Emkay Research

Marico Ltd

Update

Change rating to 'HOLD'

30th April 2008

HOLD

Price	Target Price
Rs66	Rs69

Sensex – 17,378

We continue to like Marico with its (1) Strong core business (Hair Oil and Edible Oil) (2) Intention to play on broader beauty and health platform (Hair Oils, Skin Care and Functional Foods) and (3) Willingness to take risks by hopping to inorganic route. But, we believe that Marico also has challenging period going ahead- in light of multiple tasks under its sleeves. This includes (1) managing acquisitions, especially in new geographies and new product categories (2) maintaining the growth in established brands and (3) maintaining growth in Kaya and transforming into self funding and profitable business model. Also, the above targets should be viewed with rising risk profile- leveraged balance sheet. We believe that, key challenge ahead for Marico lies to (1) manage growth expectation in individual business and (2) return ratios on every incremental capital deployed.

Thus, considering above we believe that- FY2009E is likely to turn into a year of consolidation. We maintain our earnings estimates for FY2009E at Rs3.0 / Share and net profit of Rs1.8 bn, growth of 16.9% yoy. We are introducing our FY2010E earnings estimates with earnings of Rs3.5 and net profit of Rs2.1 bn, growth of 14.0% yoy. Marico is trading at PER of 22.0X FY2009E earnings and 19.3X FY2010E earnings. We believe that, valuations are not demanding but path ahead is challenging. Thus, in absence of near term trigger we are changing our rating from 'BUY' to 'HOLD' and maintain our target price of Rs69. We will wait for positive developments to change our rating.

Q4FY2008 revenue growth at 17.8% yoy, triggered largely by volume growth

In Q4FY2008, Marico's revenue growth was 17.8% yoy to Rs4.7 bn, in line with our estimates. The growth was largely volume driven with miniscule contribution from better pricing. The standalone performance contributed largely by domestic FMCG business reported 10.6% yoy growth to Rs3.7 bn, largely volume led. Unlike previous quarters, contribution from inorganic growth was lower due to absence of base effect. All the key brands except 'Parachute' registered strong volume growth- Saffola +21% and Hair Oils +16%. 'Parachute' witnessed sluggish volume growth at +4.4% yoy, all thanks to inflationary trends in coconut oil market. The international FMCG business continued its growth momentum, registering 36.8% yoy growth to Rs0.8 bn.

EBIDTA registered slower growth at 8.2% yoy to Rs0.45 bn – slightly below estimates

Q4FY2008 witnessed launch of new products like 'Parachute Advanced Starz, 'Night Repair Crème' and 'Parachute Maha Thanda'. Thus, new product launches along side aggressive brand promotions and marketing on existing brands resulted in higher advertising expenditure. The advertising spends grew 19.0% yoy to Rs0.7 bn. Currently, Kaya is in investment mode and added nine clinics in the ongoing quarter. This triggered a 114.5% yoy jump in employee expenses to Rs0.36 bn. Addition of new clinics has resulted in upfront booking of expenses and future realization of revenues, owing to long gestation in business. Due to above reasons, EBIDTA reported sluggish growth at 8.2% yoy to Rs0.45 bn, slightly below estimates. EBIDTA margins dropped by 86 bps to 9.7%, lowest in last nine quarters.

YE-Mar	Gross Sales	EBITDA (Core)	EBITDA (%)	APAT	AEPS (Rs)	EV/ EBITDA	P/BV	Div Yld (%)	RoE (%)	P/E
FY2006	11462	1354	11.8	891	1.5	30.0	15.0	0.9	23.7	43.6
FY2007	15569	2121	13.6	1129	1.9	20.2	21.2	1.0	27.5	36.1
FY2008P	19067	2500	13.1	1691	2.8	17.3	12.9	1.1	35.7	24.1
FY2009E	22219	2926	13.2	1853	3.0	14.6	9.0	1.1	33.2	22.0
FY2010E	25253	3309	13.1	2113	3.5	12.7	6.6	1.3	31.6	19.3

Price Performance

(%)	1M	3M	6M	12M
Absolute	0	3	4	23
Rel. to Sensex	(6)	7	19	(2)

Source: Bloomberg

Stock Details

Sector	FMCG
Reuters	MRCO.BO
Bloomberg	MRCO@IN
Equity Capital (Rs mn)	609
Face Value (Rs)	1
52 Week H/L (Rs)	83/47
Market Cap (Rs bn)	40.8
Daily Avg Vol (No of shares)	314668
Daily Avg Turnover (US$ mn)	0.5

Shareholding Pattern (%)
(31st June.'06)

Promoters	63.5
FII/NRI	17.7
Institutions	9.4
Private Corp.	2.0
Public	7.5

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Net profit growth at 0.2% yoy to Rs0.30 bn- due to higher other income in same quarter last year

The net profit growth at 0.2% yoy to Rs0.30 bn is slightly below estimates. Dismal growth during Q4FY2008 is attributed to 57.5% drop in other income to Rs37 Mn. Adjusting for above the net profit actually witnessed stronger growth at 20.1% yoy. In continuity to previous quarters, depreciation and amortization expenses dropped by 31.1% yoy to Rs79 Mn. The interest expenses grew by 55% yoy to Rs72 Mn, thanks to acquisition in the previous quarter.

Kaya Skincare to remain under investment phase- dependent on Marico's cash flows

Kaya Skincare continues to remain under investment mode. The business maintained its growth momentum and grew by 36% yoy to Rs0.30 bn. During Q4FY2008, Kaya Skin added nine clinics taking the total tally to 65 clinics. This includes 3 clinics of the new business format 'Kaya Life'. Marico now has 65 clinics- 56 in India and 9 abroad. Kaya Skin has earned revenues of Rs1.0 bn in FY2008, meeting our estimates. Kaya earned Rs50 Mn at EBIDT level, turning EBIDT positive. However, Kaya Skin could not achieve our FY2008 net profit estimates. Marico has chalked an aggressive expansion plan to take this business model to higher level- will add 15 new clinics every year and also leverage 'Kaya' brand to new model' Kaya Life'. Looking at its plans, Kaya Skin will continue to depend on Marico cash flows to support growth. We believe that, Kaya Skin has not achieved critical mass and scale to fund incremental growth. Thus, Kaya Skin is expected to remain under investment mode with continued dependence on Marico's cashflow.

Streak of acquisitions in Bangladesh, India, Egypt and South Africa- time to consolidate

In Q3FY2008, Marico acquired Enaleni Pharmaceuticals Consumer Division Pty Ltd and signaled its entry in South African ethnic hair care and health care market. Company spent around Rs0.5 bn on the acquisition to gain presence in 20% growth South African market. Not to forget, above acquisition is after making two acquisitions each in Egypt, Bangladesh and India during FY2005-08 period. Company acquired (1) Only competitor in India i.e. Nihar (2) 'Fiancee' and 'Hair Code' in Egypt and (3) Soap brands 'Manjal' and 'Camelia' in Bangladesh. Marico has utilized its cash flows and stretched its balance sheet and spent approximately Rs4.5 bn on acquisitions. Considering its own capital employed at Rs2.8 bn in FY2005, we view this as aggressive and bold initiative. Infact, company has committed 1.5X it own capital employed on acquired business. We believe that, FY2009E is likely to be year of consolidation for the acquired business. This may warrant incremental cash infusion or aggressive marketing and advertising spends to purchase growth. In either case, it may prove detrimental to our earnings estimates. We expect considerable management time to get diverted to acquired businesses, Kaya Skin business and new products under Marico FMCG stable.

Marico is not lean on balance sheet, stakes are high

Marico is not lean on balance sheet anymore, fact well known. The balance sheet structure has undergone radical change in FY2005-08 period, thanks to the aggressive approach adopted in same time period. Marico concluded eight acquisitions and spent around Rs4.5 bn. Company used a mix internal cash flows and external borrowing. In the process, Marico has leveraged its balance sheet with debt liabilities of Rs3.0 bn and debt equity of 1:1.5. This is in sharp contrast to zero debt in FY2004 and net cash positive balance sheet. Company has taken recourse to leveraged money and altered its balance sheet. We believe that, risk level has increased tremendously in last 2-3 years. We believe that, debt-equity ratio of 1:1.5 is not aggressive and debt servicing is possible through Marico's cashflow, but the risk levels have changed dramatically.

Managing return ratios- will be key challenge

We believe that, Marico has undergone significant re-rating in the past due to (1) aggressive approach (2) strong product franchisee and (3) growth oriented strategy of 'Beauty & Wellness'. This also has been our core argument for 'Buy' rating. We believe that, above arguments will hold true in the longer term as well. But, continuity of strong financial performance is likely to take center stage in the mid term. We believe that, key challenge for the company is to maintain the return ratios at 30-33% band and manage growth profitable expectations. This will warrant churning of 30-33% return ratios on all new acquisitions like 'Fiancee', 'Hair Code' and 'Enaleni'. This is far more challenging considering diverse geographies and varied products. Not to forget, 'Kaya Skin' a large bet is currently under investment phase- great challenge ahead.

We are changing the rating from 'BUY' to 'HOLD"

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Quarterly Results

In Rs Mn	Q4FY2008	Q4FY2007	% yoy	Q4FY2008	% qoq
Gross Sales	4675.3	3969.6	17.8	506.24	-7.6
Expenditure	4219.6	3548.6	18.9	441.99	-4.5
Material Cost	2375.1	2065.0	15.0	267.37	-11.2
% of Sales	50.8	52.0	-	52.81	-
Employee Expenses	363.4	169.4	114.5	30.72	18.3
% of Sales	7.8	4.3	-	6.07	-
Selling & Marketing Expenses	711.8	598.4	19.0	62.77	13.4
% of Sales	15.2	15.1	-	12.40	-
Other Expenses	769.3	715.8	7.5	81.13	-5.2
% of Sales	16.4	18.0	-	16.03	-
Operating Profit	455.7	421.0	8.2	64.25	-29.1
EBIDTA (%)	9.7	10.6	-	12.69	9.7
Other Income	37.0	87.0	-57.5	0.00	-
Interest	72.6	46.8	55.1	6.83	6.3
Depreciation	79.3	115.1	-31.1	6.43	23.3
PBT	340.8	346.1	-1.5	50.99	-33.2
Tax	39.0	44.9	-13.1	8.32	-53.1
PAT	301.7	301.2	0.2	42.63	-29.2
PAT (%)	6.4	7.6	-	8.42	-
EPS	0.5	0.5	0.2	0.70	-29.2

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