India Equity Research | FMCG

Initiating Coverage

DABUR INDIA

INR 97

Real and active

ACCUMULATE

Edelweiss
Ideas create, values protect

March 2, 2007

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Emerging as the best play on Indian FMCG spend

Dabur's broad product portfolio provides the best play on Indian FMCG spend by virtue of its strong presence in under penetrated and high growth categories. Dabur's positioning on the 'health and wellness' platform backed by its ANH (Ayurvedic/Natural/Herbal) image is very progressive. This, combined with its demonstrated ability to create new categories and sub-categories, and a strong product pipeline makes it best placed to capture lifestyle changes led growth in the FMCG space.

Product portfolio well positioned for accelerating growth

Dabur is well placed to grow across all categories where it is present: conventional consumer care where it is likely to gain market share in toothpastes and maintain or grow shares in shampoos and hair care; fast growing categories such as juices and ayurved-based health supplements and medicines, where it is the market leader and driving category growth. Dabur has also demonstrated the ability to make and integrate smart acquisitions (Balsara) that complement its product portfolio and thereby drive inorganic growth. We forecast Dabur's topline to grow, significantly above industry, at a CAGR of 17% over FY06-09E.

Margin improvement backed by foods and international businesses, and Balsara

We forecast Dabur's consolidated EBIT margins to increase from 15.4% in FY06 to 16.8% in FY09 on the back of improved margins in the foods and international businesses, driven by increase in scale and setting up of new factories, respectively. Further, we believe there is still some upside left from the turnaround of the Balsara business.

Valuation

We believe Dabur is one of the best plays on FMCG consumption in India. At CMP of INR 97, the stock trades at P/E of 25.6x and 21.2x and EV/EBITDA of 13.4x and 11.2x on our FY08E and FY09E numbers, respectively. While we expect a significant EPS growth at a CAGR of 23% over FY06-09E, a large part of this growth is already priced into the stock. We initiate coverage on the stock with a **'ACCUMULATE'** recommendation.

Reuters	:	DABU.BO
Bloomberg	:	DABUR IN

Market Data

52-week range (INR)	:	118 / 71
Share in issue (mn)	:	861.1
M cap (INR bn/USD mn)	:	83.8 / 1,895.8
Avg. Daily Vol. BSE/NSE ('000)	:	1,729.5

Share Holding Pattern (%)

Promoters	:	74.0
MFs, FIs & Banks	:	7.1
FIIs	:	9.8
Others	:	9.0

Financials

Year to March	FY06	FY07E	FY08E	FY09E
Revenues (INR mn)	18,658	22,257	25,958	30,095
Growth (%)	*24.9*	*19.3*	*16.6*	*15.9*
Net profit (INR mn)	2,139	2,696	3,290	3,977
EBITDA (INR mn)	2,866	3,422	4,249	5,052
Net profit (INR mn)	2,139	2,696	3,290	3,977
Shares outstanding (mn)	578	866	866	866
EPS (INR)	3.7	3.1	3.8	4.6
EPS growth (%)	*35.8*	*(16.0)*	*22.0*	*20.9*
PE (x)	26.3	31.3	25.6	21.2
EV/EBITDA (x)	19.8	16.6	13.4	11.2
ROE (%)	42.6	57.0	51.9	48.2

Investment Rationale

Emerging as the best play on Indian FMCG spend

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Product portfolio well positioned for accelerating growth

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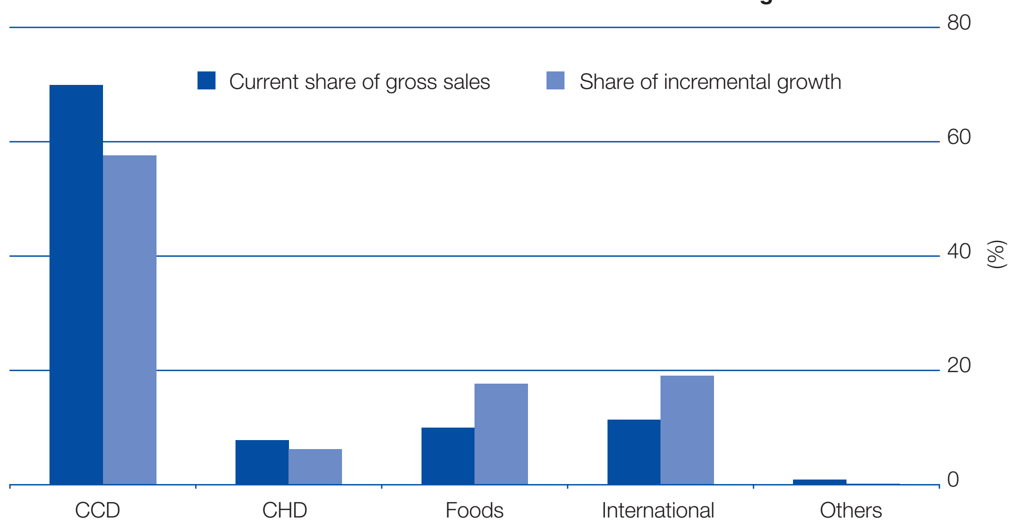
Dabur has grown at a CAGR of 20% over FY04-06E, thanks to the growth in consumer consumption, success of its new products and Balsara acquisition. Dabur's CCD formed 70% of total sales in FY06 and is expected to contribute 56% of the incremental growth over FY07-09E. The smaller divisions, foods and international business, which formed 10% and 11% of the total gross sales in FY06, respectively, are expected to contribute 18% and 19%, respectively, to the incremental growth over FY07-09E. Though consumer health division's (CHD) share of incremental growth will be below its current share of revenues, a 15% CAGR growth over FY06-09E is a substantial turnaround in the business.

Chart 1: Division-wise current revenue share vs share of incremental growth



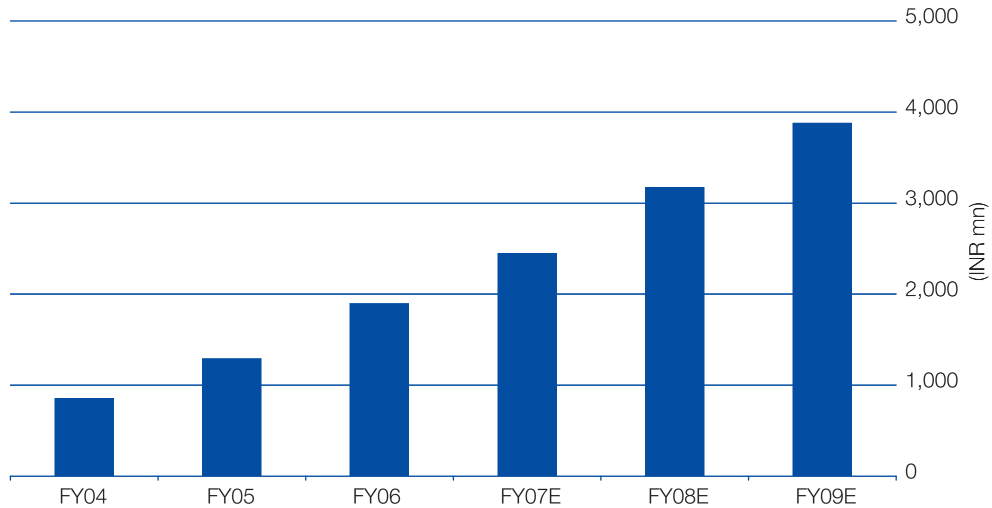
Source: Company, Edelweiss research

Foods: A huge untapped market at disposal

We forecast the foods segment to grow at a CAGR of 27% over FY06-09E, as changing preferences towards healthy lifestyle and increase in disposable income levels continue to boost fruit juice sales. Moreover, the management plans to increase the penetration of juices to more towns from 70 towns currently. This is expected to boost the company's sales further.

Dabur's venture into concentrate exports has been successful on the back of its efficient backend that secures fruit supplies through contract farming. According to the management, concentrate exports have increased from ~INR 140 mn in FY06 to INR 220 mn for the first nine months in FY07. We expect concentrate exports to grow at a CAGR of 50% over the next two years. Apart from expansion in the existing categories, the company is also planning to venture into new categories such as cut fruits and culinary ready-to-cook items, which could provide further impetus for growth.

Chart 2: Foods division—Gross sales

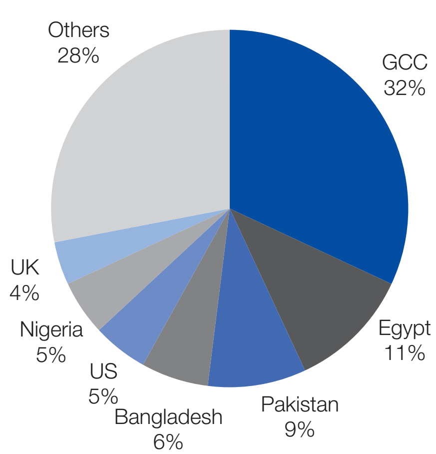


Source: Company, Edelweiss research

International business: New markets and new products

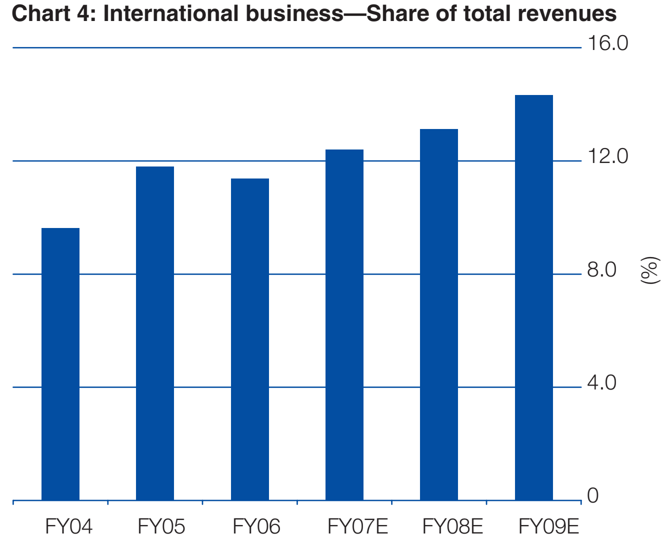
We expect Dabur's international business to grow at a CAGR of 27% over FY06-09E, driven by its entry into new markets and growth from introduction of new products in the existing markets. Currently, GCC contributes more than 30% to the international division's total revenues. The company's intention to set up an additional factory in the UAE, to cater to the Middle East markets, indicates significant growth prospects in the region. Further, the company's venture into markets such as Pakistan and Bangladesh provide a huge opportunity to replicate the success of most of its products in India.

Chart 3: Intl. Business—Split of revenues across regions



Source: Company

Chart 4: International business—Share of total revenues



Source: Company, Edelweiss research

CHD: Beginning to ramp up

The management's initiative to streamline the distribution of CHD products and focus on over-the-counter (OTC) products led to 20% growth in CHD's revenues in FY06. We expect this growth to continue over the next few years on the back of the huge potential of ayurvedic medicine in India. Further, Dabur has submitted about twenty products for registration in the UK market. We expect the company's entry into the UK market to provide further growth momentum. Though the growth slowed down in FY07 to ~12% due to distribution problems in Q1FY07 during implementation of ERP, we expect this division to grow at a CAGR of 15% over FY07-09E.

Rural demand to boost CCD sales

We forecast CCD to grow at a CAGR of 14% over FY06-09E, backed by strong growth in rural demand. Government of India (GoI) is taking several initiatives such as increasing agricultural credit, guaranteeing employment to lower rung of the rural population, and supporting micro finance institutions, to promote growth in rural areas. We expect these initiatives to result in a rural GDP growth of 6% per annum over the next few years, driven by agricultural GDP growth of 3% and non-agricultural GDP growth of 9% (each constituting approximately half of rural GDP). This will result in higher disposable income with the rural population, which will eventually lead to a sustained growth in demand.

Promising products in the pipeline

The company targets to achieve at least 7-8% of total revenues from new products every year. This strategy has led to continuous innovation, boding well for the company's future. Dabur has tasted success with its new product introductions over the last few years such as *Real* and *Activ* fruit juices, *Dabur Red toothpaste*, variants of *Vatika* hair oil and shampoos; recently products such as *Chyawanshakti* and *Chyawanprakash* have evoked good market response.

In FY08, the company plans to launch a variant of *Dabur Chyawanprash* for Children. Further, the company intends to enter the herbal beauty care market, estimated at INR 2,000 mn, and launch an herbal soap under the brand 'Dabur'. We believe this continuous innovation provides an edge to Dabur over other companies.

Margin improvement backed by foods, international business, and Balsara

Dabur's consolidated EBITDA margins have increased from 10.8% in FY02 to 15.4% in FY06 backed by disposal of pharmaceutical business, excise benefits, and turnaround of Balsara business. We forecast the EBITDA margins to increase from 15.4% in FY06 to 16.8% in FY09E on the back of improved margins in the foods and international businesses. Better margins in the foods business is likely to be on account of an increase in scale, while the setting up of factories in Dubai and Pakistan will result in lower costs and better margins in the international business. Further, we believe there is still some upside left from the turnaround of Balsara business.

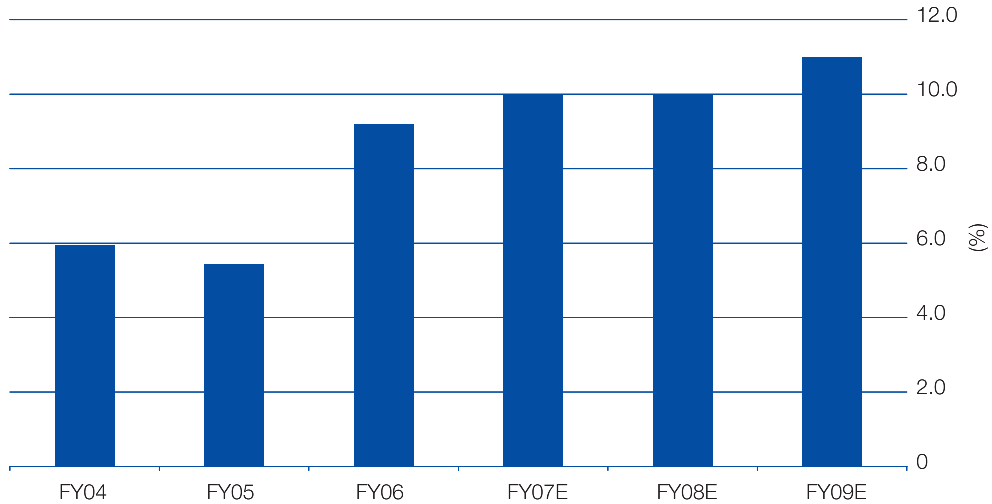
History of margin expansion

Since the new management took over the operations of the company in FY02, EBITDA margins of the company expanded from 10.8% in FY02 to 15.4% in FY06E. A 150bps margin improvement over FY02-Y04 was on account of disposal of the pharmaceutical business and restructuring of the overall business. While a 160bps expansion in FY05 was driven by excise benefits, margins continued to expand in FY06 backed by turnaround of the Balsara business and further excise benefits. Looking forward, we expect this margin expansion story to continue with a further 90bps expansion over FY06-09E, backed by growth in foods and international businesses.

Foods margins to increase

Dabur's foods margins have increased gradually from 5% in FY03 to 9% in FY06 due to the advantage of operational leverage arising from increased scale. We expect 32% gross margins and 12% EBIT margins for the additional revenues. Incorporating these, we expect Dabur's foods margins to increase by 180bps over FY06-09E.

Chart 5: Foods division—Margins



Source: Company, Edelweiss research

New factories to improve international operations margins

We expect Dabur's international operations margins to improve, following the set up of two new factories, one each in Dubai and Pakistan in FY09. This is likely to entail improvement in net profit margins of the company's international business from 8.6% in FY06 to ~12% in FY09.

Further benefits from Balsara's integration likely

In FY06, we expect Balsara's operations to have contributed INR 1,400 mn and INR 149 mn to Dabur's topline and bottomline, respectively. We expect net profit margins of Balsara's portfolio to improve from ~10.5% in FY06 to 12% by FY09, as further advantages from integration accrue.

Risks and Concerns

Slowdown in rural demand growth

A slowdown in rural demand due to lower government spending or a monsoon failure could impact Dabur's revenues significantly. The company's products such as *Dabur Chyawanprash* and *Dabur Lal Tail* are prominently sold in the rural areas and hence depend on growth in rural demand.

Restrictions on ayurvedic products

AYUSH (Department of Ayurveda, Yoga, Naturopathy, Unani, Siddha and Homepathy) has recently declared strict adherence to Ayurvedic norms. The body asked many companies to change the formulation of *chyawanprash*. Any such changes in future could dampen the sales, especially during the change of formulation, when the product is taken off the shelf.

Input cost pressures

An increase in raw materials could impact margins significantly. Crude oil price increase could lead to significant rise in packaging costs, while a rise in vegetable oils could impact gross margins of products such as shampoos, soaps etc.Organge juice concentrate, which is an important raw material for orange juice, has been on the rise over the last year and a further rise could hurt operating margins of the food segment.

Financials

ROE and ROCE to improve

We forecast Dabur's ROE to improve from 43% in FY06 to 57% in FY07E due to writing off of goodwill against reserves. Consequently, ROCE is likely to improve from 34% in FY06 to 45% in FY07E.

Net profit to grow at a CAGR of 23%

Dabur's net profit is expected to grow at CAGR of 23% over FY06-09E, driven by growth at the CAGR of 17% in net sales and improvement in EBIT margins. A greater than expected success of the new products and acquisitions provide an upside to this growth.

Free cash flows to grow at a CAGR of 20% over FY06-09E

We expect Dabur's free cash flows to grow at a CAGR of 20% over FY06-09E. We have assumed a capital expenditure of ~INR 2500 mn over FY07-09E to accommodate for setting up of new factories in Middle East and Pakistan.

Foods and international businesses to contribute one-third of incremental revenues

We expect foods and international business to grow at a CAGR of more than 25%, each, over FY06-09E. This is likely to result in these two divisions contributing 34% of the incremental revenues over FY07-09E. The overall share of these two divisions in the gross sales is expected to increase from 21% in FY06 to 26% in FY09. The share of foods in incremental contribution to operating profit is likely to increase from 10% in FY05-06 to 14% during FY07-09E.

Table 1: Share of various segments in incremental contribution to EBIT

	FY05-06	FY07-09E	EBIT growth FY06-09E (CAGR)
FMCG	89	85	19
Foods	10	15	37
Others	1	0	(1)

Source: Company, Edelweiss research

Table 2: Share of various business divisions in gross sales

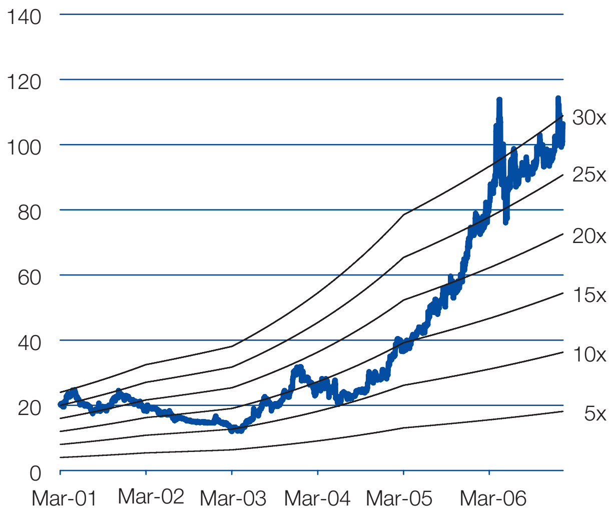
	FY04	FY05	FY06	FY07E	FY08E	FY09E
CCD (%)	75	71	70	68	67	65
CHD (%)	7	7	8	8	7	7
Foods (%)	6	8	10	11	12	13
International (%)	10	12	11	12	13	14
Others (%)	1	2	1	1	1	1

Source: Company, Edelweiss research

Valuation

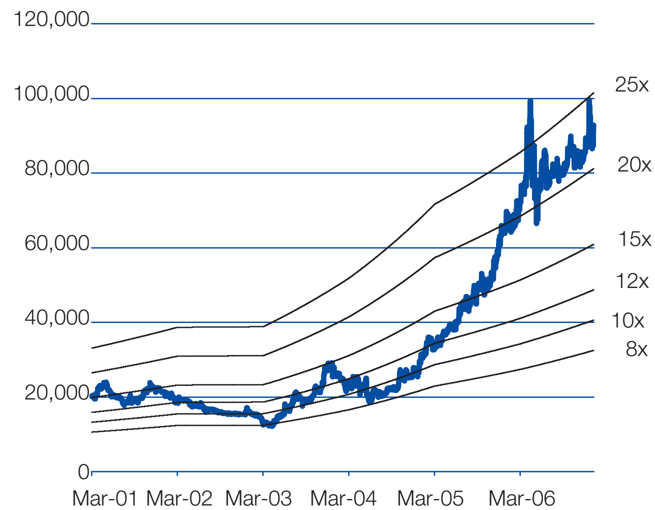
We believe Dabur is one of the best plays on FMCG consumption in India. At CMP of INR 97, the stock trades at P/E of 25.6x and 21.2x and EV/EBITDA of 13.4x and 11.2x on our FY08E and FY09E numbers, respectively. While we expect a significant EPS growth at a CAGR of 23% over FY06-09E, a large part of this growth is already priced into the stock. We initiate coverage on the stock with a **'ACCUMULATE'** recommendation.

Chart 6: One year forward P/E



Source: Edelweiss research

Chart 7: One year forward EV/EBITDA

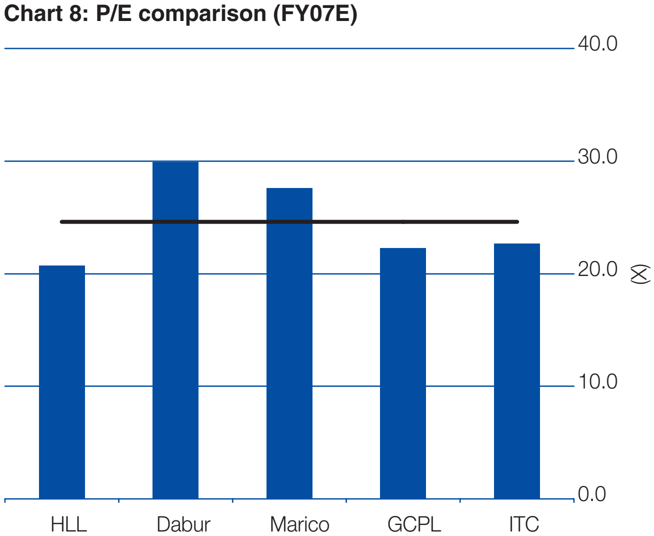


Source: Edelweiss research

Relative valuation: Deserves the premium

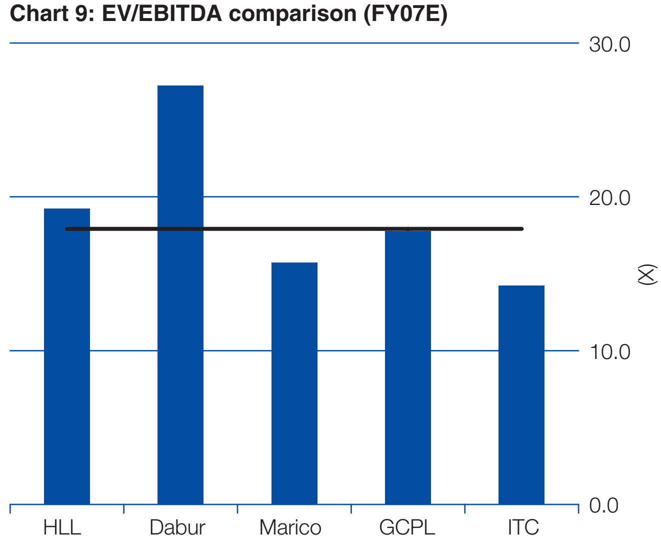
Dabur trades at a premium compared with other stocks in the FMCG sector. We believe this premium is justified, given the differentiated products in its portfolio, demonstrated management capabilities to outperform, and limited risk to its margins in the current scenario. We expect this premium to be maintained going forward.

Chart 8: P/E comparison (FY07E)



Source: Consensus, Edelweiss research

Chart 9: EV/EBITDA comparison (FY07E)



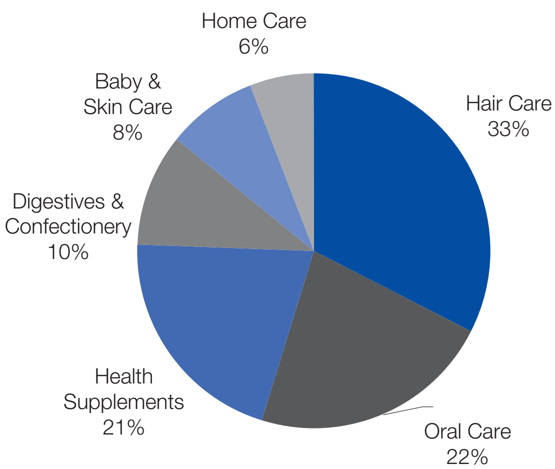
Source: Consensus, Edelweiss research

Business Overview

Dabur India (Dabur) has three divisions in India apart from its international operations. Consumer Care Division (CCD) offers a wide range of products in hair care, oral care, health supplements, digestives and candies, and baby and skin care products, based on ayurveda. Consumer health division (CHD) sales both prescribed and over the counter ayurvedic medicines. The third division, Dabur Foods Ltd produces fruit juices, cooking pastes, sauces, and items for institutional food purchases. Dabur is unique among its FMCG peers, because of its positioning as an Indian company whose products are derived from exotic sources such as ancient ayurvedic texts and natural ingredients such as herbs.

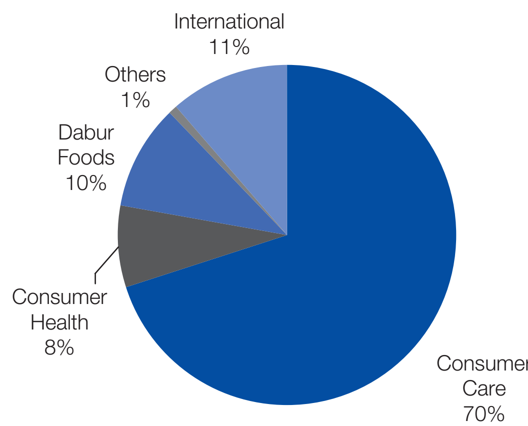
The company has various brand leaders in different market segments - *Dabur Chyawanprash*, a health tonic and *Hajmola*, a digestive tablet. Two new brands, *Real* and *Hommade*, launched during 1996-97, have also successfully carved their niche in the market.

Chart 10: Spilit of gross sales in FY06



Source: Company

Chart 11: Split of consumer care net sales in FY06



Source: Company

Financial Statements

Income statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Gross sales	15,370	18,996	22,659	26,427	30,639
Excise duties	428	337	402	469	544
Net sales	14,941	18,658	22,257	25,958	30,095
Materials consumed	6,594	8,077	9,635	11,110	12,760
Gross profit	8,347	10,581	12,622	14,848	17,335
Operating expenditure	6,274	7,716	9,200	10,599	12,283
EBITDA	2,073	2,866	3,422	4,249	5,052
Depreciation/Amortization	280	269	388	435	492
EBIT	1,793	2,596	3,034	3,814	4,560
Other income	92	133	237	113	119
Net interest paid	124	163	142	122	92
PBT	1,761	2,566	3,130	3,805	4,587
Provision for taxation	191	300	433	515	610
PAT before prior period items	1,570	2,266	2,696	3,290	3,977
Prior period items (net of tax)	0	(127)	0	0	0
Profit after tax	1,570	2,139	2,696	3,290	3,977
Minority interest	12	(3)	0	0	0
Dividends inc. ESOP	814	1,144	1,440	1,758	2,125
Retained profit	2,372	3,286	4,137	5,048	6,102
Shares outstanding (mn)	576	578	866	866	866
Dividend per share (INR)	1.4	2.0	1.7	2.0	2.5
Dividend payout ratio (%)	51.8	53.5	53.4	53.4	53.4

Common size metrics as a % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Materials consumed	44.1	43.3	43.3	42.8	42.4
Operating expenditure	42.0	41.4	41.3	40.8	40.8
EBITDA margin	13.9	15.4	15.4	16.4	16.8
EBIT margin	12.6	14.6	14.7	15.1	15.5
Net profit margin	10.5	11.5	12.1	12.7	13.2

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	18.2	24.9	19.3	16.6	15.9
EBITDA	33.5	38.2	19.4	24.2	18.9
EBIT	37.5	44.8	16.9	25.7	19.5
Net profit	43.7	36.2	26.1	22.0	20.9
EPS	(28.4)	35.8	(16.0)	22.0	20.9

Cash flow statement (INR mn)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
CFO before working cap changes	2,170	2,792	3,659	4,362	5,171
Cash for working capital	365	(59)	(498)	(268)	(263)
Income tax and dividend tax	(256)	(385)	(610)	(731)	(871)
Other operating cash flows	(122)	(160)	(95)	(95)	(95)
Net operating cash flow	2,157	2,187	2,456	3,268	3,942
Net cash flow from investing	(1,730)	(488)	867	(843)	(939)
Net cash flow from financing	(482)	(1,335)	(2,880)	(1,542)	(1,864)
Net cash flow	**(55)**	**364**	**443**	**884**	**1,140**

Balance sheet (INR mn)

As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	286	573	573	573	573
Reserves and surplus	3,353	4,397	4,105	5,706	7,628
Minority interests	152	55	55	55	55
Shareholders funds	3,792	5,025	4,733	6,334	8,256
Secured loans	971	808	808	808	808
Unsecured loans	538	235	235	235	235
Deferred tax (net)	114	158	158	158	158
Funds employed	**5,414**	**6,227**	**5,935**	**7,536**	**9,457**
Net fixed assets	2,945	5,125	3,891	4,341	4,860
Investments	2,333	421	421	421	421
Current assets, loans and advances	4,075	4,713	6,229	7,768	9,641
Inventories	2,031	2,128	2,890	3,371	3,908
Sundry debtors	759	744	1,054	1,229	1,425
Cash and bank balance	147	512	955	1,838	2,978
Loans & advances	1,138	1,330	1,330	1,330	1,330
Current liabilities	3,997	4,361	4,935	5,324	5,794
Liabilities	3,044	3,028	3,602	3,991	4,461
Provisions	953	1,333	1,333	1,333	1,333
Working capital	78	352	1,293	2,445	3,847
Misc expen not written off	58	329	329	329	329
Uses of funds	**5,414**	**6,227**	**5,935**	**7,536**	**9,457**
BV (INR)	6.6	8.7	5.5	7.3	9.5

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE	41.4	42.6	57.0	51.9	48.2
ROCE	28.7	34.0	45.1	43.4	41.9
Debtor Days	18	14	17	17	17
Inventory Days	48	41	47	47	47
Fixed assets T/o	5.1	3.6	5.7	6.0	6.2
Debt/Equity	0.4	0.2	0.2	0.2	0.1
Interest coverage	15.2	16.8	23.1	32.2	51.1

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	2.7	3.7	3.1	3.8	4.6
Y-o-Y growth (%)	*(28.4)*	*35.8*	*(16.0)*	*22.0*	*20.9*
CEPS	3.2	4.2	3.6	4.3	5.2
PE (*x*)	35.7	26.3	31.3	25.6	21.2
Price/BV	14.8	11.2	17.8	13.3	10.2
EV/Sales	3.7	3.0	2.5	2.1	1.9
EV/EBITDA	27.4	19.8	16.6	13.4	11.2

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INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
GautamRoy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
Vishal Goyal, CFA	-	2286 4370	Banking & Finance
Revathi Myneni	-	2286 4413	Cement
Sumeet Budhraja	-	2286 4430	FMCG
Harish Sharma	-	2286 4307	Infrastructure, Auto Components, Mid Caps
Priyanko Panja	-	2286 4300	Infrastructure, Engineering, Telecom
Hitesh Zaveri	-	2286 4424	Information Technology
Parul Inamdar	-	2286 4355	Information Technology
Priyank Singhal	-	2286 4302	Media, Retail
Prakash Kapadia	-	2286 4432	Mid Caps
Niraj Mansingka	-	2286 4304	Oil & Gas, Petrochemicals
Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals
Manika Premsingh	-	4019 4847	Economist
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Shabnam Kapur	-	2286 4394
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Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
AnubhavKanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Ravi Pilani	-	4009 4533
Dipesh Shah	-	2286 4434

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	**Reduce**	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	**Sell**	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	**Trading Sell**	Expected to depreciate more than 10% over a 45-day period