Dabur India Ltd. – BUY

DABUR IN	Rs 90	FMCG	6 Feb 2008	Update

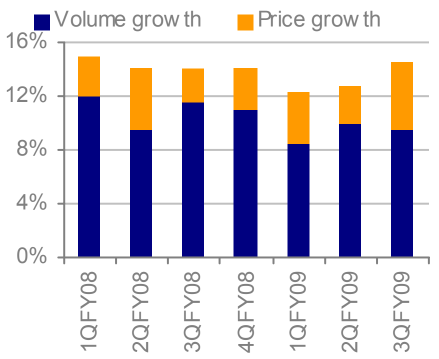
High volume growth, expanding margins

Dabur's steady volume growth in recent quarters is particularly important in an environment of increasingly constrained pricing power. Dabur took minimal price hikes in 2008 (4-5%) and is not encumbered by categories with stagnant/declining volumes. As such, there is no pressure to take price cuts. The company's domestic volumes have grown 8-11% YoY in each of the last eight quarters. Issues in underperforming businesses such as hair-oil and toothpastes have been addressed, and the effects are already visible in hair oils. An expanding international business footprint and the integration of Fem Care from the next fiscal will lend further support to Dabur's growth momentum. With softening input prices and a pull-back in retail roll-out plans, margins will get a respite even as ad spends may be marginally scaled up. Dabur has underperformed its HPC peers by 35% over the last one year on concerns that we see abating. We upgrade the stock to BUY from REDUCE with a target price of Rs111 based on one-year forward earnings.

Volume growth key in a price-sensitive market: Dabur is one of the few FMCG companies that have seen stable volume growth over the last eight quarters—a function of a relatively benign input cost environment over the last year, minimal price hikes, and presence in categories that are still growing at 10-20% pa. In an environment of increasing constraints on price hikes, revenue growth will be driven by volumes. Management has rectified issues in segments such as hair oil and is now addressing those in the toothpaste segment. As such, we expect the current volume growth momentum in Dabur to persist. In international business (up 44% YoY in 9MFY09), further growth will be led by an expanding geographical footprint, while Fem Care integration will lend further support. We expect Dabur's revenues to register 19% CAGR over FY09-11.

Raw-material price correction, price retention provides visibility on margin expansion: Dabur's key raw materials, such as plastics and laminates, light liquid paraffin, vegetable oil and herbs, have all seen sharp price falls over the past 3-6 months. With the company's forward covers for raw materials being exhausted (by January 2009) and volumes in core categories remaining healthy (thus making price cuts unnecessary), gross margins are likely to expand by 140bps over FY09-11ii. Increased ad spends to support new product launches would be partly offset by lower retail losses, which we reckon would lead to EBITDA margin expansion of 80bps over this period. We forecast an earnings CAGR of 21% for Dabur over the next two years.

Volume growth is sustaining



Source: Company data, IIFL Research

Financial summary

Y/e 31 Mar	FY07A	FY08	FY09ii	FY10ii	FY11ii
Revenues (Rs m)	20,431	23,611	27,806	33,647	39,335
EBITDA Margins (%)	17.1	17.3	16.8	17.6	17.9
Pre-Exceptional PAT (Rs m)	2,831	3,339	3,841	4,700	5,637
Reported PAT (Rs m)	2,831	3,339	3,841	4,700	5,637
EPS (Rs)	3.3	3.9	4.4	5.4	6.5
Growth (%)	-12.2	17.8	15.0	22.4	19.9
PER (x)	**27.4**	**23.3**	**20.2**	**16.5**	**13.8**
ROE (%)	59.0	54.1	46.3	42.9	39.9
Debt/Equity (x)	0.3	0.2	0.1	0.1	0.1
EV/EBITDA (x)	**22.5**	**19.0**	**16.8**	**13.1**	**10.6**
Price/Book (x)	16.2	12.6	9.4	7.1	5.5

Price as at close of business on 5 February 2009

12-mth Target price (Rs) 111 (22%)

Market cap (US$ m)	**1,608**
52Wk High/Low (Rs)	116/60
Diluted o/s shares (m)	864
Daily volume (US$ m)	1.5
Dividend yield FY08 (%)	1.9
Free float (%)	29.3

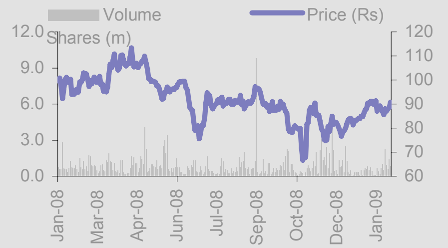
Shareholding pattern (%)

Promoters	70.7
FIIs	8.5
Domestic MFs/Insurance cos	13.8
Others	7.0

Price performance (%)

	1M	3M	1Y
Dabur India	7.1	2.5	-10.2
Rel. to Sensex	18.7	12.7	41.1
HUL	8.4	10.3	26.0
Colgate	2.5	9.3	0.1
Marico	0.0	16.2	-11.7

Stock movement



Pragati Khadse
pragati.khadse@iiflcap.com
(91 22) 6620 6665

Arnab Mitra
arnab.mitra@iiflcap.com
(91 22) 6620 6661

Improving business outlook; we upgrade to BUY

We have been negative on Dabur owing to concerns on:

1. Slowdown in revenue growth as core categories such as foods, oral care and hair care;
2. Restricted margin expansion owing to increased agri input costs and crude-linked packaging materials (17% of FY08 sales); and
3. Risk of retail losses weighing on margins.

These concerns have weighed heavily on the stock, which has underperformed its HPC FMCG index consisting of Hindustan Unilever, Colgate and Marico by 36.5% over the last one year.

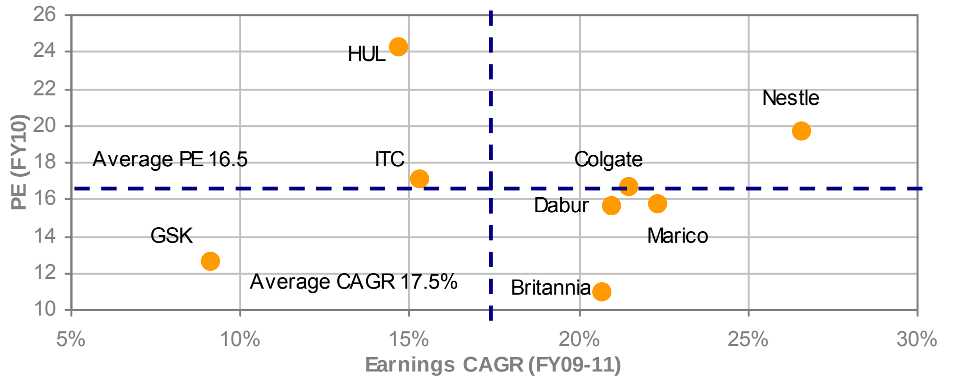
Figure 1: Dabur has underperformed the HPC FMCG index

Return	3-month	6-month	1-year
Dabur	0.4%	-1.3%	-11.4%
FMCG HPC Index*	12.4%	9.1%	25.1%
Dabur relative to FMCG HPC Index	-12.0%	-10.4%	-36.5%

Source: IIFL Research. *Comprises HUL, Colgate and Marico

Most of these concerns have started abating, in our view, with the improving outlook on key categories such as domestic hair care and improved visibility on margin expansion (due to softness in key inputs and crude-linked packaging costs). With the fall in Dabur's key inputs and packaging costs, the margin outlook is promising. Furthermore, with the FMCG industry moving into a period of constrained pricing power with minimal price increases, Dabur's primarily-volume-led growth in recent quarters assumes significance and is a key positive, in our view. Given the improved revenue and margin outlook, we revise our FY09-11ii estimates upwards. We raise our target price to Rs111 and upgrade the stock from REDUCE to BUY. Dabur is trading at 13.8x FY11ii earnings, which represents a 30% discount to the average of its 1-year forward PE over the last five years.

Figure 2: FMCG valuation matrix

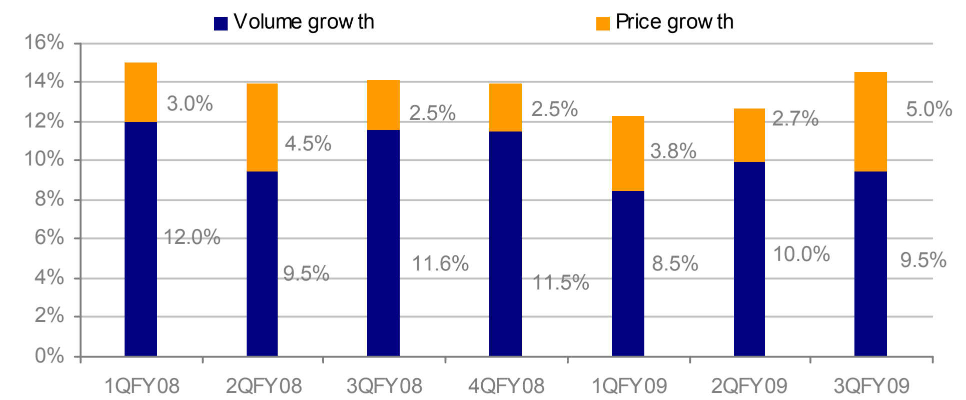


Source: IIFL Research

Robust volumes amid constrained pricing power

Dabur's revenue growth momentum over the last few quarters has been impressive, with the quality of growth being far superior to that of its peers in the HPC space. The company has maintained volume growth in the domestic business at 8.5-10%, while total volume growth has reached 14.5% YoY in 3QFY09, the highest among HPC companies.

Figure 3: Dabur's domestic business has maintained strong volume growth



Source: Company, IIFL Research

The acceleration in growth has been led by both the international and domestic businesses. In the international business, growth has been led by Dabur's expanding geographical footprint; in the domestic business, growth has picked up following a revival in key categories such as hair oil through Dabur's key brand *Vatika*. Dabur derives a large chunk of its revenues (45% of FY08 sales) from hair oils, shampoos, toothpastes, and juices, etc, which have witnessed no apparent slowdown in consumption. With increasingly fettered pricing power, revenue growth in the approaching fiscal is likely to be led by volumes. In this backdrop, Dabur's consistent volume growth over the last eight quarters is a key positive.

Core hair-care business on a strong footing

Dabur's hair-oil business, which accounts for 18% of net sales, had witnessed a slowdown during 1QFY09. Management's initiatives to revive growth by re-launching the Vatika hair oil brand have yielded results. In hair oils, Dabur is aggressively promoting its complete portfolio, comprising flagship brand *Dabur Amla* and other coconut oil brands such as *Dabur Vatika* and *Dabur Anmol*. While *Dabur Amla* is strengthening its dominant position in *Amla* hair oils, *Dabur Vatika* and *Anmol* are gaining share in the coconut-oil category through aggressive advertising and trade promotions.

Figure 4: Dabur's hair care portfolio has visible growth outlook

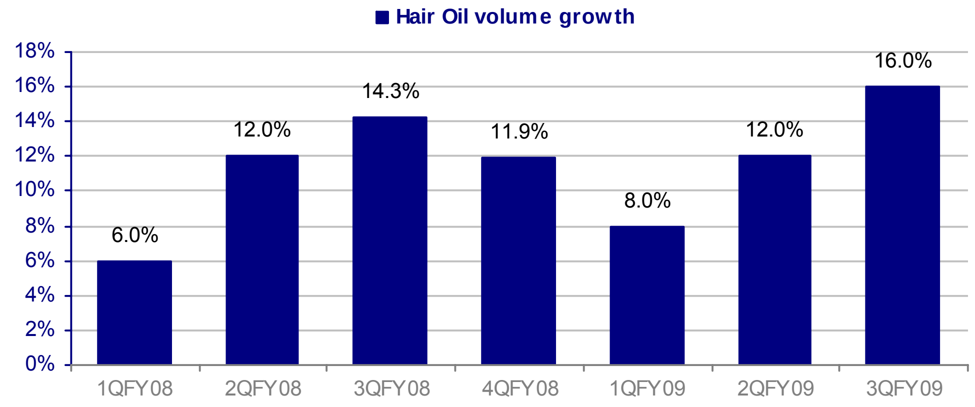
Category/Brand	% of net sales	Growth outlook	Growth drivers
Dabur Amla Oil	13%	15%	Value-added hair-care segment is growing by 15% in volume. Dabur Amla will grow in-line with the market being a dominant player in the Amla segment
Dabur Vatika Oil	3%	25%	Was re-launched with new packaging and advertising which has been received very well
Dabur Anmol Oil	2%	25%	A small player in the coconut oil segment and talking share from Nihar in discount coconut oils
Vatika Shampoo	5%	25%	A niche player and would grow by new launches like Vatika Black Shine
Overall Hair Care	23%	18-20%	Growth faster than the category

Source: IIFL Research

In shampoos, Dabur is growing at 25-35%—faster than the category—by creating niche brands such as *Vatika Black Shine*. The company has been able to grow its market share from 5.1% in 9MFY08 to 6.4% in 9MFY09 and with enough headroom for growth by way of gaining share from other players, this category holds promise.

Overall, we expect the hair-care portfolio (23% of sales) to grow at 18-20% pa over the next two years. Dabur's hair oils and shampoo brands have seen an acceleration in growth over the last two quarters. In 3QFY09, Dabur's hair-oil grew 25% YoY and shampoo volumes grew 32% YoY. The growth in both categories was largely volume-led, with volume sales of hair-oils growing by 15% and those of shampoos by over 25%.

Figure 5: Hair-oil volume growth has accelerated

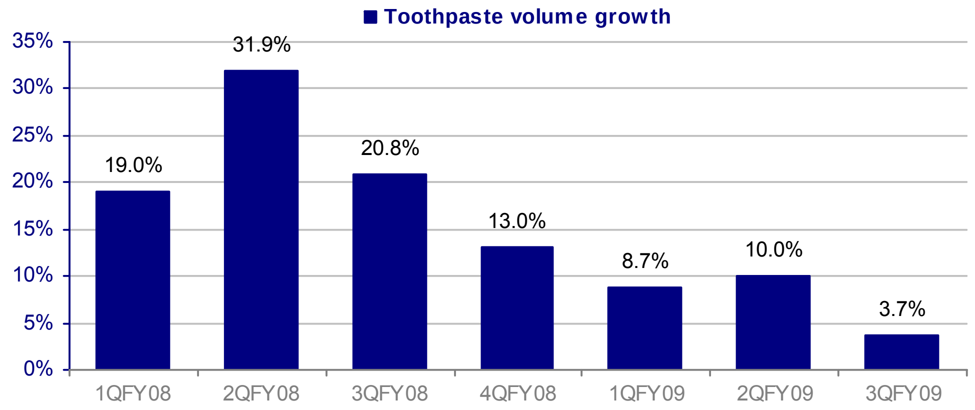


Source: IIFL Research

Toothpastes likely to see a revival

Dabur's sales in the toothpaste segment have been slower than the category's growth; in 3QFY09, the company's sales in the segment grew 3.7% YoY, far slower than the category's growth of 14-15% (volumes of *Dabur Red* toothpaste grew 18% while those of *Babool* and *Meswak* grew at very low single-digit rates). *Babool* sales have suffered because of flip-flops in Dabur's strategy on the key Rs10 SKU, where the company first took a price hike and then reversed it, while withdrawing the free-toothbrush promotion offer. Both these moves went wrong, to the benefit of Colgate's *Cibaca*. Dabur's management has now taken corrective steps, having restored the old Rs10 toothpaste pack with a free toothbrush. This move has been made possible by the fall in plastics prices and sourcing from China (which has reduced the cost of the brush). We expect growth in *Babool* to get a boost after this move, growing at the category growth rate of c15%. The new launch of *Babool Gel* and re-launch of *Meswak* toothpaste will also add to incremental sales growth.

Figure 6: Toothpaste volume growth has been very poor in 9MFY09

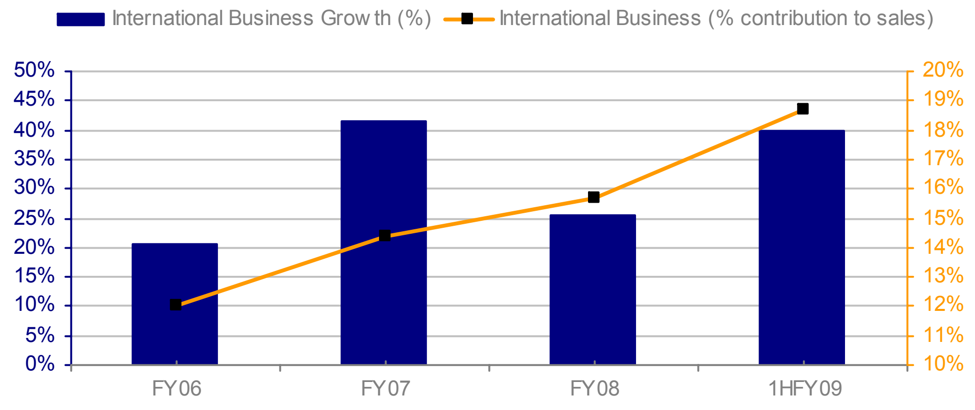


Source: IIFL Research

International businesses continues to shine

Dabur's international revenues grew by 44% YoY during 9MFY09, with volume growth of over 25%. In the fiscal so far, Dabur has entered new geographies—Algeria, China, Lebanon and Turkey—and plans to enter Jordan, Syria and Kenya shortly. The company also strengthened itself in older international markets. Revenues from the Middle East grew by 47%, Egypt by 85% and Bangladesh by 52%. With a large manufacturing facility in UAE becoming fully operational, the company is well positioned to meet supplies for the fast growth trajectory. We expect Dabur's international business to grow at 30% for the next two years.

Figure 7: The share of international business is growing



Source: IIFL Research

Other categories to see stable growth

Other important categories such as foods and health supplements, we reckon, will register stable growth. Foods (15% of sales) should get a fillip from the launch of fruit drinks by Dabur during summer this year. The fruit-drink segment has been growing much faster than the fruit-juice segment in which Dabur is currently present. Also, the integration of the foods sales system with the larger consumer-care sales system will benefit distribution reach as well as profitability of the foods business. Health supplements (14% of sales) will see subdued growth, as the category is discretionary in nature and may be impacted by the economic slowdown. This year's unusually warm winter has also kept volumes of health supplements low.

Impressive new product pipeline for FY10

Dabur has an impressive pipeline of new products for launch in FY10. The company plans to enter the fast-growing fruit-juices category. Dabur also plans to launch an ayurvedic skin-care range over the next

3-4 months, dovetailing on the company's brand positioning as a 'traditional products' company. Besides this, the company will increase its focus on skin-care, with new launches planned under the newly acquired *Fem Care* brand.

Gross margin set for 140bps expansion in FY10

Product prices to be retained as volume growth remains healthy
Dabur is one of the few consumer-goods companies in India that faced relatively subdued levels of inflation in raw materials over the last fiscal. The important fallout of this was the nominal price increases that this minimal level of raw-material inflation warranted—Dabur took price hikes of 4-5% during 2008, compared to the 5-30% price increases effected by its peers. As such, Dabur's core categories have seen healthy volumes. Volume growth in the domestic business has remained robust at 9-10% during 9MFY09. As such, the company is under no pressure to cut prices as commodity prices recede. Dabur's key competitors are Marico and Colgate, both of which are unlikely to wage a price war, based on their management commentary and past record. We expect Dabur's gross margin to expand from 1QFY10 as input prices come down on a YoY basis. We forecast a 140bps expansion in gross margin in FY10 over FY09.

Raw materials soften across the board
Prices for Dabur's raw and packaging materials have softened across the board. Forward covers taken during the commodity up-cycle have been completely exhausted till January 2009, and as such there is a strong likelihood of margin pressure easing in the quarters ahead.

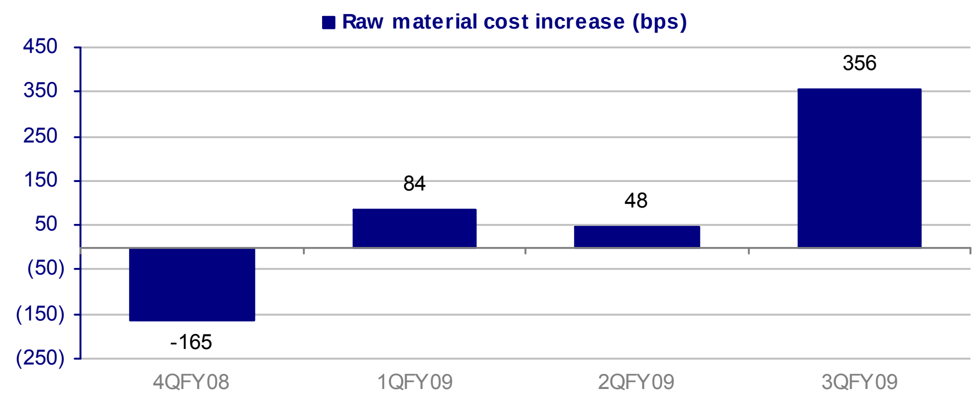
Dabur uses a large variety of raw & packing materials, most of which are now seeing a downtrend in prices. Plastics and laminates are the largest component of raw & packing materials, and have seen a significant correction even on a YoY basis, as most of these are crude derivatives. Chemicals include a large amount of light liquid paraffin, which is a crude derivative and has thus seen a sharp fall in prices of late. Other key raw materials, such as herbs and vegetable oils, have also seen a YoY decline in prices. Overall, we estimate a 10-15% YoY decline in Dabur's raw-material price index for FY10 over FY09.

Figure 8: There has been an all-round reduction in material costs

Material	As a % of material cost	As a % of net sales	Current outlook
Plastics & laminates	20.4%	10.8%	Prices down 10-15% YoY as they are mainly crude derivatives
Chemicals	20.3%	10.8%	Includes Light Liquid Paraffin Oil used in hair oils which has seen a sharp correction being a crude derivative
Herbs	15.1%	8.0%	There has been a c20% YoY decline in prices of herbs procured by Dabur
Vegetable oils	13.0%	6.9%	Prices are down 20-30% YoY as palm oil prices drive overall vegetable oil prices
Glass containers	3.3%	1.7%	Though prices are still up YoY, there is a downtrend
Sugar	3.2%	1.7%	Prices are up 15-20% YoY
Others	24.7%	13.1%	Prices are down 15-20% YoY
Total raw & packaging materials	100%	53.0%	Down 15% YoY and 25% from the peak prices

Source: Company, IIFL Research

Figure 9: Dabur's raw-material costs have increased sharply in 3QFY09

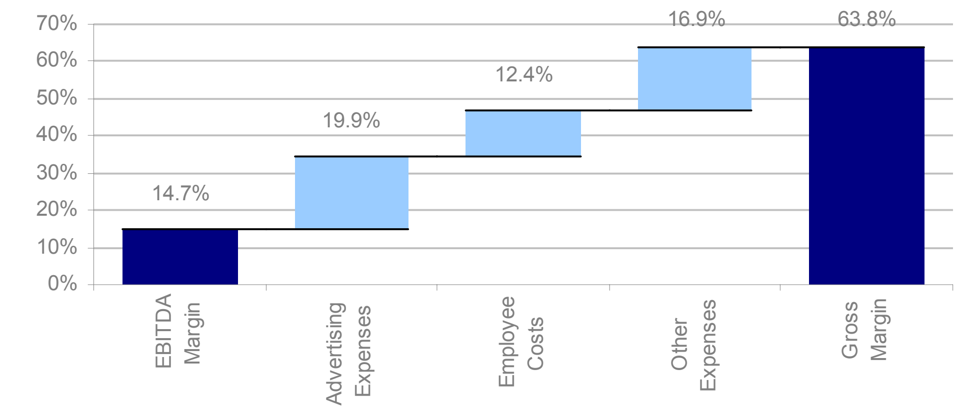


Source: Company, IIFL Research

FCPL cost synergies likely to kick in from FY10

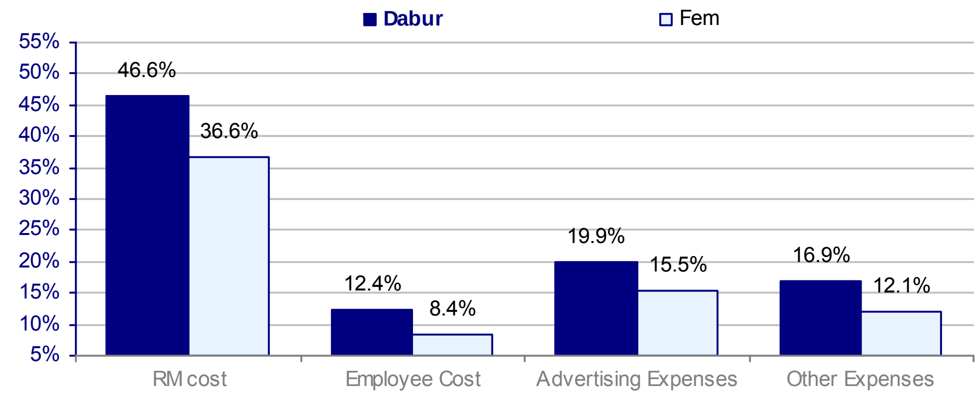
The cost structure of FCPL reveals considerable inefficiencies. Despite high gross margins (64%, vs the peer group average of ~52%), FCPL's EBITDA margin is comparable to the peer group's. Lack of scale translates into higher fixed costs in areas such as employee spends and operational overheads, indicating clear potential for significant savings. Also, FCPL had scaled up its ad spend from 14.4% (of sales) to 19.9% in FY08, as there was a major launch of *Oxybleach;* ad spends should come down in FY10ii as media-buying efficiency kicks in and no major new launches are planned. We estimate FCPL will add 7% to incremental PAT in FY11ii and 30% to incremental sales for FY11ii.

Figure 10: FCPL - high gross margins do not translate into high OPM; room to cut costs*



Source: Company, IIFL Research* FY08 nos.

Figure 11: Fem has much higher cost base than Dabur except raw materials



Source: Company, IIFL Research

Retail losses to reduce with slow ramp-up

Dabur's retail expansion plans have been further scaled down in view of the economic slowdown and the volatility in real-estate rentals. The current store count stands at 6 and the company is likely to end FY09 with 13 stores. This is a marked scale-down from the 50 stores that were planned earlier on. The size of outlets has also been pruned—from the original plan of 1,500sq ft to 6,000sq ft, and finally to less than 1,000 sq ft. The management has guided for Rs20m-25m quarterly loss in retail from 4QFY09 as compared to the Rs50m-60mn quarterly loss seen during the last few quarters.

We raise earnings estimates

We have upgraded Dabur's FY10 and FY11 EPS estimates to reflect the expansion in gross margins and higher growth rates from the domestic business.

Figure 12: EPS estimates for FY10 and FY11 increased by 7% and 10% respectively

Rs m	FY10			FY11		
	Old	New	% change	Old	New	% change
Sales	32,250	33,646	4.3%	37,622	39,335	4.6%
PAT	4,606	4,699	2.0%	5,558	5,637	1.4%
EPS (Rs)	5.3	5.4	2.0%	6.4	6.5	1.4%

Source: IIFL Research

Financial summary

Other income reduction in FY10ii due to lower cash post Fem Care acquisition

Capex increase in FY10ii due to construction of new facility at Baddi

Fem Care acquisition appears as 'investments' in FY09, while liquid investments are used for the acquisition

Income statement summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenue	20,431	23,611	27,806	33,647	39,335
EBITDA	3,498	4,094	4,668	5,926	7,061
EBIT	**3,090**	**3,673**	**4,244**	**5,405**	**6,477**
Net Interest expense	-154	-168	-171	-179	-181
Other Income	259	339	373	252	277
Profit before tax	**3,195**	**3,844**	**4,446**	**5,478**	**6,572**
Taxes	-373	-507	-600	-774	-930
Minorities and other	9	1	-5	-5	-5
Net profit	**2,831**	**3,339**	**3,841**	**4,700**	**5,637**

Cashflow summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Profit before tax	3,195	3,844	4,446	5,478	6,572
Depr. & amortization	343	364	424	522	584
Tax paid	-387	-499	-600	-774	-930
Working capital Δ	-1,440	1,628	-724	-313	-479
Other operating items	108	-218	-5	-5	-5
Operating cashflow	1,819	5,119	3,541	4,908	5,742
Capital expenditure	990	-1,225	-972	-1,915	-666
Free cash flow	**2,809**	**3,894**	**2,569**	**2,993**	**5,077**
Equity raised	290	1	0	0	0
Investments	-386	-1,230	-1,263	0	0
Debt financing/disposal	556	-607	200	0	0
Dividends paid	-1,392	-1,516	-1,728	-2,040	-2,447
Other items	-1,782	-382	-4	0	0
Net change in cash	**95**	**159**	**-227**	**953**	**2,629**

Source: Company data, IIFL Research

Financial summary

Cash reduction in FY09 due to Fem Care acquisition

Pick-up in revenue growth from FY10ii due to Fem Care and international business

Fem Care will be consolidated from FY10 onwards

Balance sheet summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Cash & equivalents	607	766	539	1,492	4,122
Sundry debtors	1,420	1,723	1,930	2,235	2,600
Inventories - trade	2,571	3,025	3,473	4,023	4,680
Other current assets	1,807	2,225	2,631	3,126	3,736
Fixed assets	**3,792**	**4,653**	**5,201**	**6,594**	**6,676**
Intangible assets	0	0	0	0	0
Other term assets	1,005	2,177	3,440	3,440	3,440
Total assets	**11,201**	**14,568**	**17,213**	**20,910**	**25,253**
Short-term debt	395	16	16	16	16
Sundry creditors	3,615	4,580	4,882	5,718	6,626
Other current liabs	902	2,741	2,775	2,976	3,220
Long-term debt/CBs	1,204	976	1,176	1,176	1,176
Other long-term liabs	245	33	33	33	33
Minorities/other equity	45	48	43	43	43
Net worth	**4,796**	**6,176**	**8,288**	**10,948**	**14,138**
Total liabs & equity	**11,201**	**14,568**	**17,213**	**20,910**	**25,253**

Ratio analysis

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Revenue growth (%)	18.6	15.6	17.8	21.0	16.9
Op Ebitda growth (%)	22.1	17.1	14.0	26.9	19.1
Op Ebit growth (%)	19.0	18.9	15.5	27.3	19.8
Op Ebitda margin (%)	17.1	17.3	16.8	17.6	17.9
Op Ebit margin (%)	15.1	15.6	15.3	16.8	17.3
Net profit margin (%)	13.9	14.1	13.8	14.0	14.3
Dividend payout (%)	49.2	45.4	45.0	43.4	43.4
Tax rate (%)	11.7	13.2	13.5	14.1	14.2
Net debt/equity (%)	20.7	3.7	7.9	-2.7	-20.7
Net debt/op Ebitda (x)	0.3	0.1	0.1	-0.1	-0.4
Return on equity (%)	59.0	54.1	46.3	42.9	39.9
ROCE (%)	52.4	58.5	54.8	54.8	58.9

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

Published in 2009. © India Infoline Ltd 2009
This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information of the clients of IIFL, a division of India Infoline, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

India Infoline or any persons connected with it do not accept any liability arising from the use of this document. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information.

India Infoline or any of its connected persons including its directors or subsidiaries or associates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained, views and opinions expressed in this publication.

India Infoline and/or its affiliate companies may deal in the securities mentioned herein as a broker or for any other transaction as a Market Maker, Investment Advisor, etc. to the issuer company or its connected persons. India Infoline generally prohibits its analysts from having financial interest in the securities of any of the companies that the analysts cover.