September 15, 2011

COMPANY UPDATE

Marico (MRCO.BO)

Buy

Equity Research

High input costs to pressure margins, volumes intact; Retain Buy

What's changed

Marico issued an update post market on Sept 14, warning that consensus operating margin estimates for FY12E were unlikely to be met by the company given: (1) input costs, which remain high; (2) the fragile demand environment given recent events in the global economy; and (3) recent accounting changes in Kaya and the international business. The company has stated a preference for maintaining volume growth at the cost of margins over the near term by not taking any further price increases.

Implications

We believe that volume growth and margin expansion are unlikely to coexist for the Indian FMCG sector given high input costs and slowing economic growth. While we had forecast a decline in margins for FY12E, we are further reducing our EBITDA margin estimates to 11.8% from 12.8% to reflect input costs and cut our FY12E-FY14E EPS estimates 6%-7%. We maintain our volume growth forecasts of 10% for the domestic business in FY12E and 18% organic volume growth for the international business.

Valuation

We retain our Buy rating as we believe medium- to long-term prospects for the company remain intact, with robust domestic volume growth in its franchise brands, improving returns for the international business, and Kaya on track to generating profits following the restructuring of its business. In line with our earnings revisions, we cut our 12-month 25X FY13E EPS-based target price to Rs163 from Rs174. Our target price is also supported by Director's Cut analysis. While at 24.4X FY13E the stock is trading close to our target multiple, we believe it offers the best risk-reward potential in our India consumer staples coverage universe.

Key risks

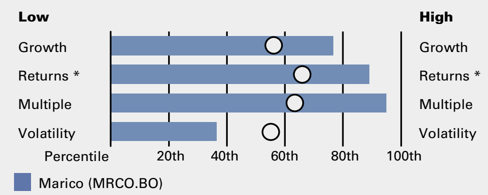
(1) Change in consumer preferences away from hair oil; (2) sustained input cost pressure; and (3) slower-than-expected turnaround at Kaya.

INVESTMENT LIST MEMBERSHIP

Asia Pacific Buy List

Coverage View: Neutral

Investment Profile

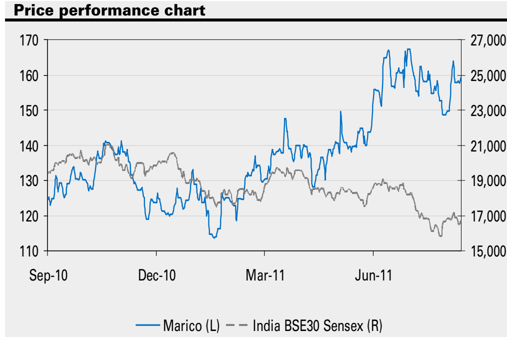


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (Rs)	159.15
12 month price target (Rs)	163.00
Market cap (Rs mn / US$ mn)	96,946.3 / 2,036.9
Foreign ownership (%)	--

	3/11	3/12E	3/13E	3/14E
EPS (Rs) New	**3.87**	**4.90**	**6.53**	**8.07**
EPS revision (%)	0.0	(5.7)	(6.0)	(7.4)
EPS growth (%)	(2.0)	26.6	33.4	23.4
EPS (dil) (Rs) New	**4.66**	**4.90**	**6.53**	**8.07**
P/E (X)	41.1	32.5	24.4	19.7
P/B (X)	10.7	8.5	6.6	5.2
EV/EBITDA (X)	19.9	21.0	16.2	13.2
Dividend yield (%)	0.4	0.5	0.7	0.9
ROE (%)	36.5	29.0	30.5	29.6
CROCI (%)	30.2	27.1	30.0	31.1

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	14.2	19.6	27.6
Rel. to India BSE30 Sensex	25.1	32.0	47.8

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/14/2011 close.

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Marico: Summary Financials

Profit model (Rs mn)	3/11	3/12E	3/13E	3/14E
Total revenue	**31,283.1**	**41,610.1**	**49,742.7**	**59,086.2**
Cost of goods sold	(16,179.3)	(22,594.3)	(26,214.4)	(31,020.3)
SG&A	(5,763.5)	(7,573.0)	(9,301.9)	(11,049.1)
R&D	0.0	0.0	0.0	0.0
Other operating profit/(expense)	(5,242.4)	(6,553.6)	(7,958.8)	(9,453.8)
EBITDA	**4,097.9**	**4,889.2**	**6,267.6**	**7,563.0**
Depreciation & amortization	(708.0)	(957.0)	(1,144.1)	(1,359.0)
EBIT	**3,389.9**	**3,932.2**	**5,123.5**	**6,204.1**
Interest income	162.3	160.3	118.4	75.7
Interest expense	(393.3)	(433.1)	(343.1)	(223.1)
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	148.0	162.8	179.1	197.0
Pretax profits	**3,275.3**	**3,822.2**	**5,077.9**	**6,253.6**
Income tax	(849.9)	(764.4)	(1,015.6)	(1,250.7)
Minorities	(50.1)	(50.1)	(50.1)	(50.1)
Net income pre-preferred dividends	**2,375.3**	**3,007.6**	**4,012.2**	**4,952.8**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**2,375.3**	**3,007.6**	**4,012.2**	**4,952.8**
Post-tax exceptionals	489.1	0.0	0.0	0.0
Net income	**2,864.4**	**3,007.6**	**4,012.2**	**4,952.8**
EPS (basic, pre-except) (Rs)	3.87	4.90	6.53	8.07
EPS (basic, post-except) (Rs)	4.66	4.90	6.53	8.07
EPS (diluted, post-except) (Rs)	4.66	4.90	6.53	8.07
DPS (Rs)	0.66	0.84	1.11	1.38
Dividend payout ratio (%)	14.1	17.1	17.1	17.1
Free cash flow yield (%)	1.3	2.1	2.6	3.2

Growth & margins (%)	3/11	3/12E	3/13E	3/14E
Sales growth	17.6	33.0	19.5	18.8
EBITDA growth	9.2	19.3	28.2	20.7
EBIT growth	7.6	16.0	30.3	21.1
Net income growth	23.6	5.0	33.4	23.4
EPS growth	22.7	5.0	33.4	23.4
Gross margin	48.3	45.7	47.3	47.5
EBITDA margin	13.1	11.8	12.6	12.8
EBIT margin	10.8	9.5	10.3	10.5

Cash flow statement (Rs mn)	3/11	3/12E	3/13E	3/14E
Net income pre-preferred dividends	2,375.3	3,007.6	4,012.2	4,952.8
D&A add-back	708.0	957.0	1,144.1	1,359.0
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	(1,510.9)	(454.6)	(759.9)	(929.1)
Other operating cash flow	(696.8)	(577.4)	(885.2)	(1,207.1)
Cash flow from operations	**2,264.6**	**3,747.1**	**4,576.8**	**5,476.4**
Capital expenditures	(1,250.0)	(1,664.4)	(1,989.7)	(2,363.4)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	(2,572.8)	(604.0)	(637.3)	(670.6)
Cash flow from investments	**(3,822.8)**	**(2,268.4)**	**(2,627.0)**	**(3,034.1)**
Dividends paid (common & pref)	(236.9)	(300.0)	(400.2)	(494.0)
Inc/(dec) in debt	3,200.0	(1,000.0)	(2,000.0)	(2,000.0)
Common stock issuance (repurchase)	4.8	0.0	0.0	0.0
Other financing cash flows	(393.3)	(433.1)	(343.1)	(223.1)
Cash flow from financing	**2,574.5**	**(1,733.1)**	**(2,743.3)**	**(2,717.1)**
Total cash flow	**1,016.3**	**(254.4)**	**(793.5)**	**(274.8)**

Balance sheet (Rs mn)	3/11	3/12E	3/13E	3/14E
Cash & equivalents	2,130.9	1,876.6	1,083.1	808.3
Accounts receivable	1,879.8	2,280.9	2,726.7	3,238.9
Inventory	6,011.3	7,531.4	8,738.1	10,340.1
Other current assets	2,060.6	2,060.6	2,060.6	2,060.6
Total current assets	**12,082.7**	**13,749.5**	**14,608.6**	**16,447.9**
Net PP&E	3,409.7	4,117.1	4,962.7	5,967.2
Net intangibles	3,976.0	3,976.0	3,976.0	3,976.0
Total investments	891.6	1,691.6	2,491.6	3,291.6
Other long-term assets	1,788.9	1,788.9	1,788.9	1,788.9
Total assets	**22,148.9**	**25,323.1**	**27,827.8**	**31,471.6**
Accounts payable	4,104.6	5,571.2	6,463.8	7,648.8
Short-term debt	0.0	0.0	0.0	0.0
Other current liabilities	952.3	1,252.2	1,652.4	2,146.4
Total current liabilities	**5,056.9**	**6,823.4**	**8,116.3**	**9,795.2**
Long-term debt	7,718.2	6,718.2	4,718.2	2,718.2
Other long-term liabilities	0.0	0.0	0.0	0.0
Total long-term liabilities	7,718.2	6,718.2	4,718.2	2,718.2
Total liabilities	**12,775.1**	**13,541.7**	**12,834.5**	**12,513.5**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**9,154.9**	**11,562.6**	**14,774.4**	**18,739.3**
Minority interest	218.9	218.9	218.9	218.9
Total liabilities & equity	**22,148.9**	**25,323.1**	**27,827.8**	**31,471.6**
BVPS (Rs)	**14.91**	**18.83**	**24.06**	**30.52**

Ratios	3/11	3/12E	3/13E	3/14E
CROCI (%)	30.2	27.1	30.0	31.1
ROE (%)	36.5	29.0	30.5	29.6
ROA (%)	15.3	12.7	15.1	16.7
ROACE (%)	20.8	20.7	24.1	25.9
Inventory days	118.0	109.4	113.3	112.2
Receivables days	19.8	18.2	18.4	18.4
Payable days	81.2	78.2	83.8	83.0
Net debt/equity (%)	59.6	41.1	24.2	10.1
Interest cover - EBIT (X)	14.7	14.4	22.8	42.1

Valuation	3/11	3/12E	3/13E	3/14E
P/E (analyst) (X)	41.1	32.5	24.4	19.7
P/B (X)	10.7	8.5	6.6	5.2
EV/EBITDA (X)	19.9	21.0	16.2	13.2
EV/GCI (X)	5.3	6.0	5.2	4.5
Dividend yield (%)	0.4	0.5	0.7	0.9

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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Near-term margin squeeze likely, volume growth intact; Buy

We maintain our Buy rating on Marico. The company appears well placed to deliver robust top-line CAGR of 24% in FY11-FY14E, backed by its flagship brands, Parachute and Saffola. We also expect its international business to provide a boost with sales CAGR of about 27% in FY11-FY14E as recent acquisitions such as ICP in Vietnam gain traction.

Robust growth of key brands

Parachute and Saffola, Marico's key brands, saw robust sales growth in the past few quarters. The company has taken significant price increases (Exhibit 3) in key brands towards the end of FY11, and we expect it to post robust sales growth, especially in the latter half of FY12 as prices stabilize.

International business CAGR of 27% between FY11-FY14E

Marico's international business currently contributes about 23% of total revenues, and we expect this proportion to increase to 27% by FY14E. We believe post the recent cycle of investments into this business, margins for the overseas businesses should catch up with those of the domestic business, providing a margin buffer.

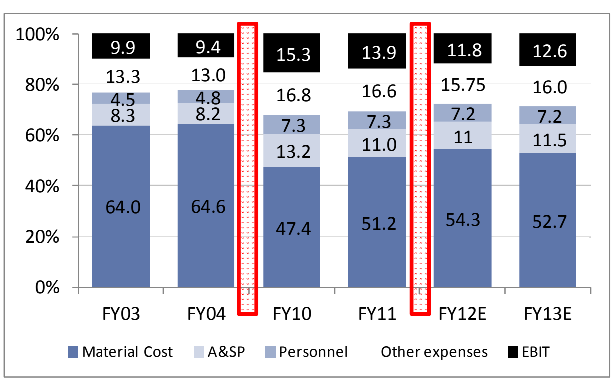
Raw material inflation still high yoy

Prices of key raw materials like copra, rice bran oil and kardi oil remain high on a yoy basis (Exhibit 2), as do the prices of crude-linked packing materials. While this may affect gross margins, particularly in the first half of FY12, we believe Marico increasingly has a margin buffer through its international business as well as through its more premium products 'Parachute Advansed' and 'Saffola Gold'.

Kaya reporting same-store sales growth

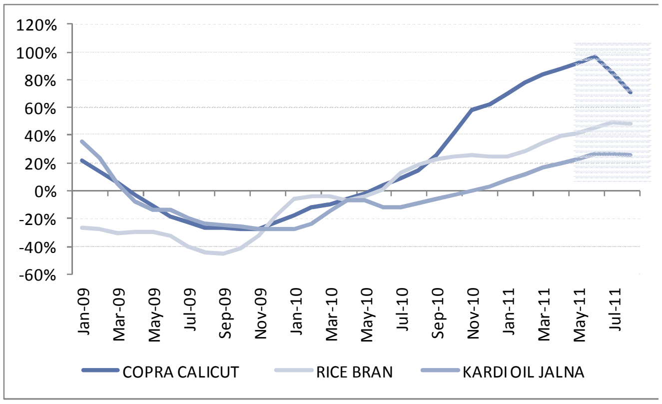
Kaya, a chain of skin clinics run by Marico, has reported same-store sales growth in 1QFY12 and 2HFY11, following a few quarters of same store declines. The company said that it has taken several measures to improve employee motivation and customer retention, in addition to cutting down on costs. Marico also acquired Derma Rx, a skin clinic chain in Singapore, in 2010 and we believe synergies from this business could boost the local business.

Exhibit 1: We are forecasting lower margins in FY12E-FY13E as compared with FY09-FY10
Marico – margin and cost trend



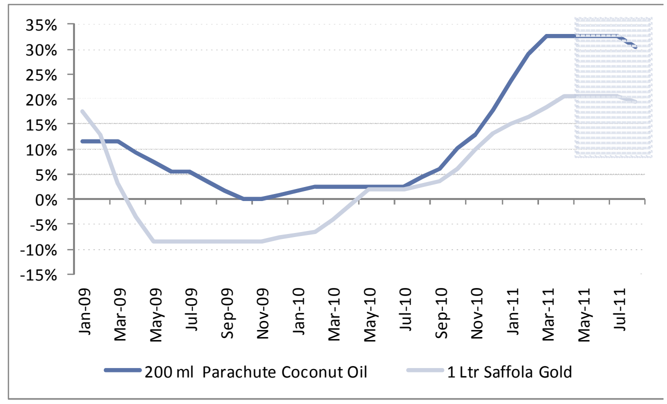
Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Prices of raw materials high yoy, although strong base effect likely in 2HFY12E
Quarterly rolling raw material price movement (yoy)



Source: Company data, Goldman Sachs Research.

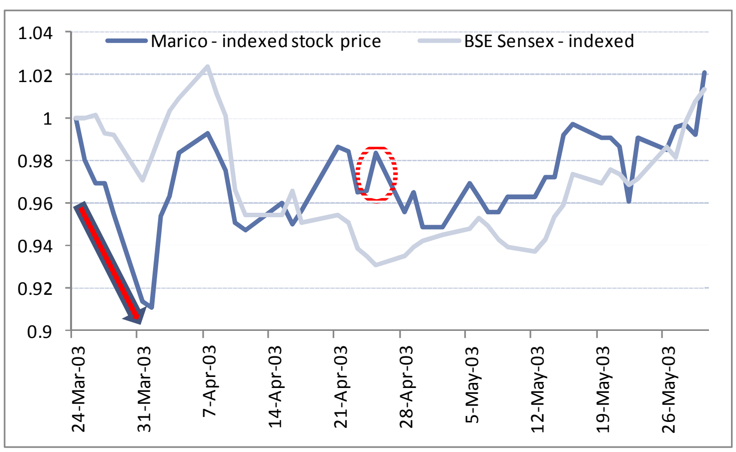
Exhibit 3: Marico has taken price increases to partially offset raw material increases
Quarterly rolling selling price movement (yoy)



Source: Company data, Goldman Sachs Research.

Although the circumstances were entirely different, Marico previously issued a profit warning after the market close on March 24, 2003, warning about lower turnover and profits in 4QFY03. Consequently, the company reported a EBITDA decline but flattish turnover and revenues on April 21, 2003. In the exhibit below we highlight the stock performance during this period relative to the Sensex.

Exhibit 4: Marico previously issued a profit warning on 24 March 2003
Indexed stock price performance versus BSE Sensex



Source: Company data, Datastream, Goldman Sachs Research.

Reg AC

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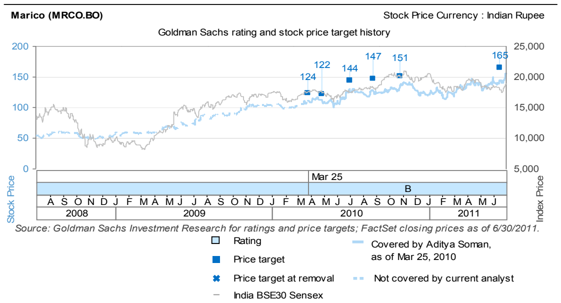
Price target and rating history chart(s)



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