Company

28 July 2010 | 9 pages

Marico (MRCO.BO)

Equity
Target price change

1QFY11 Results Operationally Below Expectations

- **1QFY11 Reported PAT at Rs737m** — Revenue growth of ~13% Y/Y was ahead of estimates, on the back of ~16% Y/Y growth in volumes. However, EBITDA margins at ~13.3% disappointed – contracting ~45bps Y/Y. Consequently, despite a lower tax rate (below guidance), reported PAT (+32% Y/Y) was a tad lower than our forecasts. Mgmt mentioned that if the provisioning for excise dispute (Rs88m in the Q) were excluded, EBITDA margins would have been stable Y/Y at ~14.5%.
- **Margin outlook mixed** — Mgmt expects input costs pressures to mount in FY11 on last year's low base (expects 8-10% increase in copra prices); however, it believes potential pricing will offset these to some extent. A&P to sales should be ~11.5-12% in FY11 (13.2% in FY10). Over the medium term, the company would sacrifice margins to increase/maintain market shares.
- **Kaya performance remains lackluster** — SSS growth in Indian operations declined 11% Y/Y, dragging down overall SSS growth to -5% Y/Y for 1Q. Indian operations will focus on store consolidation, consumer acquisition and retention, with clinic rollouts a secondary consideration. Mgmt is aiming for ~3-4% sequential improvement in revenues from hereon and targets breakeven in FY12.
- **Conference Call Takeaways** — a) Mgmt mentioned that rural markets are growing faster than urban markets (mirroring the trends seen in other consumer companies like HLL, Asian Paints, etc) – plans to focus on rural India, increasing contribution from 25% of sales to 30% in 2-3 years. Distribution initiatives & smaller SKUs are likely to spur growth. b) Tax rates are likely to be ~18-20%, as both the production from Paonta Sahib & international contribution increase.
- **Maintain Sell** — We are concerned about muted revenue growth and near-term issues surrounding Kaya. Our target price is revised to Rs119 (from Rs104) based on 22x Dec11E, as we roll forward from Sept11E and increase multiple to 22x from 20x, maintaining discount with other peers in the consumer universe.

Sell/Low Risk	**3L**
Price (28 Jul 10)	Rs126.05
Target price	Rs119.00
from Rs104.00	
Expected share price return	-5.6%
Expected dividend yield	0.5%
Expected total return	**-5.1%**
Market Cap	Rs77,279M
	US$1,656M

Price Performance (RIC: MRCO.BO, BB: MRCO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	1,970	3.24	24.3	39.0	16.9	51.3	0.5
2010A	2,415	3.96	22.5	31.8	11.7	43.6	0.5
2011E	2,763	4.53	14.4	27.8	8.7	35.9	0.5
2012E	3,515	5.77	27.2	21.9	6.5	34.0	0.6
2013E	4,364	7.16	24.2	17.6	4.9	31.8	0.6

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	39.0	31.8	27.8	21.9	17.6
EV/EBITDA adjusted (x)	26.8	21.3	19.6	15.9	13.0
P/BV (x)	16.9	11.7	8.7	6.5	4.9
Dividend yield (%)	0.5	0.5	0.5	0.6	0.6
Per Share Data (Rs)					
EPS adjusted	3.24	3.96	4.53	5.77	7.16
EPS reported	3.10	3.80	4.53	5.77	7.16
BVPS	7.45	10.73	14.50	19.40	25.70
DPS	0.66	0.66	0.66	0.74	0.74
Profit & Loss (RsM)					
Net sales	23,884	26,608	30,624	35,163	40,172
Operating expenses	-21,270	-23,457	-27,227	-30,988	-35,157
EBIT	**2,615**	**3,151**	**3,397**	**4,175**	**5,016**
Net interest expense	-357	-257	-252	-202	-135
Non-operating/exceptionals	122	183	245	366	508
Pre-tax profit	**2,379**	**3,077**	**3,390**	**4,339**	**5,388**
Tax	-409	-643	-627	-824	-1,024
Extraord./Min.Int./Pref.div.	-82	-117	0	0	0
Reported net income	**1,889**	**2,317**	**2,763**	**3,515**	**4,364**
Adjusted earnings	1,970	2,415	2,763	3,515	4,364
Adjusted EBITDA	2,973	3,752	4,023	4,837	5,718
Growth Rates (%)					
Sales	25.4	11.4	15.1	14.8	14.2
EBIT adjusted	21.3	20.5	7.8	22.9	20.1
EBITDA adjusted	20.7	26.2	7.2	20.2	18.2
EPS adjusted	24.3	22.5	14.4	27.2	24.2
Cash Flow (RsM)					
Operating cash flow	**1,584**	**2,100**	**3,409**	**3,572**	**4,436**
Depreciation/amortization	358	601	626	662	702
Net working capital	-1,077	-1,066	20	-605	-631
Investing cash flow	**-1,017**	**-2,192**	**-800**	**-800**	**-700**
Capital expenditure	-896	-1,486	-800	-800	-700
Acquisitions/disposals	-121	-706	0	0	0
Financing cash flow	**-336**	**403**	**-988**	**-1,677**	**-1,602**
Borrowings	163	716	-518	-1,150	-1,075
Dividends paid	-467	-470	-470	-527	-527
Change in cash	**149**	**213**	**1,621**	**1,095**	**2,135**
Balance Sheet (RsM)					
Total assets	**11,422**	**15,260**	**17,683**	**20,142**	**23,592**
Cash & cash equivalent	902	1,115	2,736	3,831	5,965
Accounts receivable	1,108	1,507	1,678	1,927	2,201
Net fixed assets	3,111	3,997	4,171	4,308	4,306
Total liabilities	**6,887**	**8,595**	**8,726**	**8,197**	**7,809**
Accounts payable	2,454	3,096	3,644	4,154	4,720
Total Debt	3,743	4,459	3,941	2,791	1,716
Shareholders' funds	**4,536**	**6,665**	**8,957**	**11,946**	**15,783**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	12.4	14.1	13.1	13.8	14.2
ROE adjusted	51.3	43.6	35.9	34.0	31.8
ROIC adjusted	35.7	30.7	29.3	33.6	37.1
Net debt to equity	62.6	50.2	13.5	-8.7	-26.9
Total debt to capital	45.2	40.1	30.6	18.9	9.8

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1QFY11 Results Summary

Revenue growth was ~13% Y/Y to Rs7.9bn (our expectation: Rs7.5bn) – on the back of organic volume growth (+16%), price deflation dragged down overall revenue growth.

EBITDA margins contracted 45bps Y/Y to 13.3% – as gross margins declined 60bps Y/Y and 710bps QoQ. Prices of inputs/packing materials will increase on the low base of FY10 — mgmt noted that copra prices rose ~4% Y/Y, while safflower oil prices declined 12% Y/Y during the Q.

Reinvestment in brands continues, albeit at a slower pace – both relative to history and peers – overall ad spends increased 11% Y/Y, lower by ~20bps Y/Y and 295bps QoQ to ~11.9% of sales.

SG&A expenses were elevated 15% Y/Y. Other expenses included Rs88m provision toward excise duty dispute during the Q.

Kaya posted revenues of Rs506m in 1Q, a ~3% Y/Y rise. Sequential growth was ~1%. PBT loss was to the tune of Rs47m

Consolidated PAT (reported) rose 32%Y/Y to Rs737m, below our expectations; but above consensus forecasts.

Mgmt mentioned that the domestic business growth was ~11% Y/Y. Reported EBITDA margins contracted ~120bps Y/Y to 14.6% for the parent business.

The performance of new products has been at par or better than anticipated – mgmt expects these to add ~2% to FY11 estimates.

Figure 1. Marico: Consolidated Results (Rupees in Million, Percent)

	1QFY10	1QFY11	%Y/Y
Net Sales	6,967	7,901	13.4
Expenditure	-6,005	-6,847	14.0
EBITDA	**962**	**1,055**	**9.7**
EBITDA Margin (%)	*13.8*	*13.3*	*-45 bps*
Interest	-87	-70	-19.3
Depreciation & Amortisation	-95	-120	26.2
Other Income	31	44	43.3
PBT	**811**	**909**	**12.1**
Tax	-210	-162	-23.1
Tax Rate (%)	*25.9*	*17.8*	*-815 bps*
PAT	**600**	**747**	**24.4**
Exceptional items & Minority Interest	-41	-10	nm
PAT after Exceptionals	**560**	**737**	**31.7**
Cost Details			
Total Raw Material Cost	3,515	4,033	14.7
% of Sales	*50.5*	*51.0*	*59 bps*
Employee/Staff Cost	488	540	10.8
% of Sales	*7.0*	*6.8*	*-16 bps*
Advertising Cost	844	938	11.2
% of Sales	*12.1*	*11.9*	*-24 bps*
Other Expenditure	1,159	1,335	15.2
% of Sales	*16.6*	*16.9*	*26 bps*

Source: Company data, Citi Investment Research and Analysis

Figure 2. Marico: Parent Results (Rupees in Million, Percent)

	1QFY10	1QFY11	%Y/Y
Net Sales	5,498	5,877	6.9
Expenditure	-4,628	-5,017	8.4
EBITDA	**870**	**860**	**-1.2**
EBITDA Margin (%)	*15.8*	*14.6*	*-119 bps*
Interest	-66	-47	-29.4
Depreciation & Amortisation	-43	-52	20.5
Other Income	29	28	-2.6
PBT	**790**	**790**	**0.0**
Tax	-178	-114	-36.0
Tax Rate (%)	*22.5*	*14.4*	*-811 bps*
PAT	**612**	**676**	**10.4**
Cost Details			
Total Raw Material Cost	3,051	3,268	7.1
% of Sales	*55.5*	*55.6*	*11 bps*
Employee/Staff Cost	260	278	7.0
% of Sales	*4.7*	*4.7*	*1 bps*
Advertising Cost	549	584	6.4
% of Sales	*10.0*	*9.9*	*-5 bps*
Other Expenditure	768	887	15.5
% of Sales	*14.0*	*15.1*	*113 bps*

Source: Company Reports

Marico

Company description

Marico is a leading consumer-goods company in India with offerings in the hair- care, skin-care, and health and wellness segments. It is a market leader in the coconut-oil category, and dominates most of the other categories in which it operates. Marico acquired two soap brands in the Bangladesh market, Camelia and Aromatic, in 2006 - marking its entry into the global FMCG market. Marico has strengthened its product portfolio through acquisitions in the domestic market. Marico exports to Bangladesh, Bhutan, and the Middle East. In 2006, Marico entered the Rs50bn Indian soap market with the acquisition of Manjal herbal bath soap. Marico acquired Enaleni in end 2008. Marico was originally part of Bombay Oil Industries, which was into coconut extraction, vegetable oil refining and chemicals.

Investment strategy

We rate Marico Sell/Low Risk (3L). Shares have run up sharply, which we reckon discounts a fair degree of positives. Marico dominates the hair-oil segment and has a strong presence in the branded edible-oil (safflower oil) segment. However, growth in the core business is entering a slower trajectory in the absence of strong pricing. Marico also has skin-care clinics (under the Kaya brand), a business that is fast expanding but with slowing same store sales in the current environment, given its discretionary nature. Over the years, Marico has re-rated as its dependency on a single product (Parachute coconut oil) has declined, and the company has positioned itself on the health and wellness planks.

Valuation

Marico's earnings growth has been steady; therefore, we believe P/E is best suited to value the company. Our target price of Rs119 is based on 22x Dec11E EPS, in line with its trailing 5-year average P/E. Marico offers healthy earnings growth (a two-year CAGR of 21%, a 3-year CAGR of 22%). If Marico can demonstrate strong profit growth in the Kaya subsidiary over the next 2 years, the stock could re-rate. Conversely, a de-rating is also possible if Kaya's business / profitability trajectory isn't as expected. We ascribe a lower multiple than the 23-24x it traded at from mid CY06-Jan08, as growth rates in that period were heightened by inorganic initiatives and also very strong growth in the core hair oils business, which we don't anticipate will recur in the next 12-18 months.

Risks

We rate Marico shares as Low Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. We believe this is warranted given the defensive nature of the company that is operating in a steady business environment. Upside risks to our target price include: (1) Considering that a sizeable sum of the consolidated entity's revenues would be from international markets, earnings would benefit from a favourable forex market. (2) Any value-accretive acquisition in emerging markets would aid further earnings growth. (3) Stronger than forecast growth in hair oil volumes (especially coconut oil), (4) Resurgence in Saffola volumes, (5) Kaya reporting a profit growth that is higher than forecasts. Downside risks include: (1) Increases in the price of copra, the key raw material; (2) Marico has aggressively acquired companies and brands. Slower-than-expected growth in the key markets would lead to slower growth in the consolidated entity; and (3) Marico recently entered categories such as baby wash, soaps, and health foods, which may be a drag on profitability until critical mass is reached.

Appendix A-1

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Marico (MRCO.BO)

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Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008

	Date	Rating	Target Price	Closing Price
1	31-Oct-07	1L	*80.00	67.40
2	26-Jun-08	*2L	*65.00	58.45
3	4-May-09	*3L	*69.00	68.20
4	28-Oct-09	3L	*94.00	97.75
5	28-Apr-10	3L	*104.00	112.25

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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