hair colour segment**

The premium cream hair color segment is marked by intense competition and threat of newer players entering the market. A number of players in the premium hair color segment are leading MNCs with deep pockets and a whole range of hair colour products. With a number of these players trying to find a foothold on the promising and fast growing hair color segment, we feel that GCPL faces the threat of losing some market share to competition. GCPL's major brands in the premium cream hair colour segment are Godrej Renew and Colour Soft. A number of players in this segment have been advertising extensively with a view to establishing a dominant presence in this segment. Their major competitor in this segment is L'Oreal (Excellence crème & Garnier Nutrisse). The other players include Wella, Revlon, Schwarzkopf etc. While the other players are currently not that aggressive in advertising, they have the means and the products to offer tough competition going forward. Moreover, since the premium hair colors are specialized offerings, many of these players have used parlours and salons to aggressively market and position their products. GCPL has not adopted this route as their range is not wide enough to make this feasible. While L'Oreal and others have a whole range of hair care products, GCPL is present only in the hair color segment.

Given the increased urban spending and a lot of the younger population looking towards hair colors as a fashion statement, we expect this segment to grow rapidly. However, we feel that intense



competition in this segment may result in GCPL losing some market share in the high end cream hair color segment. However, this is not a major concern as 70% of its hair color sales come from the powder hair dye segment, which is also a fast growing segment where competition is mainly from unorganized players.

### **Ownership and Management**

GCPL is part of the 108-year old Godrej group, a diversified conglomerate. The group owns 68.2% of the company's equity through various entities like Godrej & Boyce Manufacturing Co Ltd, Godrej Industries Ltd, Godrej Investments Pvt.Ltd and a few individuals. Of the remaining 31.8%, a substantial 19.8% is held by various financial institutions, leaving only 12% for non-promoter, non-institutional investors.

GCPL is a favorite among FIIs, who hold almost 17% in the company. Some of the major FIIs invested in GCPL are Aberdeen Asset Management Ltd, First State Asia Pacific Fund, Arisaig India Fund Ltd and First State Asian Equity Plus Fund.

GCPL has been consistently announcing buyback programs since its listing in Jun-01 bringing down its equity capital from Rs.239.3mn to Rs.225.8mn in Sep-05. On July 8, 2005 also, the company had announced a buyback of company shares through open market at a price not exceeding Rs.400 per share for a total amount not exceeding Rs.105mn. However, with GCPL's share price crossing Rs.400 by end of July itself and currently trading at Rs.537, we do not expect any further reduction in equity capital until the company raises the buyback price.

### **Valuation and key underlying assumptions**

We estimate one-year out fair value per share in the range of Rs.895-Rs.1290 (point estimate: Rs.1053) using the discounted cash flow methodology. Key assumptions for the valuation are 4% terminal growth rate. Cost of equity was estimated at 10.2% based on beta of 0.39, risk free rate of 7.1% and market risk premium of 8%. Fair value range is based on extreme assumptions on key variables like raw material costs, realisations and growth in key segments like Soap and hair colors.





## Income Statement

Rs. Mn.	Mar-06E	Mar-07P	Mar-08P
Revenues	6,793	8,160	9,812
EBIT	1,308	1,617	1,896
PBT	1,297	1,591	1,896
Adj. PAT	1,177	1,450	1,712
EPS Rupees	20.83	25.66	30.31

## Ratios

	Mar-06E	Mar-07P	Mar-08P
Revenue Growth %	9.4	20.1	20.2
EPS Growth %	42.2	23.2	18.1
RoE %	108.3	103.6	97.9
D/E x	0.5	0.5	-
Receivables days	5.	5	5.
FG Inventory days	20	19	19
Suppliers Credit days	115	115	115

## Balance Sheets

Rs. Mn.	Mar-06E	Mar-07P	Mar-08P
<b>Assets</b>			
Net Block	1,114	1,614	1,514
Investments	485	485	485
Net Current Assets	(528)	(658)	(764)
<b>Liabilities</b>			
Equity Capital	226	226	226
Reserves	449	666	923
Debt	317	474	-
Non-Current Liab.	80	75	86

## Interim Performance

Rs. Mn.	Dec-05	Dec-04	Ch %
No. of months:	9	9	
Net Revenues	4,939	4,250	16.2
EBITDA	1,006	762	32.0
Depreciation	82	80	2.3
EBIT	924	682	35.4
Interest & Fin charges	29	24	19.2
Other Income	92	15	
PBT	988	674	46.6
Tax	78	66	17.2
PAT	910	681	33.7
Equity Capital	226	226	
EPS -annualized	21.51	16.05	34.0

## Half Yearly Ratios

%	Dec-05	Dec-04	Ch %
No. of months:	9	9	
EBITDA / Sales	20.5	17.7	2.8
EBIT / Sales	18.8	15.8	3.0
Tax/PBT	9.8	7.8	2.0
Material cost /Sales	51.0	46.9	4.1
Staff cost/Sales	6.3	5.4	-0.9
Ad & sales promo /Sales	7.7	9.3	1.6
Other costs/sales	18.6	16.7	-1.9

## Multiple Valuation

	Mar-06E	Mar-07P	Mar-08P
EV/EBITDA x	21.9	18.0	15.1
EV/EBIT x	23.7	19.2	16.3
Mkt. Cap/Sales x	4.4	3.8	3.2
P/E x	26.3	21.3	18.0
Price/Book x	45.8	34.6	26.9

## Free Cash Flow

Rs. Mn.	Mar-06E	Mar-07P	Mar-08P
NOPLAT	1,187	1,473	1,713
Change in Net Working Capital	(141)	(118)	(121)
<b>Operating Cash Flows</b>	<b>1,328</b>	<b>1,591</b>	<b>1,834</b>
Net Capex & others	105	504	(111)
<b>Free Cash Flow</b>	<b>1,222</b>	<b>1,087</b>	<b>1,945</b>
Non-opr. Cash flow	15	31	32
Cash Flow to Investors	<b>1,238</b>	<b>1,118</b>	<b>1,977</b>

## Financing Cash Flow

Rs. Mn	Mar-06E	Mar-07P	Mar-08P
Post-tax Interest	25	54	32
Repayment/ (issue) of Debt	(262)	(157)	474
Equity Share Dividend Buyback/Redn/ (issue) of equity shares	988	1,220	1,444
Increase in cash/Investments	0	-	-
	485	-	26
<b>Financing Cash Flow</b>	<b>1,238</b>	<b>1,118</b>	<b>1,977</b>

## DCF Valuation

	Rs. Mn.	%
<b>Key Assumptions</b>		
Terminal Growth Rate		4.0
WACC		10.2
Cost of Equity		10.2
Terminal ROIC		30.2
Fair Value Range (Rs.)	895-1290	
<b>Per share Value (Rs.)</b>	<b>1053</b>	



## **Important Disclosure**

**This material has been prepared by Impetus Advisors, Mumbai, India ([www.impetusadvisors.com](http://www.impetusadvisors.com)).**

The views expressed herein correctly reflect Impetus Advisors' views. Owners, analysts, and/or employees of Impetus Advisors hold position in the stock of Godrej Consumer Products Ltd.

This document is not for public distribution and has been furnished to you solely for your information and may not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to inform themselves of, and to observe such restrictions.

This material is for the personal information of the authorised recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. No person associated with Impetus Advisors is authorised to call or initiate contact with you for the purposes of elaborating or following up on the information contained in this document. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Neither Impetus Advisors, nor any person connected with it, accepts any liability arising from the use of this document. The recipient of this material should rely on their own investigations and take their own professional advice. Opinions expressed are our current opinions as of the date appearing on this material only. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice.

No part of this material may be duplicated in any form and/or redistributed without Impetus Advisor's prior written consent.

## **About Impetus Advisors**

**Impetus Advisors is an equity research boutique, which specialises in identifying multi-bagger stock ideas among Indian equities. It caters to equity research needs of institutional and high networth individuals & entities.**

**Impetus Advisors is an independent research outfit. It is into neither stock broking nor merchant banking nor any other activity which can potentially conflict with equity research.**

**Please visit [www.impetusadvisors.com](http://www.impetusadvisors.com) for details. Write to [research@impetusadvisors.com](mailto:research@impetusadvisors.com) with your contact numbers to know how you can benefit from our research-backed investment ideas.**