Company Focus

24 October 2007 | 7 pages

Marico (MRCO.BO)

Buy: 2QFY08 – All Businesses Firing, Investing for Future Growth

- **Solid 2Q profit growth** — Marico's strong run continued in 2QFY08, with net profits (pre exceptionals) increasing 97.3%, aided by a significantly lower tax rate in 2Q. Sales grew a strong 22.7%, though EBITDA margins declined 81bps to 14.1% due to raw material cost pressures. EBITDA profit grew 16% yoy.
- **All businesses firing** — All businesses continue to demonstrate strong growth – hair oil volumes increased 15% in 2QFY08, edible oils (Saffola) registered 21% growth while coconut oil (Parachute) volumes grew 8%. International business also continues to expand rapidly, registering 73% sales growth aided by acquisitions made in Egypt.
- **Cost pressures, but manageable** — 2Q EBITDA margins declined by 81bps due to higher raw material costs, mainly due to edible oil costs, which are up 30% YTD 2007. Price increases of edible oil brands by 10%-15% are not commensurate with costs, given Marico's volume focus. Copra prices have stabilized, but Marico has taken a pre-emptive 3% hike in coconut oil brands.
- **Thinking ahead** — Management seems to be thinking ahead and investing for future growth by venturing into segments that would become significant over the next few years. It has established a strong presence in the post hair-wash conditioner segment, keeping with the changing consumer profile. Also, after breaking even its skin care service business (Kaya Clinincs), Marico has ventured in weight management services through 'Kaya Life' clinics.

Buy/Low Risk	1L
Price (24 Oct 07)	Rs61.70
Target price	Rs74.00
Expected share price return	19.9%
Expected dividend yield	2.0%
Expected total return	**21.9%**
Market Cap	Rs37,575M US$949M

Price Performance (RIC: MRCO.BO, BB: MRCO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	869	1.50	27.6	41.2	13.7	36.3	1.1
2007A	1,129	1.85	23.8	33.3	19.5	49.7	1.2
2008E	1,502	2.47	33.0	25.0	14.1	65.4	2.0
2009E	1,810	2.97	20.5	20.8	10.5	58.1	2.4
2010E	2,153	3.54	19.0	17.4	8.1	52.5	2.9

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	41.2	33.3	25.0	20.8	17.4
EV/EBITDA adjusted (x)	26.9	18.7	14.9	12.4	10.4
P/BV (x)	13.7	19.5	14.1	10.5	8.1
Dividend yield (%)	1.1	1.2	2.0	2.4	2.9
Per Share Data (Rs)					
EPS adjusted	1.50	1.85	2.47	2.97	3.54
EPS reported	1.50	1.85	2.47	2.97	3.54
BVPS	4.51	3.16	4.38	5.86	7.61
DPS	0.67	0.73	1.24	1.50	1.78
Profit & Loss (RsM)					
Net sales	11,439	15,569	17,608	19,756	21,970
Operating expenses	-10,444	-13,964	-15,574	-17,335	-19,117
EBIT	**995**	**1,605**	**2,034**	**2,421**	**2,854**
Net interest expense	-51	-206	-144	-141	-137
Non-operating/exceptionals	35	102	60	70	80
Pre-tax profit	**980**	**1,501**	**1,950**	**2,350**	**2,797**
Tax	-111	-372	-449	-541	-643
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**869**	**1,129**	**1,502**	**1,810**	**2,153**
Adjusted earnings	869	1,129	1,502	1,810	2,153
Adjusted EBITDA	1,443	2,127	2,590	2,963	3,392
Growth Rates (%)					
Sales	13.6	36.1	13.1	12.2	11.2
EBIT adjusted	35.6	61.3	26.7	19.0	17.9
EBITDA adjusted	63.4	47.4	21.7	14.4	14.5
EPS adjusted	27.6	23.8	33.0	20.5	19.0
Cash Flow (RsM)					
Operating cash flow	**1,599**	**1,564**	**1,779**	**2,283**	**2,572**
Depreciation/amortization	448	522	556	542	538
Net working capital	282	-87	-278	-69	-119
Investing cash flow	**-2,861**	**1,823**	**-2,259**	**-1,318**	**-1,435**
Capital expenditure	-2,801	0	-81	-300	-200
Acquisitions/disposals	-61	185	-2,179	-1,018	-1,235
Financing cash flow	**1,316**	**-1,707**	**-1,207**	**-962**	**-1,135**
Borrowings	1,739	113	-450	-50	-50
Dividends paid	-407	-436	-45	-45	-45
Change in cash	**54**	**1,680**	**-1,687**	**2**	**2**
Balance Sheet (RsM)					
Total assets	**6,799**	**7,258**	**7,208**	**8,351**	**9,674**
Cash & cash equivalent	415	427	400	400	400
Accounts receivable	515	643	724	812	903
Net fixed assets	3,813	1,654	1,181	940	603
Total liabilities	**4,184**	**5,334**	**4,540**	**4,785**	**5,040**
Accounts payable	1,498	2,677	2,316	2,598	2,889
Total Debt	2,397	2,510	2,060	2,010	1,960
Shareholders' funds	**2,615**	**1,924**	**2,669**	**3,566**	**4,634**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	12.6	13.7	14.7	15.0	15.4
ROE adjusted	36.3	49.7	65.4	58.1	52.5
ROIC adjusted	24.3	27.9	49.0	84.1	107.6
Net debt to equity	75.8	108.2	62.2	45.1	33.7
Total debt to capital	47.8	56.6	43.6	36.0	29.7

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Marico 2QFY08 Results Tables

Figure 1. Marico: 2QFY08 Consolidated Profit & Loss Statement

Rs Mn	2QFY07	2QFY08	% yoy
Net Sales	**3,779.8**	**4,637.9**	**22.7**
Expenditure	-3,221.4	-3,990.4	23.9
EBITDA	**558.4**	**647.5**	**16.0**
EBITDA Margin (%)	*14.8*	*14.0*	*-81 bps*
Interest	-57.1	-64.9	13.7
Depreciation & Amortisation	-126.9	-64.4	-49.3
Other Income	0.6	5.2	766.7
PBT	**375.0**	**523.4**	**39.6**
Tax	-160.9	-100.9	-37.3
Tax Rate (%)	*42.9*	*19.3*	*-2363 bps*
PAT	**214.1**	**422.5**	**97.3**
Exceptional items	47.0	-0.1	-100.2
PAT after Exceptionals	**261.1**	**422.4**	**61.8**
No of shares	609.0	609.0	
EPS	**0.4**	**0.7**	

Source: Company Reports

Figure 2. Marico: 2QFY08 Cost Details

Rs Mn	2QFY07	2QFY08	% yoy
Total Raw Material Cost	**1,871.8**	**2,393.0**	**27.8**
% of Sales	*50.2*	*51.6*	*138 bps*
Employee/Staff Cost	**257.2**	**255.8**	**-0.5**
% of Sales	*6.9*	*5.5*	*-138 bps*
Advertising Cost	**481.8**	**603.4**	**25.2**
% of Sales	*12.9*	*13.0*	*9 bps*
Other Expenditure	**610.6**	**738.2**	**20.9**
% of Sales	*16.4*	*15.9*	*-46 bps*

Source: Company Reports

Marico

Company description

Marico is a leading consumer-goods company in India with offerings in the hair- care, skin-care, and health and wellness segments. It is a market leader in the coconut-oil category, and dominates most of the other categories in which it operates. Marico acquired 2 soap brands in the Bangladesh market, Camelia and Aromatic, in 2006 — marking its entry into the global FMCG market. Marico has strengthened its product portfolio through acquisitions in the domestic market. Marico exports to Bangladesh, Bhutan, and the Middle East. In 2006, Marico entered the Rs50bn Indian soap market with the acquisition of Manjal, an herbal bath soap. Marico was originally part of Bombay Oil Industries, which was into coconut extraction, vegetable oil refining and chemicals.

Investment strategy

We rate Marico as Buy/Low Risk (1L). Marico, by virtue of being a leading consumer-goods company in India, looks well positioned to benefit from strong consumption growth. The company dominates the hair-oil segment, and has a strong presence in the branded edible-oil (safflower oil) segment. Marico also has skin-care clinics (under the Kaya brand), a business that is fast expanding. It has entered Bangladesh, the Middle East and Egypt. The company has a two-pronged growth strategy: (1) drive the top line by expanding into new segments and geographies, both organically and through acquisitions; and (2) focus on high-margin brands and continue to improve margins through a better product mix. The company has targeted to increase revenues to Rs20bn from Rs14.5bn by FY10. Marico's current valuations look attractive against peers.

Valuation

Marico's earnings growth has been steady, therefore we believe P/E is best suited to value the company. Our target price is Rs74, based on 25x FY09E EPS. Our P/E target is based on an 8-10% discount to sector leader HLL. Marico offers the strongest earnings growth (a 3-year CAGR of 25%) in the consumer peer group, based on our estimates, and therefore we believe it can trade at a premium to its peer group. However, our target multiple is on a par with the peer group target multiples. Over the past few years, Marico has re-rated, from a 40% P/E discount to the Sensex to an average 20% premium. Its re-rating has been driven by a pickup in growth and margins, with the recent run-up fuelled by better prospects for the gross margin followingthe decline in the price of copra — a key raw material. Marico is trading close to its historical 5-year average but much below Citigroup's India Consumer Universe average P/E premium to the Sensex of 35%.

Risks

We rate Marico as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility, and because the company operates in a steady business environment. Risks that could impede the stock from reaching our target include: (1) Increases in the price of copra, the key raw material; (2) Marico has aggressively acquired companies and brands. Slower-than-expected growth in the key markets would lead to slower growth in the consolidated entity; (3) Considering that a sizeable sum of the consolidated entity's revenues would be from international markets, earnings would be at risk in an unfavorable forex market; and (4) Marico recently entered categories such as baby wash, soaps, and health foods, which may be a drag on profitability until critical mass is reached.

Appendix A-1

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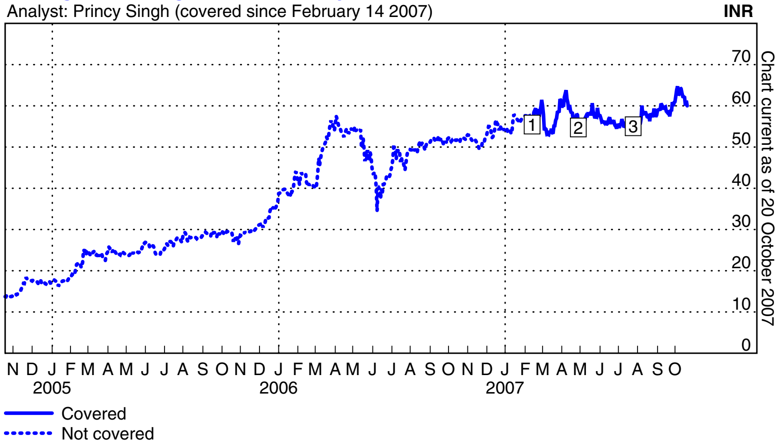
Marico (MRCO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since February 14 2007)



#	Date	Rating	Target Price	Closing Price
1:	13 Feb 07	1L	67.00	55.45
2:	27 Apr 07	1L	67.00	55.65
3:	25 Jul 07	1L	*74.00	55.05

*Indicates change.

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