Company Focus

31 October 2007 | 9 pages

Marico (MRCO.BO)

Target price change ☑
Estimate change ☑

Buy: Enaleni Acquisition – Strengthening Foothold in Africa

- **Enaleni acquisition** – Marico has acquired the consumer division of Enaleni Pharmaceuticals in South Africa. This acquisition provides Marico entry into the ethnic hair care market in South Africa. Enaleni's products include hair relaxants, hair care foods & conditioners. The ethnic hair products market and relevant OTC products in South Africa are valued at Rs6bn, growing at 20%
- **Seems value accretive** – Marico has paid 1x current year sales (Rs530m) and about 15x current year EBITDA for Enaleni. While we do not have detailed financials for Enaleni, the deal seems value accretive at the outset. Given Enaleni's small size (3% of Marico's turnover) the extent of earnings accretion will be marginal in the near term. However, we see strategic value from the acquisition, as it strengthens Marico's foothold in the African continent.
- **Strengthens presence in Africa** – Marico had earlier entered Egypt through acquisition of the 'Hair Code' brand gaining presence in the hair creams & gels segments. The Enaleni acquisition will consolidate Marico's position in Africa, and we expect Marico to expand the geographic presence of these products.
- **Raising estimates and target price** – Following better than expected 1HFY08 earnings and incorporating the Enaleni acquisition into our estimates, we raise FY08E-FY10E EPS estimates by 2.32%-7.23% and increase our target price to Rs80, still based on 25xFY09E P/E.

Buy/Low Risk	1L
Price (31 Oct 07)	Rs67.40
Target price	Rs80.00
from Rs74.00	
Expected share price return	18.7%
Expected dividend yield	1.9%
Expected total return	**20.6%**
Market Cap	Rs41,047M
	US$1,044M

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 (%)
2006A	869	1.50	27.6	45.0	14.9	36.3	1.0
2007A	1,129	1.85	23.8	36.4	21.3	49.7	1.1
2008E	1,539	2.53	36.3	26.7	15.3	66.8	1.9
2009E	1,935	3.18	25.7	21.2	11.3	61.1	2.4
2010E	2,312	3.80	19.4	17.8	8.6	54.8	2.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	45.0	36.4	26.7	21.2	17.8
EV/EBITDA adjusted (x)	29.3	20.3	15.7	12.7	10.7
P/BV (x)	14.9	21.3	15.3	11.3	8.6
Dividend yield (%)	1.0	1.1	1.9	2.4	2.8
Per Share Data (Rs)					
EPS adjusted	1.50	1.85	2.53	3.18	3.80
EPS reported	1.50	1.85	2.53	3.18	3.80
BVPS	4.51	3.16	4.41	5.99	7.87
DPS	0.67	0.73	1.27	1.60	1.91
Profit & Loss (RsM)					
Net sales	11,439	15,569	18,720	21,566	24,447
Operating expenses	-10,444	-13,964	-16,609	-18,954	-21,359
EBIT	**995**	**1,605**	**2,111**	**2,612**	**3,087**
Net interest expense	-51	-206	-172	-169	-165
Non-operating/exceptionals	35	102	60	70	80
Pre-tax profit	**980**	**1,501**	**1,999**	**2,514**	**3,002**
Tax	-111	-372	-460	-578	-691
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**869**	**1,129**	**1,539**	**1,935**	**2,312**
Adjusted earnings	869	1,129	1,539	1,935	2,312
Adjusted EBITDA	1,443	2,127	2,667	3,154	3,626
Growth Rates (%)					
Sales	13.6	36.1	20.2	15.2	13.4
EBIT adjusted	35.6	61.3	31.5	23.7	18.2
EBITDA adjusted	63.4	47.4	25.4	18.3	14.9
EPS adjusted	27.6	23.8	36.3	25.7	19.4
Cash Flow (RsM)					
Operating cash flow	**1,599**	**1,564**	**1,746**	**2,369**	**2,690**
Depreciation/amortization	448	522	556	542	538
Net working capital	282	-87	-348	-108	-160
Investing cash flow	**-2,861**	**1,823**	**-2,608**	**-1,342**	**-1,473**
Capital expenditure	-2,801	0	-81	-300	-200
Acquisitions/disposals	-61	185	-2,527	-1,042	-1,273
Financing cash flow	**1,316**	**-1,707**	**-826**	**-1,025**	**-1,215**
Borrowings	1,739	113	-50	-50	-50
Dividends paid	-407	-436	-45	-45	-45
Change in cash	**54**	**1,680**	**-1,687**	**2**	**2**
Balance Sheet (RsM)					
Total assets	**6,799**	**7,258**	**7,773**	**9,070**	**10,559**
Cash & cash equivalent	415	427	400	400	400
Accounts receivable	515	643	769	886	1,005
Net fixed assets	3,813	1,654	1,181	940	603
Total liabilities	**4,184**	**5,334**	**5,086**	**5,423**	**5,766**
Accounts payable	1,498	2,677	2,462	2,836	3,215
Total Debt	2,397	2,510	2,460	2,410	2,360
Shareholders' funds	**2,615**	**1,924**	**2,687**	**3,647**	**4,794**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	12.6	13.7	14.2	14.6	14.8
ROE adjusted	36.3	49.7	66.8	61.1	54.8
ROIC adjusted	24.3	27.9	50.5	87.5	109.8
Net debt to equity	75.8	108.2	76.6	55.1	40.9
Total debt to capital	47.8	56.6	47.8	39.8	33.0

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Enaleni Acquisition Positive

Marico has acquired the consumer division of Enaleni Pharmaceuticals in South Africa. This acquisition provides Marico with entry into the ethnic hair care market in South Africa. The acquisition comes with integrated operations, including manufacturing facilities at Mobeni, Durban, along with a team of about 100 members. EPCD will continue to be run by the local management in South Africa.

Enaleni's products include hair relaxants, hair care foods and conditioners, and its key brands include Caivil in the premium ethnic hair care segment, Black Chic in the value hair care segment, Herculesin OTC Health Care. Enaleni's market share in relevant segments of Hair Care is about 5%- 6% and 9%-10% in relevant OTC segments. The brands are also present in key supermarket chains like Clicks & Discom, with about 10% share. The ethnic hair products market and relevant OTC products in South Africa are valued at Rs6bn, growing at 20%.

While the Enaleni acquisition is not materially accretive to earnings, given the relatively small size of the business, we view it positively. Entry into South Africa will consolidate Marico's presence in the African continent. Marico had earlier entered Egypt through acquisition of the 'Hair Code' brand gaining presence in the hair creams and gels segments. The Enaleni acquisition will consolidate Marico's position in Africa, and we expect Marico to expand the geographic presence of these products.

Marico paid Rs530m for the acquisition, valuing Enaleni at about 1x current year sales (annualized) and about 15x the current year's EBITDA. The deal will be funded through dollar denominated debt. At the outset, the deal seems marginally accretive to the current year's earnings. However, we see greater strategic value from the acquisition, as it strengthens Marico's foothold in the African continent and provides a platform for Marico to expand its presence in Africa.

We have incorporated Enaleni into our earnings estimates for Marico. Based on our estimates, the acquisition is marginally accretive to Marico's earnings, but not material given the relatively smaller size.

Figure 1. Acquisition of Enaleni

	FY08E	FY09E
Cost of Acquisition (Rsm)	530	
Enaleni Sales (Rsm)	530	636
Enaleni EBITDA (Rsm)	35.3	45.9
Funding Cost (@ 8% interest tax adjusted, Rsm)	14.0	14.0
Depreciation (Assuming Rs300m gross block, Rsm)	18.0	17.1
Incremental PBT (Assuming zero debt, Rsm)	3.3	14.8
Incremental PAT (Rsm)	2.5	11.1
Price / Sales (x)	1.0	0.8
Price / EBITDA (x)	15.0	11.5

Source: Company, Citi Investment Research

Raising Estimates, Target Price

We are increasing our EPS estimates for FY08E-FY10E by 2.32%-7.23% following better than expected 1HFY08 earnings growth and incorporating the Enaleni acquisition into our estimates. Our earnings revision summary is enumerated below:

Figure 2. Earnings Revision Table

			EPS (Rs)			Net Profit (Rs Mils)			DPS (Rs)
	Old	New	% Change	Old	New	% Change	Old	New	% Change
2008E	2.47	2.53	2.32	1,501.5	1,539.2	2.51	1.24	1.27	2.73
2009E	2.97	3.18	7.00	1,809.8	1,935.4	6.94	1.50	1.60	6.78
2010E	3.54	3.80	7.23	2,153.5	2,311.7	7.35	1.78	1.91	7.48

Source: Citi Investment Research

We are also increasing our price target from Rs74 to Rs80 following our upwards revision of earnings estimates. Our price target continues to be based on 25xFY09E P/E.

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 2 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, an herbal bath soap. Marico was originally part of Bombay Oil Industries, which was into coconut extraction, vegetable oil refining and chemicals.

Investment strategy

We rate Marico as Buy/Low Risk (1L). Marico, by virtue of being a leading consumer-goods company in India, looks well positioned to benefit from strong consumption growth. The company dominates the hair-oil segment, and has a strong presence in the branded edible-oil (safflower oil) segment. Marico also has skin-care clinics (under the Kaya brand), a business that is fast expanding. It has entered Bangladesh, the Middle East and Egypt. The company has a two-pronged growth strategy: (1) drive the top line by expanding into new segments and geographies, both organically and through acquisitions; and (2) focus on high-margin brands and continue to improve margins through a better product mix. The company has targeted to increase revenues to Rs20bn from Rs14.5bn by FY10. Marico's current valuations look attractive against peers.

Valuation

Marico’s earnings growth has been steady; therefore, we believe P/E is best suited to value the company. Our target price is Rs80, based on 25x FY09E EPS. Our P/E target is based on an 8-10% discount to sector leader HLL. Marico offers the strongest earnings growth (a 3-year CAGR of 25%) in the consumer peer group, based on our estimates, and therefore we believe it can trade at a premium to its peer group. However, our target multiple is on a par with the peer group target multiples. Over the past few years, Marico has re-rated, from a 40% P/E discount to the Sensex to an average 20% premium. Its re-rating has been driven by a pickup in growth and margins, with the recent run-up fuelled by better prospects for the gross margin following the decline in the price of copra — a key raw material. Marico is trading close to its historical 5-year average but much below Citi's India Consumer Universe average P/E premium to the Sensex of 35%.

Risks

We rate Marico as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility, and because the company operates in a steady business environment. Risks that could impede the stock from reaching our target 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; (3) Considering that a sizeable sum of the consolidated entity's revenues would be from international markets, earnings would be at risk in an unfavorable forex market; and (4) 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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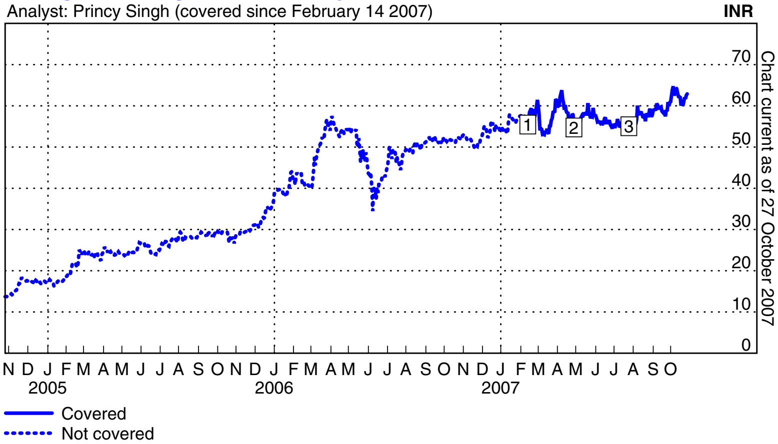
Analyst: Princy Singh (covered since February 14 2007)



#	Date	Rating	Target Price	Closing Price
1:	13 Feb 07	1L	67.00	55.45
2:	27 Apr 07	1L	67.00	55.65
3:	25 Jul 07	1L	*74.00	55.05

*Indicates change.

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