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In Focus

Marico

Outperformer	Rs 540	December 22, 2006

Marico on an Egyptian walk

- The Hair Code acquisition increases market share to 50% in the Egyptian pre- and post-wash hair-care market
- Sales of Hair Code estimated at Rs 350m, with expected strong PAT margins of 18-20%
- The two acquisitions estimated to contribute 4.5--5% of sales and 7% of EBIDTA in FY08
- Brand sales to grow through expansion of operations and higher income levels in Egypt
- Marico's debt, estimated at Rs 2bn--2.5bn, to slide to Rs 1.25bn--1.5bn by year-end
- Post-QIP of 2.9m shares, the diluted EPS stands at Rs 22.1 for FY07 and Rs 26.2 for FY08.
- May write off a major portion of the total acquisition cost by year-end. Post-write-off EPS estimated at Rs 27.2 for FY07 and Rs 31.1 for FY08.

At the CMP of Rs 540, the stock trades at 24.5x FY07E earnings and 20.6x FY08E earnings. With the improved margins and the display of the company's brand strength in the hair care segment, the stock has been re-rated. We believe that the company can sustain the current valuations and thus we maintain an OUTPERFORMER **rating on the stock at current levels.**

Key Figures

Y/e March	FY05	FY06	FY07E	FY08E
Net Sales *(Rs m)*	10,070	11,439	15,453	18,082
EBITDA *(Rs m)*	883	1,443	2,452	2,875
PAT *(Rs m)*	681	1,066	1,344	1,596
PAT Growth (%)	*15.5*	*56.6*	*26.0*	*18.8*
EPS *(Rs)*	11.2	17.5	22.1	26.2
PER *(x)*	48.3	30.9	24.5	20.6
EV / EBITDA *(x)*	35.7	23.1	13.4	10.8
EV / Sales *(x)*	3.1	2.9	2.1	1.7
RoE (%)	*33.9*	*44.6*	*34.6*	*27.6*
RoCE (%)	*29.1*	*28.4*	*25.1*	*23.9*

Hair oil major, Marico, has made its second acquisition in the Egyptian market by acquiring hair-care brand, Hair Code. This would increase its market share in the Rs 1.7bn pre- and post-wash hair-care market in Egypt to 50%. The pre- and post-wash hair-care market in Egypt is growing at about 6.5% per annum. The acquisition has been funded through short-term debt.

(Stock price as on December 21, 2006)

Hair Code is believed to have sales of about Rs 350m and is expected to have strong margins—in the range of 18-20%. The brand enjoys a tax exemption for the next 10 years. The strong margin profile is expected to be similar to the earlier acquisition, Fiancee. We further believe that both the acquisitions have been valued at about 14--15x their PAT (profit after tax).

We believe the two acquisitions, Fiancee and Hair Care, would collectively contribute about 4.5—5% to Marico's sales and about 7% to its operating profit during FY08. To arrive at the FY08 consolidated sales from these two brands we have taken the current growth rate of about 6.5% per annum.

The first task for Marico, after acquiring the two brands, would be to accelerate their growth rates in the Egyptian market. The management believes that, with the higher expected growth in income levels in Egypt, the Egyptian market has decent potential to increase its current growth in the coming years. With an increase in liberalization, the present 5--6% Egyptian GDP growth is likely to improve in the years to come. Also, with a dominant 50% market share in the pre- and post-wash hair-care segment, Marico could work towards increasing the acquired brands' market share in Egypt. Further, the company can also extend the brand to North African and Middle East countries.

Marico has recently repaid about Rs 1.5bn of the Rs 2bn short-term debt taken to acquire Nihar. During Q1 FY07, it had already paid about Rs 250m of the short-term debt. Thus, with the recent repayment of the short-term debt, the total debt against the Nihar acquisition stands reduced to Rs 250m. Considering the short-term loans required for the acquisition of the two Egyptian brands and the repayment of the earlier loan for the Nihar acquisition, we expect the short-term debt during the year to be about Rs 2bn–2.5bn. In view of the high cost of the short-term debt, the company may convert it to low-cost long-term debt. Besides, by the end of the year, the company would be in a position to further repay a portion of this debt through cash from operations. We estimate the year-end debt to be in the region of Rs 1.25bn—1.5bn.

Funds to repay the short-term debt came through the private placement of 2.9m shares at Rs 522 each. This has increased the company's equity by about 5% to Rs 609m. Thus, after accounting for the additional sales from the acquisitions and for the diluted equity, we arrive at an EPS of Rs 22.1 for FY07 and Rs 26.2 for FY08.

Marico normally amortizes over 10 years the acquisition cost of brands. However, it is now planning to write off against reserves a major portion of the acquisition cost by then end of FY07. We have tried to estimate the impact of such a move on the adjusted PAT (profit after tax) during FY07 and FY08. We arrive at an EPS of Rs 27.2 for FY07 and Rs 31.1 for FY08.

Estimated earnings post-write-off of total acquisition cost *(Rs m)*

	Pre-write-off estimates		Post-write-off estimates	
	FY07E	**FY08E**	**FY07E**	**FY08E**
PBDT	2,317	2822	2317	2822
Depreciation	573	720	258.0	422
PBT	1,745	2102	2059	2400
Provision for Tax	401	506	401	506
Effective Tax Rate (%)	*23.0*	*24.1*	*19.5*	*21.1*
PAT	1,344	1596	1658	1894
Diluted Equity	60.90	60.90	60.90	60.90
EPS *(Rs)*	22.1	26.2	27.2	31.1

Outlook and View

We believe that the acquisition has been a positive step by Marico and, with the increase in size, would aid in improving margins. This acquisition would also help the company strengthen its presence in Egypt and neighbouring markets. The acquisition could also act as a platform to promote its Indian-made products in these markets due to access to the distribution network and better understanding of the markets. Further, the possibility of writing off the acquisition might prove to be a booster for EPS growth.

At the CMP of Rs 540, the stock trades at 23.3x FY07E earnings and 19.6x FY08E earnings. With the improved margins and display of the company's brand strength in the hair-care segment, the stock has been re-rated. We believe that the company can sustain the present valuations and thus maintain an ***Outperformer*** on the stock at levels now.