



Marico

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,724	MRCO IN
	REUTERS CODE
S&P CNX: 3,678	MRCO.BO

19 October 2006

Buy

Previous Recommendation: Buy

Rs511

Equity Shares (m)	58.0
52-Week Range	586/263
1,6,12 Rel. Perf. (%)	-8/-12/20
M.Cap. (Rs b)	29.7
M.Cap. (US\$ b)	0.7

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
03/06A	11,439	1,044	18.0	48.7	28.4	11.3	39.9	20.8	2.8	21.8
03/07E	14,657	1,331	23.0	27.6	22.3	9.4	42.0	37.5	2.1	13.4
03/08E	17,022	1,684	29.0	26.5	17.6	6.9	39.3	44.0	1.8	10.9

- Marico's 2QFY07 results were in line with our expectations. Sales growth at 37% is much higher than our estimates of 21% while PAT growth at 51.3% is in line with our estimates of 49.3%.
- The company achieved organic growth of 26% whilst acquisitions added a further 11% growth. Kaya skin care achieved all-time high sales of Rs170m during the quarter, a YoY growth of 58%. We are particularly impressed with the 13% and 20% growth rates in Parachute and Saffola brands even as various hair oil brands grew at a faster 33% rate.
- Although EBITDA margins expanded 500bp to 16% YoY, we believe the phase of sharp margin expansion which started from 3QFY06 appears to be over. We expect muted margin expansion in the coming quarters.
- Marico plans to raise Rs5b to retire various debts taken for the acquisitions. We expect the company to dilute 10%-15% equity in the coming months. We expect the company to reduce debt and write off trademark payment against share premium. We expect the dilution to be EPS accretive.
- We are upgrading our FY07 and FY08 sales estimates by 7% and 9.5% respectively. We are cutting our FY07 EPS estimate marginally to Rs23 from Rs23.3, and revising FY08 EPS upward to Rs29 from Rs27.8. These estimates do not factor in the benefits of the company's expected equity dilution. The stock trades at 22.3x FY07 and 17.6x FY08 earnings. We maintain **Buy**.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	2,708	2,750	3,038	2,977	3,728	3,780	3,650	3,499	11,439	14,657
YoY Change (%)	11.0	7.6	17.0	18.9	37.7	37.5	20.2	17.6	13.6	28.1
Total Exp	2,412	2,448	2,563	2,613	3,165	3,174	3,050	2,957	9,997	12,346
EBITDA	296	302	474	364	563	605	600	543	1,443	2,311
Margins (%)	10.9	11.0	15.6	12.2	15.1	16.0	16.4	15.5	12.6	15.8
Depreciation	-65	-77	-71	-84	-112	-127	-100	-89	-307	-427
Interest	-8	-6	-13	-23	-48	-57	-50	-51	-64	-206
Other Income	18	8	8	2	11	1	25	21	49	57
PBT	241	227	398	258	414	422	475	424	1,121	1,735
Tax	-33	-24	-39	-7	-111	-116	-90	-87	-77	-403
Rate (%)	13.7	10.6	9.8	2.7	26.8	27.5	18.9	20.4	6.9	23.3
Adjusted PAT	208	203	359	251	303	306	385	338	1,044	1,331
YoY Change (%)	27.4	30.1	98.7	50.2	45.7	50.7	7.2	34.3	51.4	27.5
Minority Interest	0	0	0	0	0	0	0	0	0	0
Exceptional Items	-24	0	-140	-12	0	-45	0	0	-174	0
Reported PAT	184	203	219	240	303	261	385	338	870	1,331

E: MOSI Estimates

Key brands continue to drive growth

Marico's 2QFY07 revenue growth was higher than our expectations as all the major brands of the company performed superiorly. Flagship brand, Parachute (rigid packs) grew 13% YoY, while Saffola grew 20% YoY.

Marico's focused hair care range (Parachute Jasmine, Shanti Badam Amla and Hair and Care) grew 33% YoY in volume terms in 2QFY07. The company consolidated its market share to 76% in perfumed hair oils, 11% in Amla hair oil and 18% in non-sticky hair oils. Silk and Shine and After Shower cream had 30% and 41% market share.

Higher interest and depreciation curtail bottomline growth

Marico's EBITDA grew 100% YoY to Rs605m. Interest burden increased from Rs6m to Rs57m due to loans taken to fund the acquisitions. Depreciation and amortization increased by 66% to Rs127m from Rs77m due to write-offs relating to the Nihar acquisition. Tax rate for the company jumped to 27% from 11% YoY as the coconut oil unit at Pondicherry came out of the tax-free period. All these measures curtailed PAT growth to 50.7% on a YoY basis.

Funds infusion to improve profitability

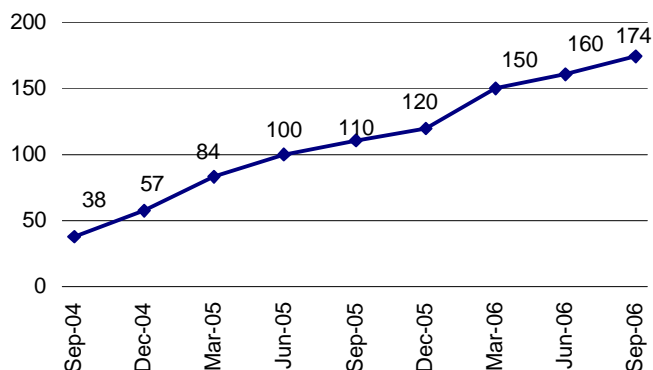
Marico plans to raise up to Rs5b to retire debt taken for various acquisitions as well as write-off the Nihar brand rights against share premium. This will reduce the interest and depreciation burden substantially from current levels. We expect tax rates to sustain in the 22%-24% range over the next few years. Overall, we expect the company to dilute 10%-15% of its equity. We estimate that the equity dilution is expected to be EPS accretive with improved cash flow and higher reported profits.

Kaya to report profits in FY07

Kaya has entered a consolidation phase with the company ending FY06 with 43 clinics in India and three in the UAE. The company plans to consolidate this business with only a few clinic additions in the domestic market. The business continues to ramp up at a fast pace and has achieved

Rs174m sales during the quarter. Marico hopes to end the current year with a positive PBT. We estimate Kaya will be a major profit driver ahead.

KAYA: SEQUENTIAL GROWTH TREND CONTINUES

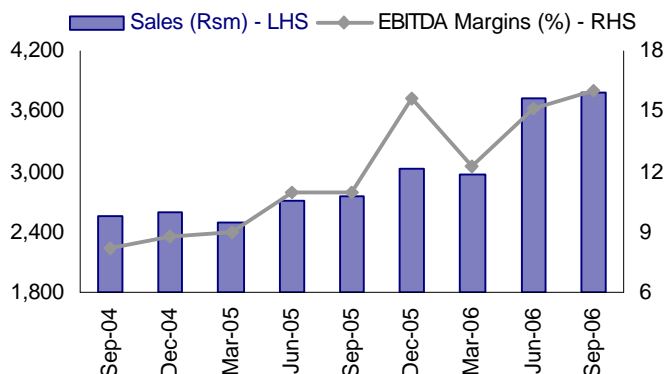


Source: Company/ Motilal Oswal Securities

Margin expansion over, secular growth trend likely

Marico's operating margins expanded 500bp YoY to 12.2% in 2QFY07, driven by lower copra prices, which are down approximately 30% YoY, even as the company increased advertising costs substantially. We believe the major phase in margin expansion is over, with 2QFY07 marking the anniversary of the margin expansion, which started with decline in copra prices. We expect Marico to sustain margins due to strong market share and pricing power in coconut hair oil coupled with strong consumer demand. We expect margin expansion to be muted in the coming quarters, in comparison with the previous four quarters. Our estimates suggest 40bp margin expansion post-FY07.

QUARTERLY PERFORMANCE TREND



Source: Company/ Motilal Oswal Securities

New products continue to gain traction

Marico's new product launches and prototypes continued to gain ground. Silk and Shine and Parachute After Shower cream continued to grow well during the quarter. The company has extended Parachute jasmine soap to other states in eastern India and Maharashtra. In addition, Marico extended the Sparsh range of baby care products - baby oil, soap and cream - countrywide. Marico's prototype testing of Parachute Therapie solution and Saffola Atta mix has been a success. The company plans to take the products national in the coming quarters. We believe that continuous flow of new products and strong pipeline will help the

company move to the next stage of growth even while its existing brands continue to grow in double digits.

Valuation and view

We are upgrading our FY07 and FY08 sales estimates by 7% and 9.5% respectively. We are marginally cutting our FY07 EPS estimate to Rs23 from Rs23.3, and upgrading our FY08 EPS to Rs29 from Rs27.8. These estimates do not factor in the benefits of expected equity dilution by the company. The stock trades at 22.3x FY07 and 17.6x FY08 earnings. We maintain **Buy**.

Marico: an investment profile

Company description

Marico has emerged as a dominant player in the coconut and hair oil segment. It is one of the best companies in product innovation with 30% success rate in launch of prototypes. 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 with 5 prototypes under test marketing.
- ✍ 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

- ✍ Copra price fluctuation are risk to the profitability in the core business of pure coconut oil despite change in the pricing policy and improved pricing power of the company.

Recent developments

- ✍ Acquired hair oil brand 'Nihar' from HLL for a consideration of Rs2.16b.
- ✍ Acquired Fiancee and Egyptian Hair Care company with a top-line of Rs450m

Valuation and view

- ✍ We have an EPS forecast of Rs23, Rs29 and Rs35.9 for FY07, FY08 and FY09 respectively.
- ✍ The stock is trading at 22.3x FY08E EPS and 17.6x FY08E . We maintain **Buy**.

Sector view

- ✍ We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- ✍ Companies with low competitive pressures and brought product portfolios will be able to better with stand any slowdown in a particular segment.
- ✍ Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		MARICO	GCPL	DABUR
P/E (x)	FY07E	22.3	25.8	29.0
	FY08E	17.6	20.5	24.0
P/BV (x)	FY07E	9.4	33.6	14.3
	FY08E	6.9	23.8	11.3
EV/Sales (x)	FY07E	2.1	4.9	3.6
	FY08E	1.8	4.2	3.1
EV/EBITDA (x)	FY07E	13.4	21.1	22.7
	FY08E	10.9	16.8	19.2

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	66.6	66.6	66.6
Domestic Inst	11.5	11.5	10.7
Foreign	15.7	13.7	14.2
Others	6.2	8.2	8.5

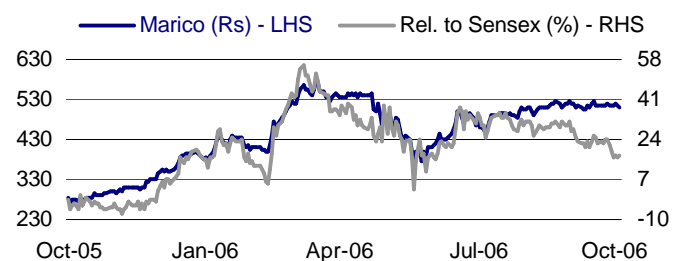
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	23.0	20.6	11.6
FY08	29.0	26.2	10.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
511	580	13.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(RS MILLION)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	10,070	11,439	14,657	17,022	19,287
Change (%)	2.7	13.6	28.1	16.1	13.3
Total Expenditure	-9,188	-9,997	-12,346	-14,267	-16,088
EBITDA	883	1,443	2,311	2,756	3,199
Change (%)	11.3	63.4	60.2	19.3	16.1
Margin (%)	8.8	2.6	15.8	16.2	16.6
Depreciation	-148	-447	-427	-471	-497
Int. and Fin. Charges	-33	-64	-206	-152	-76
Other Income - Recurring	30	49	57	62	83
Profit before Taxes	731	1,155	1,735	2,194	2,709
Change (%)	7.0	34.2	77.0	26.5	23.5
Margin (%)	7.3	10.1	11.8	12.9	14.0
Tax	-43	-79	-334	-422	-522
Deferred Tax	2	-32	-69	-88	-108
Tax Rate (%)	-5.7	-9.6	-23.3	-23.3	-23.3
Profit after Taxes	689	1,044	1,331	1,684	2,079
Change (%)	10.8	26.2	53.2	26.5	23.5
Margin (%)	6.8	9.1	9.1	9.9	10.8
Minority Interest	8	0	0	0	0
Reported PAT	697	870	1,331	1,684	2,079

BALANCE SHEET					
(RS MILLION)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	580	580	580	580	580
Reserves	1,589	2,035	2,590	3,700	5,088
Net Worth	2,169	2,615	3,170	4,280	5,668
Minority Interest	0	0	0	0	0
Loans	657	2,398	2,005	1,057	100
Capital Employed	2,826	5,013	5,175	5,337	5,768
Gross Block	2,140	4,761	4,961	5,161	5,361
Less: Accum. Deprn.	-865	-1,289	-1,717	-2,188	-2,684
Net Fixed Assets	1,275	3,472	3,245	2,974	2,677
Capital WIP	184	341	341	341	341
Goodwill	17	17	0	0	0
Investments	124	185	200	97	711
Curr. Assets, L&A	2,427	2,783	3,302	4,006	4,391
Inventory	1,197	1,323	1,686	1,958	2,218
Account Receivables	492	515	623	723	771
Cash and Bank Balance	338	415	407	644	631
Others	401	531	586	681	770
Curr. Liab. and Prov.	1,144	1,704	1,977	2,192	2,464
Current Liabilities	994	1,508	1,781	1,969	2,215
Provisions	151	196	197	223	249
Net Current Assets	1,283	1,079	1,324	1,814	1,927
Miscellaneous Expense	4	3	0	0	0
Deferred Tax Liability	-61	-83	66	112	111
Application of Funds	2,826	5,013	5,175	5,337	5,768

E: Most Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	12.1	18.0	23.0	29.0	35.9
Cash EPS	14.6	25.7	30.3	37.2	44.4
BV/Share	37.4	45.1	54.7	73.8	97.7
DPS	5.4	6.2	7.5	8.8	10.6
Payout %	44.2	34.5	32.7	30.3	29.6
Valuation (x)					
P/E		28.4	22.3	17.6	14.3
Cash P/E		19.9	16.9	13.8	11.5
EV/Sales		2.8	2.1	1.8	1.5
EV/EBITDA		21.8	13.4	10.9	8.9
P/BV		11.3	9.4	6.9	5.2
Dividend Yield (%)		12	15	17	2.1
Return Ratios (%)					
RoE	318	39.9	42.0	39.3	36.7
RoCE	27.0	20.8	37.5	44.0	48.3
Working Capital Ratios					
Debtor (Days)	18	16	16	16	15
Asset Turnover (x)	3.6	2.3	2.8	3.2	3.3

Leverage Ratio					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Debt/Equity (x)	0.3	0.9	0.6	0.2	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
OP/(loss) before Tax	735	996	1,883	2,285	2,703
Int./Div. Received	30	49	57	62	83
Depreciation and Amort.	148	447	427	471	497
Interest Paid	-33	-64	-206	-152	-76
Direct Taxes Paid	-43	-79	-334	-422	-522
(Incr)/Decr in WC	-383	280	-253	-252	-126
CF from Operations	452	1,629	1,575	1,990	2,558
Extraordinary Items	0	0	0	0	1
(Incr)/Decr in FA	-476	-2,778	-200	-200	-200
(Pur)/Sale of Investments	-119	-61	-15	103	-64
CF from Invest.	-596	-2,839	-215	-97	-813
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	547	1,741	-393	-948	-957
Dividend Paid	-356	-405	-496	-574	-692
Others	-49	-49	-478	-134	-110
CF from Fin. Activity	142	1,287	-1,367	-1,657	-1,758
Incr/Decr of Cash	-2	77	-7	237	-13
Add: Opening Balance	340	338	415	407	644
Closing Balance	338	415	407	644	631

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Marico

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|---|----|
| 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 |

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