

27 October 2010

MF Global Quarterly Report

Marico Industries

| Valuations peaking

FMCG

MRCO IN: Downgrade to NEUTRAL

RS 133

Results below expectations, but strong volume growth: Revenues grew by 12.5% YoY to Rs 7.78bn, which was below our estimates, but volume growth continued to be robust at 15%. On a YoY basis, the key domestic brands continue to show a price degrowth of 2%-3%, leading to lower value growth. Saffola and the International business (IB) sustained the growth momentum with a volume growth of 18% YoY for both. Key markets like South Africa and strong brands in Bangladesh, Egypt and MENA maintained leadership positions. The Hair oil business grew by 14% YoY, the slowdown in growth was on account of higher base in Q2FY10 due to pre-festive sales. There has been a market share gain of 140bps YoY in H1FY11, led by Shanti Badam Amla and Cooling Oil variants. Parachute volume growth was lower at 6% as flexi packs (c. 25%) reported no volume growth.

Margins decline due to costs pressure: The gross margins declined by 270bps YoY on account of the rise in the price of copra (+26% YoY), packaging (+5% YoY) and rice bran (+23% YoY). Safflower prices have declined by 6% YoY.

Price hikes will improve margins in H2FY11: Marico undertook a first round of weighted average price hike of ~5% in Parachute, Saffola and Hair oil brands and is rolling out a second round of ~7% price hike across Parachute's product portfolio. The management expects Copra (c. 40%) prices to soften in H2FY11 and we expect the price hikes to enable the company to maintain gross margins.

Other business highlights: Kaya has shown initial signs of recovery with 9% sequential growth and 28% YoY revenue growth to Rs 624mn, including Derma Rx. Same clinic growth declined by 3% as against a 5% decline in Q1FY11. Marico has introduced Derma Rx products in India and has maintained that the Kaya business could show a positive PBT result in FY11, led by the Middle East and Derma Rx.

Earnings and recommendation: We have downgraded our earnings estimates on account of higher raw material prices. We value the company at 24x FY12E earnings at Rs 140, which presents an upside of 5% from the current levels. Hence, we downgrade our recommendation to Neutral

TARGET RS 140 (+5%)

STOCK RATING

BUY	NEUTRAL	SELL
> 15%	-15% TO +15%	< -15%

COMPANY DATA

O/S SHARES :	614MN
MARKET CAP (RS) :	82BN
MARKET CAP (USD) :	1.84BN
52 - WK HI/LO (RS) :	153 / 94
AVG. DAILY VOL. (3MTH) :	0.7MN
FACE VALUE (RS) :	1

SHARE HOLDING PATTERN, %

PROMOTERS :	63.0
FII / NRI :	24.5
FI / MF :	5.2
NON-PROMOTER CORP. HOLDINGS :	1.1
PUBLIC & OTHERS :	6.2

PRICE PERFORMANCE, %

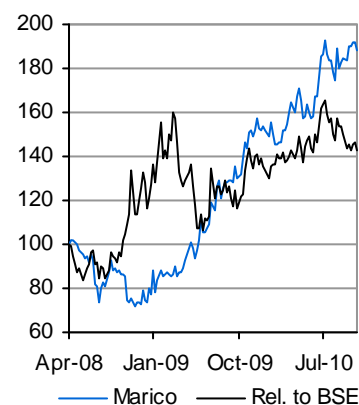
	1MTH	3MTH	1YR
ABS	3.0	6.5	33.7
REL TO BSE	2.1	-5.7	12.9

VALUATION SUMMARY

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
TOTAL INCOME	19,050	23,884	26,608	31,196	36,219
TOTAL INCOME GROWTH, %	22.4	25.4	11.4	17.2	16.1
CORE EBIDTA	2,462	3,040	3,752	4,167	5,111
EBIDTA MARGINS, %	13.6	13.5	15.0	14.1	14.9
NET PROFIT	1,586	2,037	2,433	2,976	3,543
PAT MARGINS, %	8.3	8.5	9.1	9.5	9.8
EPS, RS	2.6	3.3	4.0	4.9	5.8
EPS GROWTH, %	46.1	28.5	19.4	22.3	19.1
PER, X	51.1	39.8	33.3	27.2	22.9
EV/EBIDTA, X	34.1	27.6	22.5	20.0	16.1
EV/NET SALES, X	4.6	3.7	3.4	2.8	2.4
PRICE/BOOK VALUE, X	25.7	17.9	12.2	9.6	7.7
ROIC, %	43.7	41.2	37.4	36.4	39.2
ROE, %	62.5	53.0	43.5	39.3	37.2

Source: Company, MF Global India Research Estimates

PRICE VS. SENSEX



Source: Bloomberg, MF Global India Research

QUARTERLY RESULTS

(RS MN)	Q2FY11	Q1FY11	QOQ, %	Q2FY10	YOY, %
NET SALES	7,788	7,901	-1.4	6,922	12.5
<i>GROWTH, %</i>	<i>12.5</i>	<i>13.4</i>		<i>14.4</i>	
TOTAL INCOME	7,788	7,901	-1.4	6,922	12.5
OPERATING EXPENSES	6,795	6,847	-0.8	5,972	13.8
EBITDA	993	1055	-5.9	950	4.5
<i>GROWTH, %</i>	<i>4.5</i>	<i>9.7</i>		<i>28.5</i>	
<i>MARGIN, %</i>	<i>12.7</i>	<i>13.3</i>		<i>13.7</i>	
DEPRECIATION	140	120	15.9	179	-21.9
EBIT	853	934	-8.7	771	10.6
<i>MARGIN, %</i>	<i>11.0</i>	<i>11.8</i>		<i>11.1</i>	
INTEREST PAID	65	70	-7.7	56	15.2
OTHER NON-OPERATING INCOME	71	44		42	
PRE-TAX PROFIT	860	909	-5.4	757	13.6
TAX PROVIDED	126	162	-21.9	133	-4.8
MF NET PROFIT	733	747	-1.8	624	17.5
REPORTED PAT	733	747	-1.8	624	17.5
<i>GROWTH, %</i>	<i>17.5</i>	<i>33.4</i>		<i>32.4</i>	
<i>MARGIN, %</i>	<i>9.4</i>	<i>9.5</i>		<i>9.0</i>	
ADJ FULLY DILLUTED EPS, RS	1.20	1.23	-1.8	1.02	17.5

Source: Company, MF Global India Research

CHANGE IN ESTIMATES

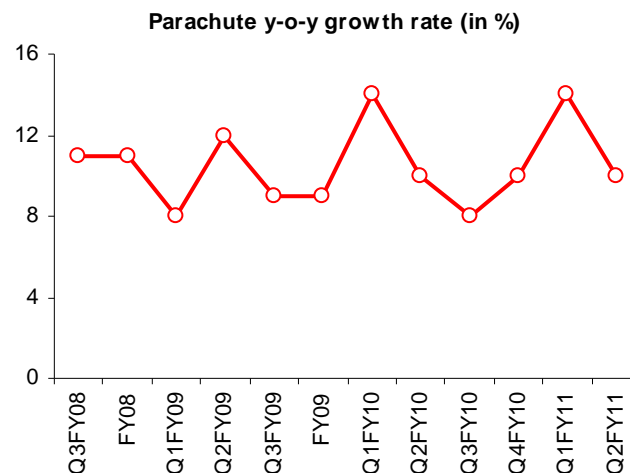
(RS MN)	EARLIER ESTIMATES		REVISED ESTIMATES		UPGRADE/(DOWNGRADE) (%)	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
NET SALES	30,567	35,345	31,196	36,219	2.1%	2.5%
EBITDA	4,332	5,347	4,167	5,111	-3.8%	-4.4%
<i>EBITDA MARGIN (%)</i>	<i>14</i>	<i>15</i>	<i>13</i>	<i>14</i>	<i>(81)</i>	<i>(102)</i>
PBT	3,725	4,648	3,560	4,412	-4.4%	-5.1%
ADJ PAT	3,028	3,720	2,976	3,543	-1.7%	-4.8%
<i>ADJ PAT MARGIN (%)</i>	<i>10</i>	<i>11</i>	<i>10</i>	<i>10</i>	<i>(37)</i>	<i>(74)</i>
ADJ EPS (RS)	5	6.1	4.9	5.8	-2.3%	-4.6%

Source: MF Global India Research Estimates

SEGMENTAL BUSINESS PERFORMANCE AND FUTURE OUTLOOK

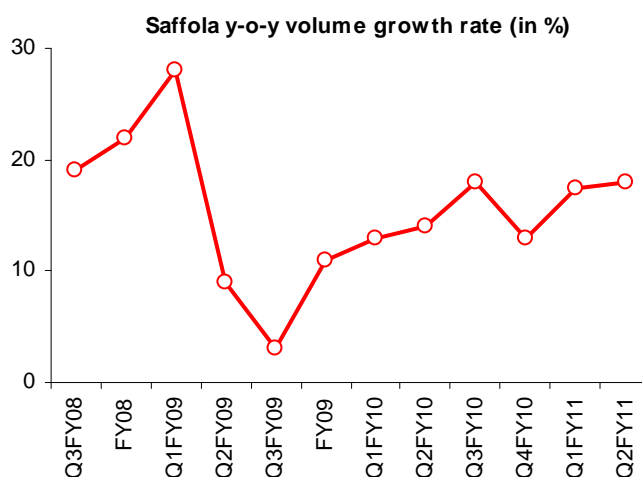
Parachute and Nihar

- » Parachute coconut oil in rigid packs clocked a volume growth of 10% YoY. The brand continues to grow above the average market growth and is supported by key low price SKUs (recruiter packs which had a growth of ~13% YoY) in expanding the category size and growth by way of conversion of loose oil users.
- » Parachute in flexi pouches did not experience any volume growth. This product portfolio has a c. 25% to Parachute brand's overall sales, thereby dragging the volume growth to 6% for the overall portfolio. The contribution of the flexi pack business has seen a decline over the last five years due to lower growth and margins compared to the rigid pack portfolio.
- » Marico's volume market share in the branded coconut hair oil market has declined by 30bps on a QoQ basis as growth was impacted by higher price premium against the loose oil brands.
- » Input costs have proved to be a major cause of concern this quarter. Copra prices grew by ~26% YoY as against the 4% YoY price increase in Q1FY11. The sudden spike in the input costs was on account of temporary shortage in supplies due to adverse weather conditions.
- » To offset the same, Marico undertook a weighted average price hike of 5% only among the large size packs in the end of August 2010, which will be fully reflected in Q3FY11. The management has stated that it will undertake another round of price hikes over the next two weeks, the quantum being 7% across the product portfolio. In totality, the price hikes of 12% have been taken to counter the 15% copra price increase in H1FY11, enabling the company to maintain margins. Currently, the copra prices have softened.
- » With the excise duty charges on 200ml coconut hair oil packs continuing to be sub-judice, Marico has made provisions of Rs 8 2mn.
- » The company continues to leverage its market leadership strength in expanding the market with recruiter packs and better rural distribution penetration. The management expects the copra prices to decline hereon as the supply stabilises and the crop's season begins in February. We expect *Parachute* to clock a growth of 15% YoY, backed by both volume and price.



Saffola

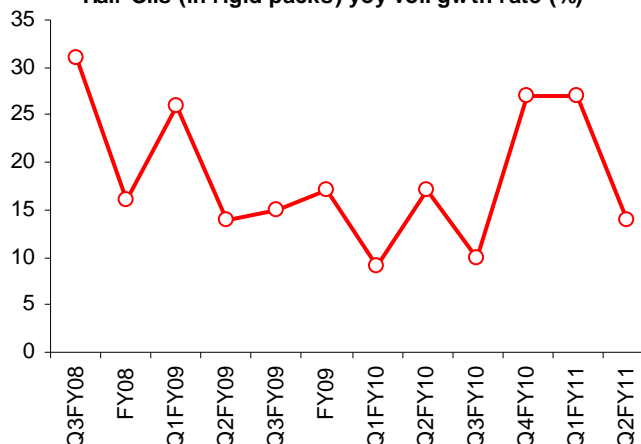
- » *Saffola* refined oils continued on the growth trajectory with a sound volume growth of 18% YoY. Input costs have started to exert pressure while Kardi price continues to decline by 6% YoY, rice bran oil prices have increased by 23% YoY.
- » *Saffola* has maintained its leadership position with a market share of 51% in the super premium refined edible oils market.
- » Marico has taken a weighted average price hike of 4%-5% across the variants over the last four weeks.
- » *Saffola Arise*, which was launched in Q4FY10 under the flagship brand *Saffola*, continues to perform in line with the company's expectations with strong repeat purchases.
- » *Saffola Oats*, launched in Q1FY11 in the Modern trade is being extended to selective General Trade outlets on the back of positive consumer response. Marico expects to end FY11 with revenue of Rs 400mn from *Saffola Arise* and *Saffola Oats*.
- » Though Kardi prices continue to be benign, costs components of the blends, that is, rice bran oil is a risk factor. But, the hike in product prices and sustenance of volumes due to *Saffola* brand's strong market standing will protect margins. We estimate a 20% YoY growth in the *Saffola* business for FY11E.



Hair oils

- » Marico's Hair Oil product portfolio in rigid packs grew by ~14% YoY—this was lower than the 27% YoY growth of Q1FY11, mainly due to the higher base of Q2FY10 that had a revenue component of pre-festive sales.
- » In terms of business strategy, Marico has undertaken a new promotional campaign for Parachute Advanced Hair oil. Parachute Advanced Coconut Cooling oil (market share of 8% in Andhra Pradesh) is to be extended to 2 new states in the South – Tamil Nadu and Karnataka. Marico has also started prototyping Parachute Advanced Ayurvedic Oil in Tamil Nadu. This category has a size of Rs 2350mn with a growth of ~19% YoY.
- » Shanti Badam Amla, post the aggressive price promotional campaign, has extended its market share to 15% as on August 2010. The company expects the brand to maintain the robust growth.
- » Marico has an all-pervasive product portfolio in its value-added Hair Oil business, after the foray into the Cooling hair oil category. We estimate that Marico will be able to leverage on the same. Also, the company is capitalising the brands at several attractive price points. These activities will enable the hair oil business to post a revenue growth of 20% in FY11E.

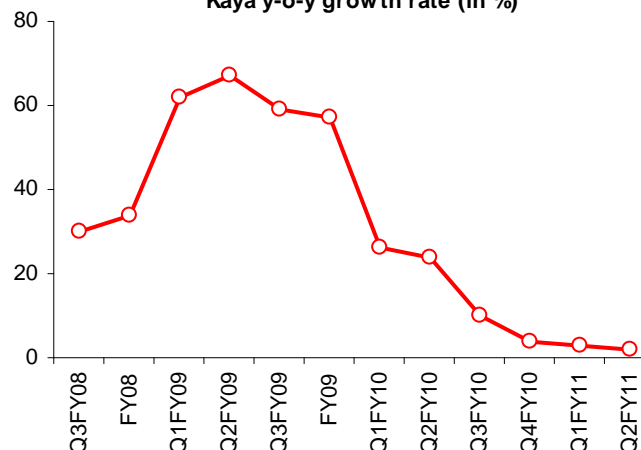
Hair Oils (in rigid packs) yoy vol. gwth rate (%)



Kaya

- » Kaya's business has shown initial signs of recovery. The sequential growth, which was 1% YoY in Q1FY11, has expanded to 9% in Q2FY11 YoY. Similarly, same-clinic growth that had decelerated by 5% YoY in Q1FY11 has declined by 3% this quarter.
- » Excluding Derma Rx, the revenue growth is nominal at 2%, with a loss of Rs 35mn, but inclusive of Derma Rx. results the revenue growth is a strong 28% YoY at Rs 624mn with a marginal positive PBT result of Rs 8.5mn.
- » As earlier stated, Marico is introducing the derma Rx product pipeline under the Kaya brand in the Indian and Middle East markets. The product launch is underway in the domestic Indian business and the Middle East launch will commence from Q4FY11.
- » The company has also maintained that though it will add 4-5 clinics in the Middle East, no clinic will be launched in the Indian markets.
- » Post the restructuring of the Indian business, the results look positive on both the revenue front and decline in losses. We expect the business to gain traction in H2FY11 on account of the festive season. The management has also stated that the Kaya business can expect to end FY11 with a positive PBT result, backed by Derma Rx and the Middle East business. We have increased our revenue estimates for Kaya to 4% YoY for FY11E.

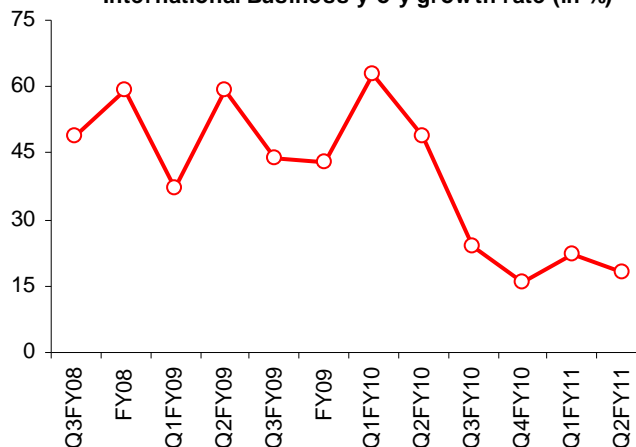
Kaya y-o-y growth rate (in %)



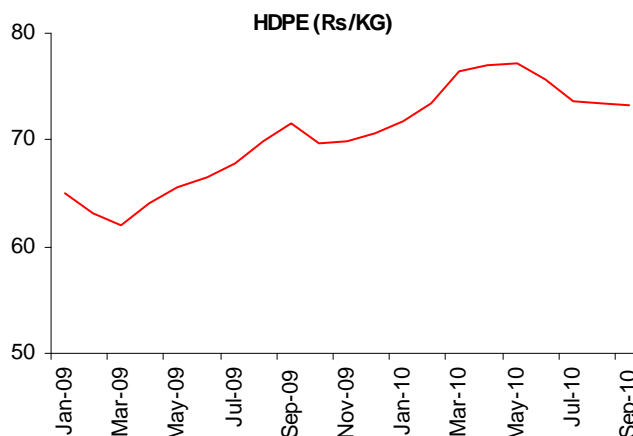
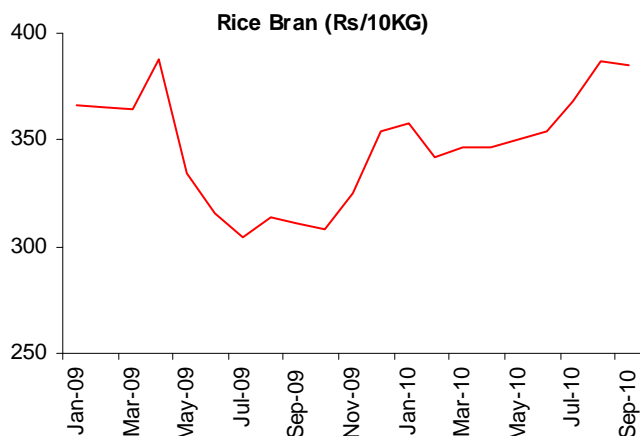
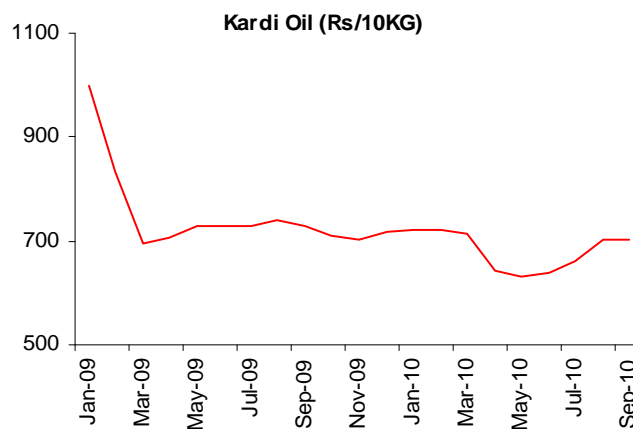
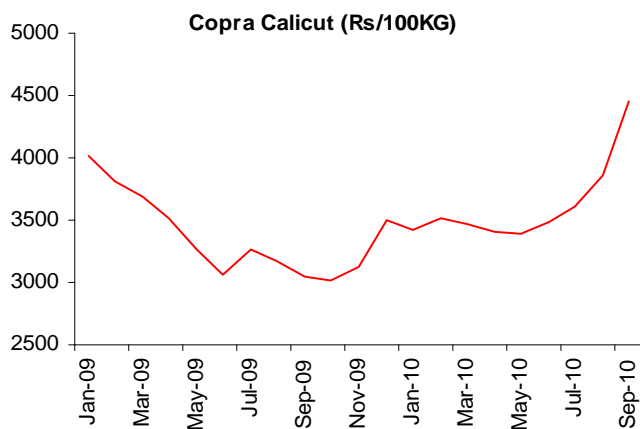
International business division

- » The IBD business maintained the growth momentum with a top-line value growth of 23% YoY o/w 18% was led by volumes and 5% by price growth.
- » In **Bangladesh** markets too, the Parachute brand continues to grow from strength to strength with the market share expanding by 300bps in the recent months to 79%. Hair Code has established itself as a strong No. 2nd player in the hair dye market. The launch of Saffola has been receiving good initial response.
- » In the **Middle East**, both the brands Parachute Cream and Parachute Gold hair oil showed healthy YoY growth. Parachute Therapie, launched in Q1FY11, is performing in line with expectations. Marico is in the process of launching its products under the Hair Code brand.
- » In **Egypt**, *Fiancee* and *Hair Code* hair cream and hair gel brands saw strong growth.
- » The revenue growth of the **South African** markets was ~31% YoY. The 3 major brands—Caivil, Hercules and Black Chic have shown strong business performance.
- » Marico had acquired the OTC healthcare brand **Ingwe** in Q2FY11. The brand has synergistic benefits for the company as it complements the existing healthcare portfolio and provides access to the independent trade channel. The integration process is ongoing.
- » Currently, the EBITDA margin of the IBD business (11%–12%) is lower than the domestic Indian operations. Marico estimates to expand the same as the business gathers a foothold in the various areas of operation and the latest acquisitions (Code 10, Ingwe) provide strong support. We estimate the IBD business to maintain the growth at 25% YoY for FY11E.

International Business y-o-y growth rate (in %)



RAW MATERIAL TRENDS



Source: Company, MF Global India Research

FINANCIALS

INCOME STATEMENT

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
NET SALES	18,134	22,493	25,001	29,586	34,327
<i>GROWTH, %</i>	21.8	24.0	11.2	18.3	16.0
OTHER OPERATING INCOME	916	1,392	1,607	1,610	1,892
TOTAL INCOME	19,050	23,884	26,608	31,196	36,219
OPERATING EXPENSES	-16,588	-20,844	-22,856	-27,029	-31,108
EBITDA	2,462	3,040	3,752	4,167	5,111
<i>GROWTH, %</i>	24.0	23.5	23.4	11.1	22.6
<i>MARGIN, %</i>	13.6	13.5	15.0	14.1	14.9
DEPRECIATION	-308	-358	-601	-533	-625
EBIT	2,155	2,682	3,151	3,635	4,486
<i>GROWTH, %</i>	24.0	23.5	23.4	11.1	22.6
<i>MARGIN, %</i>	13.6	13.5	15.0	14.1	14.9
INTEREST RECEIVED/(PAID)	-305	-357	-257	-257	-257
OTHER INCOME	96	122	183	183	183
PRE-TAX PROFIT	1,945	2,447	3,077	3,560	4,412
TAX PROVIDED	-360	-409	-643	-584	-868
PROFIT AFTER TAX	1,586	2,037	2,433	2,976	3,543
MF NET PROFIT	1,586	2,037	2,433	2,976	3,543
<i>GROWTH, %</i>	50.9	28.5	19.4	22.3	19.1
EXTRAORDINARY ITEMS: GAINS/(LOSSES)	106	-150	-98	0	0
UNADJ. SHARES (M)	609	609	609	609	609
WTD AVG SHARES (M)	609	609	609	609	609

CASH FLOW

Y/E MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
PRE-TAX PROFIT	1,945	2,447	3,077	3,560	4,412
DEPRECIATION	308	358	601	533	625
CHG IN WORKING CAPITAL	-1,052	-743	-1,041	-492	-462
TOTAL TAX PAID	-360	-409	-643	-584	-868
OTHER OPERATING ACTIVITIES	-55	-104	-573	552	0
CASH FLOW FROM OPERATING ACTIVITIES	786	1,548	1,420	3,569	3,706
CAPITAL EXPENDITURE	-1,068	-973	-1,049	-1,265	-1,000
CHG IN INVESTMENTS	0	-121	-706	0	0
CHG IN MARKETABLE SECURITIES	0	0	0	0	0
OTHER INVESTING ACTIVITIES	0	0	0	0	0
CASH FLOW FROM INVESTING ACTIVITIES	-1,068	-1,094	-1,755	-1,265	-1,000
FREE CASH FLOW	-282	454	-336	2,304	2,706
EQUITY RAISED/(REPAID)	1	0	178	-20	0
DEBT RAISED/(REPAID)	1,070	163	716	0	0
DIVIDEND (INCL. TAX)	-467	-467	-470	-1,114	-1,451
OTHER FINANCING ACTIVITIES	0	0	0	0	0
CASH FLOW FROM FINANCING ACTIVITIES	605	-305	549	-1,134	-1,451
NET CHG IN CASH	323	149	213	1,170	1,256

BALANCE SHEET

AS AT 31ST MAR, RS MN	FY2008	FY2009	FY2010	FY2011E	FY2012E
CASH & BANK	753	902	1,115	2,018	3,274
MARKETABLE SECURITIES AT COST	0	0	0	0	0
DEBTORS	863	1,108	1,507	1,775	2,060
INVENTORY	2,605	3,390	4,448	4,974	5,552
LOANS & ADVANCES	1,061	1,299	1,900	2,115	2,331
OTHER CURRENT ASSETS	0	0	0	0	0
TOTAL CURRENT ASSETS	5,281	6,699	8,970	10,883	13,217
INVESTMENTS	0	121	827	827	827
GROSS FIXED ASSETS	3,561	4,569	5,292	6,292	7,292
LESS: DEPRECIATION	1,635	2,035	2,424	2,957	3,582
ADD: CAPITAL WIP	647	577	1,129	1,129	1,129
NET FIXED ASSETS	2,573	3,111	3,997	4,464	4,839
OTHER NON-CURRENT ASSETS	0	0	0	0	0
TOTAL ASSETS	9,678	11,423	15,260	17,640	20,349
CURRENT LIABILITIES	2,560	2,779	3,368	3,886	4,503
PROVISIONS	0	0	0	0	0
TOTAL CURRENT LIABILITIES	2,560	2,779	3,368	3,886	4,503
NON-CURRENT LIABILITIES	3,579	3,743	4,459	4,459	4,459
TOTAL LIABILITIES	6,531	6,887	8,595	9,113	9,729
PAID-UP CAPITAL	609	609	609	609	609
RESERVES & SURPLUS	2,537	3,927	5,930	7,763	9,855
SHAREHOLDERS' EQUITY	3,146	4,536	6,539	8,352	10,444
TOTAL EQUITY & LIABILITIES	9,678	11,423	15,260	17,640	20,349

PER-SHARE DATA

	FY2008	FY2009	FY2010	FY2011E	FY2012E
MF EPS (INR)	2.6	3.3	4.0	4.9	5.8
GROWTH, %	46.1	28.5	19.4	22.3	19.1
BOOK NAV/SHARE (INR)	5.2	7.4	10.9	13.9	17.4
FDEPS (INR)	2.6	3.3	4.0	4.9	5.8
CEPS (INR)	3.1	3.9	5.0	5.8	6.8
CFPS (INR)	1.9	2.5	3.0	4.7	5.8
DPS (INR)	0.7	0.7	0.7	1.6	2.0

FINANCIAL STRUCTURE

	FY2008	FY2009	FY2010	FY2011E	FY2012E
TOTAL DEBT/EQUITY (%)	113.7	82.5	66.9	52.6	42.2
NET DEBT (CASH)/EQUITY (%)	89.8	62.6	50.2	28.8	11.2

PROFITABILITY, PRODUCTIVITY, LIQUIDITY AND VALUATION RATIOS

	FY2008	FY2009	FY2010	FY2011E	FY2012E
RETURN ON ASSETS (%)	21.1	21.5	19.5	19.1	19.5
RETURN ON EQUITY (%)	62.5	53.0	43.5	39.3	37.2
RETURN ON INVESTED CAPITAL (%)	43.7	41.2	37.4	36.4	39.2
ROIC/COST OF CAPITAL (X)	4.0	3.9	3.5	3.4	3.7
ROIC - COST OF CAPITAL (%)	32.7	30.6	26.8	25.8	28.6
RETURN ON CAPITAL EMPLOYED (%)	30.4	28.8	25.3	24.5	25.1
COST OF CAPITAL (%)	11.0	10.6	10.6	10.6	10.6
ROCE - COST OF CAPITAL (%)	19.5	18.2	14.7	14.0	14.6
ASSET TURNOVER (X)	3.9	3.7	3.2	3.1	3.3
SALES/TOTAL ASSETS (X)	2.1	2.1	1.9	1.8	1.8
SALES/NET FA (X)	8.7	7.9	7.0	7.0	7.4
WORKING CAPITAL/SALES (X)	0.1	0.1	0.2	0.2	0.2
FIXED CAPITAL/SALES (X)	1.4	1.2	1.1	0.9	0.8
RECEIVABLE DAYS	17.4	18.0	22.0	21.9	21.9
INVENTORY DAYS	52.4	55.0	64.9	61.4	59.0
PAYABLE DAYS	56.3	48.7	53.8	52.5	52.8
CURRENT RATIO (X)	2.1	2.4	2.7	2.8	2.9
QUICK RATIO (X)	1.0	1.2	1.3	1.5	1.7
INTEREST COVER (X)	7.1	7.5	12.3	14.2	17.5
DIVIDEND COVER (X)	4.0	5.1	6.1	3.1	2.9
PER (X)	51.1	39.8	33.3	27.2	22.9
PEG (X) - Y-O-Y GROWTH	1.1	1.4	1.7	1.2	1.2
PRICE/BOOK (X)	25.7	17.9	12.2	9.6	7.7
YIELD (%)	0.5	0.5	0.5	1.2	1.5
EV/NET SALES (X)	4.6	3.7	3.4	2.8	2.4
EV/EBITDA (X)	34.1	27.6	22.5	20.0	16.1
EV/EBIT (X)	34.1	27.6	22.5	20.0	16.1
EV/NOPLAT (X)	41.8	33.1	28.4	24.0	20.0
EV/CE	11.8	9.7	7.1	6.1	5.2
EV/IC (X)	18.3	13.6	10.6	8.7	7.8

Source: Company, MF Global India Research Estimates

RECOMMENDATION HISTORY

RECOMMENDATION	TARGET, RS	CMP, RS	DATE
NEUTRAL	140	133	27-OCTOBER-2010
BUY	150	126	29-JULY-2010
NEUTRAL	105	98	29-JAN-2010
BUY	105	91	30-SEPTEMBER 2009

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