Marico – ADD

20 April 2011

Management meeting

IIFL Institutional Equities

Positive mix change, but priced in

Marico's business is seeing significant transition, with the company selling off the low-margin *Sweekar* edible-oil business and entering Vietnam by acquiring a very high-quality personal-care company. The Vietnam acquisition has added a new dimension to Marico's business and opens up possibilities of expanding in male-grooming segments in India, Egypt and Malaysia. However, the company continues to face near-term headwinds, among them instability in the Middle East and North Africa (MENA), and high commodity costs. In our view, the stock is fully valued after the recent run-up in prices. We downgrade the stock from BUY to ADD.

Vietnam acquisition a very high-quality franchise: ICP is a high-quality play on the fast-growing male grooming segment in Vietnam, with market leadership in men's shampoo and a complete male-grooming product suite comprising face wash, deodorant and shower gel. The retention of the founder, who has driven this innovative company, is a major positive for the company. Marico expects 20%+ revenue growth in the business. The lead brand, *X-Men*, can be extended into other key markets such as Malaysia and Egypt.

Hair-oils growth unabated despite steep price hikes: Marico's management sees no slowdown in the value-added hair-oils category, despite steep 12-14% price hikes. Marico is seeing significantly faster-than-category growth in value-added hair-oils, with its thrust on Amla and Ayurvedic oils delivering results. The management is now looking at 15-17% volume growth in value-added oils as compared to its earlier expectation of 12-14% for the next 2-3 years. Volume growth in Parachute continues to be positive despite a 35% price hike in the past six months, demonstrating its high pricing power.

MENA faces price controls now: While operations have resumed in most of the MENA region, an ad hoc government order disallowing price hikes has come from Egypt and Saudi Arabia. This is likely to cause margin pressures in the current situation of commodity inflation.

Company update

CMP	**Rs137**
12-mth TP (Rs)	***147 (7%)***
Market cap (US$ m)	**1,871**
Bloomberg	**MRCO IN**
Sector	**FMCG**

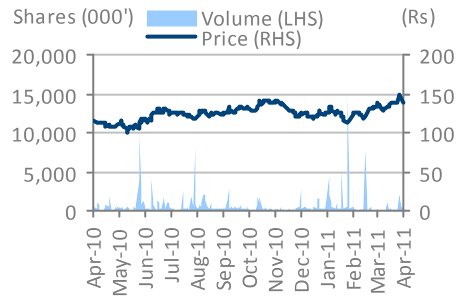
Price performance (%)

	1M	3M	1Y
Marico	0.9	2.9	20.2
Rel. to Sensex	**-6.0**	**2.2**	**10.7**
Dabur	5.8	2.1	16.9
Colgate	6.6	6.3	21.7
Hind. Unilever	3.1	-7.6	21.6

Shareholding pattern (%)

Promoters	62.9
FIIs	25.9
DIIs	4.4
Others	6.8
52Wk High/Low (Rs)	153/99
Shares o/s (m)	614
Daily volume (US$ m)	2
Dividend yield FY11ii (%)	0.6
Free float (%)	37.1

Stock performance



Financial summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenues (Rs m)	23,864	26,608	31,394	38,718	44,893
EBITDA Margins (%)	12.7	15.2	13.0	12.6	13.2
Pre-Exceptional PAT (Rs m)	2,017	2,708	2,814	3,415	4,288
Reported PAT (Rs m)	1,866	2,317	3,191	3,059	3,897
Adj. EPS (Rs)	3.3	4.4	4.6	5.6	7.0
Growth (%)	30.4	34.3	3.9	21.3	25.6
IIFL vs consensus (%)			-1.2	-1.3	2.3
PER (x)	**41.7**	**31.0**	**29.9**	**24.6**	**19.6**
ROE (%)	41.2	35.4	34.8	26.4	26.4
Debt/Equity (x)	0.8	0.7	0.7	0.4	0.3
EV/EBITDA (x)	28.8	21.6	21.8	18.0	14.4
Price/Book (x)	18.5	12.9	9.2	7.3	5.7

Source: Company, IIFL Research. Priced as on 19 April 2011

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Vietnam acquisition (ICP) adds a new dimension to Marico's business

- **Male grooming brand *X-men* contributes over 80% of revenues:** The brand has a range of male-grooming products—shampoos, deodorants, face washes and shower gels. It was the first to introduce a shampoo for men and holds market leadership in this segment, with c35% marketshare. Unilever's Clear Men is the second-largest brand, with 15% share. The men's shampoo segment represents 25% of the overall shampoo market in Vietnam.
- **Foods is a fast-growth segment for the company:** Ten percent of the company's revenues come from foods—largely sauces, in which ICP holds single-digit market share. This is a very fast-growing segment, which is driven by widespread conversion from loose to branded sauces. The market leader in the category has seen a 10x increase in revenues in two years.
- ***X-Men* brand could be extended to other markets:** Marico has a major presence in Egypt's male-grooming market, with its hair creams. The X-Men brand would have appeal in that market as it would in Malaysia, where Marico has a small presence and a distribution reach through the acquisition of Code 10 a year ago. While the product has relevance for India too, the highly competitive environment could make the management weary of a major launch at this stage.
- **Founder retained in the company for at least three years:** The founder of ICP would continue to be CEO for another three years. This should ensure robust continuity in the company's strategy and operations.
- **CY10 revenues were flat YoY owing to changes in managemnet structure; growth should now pick up to 20%+:** ICP went through a difficult time in CY10 after management changes at senior levels. Revenues remained flat YoY (albeit after strong growth in CY09). With the complete management structure now back in place, Marico expects 20%+ revenue growth in CY11.
- **US$ acqusition debt is unhedged; acquisition would likely be EPS-accretive in FY12:** The acquisition has been funded by unhedged US$ debt at c3% interest rate. Thus, the aquisition is likely to be EPS-accretive, even though it was done at a P/E of 20-25x.

Commodity inflation will continue to be a headwind

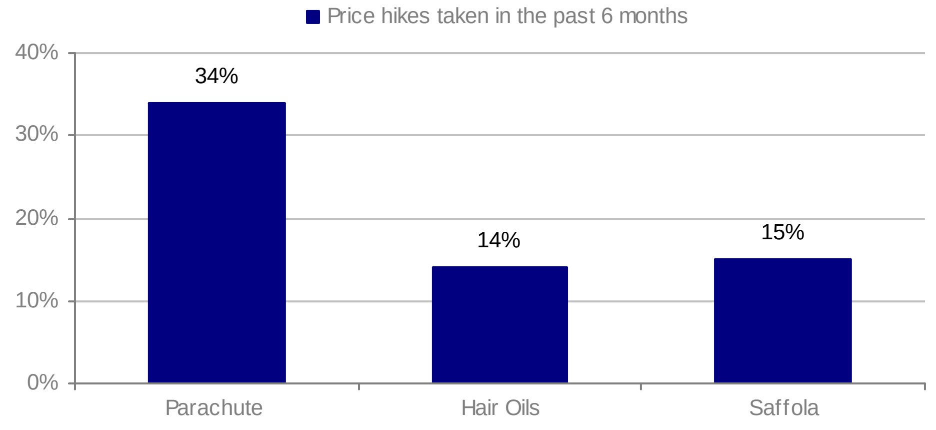
Marico's commodity costs are seeing continuous inflation despite copra prices stabilising lower than the peak seen in February. The overall inflation in raw-material index of the domestic business is over 35% YoY now. Marico has taken blended price hikes of 20-25% in the last six months, which would help mitigate the inflation at a unit margin level (absolute margin per unit volume), though gross margins in percentage terms would decline YoY.

Figure 1: Raw-material inflation continues to be very high at c35%

Raw materials	Commodity price Increase over 1QFY11 average
Copra	75%
Safflower	40%
Sunflower	35%
Rice Bran	35%
Corn Oil	20%
Packaging	15%
LLP	54%
Others (international business, Kaya)	10%
Blended Cost Index Increase	**35%**

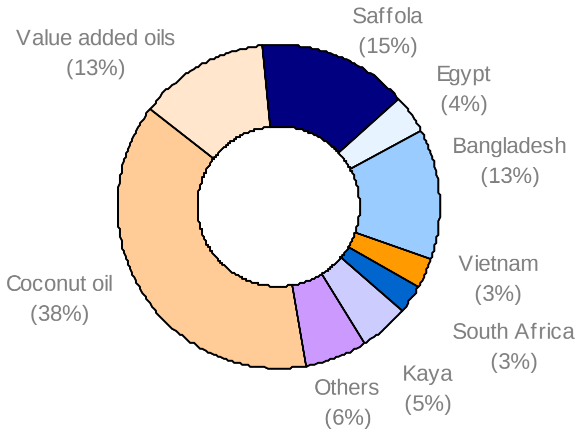
Source: Company, IIFL Research

Figure 2: Price hikes have been very steep in the past 6 months



Source: Company, IIFL Research

Figure 3: Marico's new business mix post sale of Sweekar and acquisition in Vietnam



Source: Company, IIFL Research

Assumptions

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Coconut oil growth (YoY)	23%	4%	20%	30%	13%
Value added oils growth (YoY)	25%	10%	30%	30%	18%
Saffola growth (% YoY)	23%	2%	15%	22%	18%
International business (% of sales)	19%	23%	23%	26%	26%

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue	23,864	26,608	31,394	38,718	44,893
EBITDA	3,019	4,045	4,081	4,864	5,926
EBIT	2,661	3,444	3,560	4,307	5,332
Net Interest expense	-301	-257	-388	-350	-277
Other Income	65	183	201	229	262
Profit before tax	**2,426**	**3,370**	**3,372**	**4,187**	**5,317**
Taxes	-409	-643	-540	-754	-1,010
Exceptional items	-150	-391	377	-355	-391
Minorities and other	0	-19	-19	-19	-19
Net profit	**1,866**	**2,317**	**3,191**	**3,059**	**3,897**

Cash flow summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Profit before tax	2,426	3,370	3,372	4,187	5,317
Depr. & amortization	358	601	521	557	593
Tax paid	-409	-643	-540	-754	-1,010
Working capital Δ	-1,064	-1,080	-1,156	-1,285	-1,079
Other operating items	-150	-410	358	-374	-409
Operating cashflow	1,161	1,838	2,556	2,332	3,412
Capital expenditure	-896	-1,486	-500	-400	-400
Free cash flow	**265**	**351**	**2,056**	**1,932**	**3,012**
Investments	212	-681	-3,183	0	0
Debt financing/disposal	170	709	2,303	-1,700	-1,191
Dividends paid	-467	-470	-570	-642	-713
Other items	-11	283	0	0	0
Net change in cash	**169**	**193**	**606**	**-410**	**1,108**

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Cash & equivalents	922	1,115	1,721	1,311	2,419
Sundry debtors	1,108	1,507	1,778	2,193	2,542
Inventories - trade	3,390	4,448	5,248	6,473	7,505
Other current assets	1,299	1,900	2,242	2,765	3,206
Fixed assets	3,111	3,997	3,976	3,818	3,625
Intangible assets	1,492	1,467	1,467	1,467	1,467
Other term assets	121	827	4,010	4,010	4,010
Total assets	**11,442**	**15,260**	**20,440**	**22,035**	**24,773**
Short-term debt	2,675	3,317	3,317	2,317	1,817
Sundry creditors	2,803	3,369	3,698	4,561	5,289
Other current liabs	355	768	694	709	725
Long-term debt/CBs	1,075	1,142	3,445	2,745	2,054
Minorities/other equity	0	125	125	125	125
Net worth	**4,535**	**6,540**	**9,161**	**11,578**	**14,763**
Total liabs & equity	**11,442**	**15,260**	**20,440**	**22,035**	**24,773**

Ratio analysis

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue growth (%)	25.4	11.5	18.0	23.3	15.9
Op Ebitda growth (%)	24.5	34.0	0.9	19.2	21.8
Op Ebit growth (%)	25.7	29.4	3.4	21.0	23.8
Op Ebitda margin (%)	12.7	15.2	13.0	12.6	13.2
Op Ebit margin (%)	11.2	12.9	11.3	11.1	11.9
Net profit margin (%)	7.8	8.7	10.2	7.9	8.7
Dividend payout (%)	25.0	20.3	17.9	21.0	18.3
Tax rate (%)	16.9	19.1	16.0	18.0	19.0
Net debt/equity (%)	62.4	51.1	55.0	32.4	9.8
Return on equity (%)	41.2	35.4	34.8	26.4	26.4

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%.
