

## Marico

STOCK INFO. BLOOMBERG  
BSE SENSEX: 9,686 MRCO IN  
REUTERS CODE  
S&P CNX: 2,940 MRCO.BO

25 January 2006

**Buy**
**Rs403**
*Previous Recommendation: Buy*

		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
Equity Shares (m)	58.0	03/05A	10,128	689	11.9	20.4	33.9	10.8	31.7	28.1	2.3	26.5
52-Week Range	420/171	03/06E	11,398	1,007	17.4	46.3	23.2	8.4	36.1	41.4	2.0	16.0
1,6,12 Rel. Perf. (%)	9/16/72	03/07E	13,036	1,251	21.6	24.2	18.7	6.5	35.1	42.2	1.7	12.3
M.Cap. (Rs b)	23.4											
M.Cap. (US\$ b)	0.5											

- Results were ahead of our expectations with robust international revenues and strong margin expansion due to lower raw material prices driving topline.
- Sales for 3QFY06 grew 17% YoY ahead of our estimates, as international business grew strongly. Healthy volume growth for the company's flagship brand, Parachute at 15%, boosted domestic growth. International business revenue growth was back on track with the company tying up new distributor alliances in the UAE.
- EBITDA margins expanded 690bp to 15.6% on a YoY basis as lower raw material costs (*copra*) reduced total material costs. Management also said that certain advertising costs were deferred to 4QFY06, resulting in expansion in margins.
- The company expects volume growth on focused brands to remain strong while raw material prices are expected to remain benign upto June 2007. Management said that Kaya is likely to be in consolidation phase for the next three quarters as they focus on improving their performance particularly in north.
- We are upgrading our FY06E EPS by 20.9% and FY07E EPS by 17.2% respectively on the back of strong growth in revenues and expansion in margins. We are introducing our FY08 EPS estimates at Rs25.9. The stock is currently valued at 23.2x FY06E EPS, 18.7x FY07E EPS and 15.6x FY08E EPS. The stock continues to be one of the cheapest in the sector. We maintain **Buy**.

**QUARTERLY PERFORMANCE**

(Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
<b>Net Sales</b>	<b>2,439</b>	<b>2,555</b>	<b>2,596</b>	<b>2,538</b>	<b>2,729</b>	<b>2,771</b>	<b>3,038</b>	<b>2,861</b>	<b>10,128</b>	<b>11,398</b>
YoY Change (%)	16.6	14.9	12.0	12.6	11.9	8.5	17.0	12.7	14.8	12.5
Total Exp	2,218	2,345	2,369	2,312	2,433	2,462	2,563	2,518	9,245	9,975
<b>EBITDA</b>	<b>221</b>	<b>210</b>	<b>227</b>	<b>225</b>	<b>296</b>	<b>309</b>	<b>474</b>	<b>343</b>	<b>883</b>	<b>1,422</b>
Margins (%)	9.1	8.2	8.7	8.9	10.8	11.2	15.6	12.0	8.7	12.5
Depreciation	-31	-31	-35	-51	-41	-77	-71	-72	-148	-260
Interest	-4	-6	-5	-18	-8	-6	-13	-9	-33	-36
Other Income	3	4	10	26	18	8	8	12	43	46
<b>PBT</b>	<b>189</b>	<b>177</b>	<b>197</b>	<b>182</b>	<b>265</b>	<b>234</b>	<b>398</b>	<b>274</b>	<b>745</b>	<b>1,172</b>
Tax	-26	-21	-16	21	-34	-32	-39	-59	-42	-164
Rate (%)	13.8	11.7	8.1	-11.6	12.9	13.7	9.8	21.5	5.6	14.0
<b>PAT</b>	<b>163</b>	<b>156</b>	<b>181</b>	<b>203</b>	<b>231</b>	<b>202</b>	<b>359</b>	<b>215</b>	<b>703</b>	<b>843</b>
YoY Change (%)	19.0	18.7	26.4	26.4	41.4	29.6	98.7	5.9	22.9	19.9
Minority Interest	6	7	-4	0	0	0	0	0	8	0
Exceptional Items	0	0	0	0	-24	0	-140	0		-164
<b>Reported PAT</b>	<b>169</b>	<b>163</b>	<b>176</b>	<b>203</b>	<b>207</b>	<b>202</b>	<b>219</b>	<b>215</b>	<b>711</b>	<b>843</b>

E: MOST Estimates

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## Revenue growth buoyed by strong global revenues

Marico's 3QFY06 revenue growth was higher than our expectations as international revenues grew 62% YoY. The company's 1HFY06 international revenues were impacted by change in distributors in UAE and Kuwait. The company has now tied up new distributor alliances in 3QFY06, which resulted in strong growth. Management however specified that there was a certain spillover effect to 3QFY06 and that international revenues are expected to grow in the range of 20%-25% going forward.

The company's focused brands grew 23% YoY and now contribute 77% to total turnover compared with 73% in 3QFY05. Domestic FMCG growth was led by strong growth in the company's flagship brand, Parachute Coconut Oil where volumes grew 15% YoY. Overall the Hair Care segment grew 12% in volumes. Saffola, the company's flagship brand in the Refined Oil segment grew 6.5% in volumes.

## Kaya to enter consolidation phase

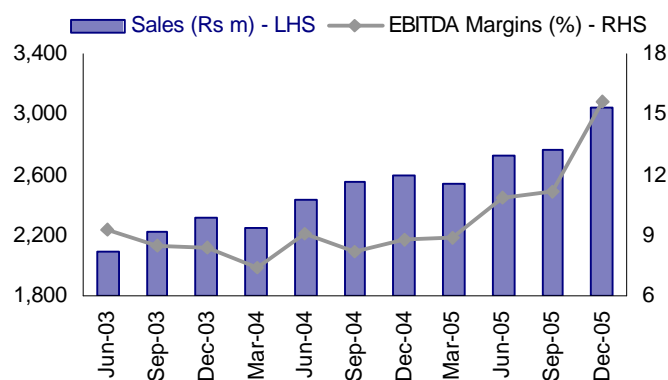
Marico increased the number of Kaya clinics to 42 at the end of 3QFY6 from 39 at end-2QFY06 and also expanded its network to 16 cities. Management said it is now looking at consolidating performance of the existing Kaya clinics and fewer clinics were likely to be opened in the next three quarters. Management focus will be to improve performance in the north where the clinics have not achieved their targets. Kaya earned revenue of Rs330m (Rs210m in 1HFY06) and incurred a loss of Rs60m at EBIT levels for the 9MFY06. Changes in the depreciation policy for Kaya assets adopted by the company in 2QFY06 have delayed breakeven for the clinics at EBIT levels — expected in early FY07. Kaya products contributed 10% to overall Kaya revenues. The management expects product revenues to increase going forward.

## Low raw material prices results in strong margin expansion

Marico's operating margins expanded 690bp YoY to 15.6% in 3QFY06, driven largely by lower raw material prices.

Further, management said that some of the budgeted advertising spends for 3QFY06 have got delayed and are likely to be incurred in 4QFY06 resulting in higher margins for the quarter. Management has given guidance for benign raw material prices until 1QFY07, which should enable them to record strong operating performance.

### STRONG MARGIN EXPANSION



Source: Company/Motilal Oswal Securities

## Effective tax rates to go up

Marico has enjoyed low income tax rates (close to Minimum Alternate Tax) due to benefits enjoyed under section 80IB. However, these benefits are likely to be exhausted over the next few years for some of their plants. We believe that this will result in increase in effective tax rates for the company even as the company would try to minimize the impact.

## Revising estimates

We are upgrading our FY06E EPS by 20.9% and FY07E EPS by 17.2% respectively on the back of strong growth in revenues and expansion in margins. We are extremely impressed with the margin expansion, especially with higher volumes. We believe that the business momentum is likely to continue with further margin expansion likely when Kaya breaks even in early FY07.

## REVISED FORECAST

	FY06E			FY07E		
	OLD	NEW	VAR (%)	OLD	NEW	VAR (%)
Revenues	11,239	11,398	1.4	12,881	13,036	1.2
Growth (%)	11.0	12.5		14.6	14.4	
EBITDA Margin	10.7	12.5		12.2	13.8	
Net Profit	833	1,007	20.9	1,068	1,251	17.2
Growth (%)	21.0	46.3		28.2	24.2	
EPS (Rs)	14.4	17.4	20.9	18.4	21.6	17.2
Growth (%)	21.0	46.3		28.2	24.2	

Source: Motilal Oswal Securities

**Valuation and view**

Marico has shown strong growth in all its businesses with growth in international revenues back on track. We are particularly encouraged by the margin expansion the company has reported in the current quarter. We are introducing our FY08 EPS estimates at Rs25.9. The stock is currently valued at 23.2x FY06E EPS, 18.7x FY07E EPS and 15.6x FY08E EPS. The stock continues to be one of the cheapest in the sector. We are raising our target price to Rs460 from Rs376 based on 18x FY08E earnings.

## Marico Industries: an investment profile

### Company description

Marico has emerged as a dominant player in the Hair care and edible oil segment. Marico is possibly the largest Indian marketer of FMCG products overseas with total export sales of approximately Rs1b in FY05. Kaya, the company's new business are in their growth and investment phase and hold immense promise.

### Key investment arguments

- ☞ The company has significantly increased its pace of innovation in its bid to reduce dependence on a few brands. New products will contribute 20% of sales in FY05 compared to just 12% in FY02.
- ☞ Kaya is a high margin business with a tested model now. Its break even at EBITDA in FY06 and at net level in FY07 will boost profits significantly.

### Key investment risks

- ☞ The company's margins are lower than peers with higher material costs. Thus, profits are susceptible to material price fluctuations.

### Recent developments

- ☞ Marico acquired a soap brand- Aromatic in Bangladesh with a turnover of Rs210m.
- ☞ Acquired a toilet soap brand 'Manjal' with an annual turnover of Rs90m.

### Valuation and view

- ☞ We have an EPS forecast of Rs17.4, Rs21.6 and Rs25.9 for FY06, FY07 and FY08 respectively.
- ☞ The stock is trading at 15.6x FY08E EPS and 9.8x FY08E EV/EBITDA. We maintain **Buy**.

### Sector view

- ☞ We are neutral on the sector. There are signs of volume pickup, but input cost pressure remains
- ☞ Companies with low competitive pressures (like ITC) will be better off.
- ☞ Longer term prospects bright, given rising incomes and low penetration.

#### COMPARATIVE VALUATIONS

		MARICO	GCPL	DABUR
P/E (x)	FY06E	23.2	27.6	29.1
	FY07E	18.7	23.2	23.2
P/BV (x)	FY06E	8.4	58.9	6.3
	FY07E	6.5	48.7	4.6
EV/Sales (x)	FY06E	2.0	4.9	1.7
	FY07E	1.7	4.3	1.4
EV/EBITDA (x)	FY06E	16.0	24.5	11.2
	FY07E	12.3	20.9	9.0

#### SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	66.6	66.6	66.4
Domestic Institutions	10.9	10.7	13.4
FIs/FDIs	14.2	14.2	10.2
Others	8.3	8.5	10.0

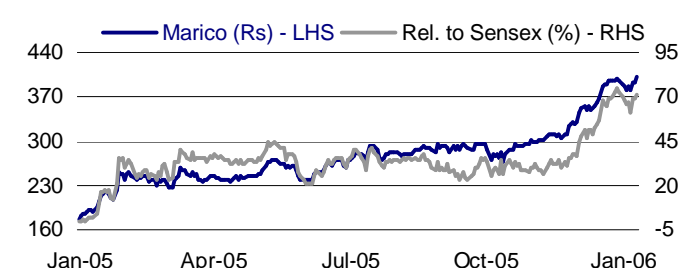
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	17.4	15.0	16.0
FY07	21.6	17.3	24.6

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
403	460	14.1	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
<b>Net Sales</b>	<b>8,824</b>	<b>10,128</b>	<b>11,398</b>	<b>13,036</b>	<b>14,959</b>
Change (%)	14.0	14.8	2.5	14.4	14.8
Total Expenditure	-8,144	-9,245	-9,975	-11,242	-12,790
<b>EBITDA</b>	<b>681</b>	<b>883</b>	<b>1,422</b>	<b>1,794</b>	<b>2,169</b>
Change (%)	-8.7	29.8	61.1	26.1	20.9
Margin (%)	7.7	8.7	2.5	13.8	14.5
Depreciation	-128	-148	-260	-280	-312
Int. and Fin. Charges	-26	-33	-36	-26	-26
Other Income - Recurring	106	28	46	44	52
<b>Profit before Taxes</b>	<b>633</b>	<b>730</b>	<b>1,172</b>	<b>1,532</b>	<b>1,882</b>
Change (%)	-0.8	5.3	60.5	30.8	22.8
Margin (%)	7.2	7.2	10.3	11.8	12.6
Tax	-60	-43	-159	-276	-376
Deferred Tax	-2	2	-5	-5	-5
Tax Rate (%)	-9.7	-5.7	-14.0	-18.3	-20.3
<b>Profit after Taxes</b>	<b>572</b>	<b>689</b>	<b>1,007</b>	<b>1,251</b>	<b>1,501</b>
Change (%)	2.0	20.4	46.3	24.2	19.9
Margin (%)	6.5	6.8	8.8	9.6	10.0
Minority Interest	18	8	0	1	1
<b>Reported PAT</b>	<b>590</b>	<b>711</b>	<b>843</b>	<b>1,252</b>	<b>1,502</b>

BALANCE SHEET					
(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Share Capital	290	580	580	580	580
Reserves	1,554	1,589	2,210	2,986	3,933
<b>Net Worth</b>	<b>1,844</b>	<b>2,169</b>	<b>2,790</b>	<b>3,566</b>	<b>4,513</b>
Minority Interest	19	0	19	19	19
Loans	111	544	111	111	111
<b>Capital Employed</b>	<b>1,974</b>	<b>2,714</b>	<b>2,919</b>	<b>3,695</b>	<b>4,642</b>
Gross Block	1,750	2,140	2,440	2,640	3,040
Less: Accum. Depn.	-681	-865	-1,125	-1,405	-1,717
<b>Net Fixed Assets</b>	<b>1,027</b>	<b>1,275</b>	<b>1,273</b>	<b>1,193</b>	<b>1,281</b>
Capital WIP	97	184	184	184	184
Goodwill	0	17	0	0	0
Investments	5	124	315	1,142	1,978
<b>Curr. Assets, L&amp;A</b>	<b>1,905</b>	<b>2,382</b>	<b>2,380</b>	<b>2,506</b>	<b>2,657</b>
Inventory	998	1,197	1,247	1,326	1,422
Account Receivables	345	379	327	373	429
Cash and Bank Balance	340	338	338	338	338
Others	221	468	468	468	468
<b>Curr. Liab. and Prov.</b>	<b>1,003</b>	<b>1,212</b>	<b>1,176</b>	<b>1,273</b>	<b>1,400</b>
Current Liabilities	881	1,061	1,094	1,191	1,318
Provisions	122	151	82	82	82
<b>Net Current Assets</b>	<b>902</b>	<b>1,170</b>	<b>1,204</b>	<b>1,233</b>	<b>1,256</b>
Miscellaneous Expense	5	4	5	5	5
Deferred Tax Liability	-62	-60	-62	-62	-62
<b>Application of Funds</b>	<b>1,973</b>	<b>2,714</b>	<b>2,919</b>	<b>3,695</b>	<b>4,643</b>

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>9.9</b>	<b>11.9</b>	<b>17.4</b>	<b>21.6</b>	<b>25.9</b>
Cash EPS	12.4	14.6	19.0	26.4	31.3
BV/Share	318	37.4	48.1	61.5	77.8
DPS	4.3	5.4	6.0	7.3	8.5
Payout %	43.1	45.1	34.5	33.8	32.9
<b>Valuation (x)</b>					
P/E		33.9	23.2	18.7	15.6
Cash P/E		27.5	21.2	15.2	12.9
EV/Sales		2.3	2.0	1.7	1.4
EV/EBITDA		26.5	16.0	12.3	9.8
P/BV		10.8	8.4	6.5	5.2
Dividend Yield (%)		1.3	1.5	1.8	2.1
<b>Return Ratios (%)</b>					
RoE	31.0	31.7	36.1	35.1	33.3
RoCE	33.4	28.1	41.4	42.2	41.1
<b>Working Capital Ratios</b>					
Debtor (Days)	14	14	10	10	10
Asset Turnover (x)	4.5	3.7	3.9	3.5	3.2

Leverage Ratio					
Debt/Equity (x)	0.1	0.3	0.0	0.0	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
OP/(loss) before Tax	552	735	1,162	1,514	1,857
Int./Div. Received	106	28	46	44	52
Depreciation and Amort.	128	148	260	280	312
Interest Paid	-26	-33	-36	-26	-26
Direct Taxes Paid	-60	-43	-159	-276	-376
(Incr)/Decr in WC	124	-271	-34	-29	-23
<b>CF from Operations</b>	<b>825</b>	<b>564</b>	<b>1,239</b>	<b>1,507</b>	<b>1,794</b>
Extraordinary Items	0	0	0	0	0
(Incr)/Decr in FA	-213	-476	-300	-200	-400
(Pur)/Sale of Investments	134	-119	-191	-827	-836
<b>CF from Invest.</b>	<b>-79</b>	<b>-596</b>	<b>-491</b>	<b>-1,027</b>	<b>-1,236</b>
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	-299	434	-434	0	0
Dividend Paid	-280	-356	-392	-476	-555
Others	-80	-48	78	-4	-4
<b>CF from Fin. Activity</b>	<b>-659</b>	<b>30</b>	<b>-747</b>	<b>-480</b>	<b>-559</b>
<b>Incr/Decr of Cash</b>	<b>87</b>	<b>-2</b>	<b>0</b>	<b>0</b>	<b>0</b>
Add: Opening Balance	253	340	338	338	338
<b>Closing Balance</b>	<b>341</b>	<b>338</b>	<b>338</b>	<b>338</b>	<b>338</b>



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	<b>Marico</b>
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

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