3 March 2010

BSE Sensex: 16773

IDFC SSKI INDIA RESEARCH

Consumer goods

Dabur India

Rs169

DOWNGRADE TO NEUTRAL

Company Update

Mkt Cap: Rs147bn; US$3.2bn

Dabur India (Dabur) offers one of the widest consumer portfolios after Hindustan Unilever, a heady mix of cash cows (hair oil and health supplements) and stars (foods, shampoo, skin care, international operations and toothpaste), a rich new product funnel and proven capabilities to manage inorganic growth. While all these factors have culminated into 25%+ earnings growth over the past five years, the stock has been rewarded with a sharp re-rating (4x increase in market capitalization against 2.5x for Sensex over FY05-10). Currently trading at 24x FY11E earnings, Dabur commands a 20% valuation premium to peers, which makes it the costliest consumer stock after Nestle. While we remain upbeat on future growth momentum as Dabur extends its portfolio to capitalize on the rural consumption story and urban uptrading (foods, Fem Care, launch of *Uveda*, home care, etc), we believe current valuations already factor in the upside. With limited scope for business re-rating from here, we downgrade our recommendation on Dabur to Neutral with a 12-month price target of Rs180.

Key valuation metrics

Year to Mar 31 (Rs m)	Net revenues	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV/EBITDA (x)	PE (x)
FY08	23,612	15.6	3,328	3.9	17.4	35.1	43.8
FY09	28,221	19.5	3,825	4.4	14.9	29.6	38.2
FY10E	34,179	21.1	5,051	5.8	31.6	21.4	29.0
FY11E	39,878	16.7	6,104	7.0	20.7	17.2	24.0
FY12E	45,611	14.4	7,204	8.3	18.0	14.2	20.3

Significant stock re-rating in the past five years

From trading at a PE multiple of 16-17x in 2005, Dabur has seen the sharpest re-rating among consumer stocks (besides Marico and GCPL). Dabur's market capitalization has more than quadrupled in the past five years to ~Rs150bn, ahead of the Sensex growing by 2.5x. The re-rating has been led by the 18% revenue CAGR (to Rs34bn) and 26% PAT CAGR registered over FY05-10 (to Rs5bn). Trading at 24x FY11E earnings, Dabur is currently the costliest consumer stock in India, only after Nestle. And the premium that Dabur is trading at to its peers is justified given its strong and wide product portfolio, strong new product funnel and new category addition at regular interval, stable of cash cows and stars in the portfolio and proven ability to take inorganic growth route. Also the earnings profile has changed over the years with margins nearing 20%.

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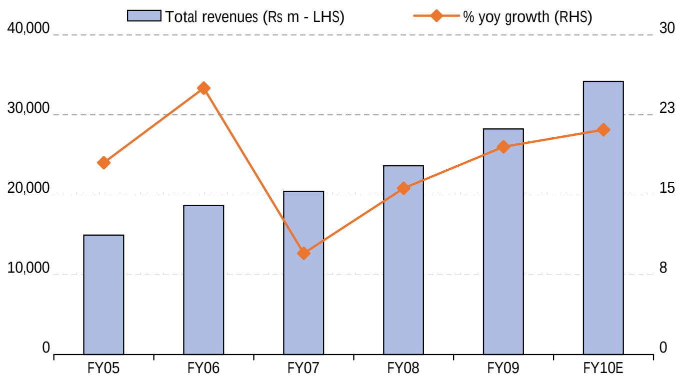
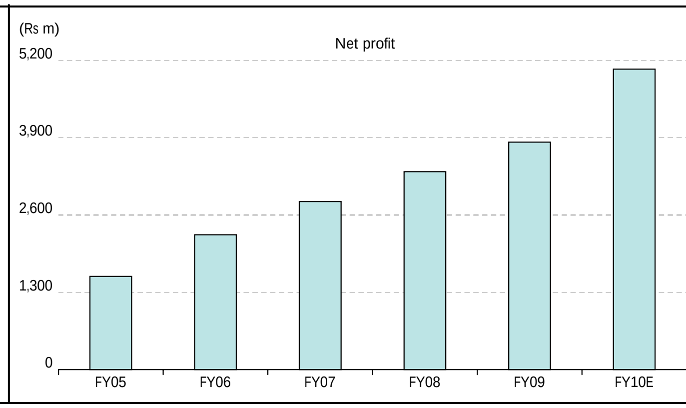
18% revenue CAGR...

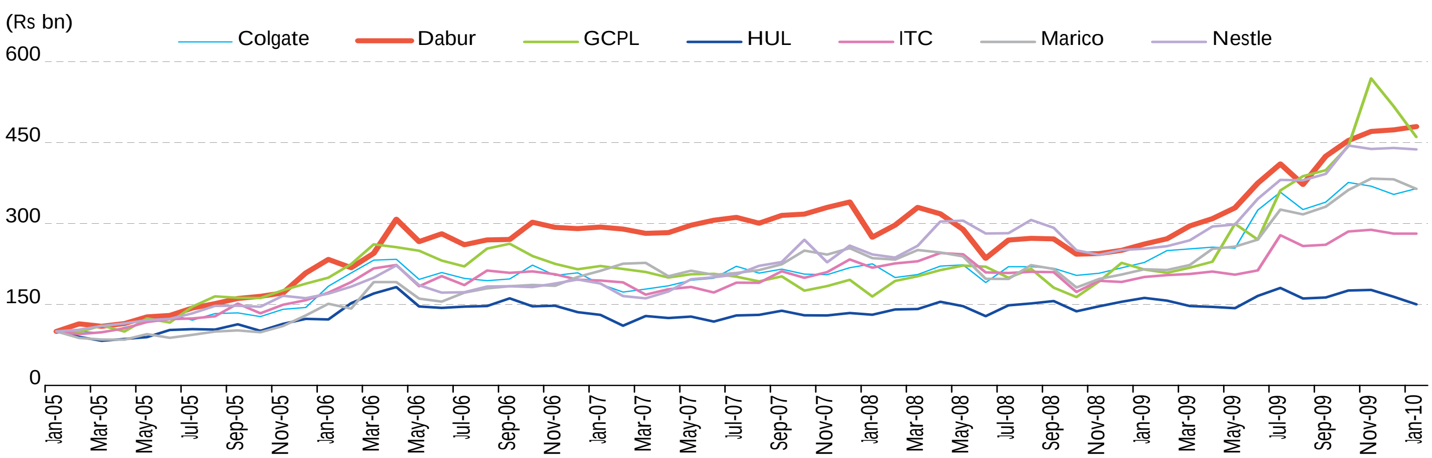


...and 26% earnings CAGR...



Source: IDFC-SSKI Research

...led to one of the sharpest re-rating in FMCG space



Source: IDFC-SSKI Research

❑ One of the widest product portfolios…

Dabur, along with Hindustan Unilever (HUL), has one of the widest consumer portfolios with business straddling hair care (hair oil and shampoo), skin care and baby care, oral care, health supplements, foods and home care. Commendably, revenues in some of the categories have scaled up rapidly with hair care business at Rs7.5bn+, oral care at Rs4bn+, health supplements at Rs4.5bn+, foods at Rs3bn+ and international operations at Rs6bn+. While Dabur leads the segments like Chyawanprash, Digestives, Fruit Juices, etc, it is a strong challenger in categories like hair oil and toothpowder. Dabur has also been gaining market share in categories Shampoo and Toothpaste to emerge as a strong number three player in these categories. This has helped Dabur scale up its operations to Rs34bn in FY10E.

Dabur – competitive positioning across segments

Category	Revenues (Rs bn)	Positioning	Overall market share	Brands	Segmental positioning
Hair care	7.5	3	12%	Dabur Amla Hair Oil, Vatika Hair Oil, Vatika Shampoo	Second largest player in hair oil and rapidly growing player in shampoo
Oral care	4.2	3	13%	Dabur Lal Toothpaste, Babool, Meswak, Promise	2nd largest player in toothpowder and 3rd largest in toothpaste with market share of 12%
Skin care and baby care	2.3	3	7%	Gulabari, Fem Care, Vatika, Uveda	
Health supplements	4.5	1	60%	Chyawanprash, Honey	Largest player in Chyawanprash segment
Digestives	1.6	1	55%	Hajmola	
Fruit juices	3.2	1	50%	Real, Activ, Burst	
Home care	1.3			Odonil, Odomos, Sanifresh	

Source: IDFC-SSKI Research

❑ …with right blend of high-growth and scalable categories…

The core to Dabur's consistent double-digit growth in the past few years is the right blend of cash cows like hair oil and Chyawanprash growing at a robust pace and Stars like toothpaste, shampoo, foods, international business and skin care. Penetration levels of less than 70% and transition from loose to branded would ensure sustained growth of ~10% in hair oil – the largest category for Dabur. In toothpaste, Dabur is the category challenger with HUL losing market share and Dabur having brands at the bottom of the pyramid. As the mass segment is growing faster, we expect Dabur to sustain 15%+ growth rate in toothpaste category, where it has a 13% market share. Similarly, Dabur has made strong inroads into the rapidly growing shampoo category with ~8% market share. Dabur also boasts of one of the largest international portfolios among Indian peers with revenues of >Rs6bn. Incrementally, Dabur is extending its reach beyond Indian diaspora in the African and South East Asian markets.

❑ …suitable for rural consumption and urban uptrading

While hair oil and oral care businesses are riding on increasing penetration and rural uptrading, Dabur has strong mass-end brands like Dabur Amla Hair Oil, Dabur Red Toothpaste, Babool, etc. Also, Dabur's Vatika brand of shampoo is well placed to piggy ride the mass segment opportunity with 70% of Dabur's shampoo revenues accruing from sachets. While Dabur has always been a strong brand in rural and semi-urban India, it is now building its portfolio to suit the urban premium market with presence in fruit juice segment, launch of premium skin care brand (like Uveda), acquisition of premium brand Fem Care and presence in home care segment. This makes Dabur's portfolio well suited to piggy ride the rapidly growing mass segment on the back of rural consumption as also tap the premium segment driven by uptrading in urban market.

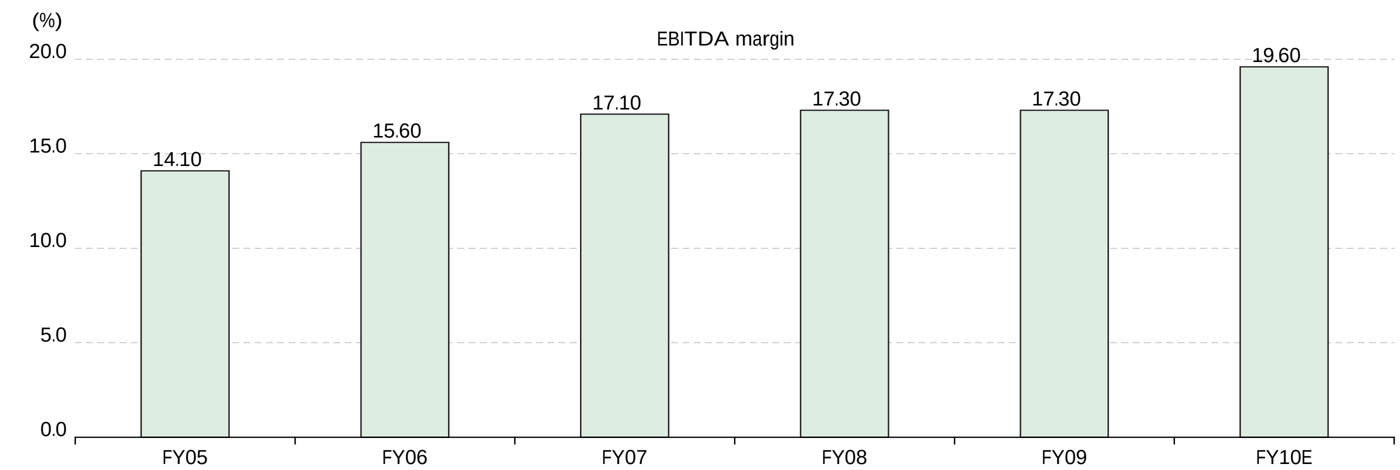
❑ Proven ability to grow through the inorganic route

Dabur has, in the past five years, made two mid-sized acquisitions – Balsara in 2005 (oral care and home care portfolio) with revenues of Rs1.6bn+ and Fem Care (premium skin care) with revenues of Rs1.2bn in 2008. The fact that Dabur has managed to scale up the Balsara portfolio to almost 2x and also garnered synergy benefits to strengthen its own toothpaste portfolio is evidence of Dabur's ability to manage inorganic growth. Fem Care operations have also been growing at 25%+ since acquisition. Dabur makes the most of its strong distribution network to scale up the brands of acquired companies. Dabur has also shown inclination to acquire mid-sized companies (even as they may be expensive at the time of acquisition), as these brands can be scaled up faster than the large size acquisitions.

❑ Improving earnings profile

Dabur has capitalized on the rapidly growing rural consumption market with revenues growing in double digits for the past nine consecutive quarters and growth being largely volume-led (mid teens). Even as the strong portfolio and entry into high growth categories have helped Dabur sustain double-digit growth, its earnings profile too has improved substantially. From margins of ~14% in FY05, Dabur's EBITDA margins have improved to >19% in FY10. This is indicative of strong pricing power enjoyed by Dabur in core categories, premiumization of portfolio and scale benefits. The wide product portfolio also insulates Dabur from commodity price fluctuations. Barring two quarters, Dabur has consistently witnessed margin expansion for the past 12 quarters.

Improved product portfolio and scale lead to a better margin profile

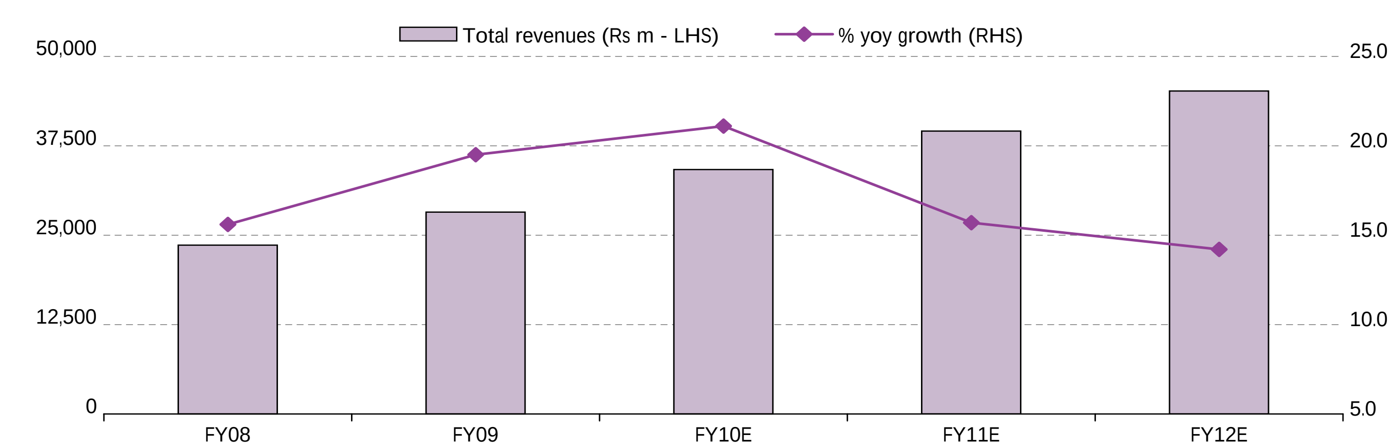


Source: IDFC-SSKI Research

Growth outlook remains bullish…

Going forward, we see Dabur sustaining the pace of growth witnessed in the past five years as core categories of hair oil and digestives sustain high single-digit growth, Dabur gains market share in high-growth segments like oral care, shampoo and skin care, new product funnel remains consistent and new international markets are charted. Dabur has also indicated its intention to scale up the health care portfolio. Also, Dabur is expected to sustain double-digit growth in the branded portfolio – suitable for rural as well as urban consumption. We expect 15% CAGR in Dabur's revenues over the next three years. Growth momentum can further improve as Dabur continues to hunt for inorganic growth opportunities.

15% revenue CAGR expected over FY10-12



Source: IDFC-SSKI Research

However, we expect volume growth to come off a tad in the near term (14%+ growth witnessed in the past few quarters) as we expect slowing offtake in the rural markets and at the mass end (impact of food inflation). Given the runaway food inflation, ability to effect price hikes would be limited, which implies tapering price-led growth in the next couple of quarters. In Q3FY10, there have been some signs of the same with volume growth slowing from 16% in Q2FY10 to 14% in Q3FY10 and categories like hair oil and shampoo bearing the maximum brunt.

Food inflation – acute pressure on a few segments

Segmental growth (%)	H1FY10	9MFY10
CCD	17.2	16.1
Hair Oils	15.2	13.9
Shampoos	**47.0**	**32.0**
Home Care	8.3	8.4
Oral Care	6.6	12.2
Health Supplements	**20.6**	**14.9**
Digestives	12.6	12.9
Baby & Skin Care	**42.7**	**29.6**
Foods	22.7	22.3
CHD	15.1	15.8
IBD	**38.3**	**31.1**

Source: IDFC-SSKI Research

…but future upsides already captured into valuations

Dabur is currently the costliest stock in our consumer basket, after Nestle. The valuation premium appears to be justified as unlike HUL, there is minimal competitive risk to Dabur’s core business and unlike Colgate and GCPL, Dabur has a wide product portfolio across categories. Dabur’s margins are also not too exposed to the underlying commodity cost pressure (as faced by Marico or Britannia). Double-digit growth in the foreseeable future further makes a case for premium valuations for Dabur over peers. Dabur has also had a rich new product funnel and consistently demonstrated its ability to add new growth avenues. However, valuations of 24x FY11E earnings – which is at 20% premium to FMCG basket and 60% premium to Sensex valuations, leave limited room for upside. We also believe that besides the long-term risk of higher effective tax rate on earnings, food inflation too could weigh heavy on Dabur’s stock performance. We downgrade our recommendation on Dabur to Neutral from Outperformer with a 12-month price target of Rs180.

Key financials

As on 31 March (Rs m)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Net sales	20,431	23,612	28,221	34,179	39,878	45,611
% growth	*9.5*	*15.6*	*19.5*	*21.1*	*16.7*	*14.4*
Operating expenses	16,931	19,518	23,345	27,495	31,787	36,123
EBITDA	3,500	4,094	4,876	6,684	8,091	9,488
Other income	259	340	213	117	146	190
Net interest	154	168	232	142	83	72
Depreciation	343	421	492	573	665	713
Pre-tax profit	3,198	3,845	4,365	6,086	7,490	8,893
Tax	373	516	540	1,035	1,386	1,690
Profit after tax	2,825	3,328	3,825	5,051	6,104	7,204

Source: IDFC-SSKI Research

IDFC - SSKI INDIA

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Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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