



## Godrej Consumer Products

STOCK INFO.	BLOOMBERG
BSE SENSEX: 15,770	GCPL IN
S&P CNX: 4,681	REUTERS CODE
	GOCP.BO

26 August 2009

Buy

Rs226

Previous Recommendation: Buy

Equity Shares (m)	257.0
52-Week Range	248/94
1,6,12 Rel. Perf. (%)	-2/13/62
M.Cap. (Rs b)	58.1
M.Cap. (US\$ b)	1.2

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/08A	11,026	1,592	7.1	18.6	32.1	33.8	92.8	64.4	4.8	24.5
03/09A	13,930	1,733	6.7	-4.4	33.5	10.2	30.4	27.2	4.1	28.0
03/10E	16,393	2,455	9.6	41.7	23.7	8.9	37.5	36.6	3.5	18.2
03/11E	18,914	2,914	11.3	18.7	19.9	7.6	38.1	37.7	2.9	15.2

We met Mr Dalip Sehgal, Managing Director of Godrej Consumer, to get his perspective on FMCG demand, strategy behind the company's strong performance, and outlook going forward. We present our key takeaways.

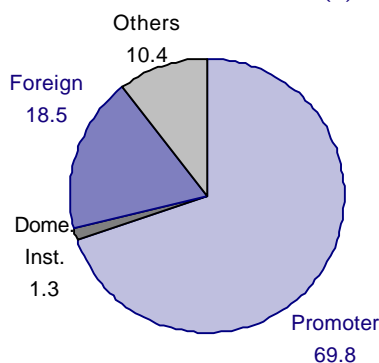
✍ **Rural demand to remain steady; down-trading likely in urban India:** Rural demand would remain steady, as higher crop prices and NREGA would cushion any big dent in incomes. Rising food inflation would have a cascading effect on disposable incomes of the urban poor, which could lead to down-trading. GCPL is well-placed in this scenario, with strong presence in the value for money segment (VFM) through brands like No1 and Expert hair dye.

✍ **No1 emerges market leader in UP; hair color growth momentum to sustain:** GCPL's initiatives like the launch of new variants in toilet soaps and re-launch of hair color portfolio would continue to drive growth. Mr Sehgal indicated that the strategy is to focus on core categories of Toilet Soaps and Hair Color by strengthening flagship brands. Some early signs of success are visible, as *Godrej No1* has become the volume leader in UP; Bihar, MP and Rajasthan are tipped as the next growth areas. GCPL is targetting 20% sales growth in Hair Color in the coming quarters.

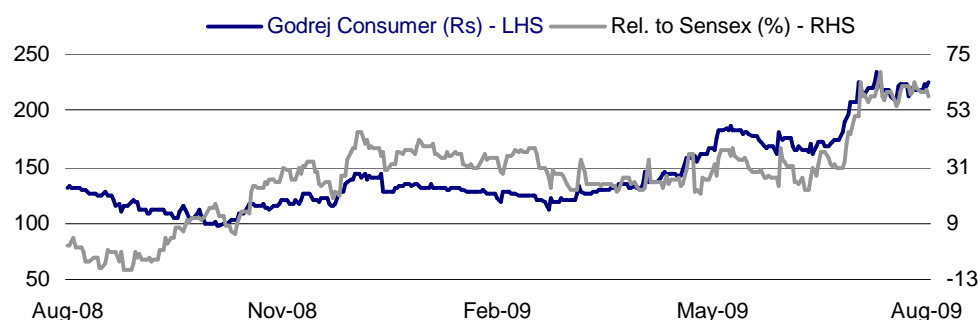
✍ **Palm oil prices locked in till March 2010; pressure on category eases:** GCPL has booked its palm oil requirements till March 2010. (It has increased inventory from September 2009 to March 2010 in recent decline). GCPL plans to invest the gains from lower raw material prices in supporting its core brands. Moreover, HUL has increased prices of *Lux* and has reduced the trade incentive on *Breeze*. This would benefit GCPL further.

✍ **Acquisition of Godrej Sara Lee positive, upgrading estimates by 2-4%; Buy:** GCPL is keen to acquire not only the balance 51% stake in Godrej Sara Lee, but also the Asian business of Sara Lee, which has a topline of US\$500m. As per the JV agreement, the acquisition of the balance stake would be at a significant discount to the Rs8b valuation for the 49% stake. We estimate that stake in Godrej Sara Lee should be EPS accretive from FY11. Acquisition of the balance stake would further add to the EPS. We are revising our EPS estimates for FY10 and FY11 by 2% and 4%, factoring in strong volume growth and margin expansion in the core business. The stock trades at 23.7x FY10E EPS of Rs9.6 and 19.9x FY11E EPS of Rs11.3. We maintain **Buy**.

SHAREHOLDING PATTERN JUN-09 (%)



STOCK PERFORMANCE (1 YEAR)



We met Mr Dalip Sehgal, Managing Director of Godrej Consumer, to get his perspective on FMCG demand, strategy behind the company's strong performance, and outlook going forward. We present our key takeaways.

### **Rural demand to remain steady; down-trading likely in urban India**

Rural demand should remain steady, as lower agri output would be compensated by higher selling prices. Farm incomes would be impacted in states where loss of productivity is high. Government initiatives like NREGA (National Rural Employment Guarantee Act) would significantly cushion the impact on incomes of non-farm labor.

However, lower agri output would lead to higher prices and food inflation. This would have a cascading effect on disposable income and demand from urban poor. GCPL expects downtrading in the urban lower income sections that have fixed incomes. It estimates that this section of population accounts for 8-10% of FMCG sales.

### **Rural and small town distribution to increase by 2x in three years**

GCPL currently has direct access to 1.5m retail outlets. It is expanding its direct distribution from 15,000 villages to 50,000 in three years. In addition, direct coverage of small towns would be increased from 4,000 to 8,000. This assumes importance, as sales in the rural areas and interiors suffer, as retailers usually stock products that provide them higher margins. Direct reach to rural areas and small towns would improve product availability and increase sales. Rural areas currently contribute 38% of GCPL's sales. GCPL is targeting 50% of sales from rural areas in the next three years.

GCPL plans to leverage its distribution by (1) launching products at price points of Rs5 and Rs10, (2) cross-selling products like Nupur Mehandi in rural areas, and (3) targeting barber shops with kits including shaving creams, soap round, talcum powder and hair color. Cross-selling opportunities would accelerate growth rates in non-focus brands by effective consumer activations.

### **Increased focus on core categories; unlikely to enter new product categories**

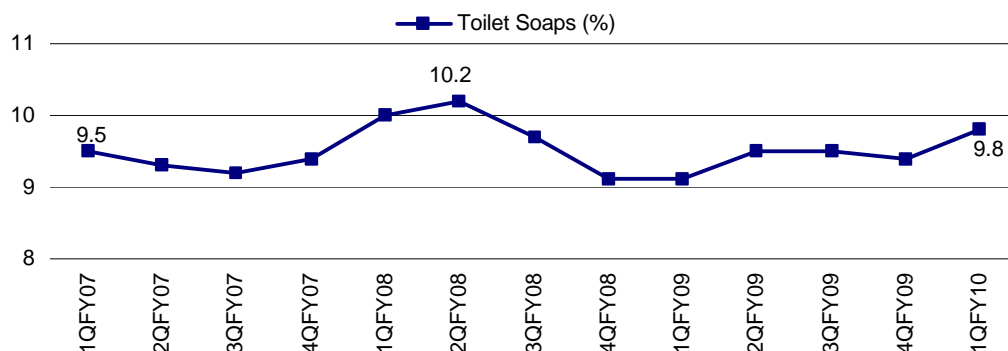
Over the last 1-2 years, GCPL has launched new variants across brands like *Godrej No1*, *Cinthol* and *Fairglow*. Similarly, its hair color portfolio has seen the re-launch of Godrej powder hair dye as *Expert* and *Renew* range of powder hair colors. Mr Sehgal indicated that the strategy going forward will be to focus on core categories of Toilet Soaps and Hair Color by strengthening flagship brands. Increase in sales and profitability would be leveraged for brand building initiatives. GCPL would not be aggressively entering completely new product categories.

### **Toilet soaps: Godrej No1 achieves leadership in UP; pricing pressure eases on No1**

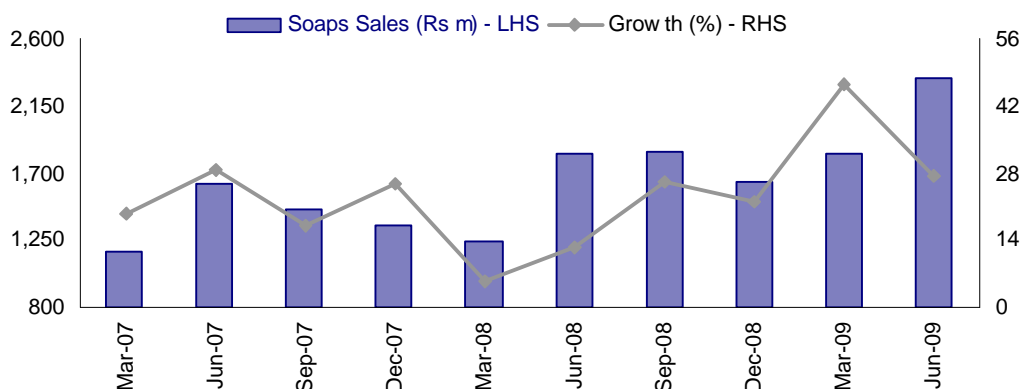
GCPL has reported volume growth of ~18% in FY09 and 15% volume growth in 1QFY10 due to continued success of its value for money brand *No1*. The key growth drivers are: (1) good product quality (76% TFM); (2) stable product prices as compared with competitors, and (3) new initiatives like low-priced unit packs (Rs5 SKU).

*Godrej No1* continues to be the key driver. It accounts for 60% of GCPL's soap volumes and 8-8.5% of total soap market volumes. *Godrej No1* continues to be the leader in North India and has acquired leadership in UP. It is weak in Bihar, East UP and MP. The company plans to improve its position in each of the states by focused strategies. Re-launch of *Cinthol* is gaining good momentum and strategy is to focus on select states to ramp up the volume share (currently 2-2.5% of total soap market).

#### MARKET SHARE INCHING UP



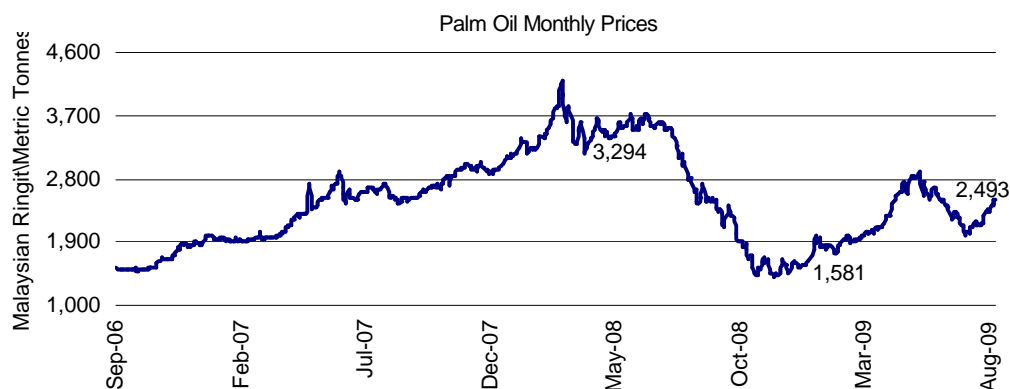
#### REVENUE GROWTH CONTINUES TO BE ROBUST



Source: Company/MOSL

GCPL has booked its palm oil requirements till March 2010. The company had booked inventory till September 2009 at rock bottom prices and has utilized the recent decline in prices to increase its inventory further. GCPL plans to invest the gains from lower raw material prices to support its core brands.

#### PALM OIL PRICES MOVING UP POST DECLINE



Source: Company/MOSL

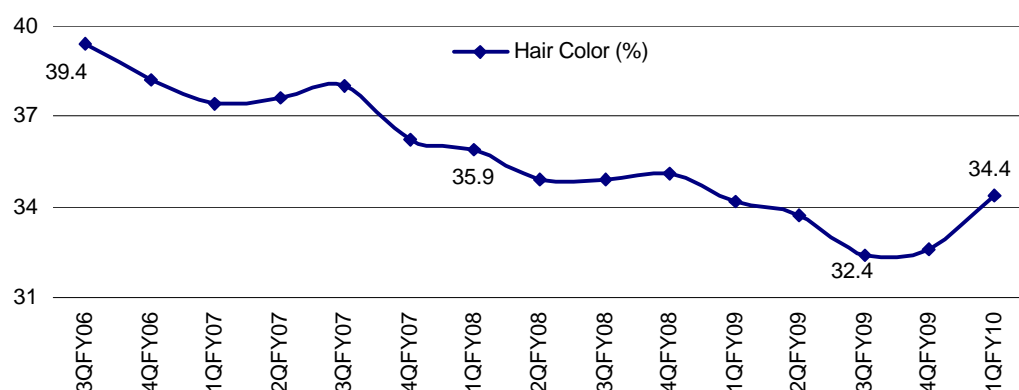
HUL has increased the prices of *Lux* from Rs66 to Rs75 for a 4x115gm pack and is reducing consumer offers (25gm free on Rs100gm). This has negated the need to reduce prices for GCPL, which had not reduced prices of *No1* despite strong price-based competition from HUL. Strong volume growth and low cost raw material would enable GCPL to maintain strong margins in the coming quarters. GCPL had reported 680bp increase in EBITDA margins in 1QFY10.

### Hair color: market share decline arrested; new launches to drive growth

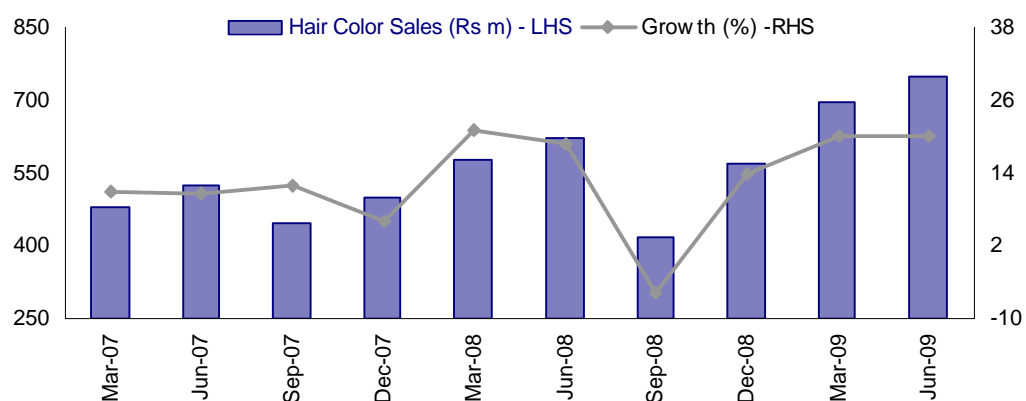
GCPL has been successful in arresting the decline in Hair Color market share by taking several initiatives such as (1) re-launching Godrej powder hair dye as Godrej *Expert*, (2) launching *Renew* powder hair dye in various colors, and (3) increasing retail margins by 6%. This has resulted in Hair Colors posting 20% sales growth in the past two quarters.

GCPL is pushing sales of *Nupur Mehandi* among non hair dye users. This would involve upgradation of consumers from unbranded to branded *Mehandi*; unbranded material accounts for bulk of sales in this segment. In addition, it has plans to increase the share of *Renew* powder hair dye to 20% of its sales from current levels of 6-7%. Overall strategy for Hair Color is to grow across segments like henna, powder hair dye and liquid hair dye. The management is confident of sustaining 20% sales growth in coming quarters.

DECLINE IN HAIR COLOR MARKET SHARE HAS BEEN ARRESTED



NEW LAUNCHES DRIVE REVENUE GROWTH



Source: Company/MOSL

### GCPL keen on full control of Godrej Sara Lee; will add significant value for shareholders

GCPL would acquire 49% stake in Godrej Sara Lee JV post acquisition of stake from Godrej Hygiene Care and Godrej Consumer Biz. The acquisition would be effective from June 2009, once the court formalities are over by the middle of September 2009.

GCPL is keen to acquire not only the balance 51% stake in Godrej Sara Lee but also the Asian business of Sara Lee, which has a topline of US\$500m. GCPL is likely to exercise right of first refusal for Godrej Sara Lee once Sara Lee sells its US\$2b worldwide operation. The acquisition of balance 51% stake would happen at a significant discount to the Rs8b valuation for the 49% stake, as per the JV agreement.

Godrej Sara Lee portfolio can be divided into: (1) Godrej brands (75% of sales) - Hit, Jet and *Good Knight*, and (2) Sara Lee brands (25% of sales) - *Kiwi*, *Brylcream* and *Ambi Pur*. While GCPL will acquire the Sara Lee brands at the pre-agreed price, the global acquirer can either purchase the brands from Godrej Sara Lee at market price or charge royalty for continued sales by Godrej Sara Lee in India.

During 1QFY10, Godrej Sara Lee reported a revenue growth of 15% and PAT growth of 28%. *Good Knight* grew by 23% YoY and Hit posted growth of 36% YoY. The *Ambi Pur* brand grew by 14% YoY.

We estimate that acquisition of stake by GCPL in Godrej Sara Lee should be EPS accretive from FY11. We believe that acquisition of the balance stake will further boost the company's EPS. We have assumed 20% CAGR in PAT over FY09-11. For estimating EPS impact in case of full acquisition, we have assumed that the remaining 51% will be acquired at Rs3.5b-4b (utilizing the current cash in the balance sheet).

#### EQUITY DILUTION OF 20% TO ACQUIRE 49% STAKE IN GODREJ SARA LEE

	GCPL	GHCL	GCBPL
Share Capital	257	23	33.3
Merger Ratio	10	11	11
Issue of Shares by GCPL		20.9	30.3
Total Issue of Shares	51.2		
Equity Post Mergers	308.2		

Source: Company/MOSL

#### FINANCIALS ASSUMING 49% CONSOLIDATION

CONSOLIDATED PROFIT GCPL	FY10E	FY11E
PAT Pre-merger (Rs m)	2,455	2,914
EPS (Rs)	9.6	11.3
Profit of Godrej Sara Lee	1,248	1,435
49% Stake	510	703
Consolidated Profit	2,880	3,618
Equity Shares (m)	308.2	308.2
EPS (Rs)	9.3	11.7
EPS Accretive (%)	-2.2	3.5

Source: Company/MOSL

FINANCIALS ASSUMING GCPL ACQUIRES 100% STAKE IN GODREJ SARA LEE (RS M)

	FY10E	FY11E
PBT Pre-merger	3,081	3,674
Less: Interest Income	314	376
PBT (excl Interest Inc)	2,767	3,299
Tax	562	683
PAT	2,205	2,616
Profit of Godrej Sara Lee	1,040	1,435
Consolidated PAT	3,245	4,051
Equity Shares (m)	308	308
EPS (Rs)	10.5	13.1
EPS Accretive (%)	10.2	15.9

Source: Company/MOSL

### Hair care business on strong wicket in Africa; Cuticura hand sanitizers a saving grace for Keyline

GCPL is confident of strong growth in the African business, which comprises *Rapidol* and *Kinky*. Hair Colors (*Rapidol*) and Hair Extensions (*Kinky*) are among the largest categories of Hair Care among people of African origin. *Rapidol* has leadership in Hair Color while *Kinky* has dominance in Hair Extensions. Hair Straighteners is the only large segment where it is not present as of now.

The African Hair Care business is likely to grow in mid teens. GCPL is integrating *Rapidol* operations with the Indian Hair Color business. This would yield the following benefits: (1) low cost R&D facilities in India, (2) integrated raw material procurement from India at 35-40% lower cost, and (3) launch of Godrej *Renew* powder hair dye in the African market under *Inecto* brand. GCPL plans to use the domain knowledge of African hair in regions having similar textures, which include Latin America, Rest of Africa and the Caribbean region, which would boost growth rates.

Although, Keyline has not able to ramp up significantly, its performance has improved due to increase sales of *Cuticura* hand sanitizers, as swine flu has increased demand for anti-bacterial hand washes. *Cuticura* hand sanitizers have achieved leadership status in the UK market. *Cuticura* accounts for 20% of sales while *Nulon* accounts for 30% of sales. Keyline has decided to focus on fewer brands, which will provide better sales and profit growth in the future.

### Valuation and view

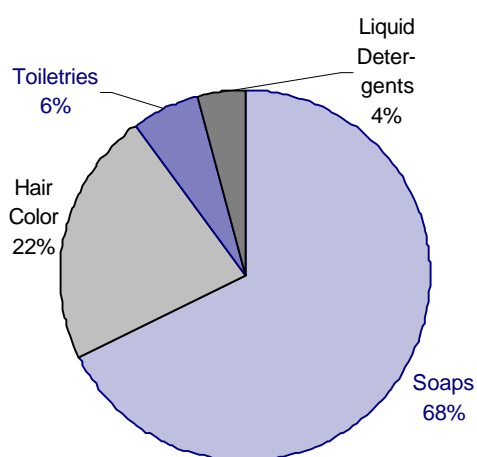
Continued traction in *Godrej No1* and *Revival* in Hair Color sales is encouraging. GCPL will gain from any down-trading in the lower income urban households due to strong presence in the value for money segment (*Godrej No1*). Low-priced palm oil inventory and reduction in discounts by HUL will further ease pressure on GCPL. Acquisition of balance 51% stake in Godrej Sara Lee will boost profitability, further. We are revising our FY10 and FY11 EPS estimates to Rs9.6 (Rs9.4 earlier) and Rs11.3 (Rs10.9 earlier). These estimates do not include the benefits of 49% stake acquisition in Godrej Sara Lee. We estimate 30.2% PAT CAGR over FY09-11. The stock trades at 23.7x FY10E EPS of Rs9.6 and 19.9x FY11E EPS of Rs11.3. We maintain **Buy**.

## REVISED ESTIMATES - EXCLUDING GODREJ SARA LEE (RS M)

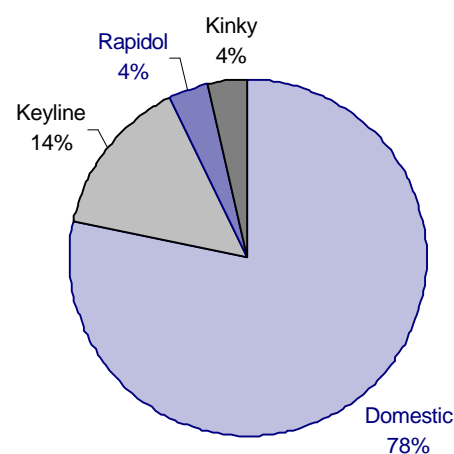
	FY10E		FY11E	
	OLD	NEW	OLD	NEW
Net Sales	16,344	16,393	18,748	18,914
Change (%)		0.3		0.9
EBITDA	3,035	3,110	3,557	3,639
Change (%)		2.5		2.3
PAT	2,414	2,455	2,820	2,914
Change (%)		1.7		3.4
EPS (Rs)	9.4	9.6	10.9	11.3
Change (%)		1.7		4.1

Source: Company/MOSL

## SALES MIX: DOMESTIC BUSINESS



## SALES MIX: CONSOLIDATED



Source: Company/MOSL

## SUBSIDIARIES MARGIN MIX (RS M)

	FY08	FY09	FY10E
<b>Keyline</b>			
Sales	1,680	2,001	2,319
EBITDA	181	222	268
PAT	93	141	174
<b>Rapidol</b>			
Sales	471	488	562
EBITDA	79	95	129
PAT	53	63	87
<b>Kinky</b>			
Sales		512	640
EBITDA		95	116
PAT		-17	13
<b>Total Subsidiaries</b>			
Sales	2,151	3,001	3,521
EBITDA	260	411	513
PAT	146	187	275
Contribution to EPS (Rs)	0.6	0.7	1.1

Source: Company/MOSL



**INCOME STATEMENT - CONSOLIDATED** (RS MILLION)

Y/E MARCH	2007	2008	2009	2010E	2011E
<b>Net Sales</b>	<b>9,515</b>	<b>11,026</b>	<b>13,930</b>	<b>16,393</b>	<b>18,914</b>
Change (%)	36.0	15.9	26.3	17.7	15.4
Cost of Goods Sold	4,622	5,180	7,695	8,096	9,426
<b>Gross Profit</b>	<b>4,893</b>	<b>5,846</b>	<b>6,234</b>	<b>8,297</b>	<b>9,488</b>
Margin (%)	51.4	53.0	44.8	50.6	50.2
Other Expenditure	3,097	3,701	4,197	5,187	5,849
<b>EBITDA</b>	<b>1,797</b>	<b>2,145</b>	<b>2,037</b>	<b>3,110</b>	<b>3,639</b>
Change (%)	27.2	19.4	-5.0	52.7	17.0
Margin (%)	18.9	19.5	14.6	19.0	19.2
Depreciation	142	182	192	215	218
Int. and Fin. Charges	96	129	-172	-78	-140
Other Income-rec.	27	40	75	108	114
<b>PBT</b>	<b>1,586</b>	<b>1,875</b>	<b>2,092</b>	<b>3,081</b>	<b>3,674</b>
Change (%)	21.4	18.2	11.6	47.3	19.2
Margin (%)	16.7	17.0	15.0	18.8	19.4
Tax	230	273	332	599	725
Deferred Tax	-13	-9	-34	-27	-35
Tax Rate (%)	13.7	15.1	17.5	20.3	20.7
<b>PAT</b>	<b>1,342</b>	<b>1,592</b>	<b>1,726</b>	<b>2,455</b>	<b>2,914</b>
Change (%)	12.5	18.6	8.4	42.3	18.7
Margin (%)	14.1	14.4	12.4	15.0	15.4
Non-rec. (Exp.)/Income	99	0	6	0	0
<b>Reported PAT</b>	<b>1,441</b>	<b>1,592</b>	<b>1,732</b>	<b>2,455</b>	<b>2,914</b>

**BALANCE SHEET** (RS MILLION)

Y/E MARCH	2007	2008	2009	2010E	2011E
Share Capital	226	226	257	257	257
Reserves	994	1,490	5,412	6,289	7,399
<b>Networth</b>	<b>1,220</b>	<b>1,716</b>	<b>5,668</b>	<b>6,546</b>	<b>7,656</b>
Loans	1,736	1,871	2,776	2,775	2,775
Deferred Liability	79	89	42	69	104
<b>Capital Employed</b>	<b>3,035</b>	<b>3,676</b>	<b>8,486</b>	<b>9,390</b>	<b>10,535</b>
Gross Block	2,699	2,937	3,370	3,858	4,154
Less: Accum. Depn.	-1,105	-1,253	-1,098	-1,312	-1,531
<b>Net Fixed Assets</b>	<b>1,594</b>	<b>1,683</b>	<b>2,272</b>	<b>2,546</b>	<b>2,623</b>
Capital WIP	398	716	25	150	150
Goodwill	886	956	2,086	2,086	2,086
Investments	1	1	3,291	3,690	4,655
<b>Currents Assets</b>	<b>2,774</b>	<b>3,519</b>	<b>4,111</b>	<b>4,679</b>	<b>5,274</b>
Inventory	1,352	1,916	1,675	2,049	2,225
Account Receivables	483	510	602	719	829
Cash and Bank Balance	474	426	567	581	756
Loans and Advances	464	668	1,268	1,330	1,463
<b>Curr. Liab. &amp; Prov.</b>	<b>2,617</b>	<b>3,227</b>	<b>3,299</b>	<b>3,760</b>	<b>4,252</b>
Account Payables	1,094	1,491	1,145	1,219	1,419
Other Liabilities	1,460	1,464	1,834	2,057	2,273
Provisions	63	271	320	484	560
<b>Net Current Assets</b>	<b>157</b>	<b>292</b>	<b>812</b>	<b>918</b>	<b>1,022</b>
Miscellaneous		29			
<b>Net Assets</b>	<b>3,035</b>	<b>3,676</b>	<b>8,486</b>	<b>9,390</b>	<b>10,535</b>

E: MOSL Estimates

**RATIOS**

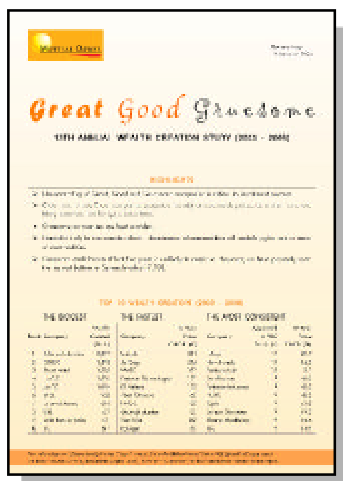
Y/E MARCH	2007	2008	2009	2010E	2011E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>5.9</b>	<b>7.1</b>	<b>6.7</b>	<b>9.6</b>	<b>11.3</b>
Cash EPS	5.3	6.2	6.0	8.7	10.5
BV/Share	4.7	6.7	22.1	25.5	29.8
DPS	3.8	4.1	4.0	5.3	6.0
Payout (%)	63.1	58.2	59.7	54.9	52.9
<b>Valuation (x)</b>					
P/E	38.0	32.1	33.6	23.7	19.9
Cash P/E	42.5	36.2	37.9	25.9	21.5
EV/Sales	5.5	4.8	4.1	3.5	2.9
EV/EBITDA	29.1	24.5	28.0	18.2	15.2
P/BV	47.6	33.8	10.2	8.9	7.6
Dividend Yield	1.7	1.8	1.8	2.3	2.7
<b>Return Ratios (%)</b>					
RoE	110.0	92.8	30.4	37.5	38.1
RoCE	64.8	64.4	27.2	36.6	37.7
<b>Working Capital Ratios</b>					
Debtor (Days)	19	17	16	16	16
Asset Turnover (x)	4.8	4.6	6.1	6.1	6.8
<b>Leverage Ratio</b>					
Debt/Equity (x)	142.3	109.1	49.0	42.4	36.2

**CASH FLOW STATEMENT**

Y/E March	2007	2008	2009	2010E	2011E
OP/(Loss) before Tax	1,797	2,145	2,037	3,110	3,639
Int./Div. Received	27	40	75	108	114
Interest Paid	-96	-129	172	78	140
Direct Taxes Paid	-230	-273	-332	-599	-725
(Inc)/Dec in WC	117	183	380	92	-72
<b>CF from Operations</b>	<b>1,615</b>	<b>1,967</b>	<b>2,332</b>	<b>2,789</b>	<b>3,096</b>
Extraordinary Items	99	0	6	0	0
(Inc)/Dec in FA	-1,256	-555	258	-614	-296
(Pur.)/Sale of Investments	9	0	-3,291	-399	-965
Goodwill	-34	-70	-1,130	0	0
<b>CF from Investments</b>	<b>-1,182</b>	<b>-626</b>	<b>-4,156</b>	<b>-1,013</b>	<b>-1,261</b>
Issue of Shares	0	0	3,601	0	0
Inc in Debt	1,049	135	905	-1	0
Dividend Paid	-974	-1,085	-1,206	-1,578	-1,804
Other Item	-298	-439	-1,336	-184	144
<b>CF from Fin. Activity</b>	<b>-223</b>	<b>-1,389</b>	<b>1,965</b>	<b>-1,763</b>	<b>-1,660</b>
<b>Inc/Dec of Cash</b>	<b>210</b>	<b>-48</b>	<b>141</b>	<b>14</b>	<b>175</b>
Add: Beginning Balance	263	474	426	567	581
<b>Closing Balance</b>	<b>473</b>	<b>426</b>	<b>567</b>	<b>581</b>	<b>757</b>



**N O T E S**





**MOTILAL OSWAL**

**“Best Overall  
Country Research  
- Local Brokerage”**



For more copies or other information, contact  
**Institutional:** Navin Agarwal. **Retail:** Manish Shah  
 Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report 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 such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

- |   |    |
|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

**Godrej Consumer Products**

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.