



## INDIA



**MRCO IN** Outperform

**Price 9 Jun 10** Rs111.50

**12-month target** Rs 135.00

**Upside/Downside** % 21.1

**Valuation** Rs 135.00

- DCF (WACC 11.5%)

### GICS sector

#### Household & Personal Products

**Market cap** Rsm 67,937

**30-day avg turnover** US\$m 2.5

**Market cap** US\$m 1,371

**Number shares on issue** m 609.3

### Investment fundamentals

Year end 31 Mar		2010A	2011E	2012E	2013E
Total revenue	m	26,608	30,893	35,517	40,597
EBITDA	m	3,751	4,333	5,156	6,145
EBITDA growth	%	23.4	15.5	19.0	19.2
EBIT	m	3,151	3,713	4,497	5,461
EBIT growth	%	17.5	17.9	21.1	21.4
Reported profit	m	2,317	2,946	3,591	4,328
Adjusted profit	m	2,415	2,946	3,591	4,328
EPS rep growth	%	22.8	27.2	21.9	20.5
EPS adj	Rs	3.96	4.84	5.90	7.11
EPS adj growth	%	18.5	22.0	21.9	20.5
PER adj	x	28.1	23.0	18.9	15.7
Total DPS	Rs	0.88	1.94	2.70	3.66
Total div yield	%	0.8	1.7	2.4	3.3
ROE	%	44.5	40.9	39.7	39.1
EV/EBITDA	x	18.1	15.7	13.2	11.0
Net debt/equity	%	-1.3	-26.3	-41.5	-60.3
P/BV	x	10.7	8.4	6.8	5.6

Source: FactSet, Macquarie Research, June 2010  
(all figures in INR unless noted)

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10 June 2010

# Marico

## First among equals

### Initiating coverage: Top pick amongst mid-cap FMCG peers

Marico has successfully metamorphosed from a "commodity oil" company to a branded FMCG business. We believe Marico is a strong play on the beauty and wellness segment, both in India and abroad. We initiate coverage with an Outperform rating and a target price of Rs135 (potential upside of 21%).

### Robust pricing power in flagship brands

Marico dominates the coconut oil market (55% share) and strong brand equity for its flagship brand, Parachute (32% of revenues). Benign competitive scenario on account of fragmented competition has led to strong pricing power. Saffola (15% of sales), Marico's second flagship brand, has successfully leveraged the growing health consciousness of Indian consumers and established a strong brand equity.

### Diversification benefits of new ventures

Marico has built multiple growth drivers like international business, Kaya, value-added hair oil. Continuous brand renovation/re-launch, new product launches and inorganic expansion has resulted in steady revenue growth for Marico. Successful implementation of this strategy has resulted in the increased resilience of top-line and margin expansion.

### Turnaround in Kaya to drive profit growth

Kaya, Marico's premium beauty-care services business, faced headwinds from overall economic slowdown and imposition of service tax in FY10. FY11 should be a year of consolidation in India – no clinic expansion planned in India; only five clinics could be opened in the Middle East. Management is taking steps to correct the decline in Kaya's growth and we expect it to break even in FY12E.

### International business a key growth driver

Marico has grown its international business at a CAGR of 45% over the past five years. International business contributed 23% of Marico's sales in FY10, up from 9% in FY05. We expect Marico's international business to grow at a CAGR of 25% over the next three years. The supply chain initiatives and ramping up of manufacturing facilities in Egypt are likely to drive margin expansions by about 200 bps over the next two to three years, in our view.

### Attractive valuations: 21% potential upside

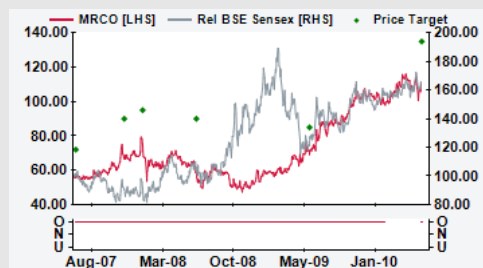
**Our estimates are 3% above consensus.** New ventures, brand extensions and overseas expansion are expected to drive 15% sales CAGR over the next three years. Importantly, the focus on these ventures is likely to result in a 100bp EBITDA margin expansion and 23% earnings CAGR, the highest amongst its peers.

**Discount to peers unwarranted.** Marico currently trades at a PER of 19x FY12E earnings, 15% below its domestic consumer peers. Moreover, it trades at a ~25% discount to its domestic peers on a growth-adjusted (PEG of 1.3x) basis. Our DCF-based target price of Rs135/share captures the growth potential from Marico's new and existing ventures.

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## MRCO IN rel BSE Sensex performance, & rec history

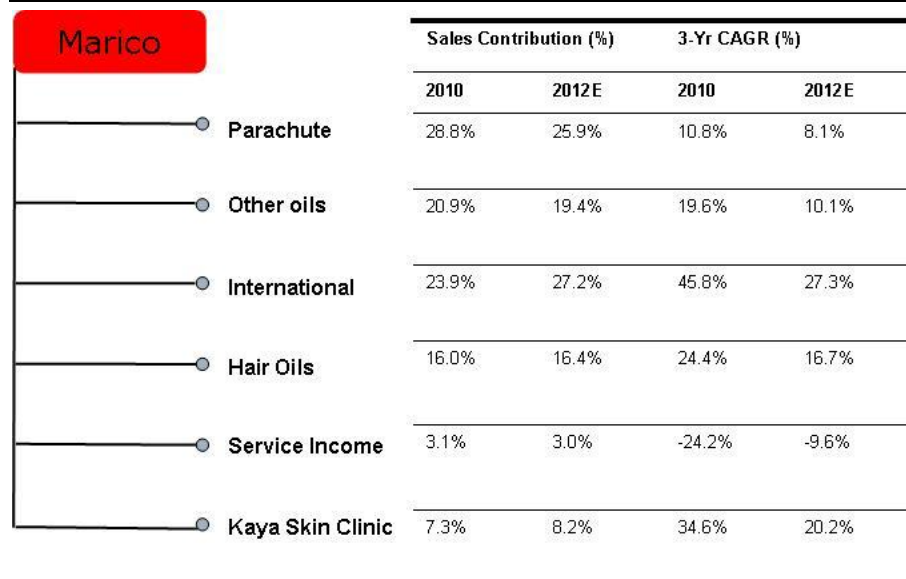


Source: FactSet, Macquarie Research, June 2010

# Marico

## Company profile

Fig 1 Company Profile

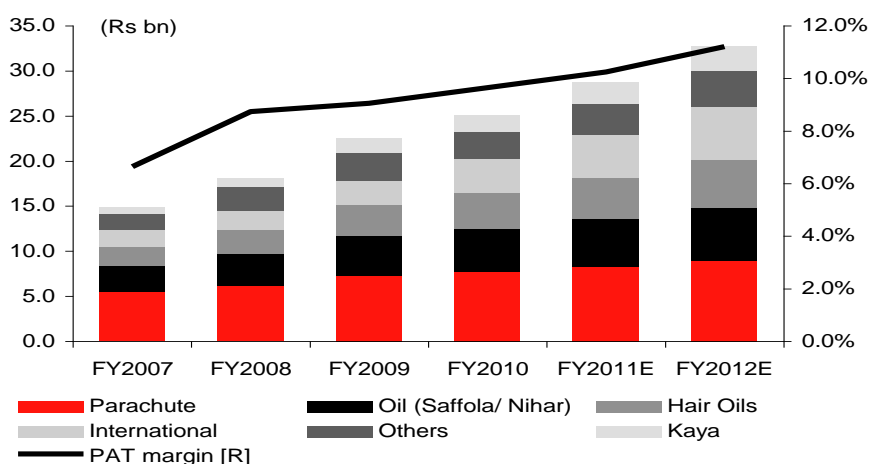


Source: Company, Macquarie Research, June 2010

## Key brands include:

- **Hair care:** Parachute, Nihar, Shanti Amla, Mediker, Hair & Care
- **Health care:** Saffola, Sweekar, Arise
- **Skin care:** Kaya skincare products

Fig 2 Expected trends in sales and margins



Source: Company data, Macquarie Research, June 2010

# First among equals

**Strong play on the  
beauty and wellness  
segment**

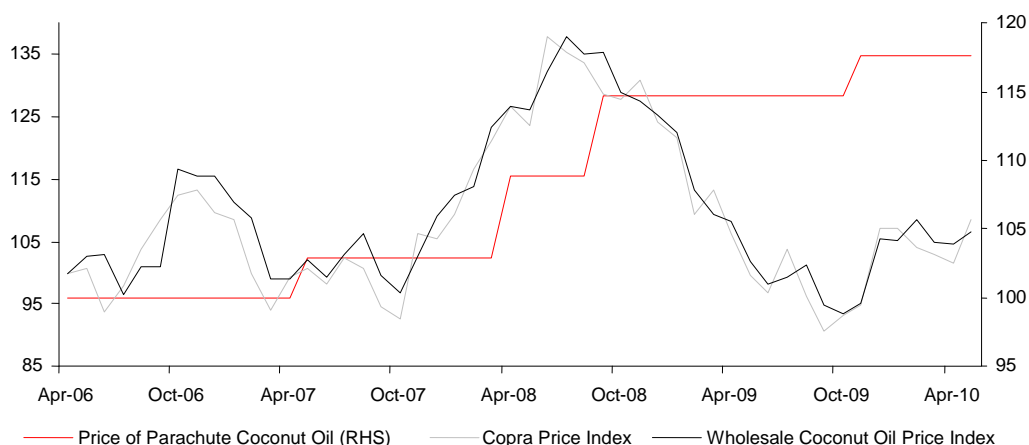
## Initiating coverage: Top pick among mid-cap FMCG peers

Marico has successfully metamorphosed from a commodity oil company to a branded FMCG business and we believe that it is a strong play on the beauty and wellness segment, both in India and abroad. We initiate coverage with an Outperform rating and a target price of Rs135 (potential upside of 21%).

## Robust pricing power in flagship brand

Marico dominates the coconut oil market (55% share) and strong brand equity for its flagship brand, Parachute (32% of revenues). A benign competitive scenario due to fragmented competition has led to strong pricing power. Marico's second flagship brand, Saffola (15% of sales), has successfully leveraged growing health consciousness of Indian consumers and established a strong brand equity.

**Fig 3 Parachute has moved away from commodity pricing**

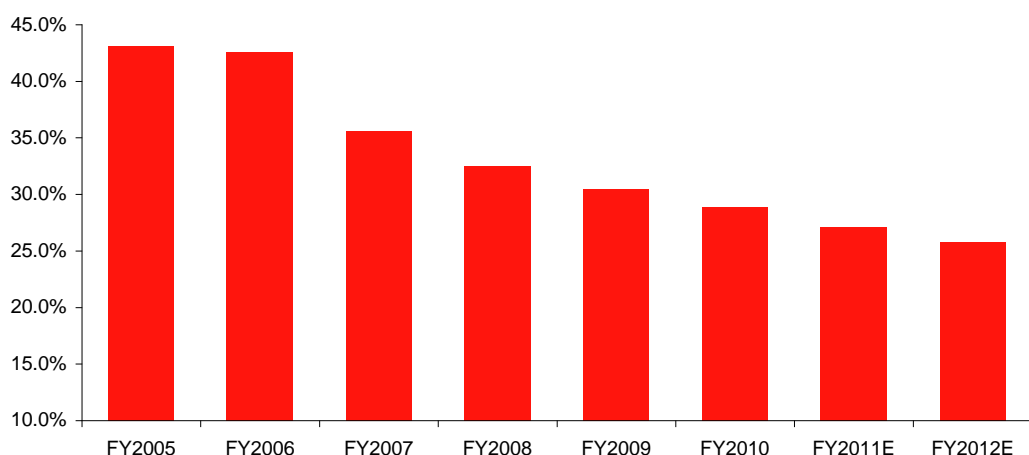


Source: Bloomberg, Macquarie Research, June 2010

## Diversification benefits of new ventures

Marico has built multiple growth drivers such as its international business, Kaya, value-added hair oil. A continuous programme of brand renovation/re-launching, new product launches and inorganic expansion has resulted in steady revenue growth for Marico. Successful implementation of this strategy has resulted in the increased resilience of the company's top line and margin expansion.

**Fig 4 Declining dependence on Parachute for growth**



Source: Company data, Macquarie Research, June 2010

**We expect Kaya to break even in FY12E**

## Turnaround in Kaya to drive profit growth

Kaya, Marico's premium beauty care services business, faced headwinds from the overall economic slowdown and the imposition of service tax in FY10. FY11 should be a year of consolidation in India – it has no plans to expand its clinics in India, and will only open five in the Middle East. Management is taking steps to correct the decline in Kaya's growth and we expect Kaya to break even in FY12E.

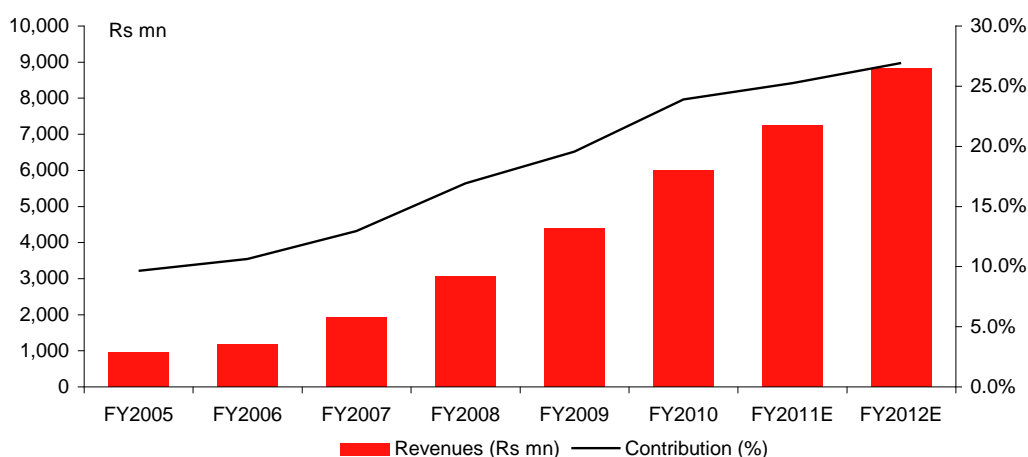
Marico has recently acquired the aesthetics business (skincare products and services business) of Singapore-based Derma Rx for a purchase consideration slightly above Rs1bn. The implied PER is around 10x, implying that the transaction is value-accretive. The acquisition is likely to be partly funded through debt.

**International business growing at a CAGR of 45%**

## International business a key growth driver

Marico has grown its international business at a CAGR of 45% over the past five years. International business contributed 23% of Marico's sales in FY10, up from 9% in FY05. We expect Marico's international business to grow at a CAGR of 25% over the next three years. The supply chain initiatives, ramping up of manufacturing facilities in Egypt and other scale benefits are likely to drive margin expansions by about 200bps from the current 11.0–11.5% over the next two to three years.

**Fig 5 International revenues growing on back of geographical expansions**



Source: Company data, Macquarie Research, June 2010

## PER discount unwarranted, given strong earnings growth profile

**Our estimates are 3% above consensus.** New ventures, brand extensions and overseas expansion are expected to drive 14% sales CAGR over the next three years. Importantly, the focus on these ventures is likely to result in a 100bp EBITDA margin expansion and 22% earnings CAGR, the highest amongst its domestic consumer sector peers.

Marico currently trades at a PER of 19x FY12E earnings, 15% below its domestic consumer peers. Moreover, it trades at a ~25% discount to domestic peers on a growth-adjusted (PEG) basis. Our DCF-based target price of Rs135/sh captures the growth potential from new and existing ventures.

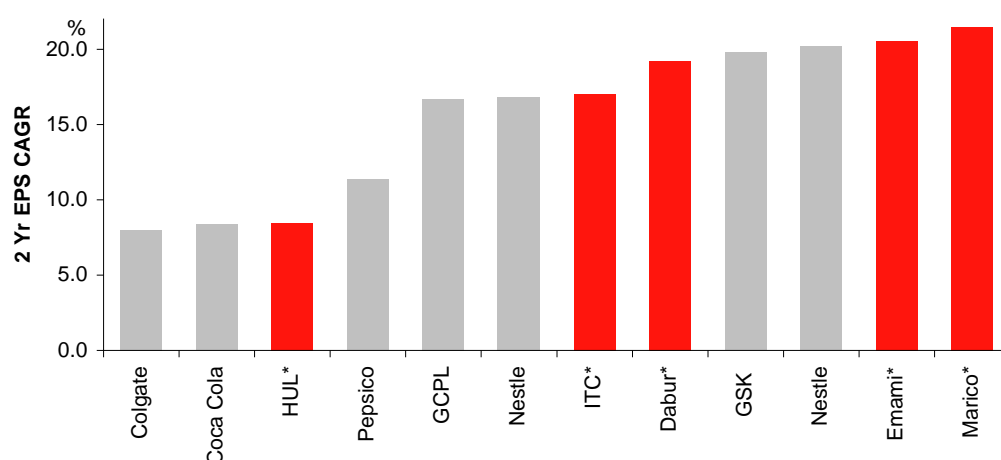
# Valuation discount unwarranted

## Expect Marico to deliver highest earnings growth amongst peers

Marico is evolving. Sales have seen a 34% CAGR over the past three years, driven by strong sales in its flagship coconut oil brand, Parachute, and international business. We believe that Marico is continuing to focus on new ventures, brand extensions and overseas expansion to emerge as a major player in 'beauty and wellness', both in India and abroad.

We believe this will lead to continuing sales momentum and we forecast 15% sales CAGR over the next three years. Importantly, we expect the focus on these premium, high-margin ventures to result in a 100bp EBITDA margin expansion during that period. Notably, the resulting 23% earnings CAGR is the highest amongst domestic consumer sector peers.

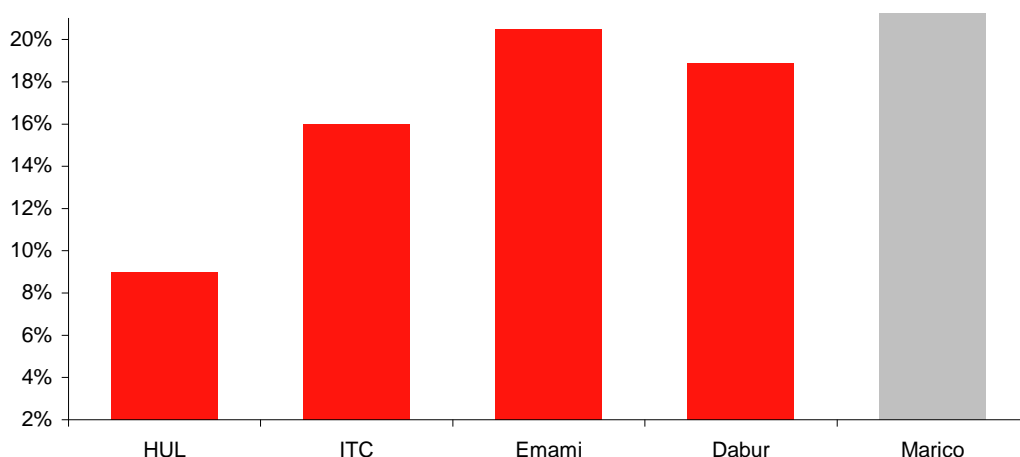
**Fig 6 We expect Marico to remain the fastest-growing FMCG player in India**



\* Macquarie Estimates, rest Bloomberg Consensus

Source: Bloomberg, Macquarie Research, June 2010

**Fig 7 Marico provides the strongest growth profile in our coverage universe**



Source: Macquarie Research, June 2010

## Our estimates stand 3% above consensus from FY11E

We believe that latent pricing power in Parachute provides a margin cushion, which has the potential to surprise the Street positively. Additionally, we hold a very positive view that the initiatives taken by management to turn around Kaya will yield positive results and we expect Kaya to break even in FY12.

## Strong growth profile justifies a PER premium

Marico currently trades at a PER of 19x FY12E earnings, 15% below its domestic consumer peers. Moreover, it trades at a ~25% discount to domestic peers on a growth-adjusted (PEG) basis. Given Marico's strong earnings growth profile, we believe a PER premium to its peers is warranted.

**Fig 8 Comparative valuations**

Company	Country	Market Cap (US\$m)	3 yr fwd** EPS CAGR (%)	EBIDTA Margin (FY10) (%)	PAT Margin (FY10) (%)	Trailing P/E (x)	Fwd P/E (FY11E) (x)	Fwd P/E (FY12E) (x)	ROE (FY10) (%)	PEG ratio
<b>Indian consumer peers</b>										
ITC Ltd*	India	22,763	17.0	33.0	21.7	25.5	22.0	18.4	29.6	1.5
Hindustan Lever*	India	11,651	8.4	14.6	11.8	26.3	24.8	22.5	86.4	3.1
Emami*	India	1,088	20.5	23.7	17.5	28.2	22.7	19.1	39.3	1.4
Dabur*	India	3,603	19.2	18.8	15.0	33.6	28.2	23.3	52.9	1.7
Marico*	India	1,446	21.5	15.0	9.6	28.2	23.1	19.0	44.5	1.3
Nestle	India	5,786	20.2	20.2	12.8	41.6	40.7	28.8	124.2	2.1
Colgate-Palmolive	India	2,404	6.9	25.9	22.1	26.1	26.0	22.8	159.2	3.8
Tata Tea	India	1,396	4.2	12.5	6.7	16.8	14.7	NM	19.9	4.0
Britannia	India	862	60.5	4.8	2.7	39.3	20.9	15.3	21.4	0.7
Godrej Consumer	India	2,383	16.7	20.1	16.6	32.8	27.4	24.1	46.9	2.0
GlaxoSmithKline Consumer	India	1,487	19.8	19.1	12.1	30.1	NA	21.0	27.9	1.5
<b>Average</b>		<b>4,988</b>	<b>19.5</b>	<b>18.9</b>	<b>13.5</b>	<b>29.9</b>	<b>25.0</b>	<b>21.7</b>	<b>59.3</b>	<b>2.1</b>
<b>Global consumer peers</b>										
Danone	France	22,867	3.2	19.0	9.1	15.5	16.2	14.6	12.4	5.0
Nestle	Switzerland	170,003	16.8	16.0	10.4	20.8	16.6	15.2	20.9	1.0
Reckitt Benckiser	UK	15,810	2.2	26.2	18.3	15.8	15.1	15.1	38.8	6.8
Coca Cola	US	118,952	8.4	30.5	22.0	16.2	15.0	13.8	30.1	1.8
Pepsico	US	101,037	11.3	22.4	13.8	16.7	15.0	13.5	41.2	1.3
Colgate-Palmolive	US	38,628	8.0	25.9	14.9	17.3	16.3	14.8	96.4	2.0
Kraft Foods	US	49,933	6.5	15.8	7.5	14.0	14.1	12.3	12.5	2.2
Procter & Gamble	US	178,957	2.6	24.3	17.0	16.4	17.0	15.6	20.4	6.5
<b>Average</b>		<b>87,023</b>	<b>7.4</b>	<b>22.5</b>	<b>14.1</b>	<b>16.6</b>	<b>15.7</b>	<b>14.4</b>	<b>34.1</b>	<b>3.3</b>

\*\* 3 year EPS CAGR for companies under coverage; 2 year EPS CAGR, based on Bloomberg consensus, for all others

Source: Bloomberg, Macquarie Research, June 2010

## DCF based value (Rs135/share) provides 21% upside potential

We value Marico using a DCF methodology (Figure 9). In our view, this methodology accurately captures the growth potential of the overseas ventures and new businesses beyond FY12E. Our target price of Rs135 implies a target forward multiple of 23x.

**Fig 9 Snapshot of DCF-based valuation**

WACC Calculations		(A) Cashflow until 2015	
Risk-free rate	7.5%	Total PV of free cashflow until 2015 (Rs m)	17,634
Market risk premium	7.0%	<b>(B) Terminal value calculation</b>	
Total market return	14.5%	Terminal growth rate from 2015	5.0%
Beta (x)	1.06	FCF in FY2015 (Rs m)	6,439
Cost of equity	14.9%	Terminal value (Rs m)	107,136
Gross cost of debt	9.0%	PV of terminal value (Rs m)	59,599
Tax rate	33.9%	Total company value (A) + (B) (Rs m)	62,698
Net cost of debt	5.9%	Net debt/ (cash) (Rs m)	(2,002)
Debt/capital ratio	40%	Value to equity holders (Rs m)	82,333
<b>WACC</b>	<b>11.3%</b>	<b>Value to equity holders (Rs/share)</b>	<b>135</b>

Source: Macquarie Research, June 2010

**Fig 10 Sensitivity of our target price to changes in risk-free rate**

Risk-free rate	7.00%	7.25%	7.50%	7.75%	8.00%
Value (Rs/ RIL share)	142	139	135	132	129

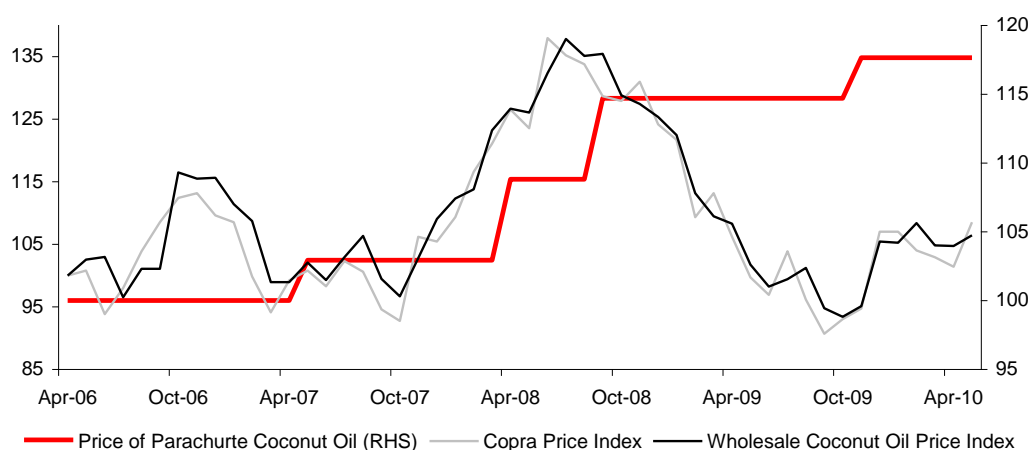
Source: Macquarie Research, June 2010

# Robust pricing power in flagship brands

## Leadership position in coconut oil

Parachute brand coconut oil is the primary product in Marico's portfolio. It has historically contributed more than 30% of sales (32% in FY09). Copra is the primary input for the production of coconut oil. Prices of copra have fallen nearly 20% from the peak in late 2008 (Figure 11). Commodity coconut oil prices naturally fell in line with this drop in input prices. However, the retail price of Parachute, which prior to 2004 moved broadly in line with copra prices, was not reduced despite the fall in input prices.

**Fig 11 Parachute has moved away from commodity pricing**



Prices are indexed to 100

Source: Bloomberg, Macquarie Research, May 2010

We believe this hold in pricing levels is a testament to the pricing power and brand equity enjoyed by Marico in the Rs19bn coconut oil market, where its share has consistently been roughly 50%. In February 2006, Marico acquired the No.2 (albeit struggling) brand in coconut oil, Nihar, from competitor Hindustan Unilever (HUVR IN, Rs250, Underperform, Target price: Rs210). This move consolidated Marico's position in the pure and value-added coconut oil market, boosted market share by more than 10% and enhanced pricing power. We therefore believe that the entry of competitors such as Adani group will have a negligible impact on company margins and volumes.

## Saffola: reaping the benefits of health-based preventive positioning

Saffola contributes ~15% of Marico's revenues and has grown volumes at an attractive CAGR of 15% since FY06. We believe this performance was driven by:

- ⇒ Growing health consciousness, increasing heart-related ailments as well as rising awareness about lifestyle diseases, especially in urban areas.
- ⇒ Positioning of Saffola as a preventive ("Good for Heart") vs earlier curative positioning.
- ⇒ Increasing proportion of modern trade.

Sustained brand-building, creation of awareness via various below-the-line efforts has resulted in Saffola's commanding a significant premium relative to its competitors.

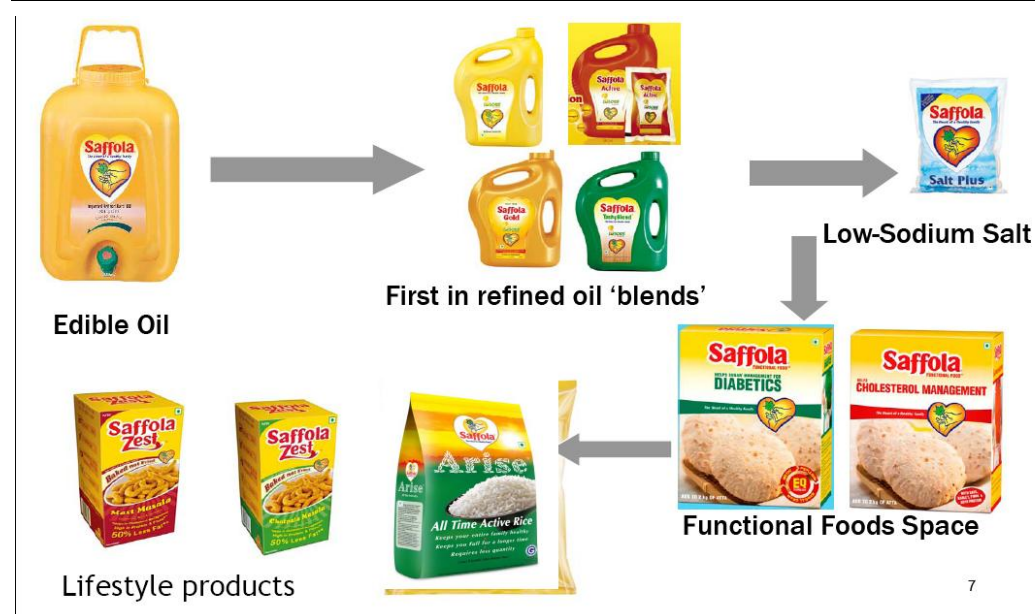
## Brand extension of Parachute and Saffola – additional growth drivers

Marico has successfully leveraged the strong brand positioning of both its flagship brands by extending it to other allied product categories. This not only helps build additional growth drivers for Marico, but also saves potential Advertising and Sales Promotion spend if it were to launch a new brand.

For example, Parachute has been extended to the hair cream, hair gel, and perfumed hair oil segments to benefit from the strong brand recognition. Recently, it test-launched Parachute Cooling Oil in Andhra Pradesh as the first coconut-oil based cooling variant. Another cooling oil variant under the Nihar brand is being prototyped in Bihar.

Saffola's health-based positioning was exploited by launching Saffola Rice (low GI rice), Saffola Zest (baked snack), Saffola Atta mix with Diabetes and Cholesterol management variants. Marico is currently modifying its product proposition for Saffola Zest, based on the feedback received from its test launch in Maharashtra.

**Fig 12 Saffola: Transitioning from an edible oil to a Lifestyle brand**



Source: Macquarie Research, June 2010

**Marico to exploit the brand franchise of Parachute and Saffola**

We expect Marico to continue to exploit the strong brand franchise of Parachute and Saffola by continuously tapping new allied segments in hair care, edible oils and functional health food.

**Benign competitive intensity**

Parachute enjoys a benign competitive situation in the branded coconut oil space. Its strength in the coconut oil category can be gauged from the fact that despite being the leader, its market share has consistently inched up from 45% in FY04 to 48% in FY09. Similarly, Saffola has ~98% market share of the branded refined safflower oil market. Marico is the market leader in most of the categories in which it is present.

**Fig 13 Marico: No.1 position in all primary product categories**

Brand	Category	Indicative market share (%)	Rank
Parachute	Coconut Oil (India)	~ 45%	1
Parachute	Coconut Oil (Bangladesh)	~ 73%	1
Saffola	Refined Safflower Oil and its blends	~ 98%	1
Mediker	Anti-lice treatment	~ 90%	1
Revive	Instant fabric starch	~ 80%	1
Parachute Jasmine, Shanti Amla, Hair & Care, Nihar	Hair Oils	~ 21%	2

Source: Company, Macquarie Research, June 2010

## Diversification benefits of new ventures

In the past few years, investors have been concerned about the operating risk arising from the dominance of Parachute coconut oil on the consolidated top line and profits. Additionally, it was not clear whether Marico would be able to utilise its strong brand in coconut oil to drive growth and margins in new product launches.

In the past four years, there have been new product launches, as well as brand extensions and renovations, including Parachute advanced non-stick hair oil, after-wash gel, hair fall solution hair oil, 'Saffola' cholesterol management flour mix, 'Saffola' Arise Low GI rice and blended edible oils.

The company has also expanded inorganically in India and overseas; notably developing markets such as Bangladesh and Egypt (Figure 14). Marico's initial strategy included a two-pronged focus on the Indian diaspora and markets with consumption habits similar to India (eg Bangladesh).

The company has entered these markets with its existing range of products, eg the Parachute portfolio, as well as via the acquisition of synergistic and related local products, such as Fiancée and Hair Code hair creams and gels in Egypt, Code 10 in Malaysia.

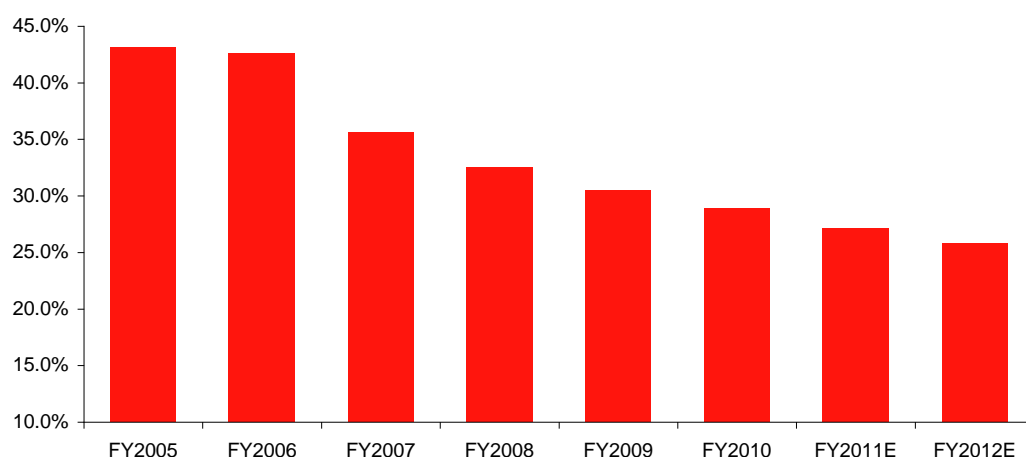
**Fig 14 Snapshot of Marico's recent inorganic initiatives**

Brands	Products	Primary markets	Year of acquisition	Seller
Range of products	Aesthetic Skin Care products	Singapore	2010	Derma Rx Asia- Egypt
Code 10	Hair Styling Products	Malaysia	2010	Colgate Palmolive
Caivil, Black Chic, Hercules	Hair Care and Health Care	South Africa	2007	Enaleni Pharmaceuticals
Fiancée	Hair cream and gels	Egypt	2006	Ready Group- Egypt
Manjal	Soaps	Southern India	2006	Oriental Extractions- Kerala, India
Nihar	Coconut oil and perfumed coconut oil	India	2006	Hindustan Lever- India
Camellia	Soaps	Bangladesh	2005	Marks and Ally- Bangladesh
Aromatic	Soaps	Bangladesh	2005	Aromatic Cosmetics- Bangladesh
Oil of Malabar	Coconut oil	India	1999	West Coast India Ltd- India
Mediker	Anti-lice treatment	India	1999	Procter & Gamble- India
Sil	Processed food	India	1995	Kenmoor Foods- India

Source: Company, Macquarie Research, June 2010

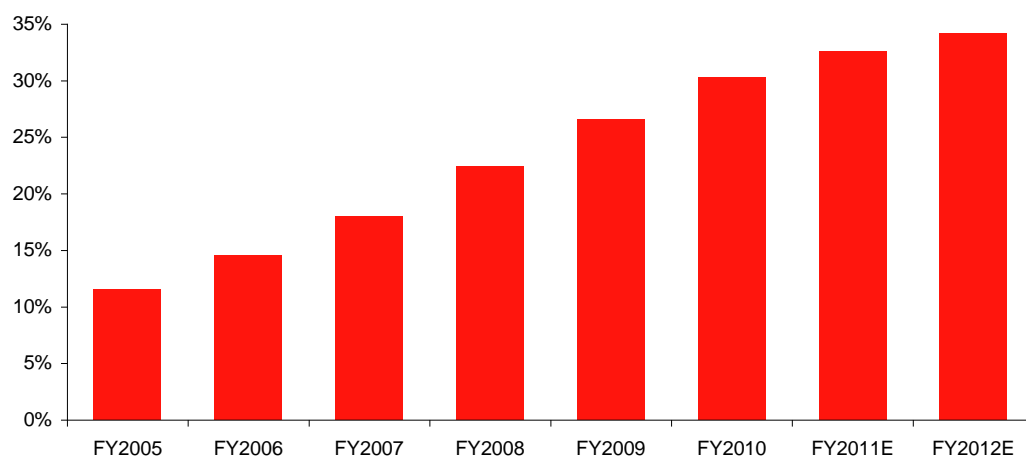
We note that these moves have resulted in Parachute's contribution to sales falling from ~44% to 36% over the past four years (Figure 15).

**Fig 15 Declining dependence on Parachute for growth**



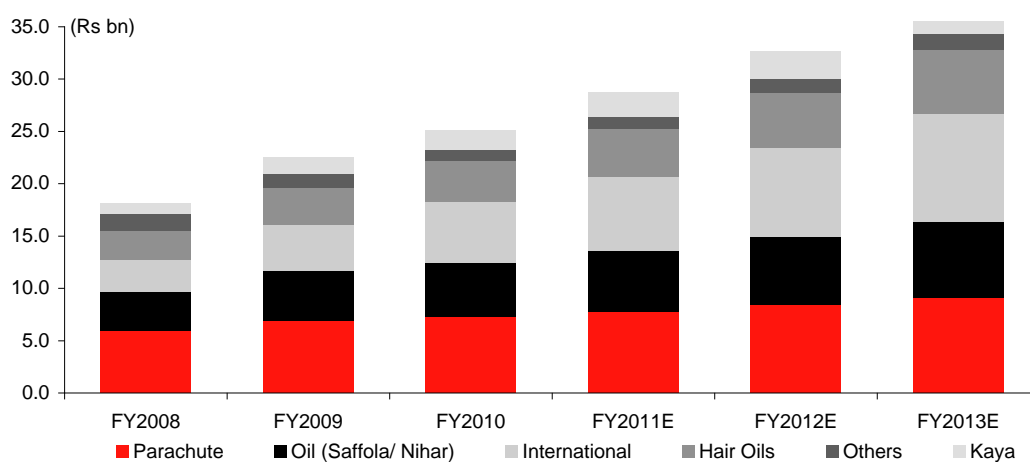
Source: Company data, Macquarie Research, June 2010

We believe the successful implementation of this strategy has resulted in a significant drop in risk and an increase in top-line resilience. New businesses now contribute 16% to sales (Figure 16). Notably, this has led to margin expansion due to the entry in previously under-penetrated markets and geographies.

**Fig 16 Kaya & international business now contribute 30% to the top line**

Source: Company data, Macquarie Research, June 2010

We expect the focus on new ventures should continue. We believe robust growth in new businesses should enable Marico to maintain its sales momentum (Figure 17). We forecast a three-year sales CAGR of 15%.

**Fig 17 New businesses driving strong top-line growth**

Source: Company data, Macquarie Research, June 2010

## Kaya – turnaround will be the key driver

The total Indian health and beauty care services market is pegged at Rs35bn, of which the organised sector accounts for 10.6%. Notably, the organised sector has grown at a whopping 75% over the past two years.

Marico's line of products focuses on personal care. The company decided to tap the explosive growth potential in the organised beauty services market by extending its brand and product base into solutions.

**Fig 18 Skin care services offered by Kaya**

Normal Skin	Problem Skin	Ageing Skin
<ul style="list-style-type: none"> <li>■ Permanent Hair Reduction</li> <li>■ Kaya Glow</li> <li>■ Skin Polishing</li> <li>■ Glycolic Peels</li> <li>■ Advanced Facials</li> </ul>	<ul style="list-style-type: none"> <li>■ Pigmentation &amp; Acne Reduction</li> <li>■ Dark Circle Reduction</li> <li>■ Wart Removal</li> <li>■ Pimple reduction</li> </ul>	<ul style="list-style-type: none"> <li>■ Non-Surgical Face Lift</li> <li>■ Photo Facials</li> <li>■ Botox</li> <li>■ Restylane</li> </ul>

Source: Company, June 2010

Marico's venture into the premium beauty care services space started with Kaya Skin Clinic, a medi-spa chain of 87 outlets in India, 13 in the Middle East and one in Bangladesh. During FY10, Kaya's skin care turnover grew by 15% YoY to Rs1.8bn. It made a loss of Rs123m in FY10. The business has been impacted by the overall economic slowdown. In addition, the price increase taken by Kaya following the imposition of the service tax from 1 September 2009 has also acted as a dampener to growth.

### Management is taking steps to turnaround Kaya

Management is taking steps to correct the decline in Kaya's growth by: a) controlling attrition among practitioners (better training and linking leadership targets to attrition); and b) customer-retention strategies, including introducing services such as high-end facials (repetitive) and cross-selling other products and services. FY11 should be a year of consolidation in India – no clinic expansion is planned in India; only five clinics are planned for opening in the Middle East.

**Fig 19 Kaya – key operating assumptions and financials**

	FY08	FY09	FY10	FY11E	FY12E	FY13E
Retail space ('000 sqft)						
	110	162	153	161	191	228
Total number of stores at end of year	72	107	101	106	126	151
- of which: new stores added	25	35	-6	5	20	25
<b>Gross retail sales (Rs m)</b>						
	1,000	1,570	1,820	2,372	2,727	3,066
- growth	34.0%	57.0%	15.9%	30.3%	15.0%	12.4%
<b>PAT (Rs m)</b>	(10)	(63)	(122)	(95)	-	153
PAT margin	-1.0%	-4.0%	-6.7%	-4.0%	0.0%	5.0%

Source: Company data, Macquarie Research, June 2010

### Derma Rx Acquisition a significant positive step

Marico has recently acquired the aesthetics business (skin care products and services business) of Singapore-based Derma Rx for a purchase consideration slightly above Rs1bn. The implied PER is around 10x – implying that the transaction is value-accretive. The acquisition is likely to be partly funded through debt.

Skin treatment products constitute >50% of Derma Rx's revenues of around Rs500m. PAT margins of ~20% imply that Marico's FY11E PAT will rise by ~3.5%, before adjusting for interest costs. Marico management notes that Derma's products retail at around S\$60–250 and are focused in areas such as anti-ageing, anti-acne and pigmentation. The products retail through four clinics and also via medical channels.

Kaya is essentially a service model, an area in which management hopes to increase contribution from products to ~20% of revenues from ~13% currently. The acquisition is a step in the right direction in our view, but we think it will be 18 to 24 months before Kaya can extract any benefits from it.

Our Kaya revenue estimates are Rs2.4bn in FY11E (ie ~8% of Marico's consolidated revenues), growing at ~30% over the medium term. Derma Rx's inclusion could add ~20–25% to Kaya's revenues and also reduce Kaya PAT losses in FY11E. Over the next five years, management believes that Derma Rx's revenues could double – Kaya revenues could grow at ~40% CAGR over FY10–13E, following the acquisition.

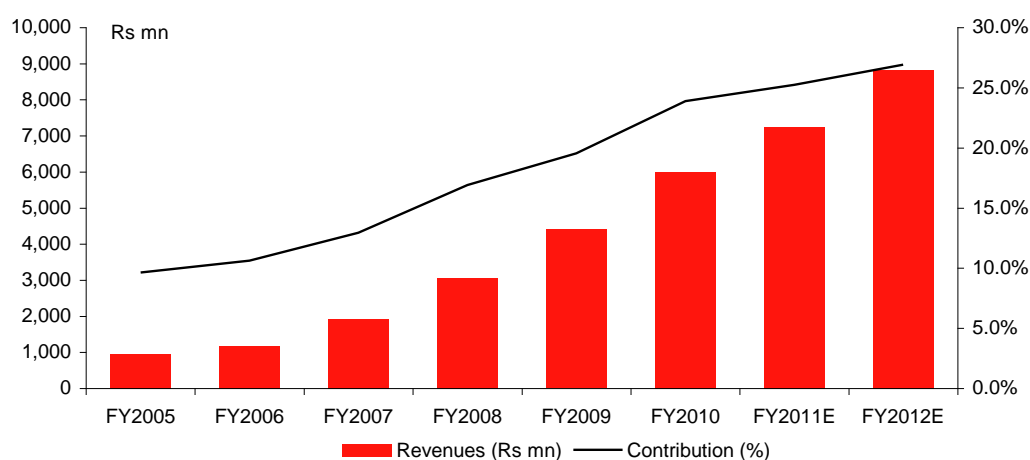
## International business a key growth driver

Marico has grown its international business at a CAGR of 45% over the last five years, contributing 23% of Marico's sales in FY10, up from 9% in FY05. Part of the growth was also led by favourable currency impact. Strong organic growth, rapid inorganic expansion and entry into new geographies, as well new product extensions/launches, have driven this strong performance.

**International business to grow at ~25% over the next three years**

We expect Marico's International business to grow at ~25% over the next three years. The supply chain initiatives, ramping up of manufacturing facilities in Egypt and other scale benefits are likely to drive margin expansions by about 200 bps from the current 11.0–11.5% over the next two to three years.

**Fig 20 International revenues growing on back of geographical expansions**



Source: Company data, Macquarie Research, June 2010

Marico's international business has now reached a critical mass after series of acquisitions since 2005 across geographies (Bangladesh, Egypt, and South Africa).

**Fig 21 Snapshot of Marico's recent inorganic initiatives**

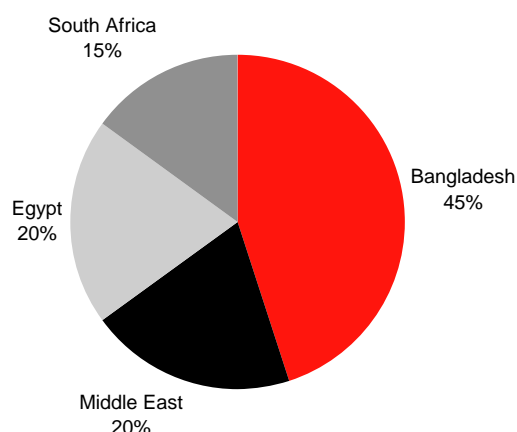
Brands	Products	Primary markets	Year of acquisition	Seller
Range of products	Aesthetic Skin Care products	Singapore	2010	Derma Rx Asia- Egypt
Code 10	Hair Styling Products	Malaysia	2010	Colgate Palmolive
Caivil, Black Chic, Hercules	Hair Care and Health Care	South Africa	2007	Enaleni Pharmaceuticals
Fiancée	Hair cream and gels	Egypt	2006	Ready Group- Egypt
Camellia	Soaps	Bangladesh	2005	Marks and Ally- Bangladesh
Aromatic	Soaps	Bangladesh	2005	Aromatic Cosmetics- Bangladesh

Source: Company, Macquarie Research, May 2010

**Parachute enjoys 73% market share in Bangladesh**

Bangladesh – largest market outside India: Bangladesh forms 45% of international revenues and is the single largest segment. Bangladesh revenues have been primarily driven by Parachute, which now enjoys 73% market share. Marico also acquired two soap brands in Bangladesh in FY06. Its robust distribution network reaching to 370,000 outlets provides key competitive advantage. It has recently established a copra crushing facility in Bangladesh, which should enhance margins going forward.

Egypt: The Egyptian business (Fiancée and Haircore, both acquired in FY07), which contributes 27% to international revenues, is back on track post the distribution initiative in FY09, when Marico transitioned from direct servicing to wholesaler to servicing through distributors. Coupled with inflation of more than 20%, this resulted in flat growth in FY09, as the distribution supply chain had to be realigned. Entry in other North African countries will be the key growth driver for Egyptian business.

**Fig 22 Bangladesh remains the largest market outside India for Marico**

Source: Company data, Macquarie Research, June 2010

**Middle East:** This region contributes around 20% of the international business. Strong traction in Hair oil and Hair creams, along with an increasing contribution from Kaya (13 clinics in Middle East), should continue to lead the growth in this geography.

**South Africa:** Entry in South Africa was marked by the acquisition of Enaleni Pharma's consumer division in October 2007. Growth in Hair care and OTC health care segments will drive the South African revenues.

We expect the International division to grow by 25% CAGR in FY10-13E. Marico is currently looking for acquisitions in the hair and beauty care space. If any materialize, they could provide upside to our estimates.

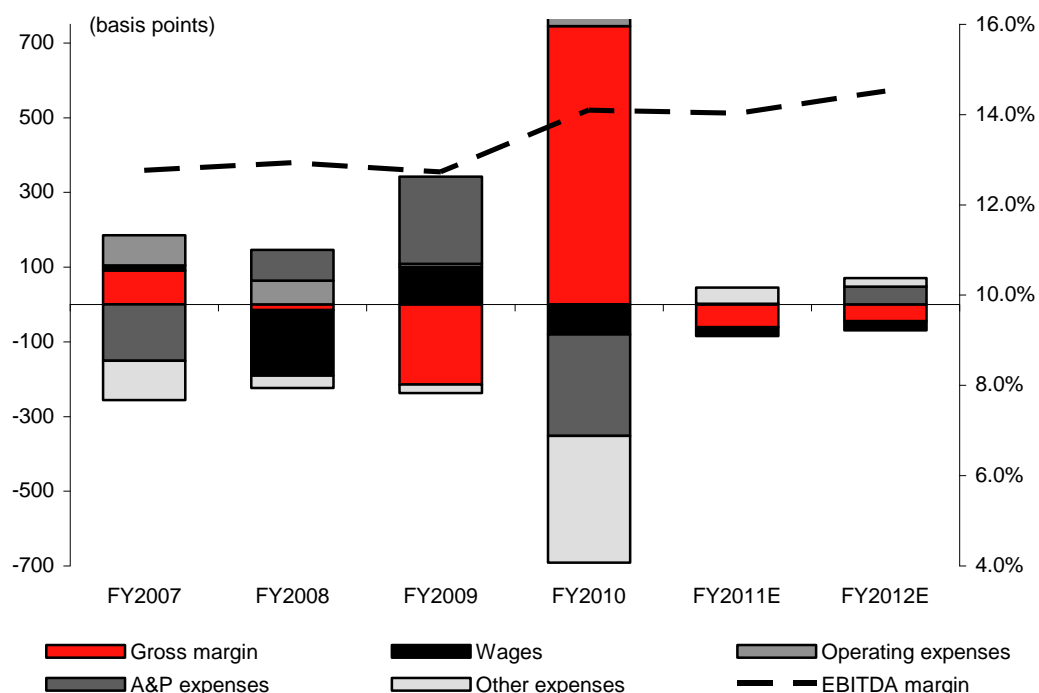
# Expect strong earnings growth profile

## Margin outlook: Consistent rise

Pricing power in 'Parachute' coconut oil should help sustain margins. We believe this will enable Marico to effectively pass on input cost inflation and promotion expenses to the customer.

New product launches and overseas forays are aimed at creating segments and tapping potential in underpenetrated markets, which typically command stronger margins. We expect this to shield the company against margin pressure from investment in new businesses such as Kaya. Hence, overall EBITDA margins should expand consistently (by 100bp) over the next three years (Figure 23).

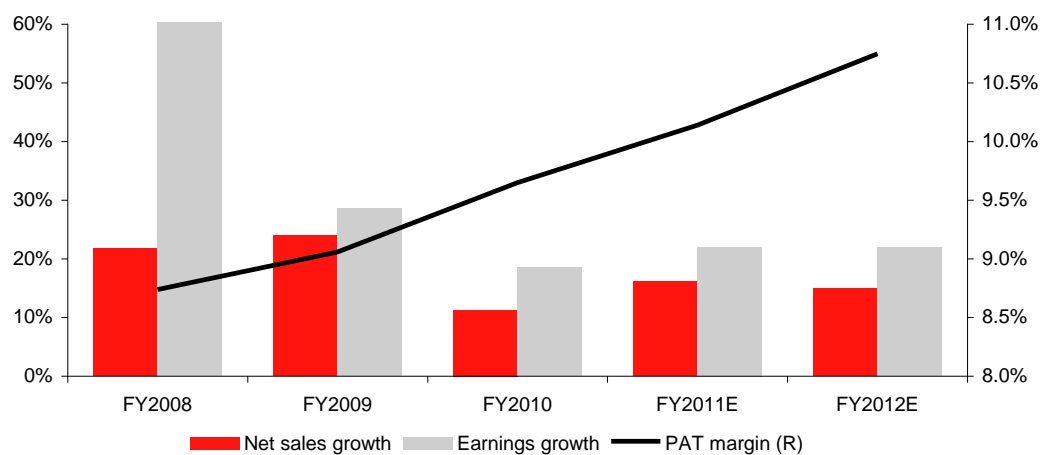
**Fig 23 Gross margin strength to flow down to the bottom line**



Source: Macquarie Research, June 2010

## Rising margins to enhance effect of top-line growth on earnings

We forecast margin expansion and strong revenue growth of 15% CAGR over the next three years to translate into earnings growth of 23% CAGR during the period (Figure 24). As a result, we expect that Marico will be the fastest-growing FMCG player in India over the next three years (Figure 6).

**Fig 24 Strong growth driven by revenue and margin expansion**

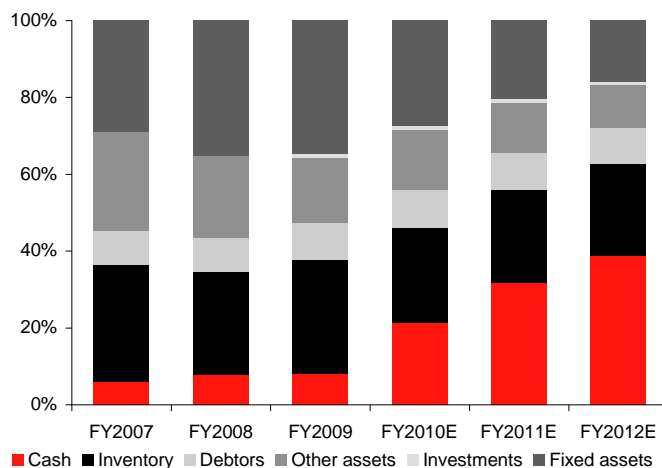
Source: Company data, Macquarie Research, June 2010

# Strong cashflow to drive inorganic initiatives

## Debt-free balance sheet provides significant financial flexibility

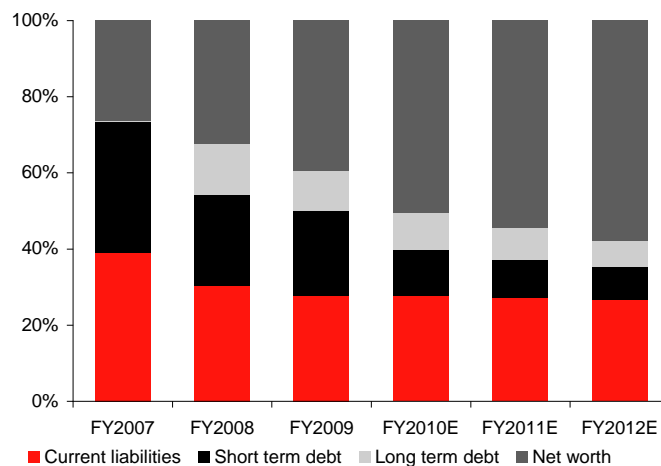
Marico is a cash-rich, nearly debt-free company, despite overseas acquisitions and new product launches over the past three years (Figures 25 & 26).

**Fig 25 Assets: Rising cash balances**



Source: Company data, Macquarie Research, June 2010

**Fig 26 Liabilities: Nearly debt-free**



Source: Company data, Macquarie Research, June 2010

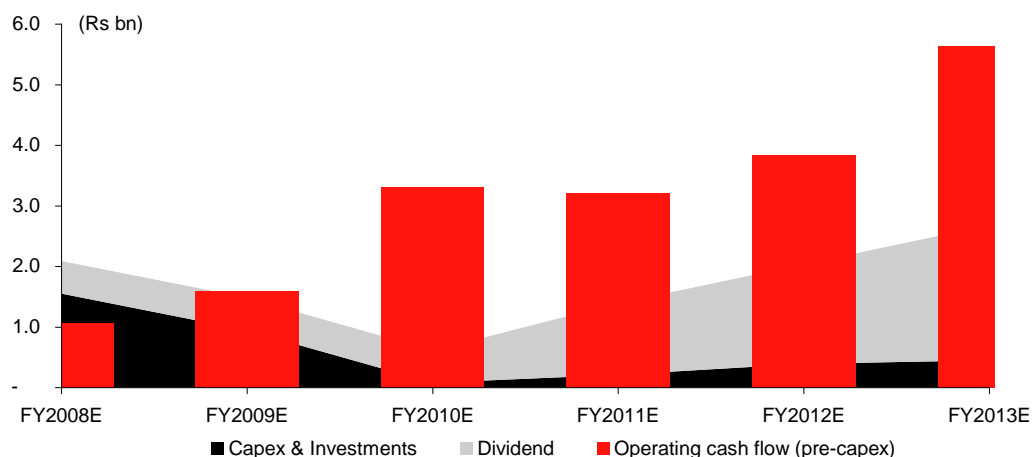
## Strong free cashflow position raises possibility of M&A

We believe the cash currently on the balance sheet, combined with the expected cashflow from operations, should be sufficient to meet planned capex requirements and sustain the dividend payout ratio above 45% (Figure 27). The cash position and strength of the balance sheet provide Marico with significant financial flexibility to leverage and invest heavily in long-term growth through organic initiatives (notably Kaya) and acquisitions.

We estimate that Marico will have US\$100m of unutilised cash over the next three years (Figure 27), after accounting for planned capex and (normal) dividends.

We believe the best use of this cash would be to create a war chest for acquisitions in the FMCG space in India and abroad. Given the success of forays in Egypt and the Middle East, we believe the cash would be better utilised in a value-accretive acquisition versus being paid out as a special dividend or buy-back.

**Fig 27 US\$100m war chest to drive inorganic strategy**



Source: Company data, Macquarie Research, June 2010

## Marico: Business profile

Marico's products and services in India are available in the hair care, skin care and healthy foods segments. The hair care range includes pre-wash products such as hair oil and post-wash products such as hair softeners, gels, hair creams, among others. Marico is also present in the healthcare segment with healthy edible oils and functional foods.

Some of the well known brands are listed below (Figure 28).

**Fig 28 Snapshot of Marico's brand portfolio**

Brands	Category
<b>Established brands</b>	
Parachute, Nihar	Coconut Oil
Saffola	Refined Safflower Oil and its blends
Parachute Jasmine, Shanti Amla, Hair & Care, Nihar	Hair Oils
Parachute	Coconut Oil (Bangladesh)
<b>Future growth businesses</b>	
Parachute Cream	Hair Cream (Middle East)
Parachute Cream, Hair & Care Silk n Shine, Parachute Hair Perfect	Post Wash Hair Care
Moisturiser	
Kaya	Skin Care Solutions
Camelia, Aromatic	Soaps (Bangladesh)
Fiancée	Hair Creams & Gels (Egypt)

Source: Company, Macquarie Research, June 2010

**Fig 29 Strong brands in beauty and wellness from products to solutions**

**Hair Care**

- Hair Oils
- Pre wash and Post wash

**Healthcare**

- Premium edible oils
- Functional Foods

**Skincare**

- Cosmetic dermatological
- Services/ Products
- Soaps

Source: Company, Macquarie Research, June 2010

▪ **Hair care (estimated market size Rs35bn)**

- ⇒ Parachute
- ⇒ Nihar
- ⇒ Shanti Amla
- ⇒ Mediker
- ⇒ Hair & Care

▪ **Health foods**

- ⇒ Saffola
- ⇒ Sweekar
- ⇒ Sil

**Kaya Skin Care**

Kaya Skin Care provides a gamut of products and services in the area of intensive skin care. Kaya's reach spans 101 outlets in India, the Middle East and Bangladesh. The services at Kaya clinics are provided by qualified doctors and target high-end customers.

**International division**

Marico's reach extends to more than 20 countries in the Middle East, Asian sub-continent, Australia and the US. Marico's product offerings in international markets include Parachute coconut oil, perfumed oils, hair creams and edible oils.

The international division houses many new brands, including the more popular ones in India, as listed below.

**▪ Hair care**

- ⇒ Parachute range of products
- ⇒ Hamam Zeit
- ⇒ Silk n Shine
- ⇒ Fiancee
- ⇒ Code 10

**▪ Health foods**

- ⇒ Saffola
- ⇒ Sweekar

**Marico (MRCO IN, Outperform, Target Price: Rs135.00)**

Quarterly Results		4Q/10A	1Q/11E	2Q/11E	3Q/11E	Profit & Loss		2010A	2011E	2012E	2013E
Revenue	m	6,386	7,723	7,723	8,032	Revenue	m	26,608	30,893	35,517	40,597
Gross Profit	m	3,358	4,014	4,014	4,175	Gross Profit	m	13,992	16,057	18,301	20,979
Cost of Goods Sold	m	3,028	3,709	3,709	3,857	Cost of Goods Sold	m	12,616	14,836	17,216	19,618
EBITDA	m	900	1,083	1,083	1,127	EBITDA	m	3,751	4,333	5,156	6,145
Depreciation	m	144	155	155	161	Depreciation	m	601	619	659	684
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	756	928	928	965	EBIT	m	3,151	3,713	4,497	5,461
Net Interest Income	m	-62	-61	-61	-63	Net Interest Income	m	-257	-243	-243	-243
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	-24	0	0	0	Exceptionals	m	-98	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	44	53	53	55	Other Pre-Tax Income	m	183	212	234	191
Pre-Tax Profit	m	714	921	921	957	Pre-Tax Profit	m	2,979	3,683	4,488	5,410
Tax Expense	m	-154	-184	-184	-191	Tax Expense	m	-643	-737	-898	-1,082
Net Profit	m	560	737	737	766	Net Profit	m	2,335	2,946	3,591	4,328
Minority Interests	m	-5	0	0	0	Minority Interests	m	-19	0	0	0
Reported Earnings	m	555	737	737	766	Reported Earnings	m	2,317	2,946	3,591	4,328
Adjusted Earnings	m	579	737	737	766	Adjusted Earnings	m	2,415	2,946	3,591	4,328
EPS (rep)		0.91	1.21	1.21	1.26	EPS (rep)		3.80	4.84	5.90	7.11
EPS (adj)		0.95	1.21	1.21	1.26	EPS (adj)		3.96	4.84	5.90	7.11
EPS Growth yoy (adj)	%	18.5	22.0	22.0	22.0	EPS Growth (adj)	%	18.5	22.0	21.9	20.5
						PE (rep)	x	29.3	23.0	18.9	15.7
						PE (adj)	x	28.1	23.0	18.9	15.7
EBITDA Margin	%	14.1	14.0	14.0	14.0	Total DPS		0.88	1.94	2.70	3.66
EBIT Margin	%	11.8	12.0	12.0	12.0	Total Div Yield	%	0.8	1.7	2.4	3.3
Earnings Split	%	24.0	25.0	25.0	26.0	Weighted Average Shares	m	609	609	609	609
Revenue Growth	%	11.4	16.1	16.1	16.1	Period End Shares	m	609	609	609	609
EBIT Growth	%	17.5	17.9	17.9	17.9						
Profit and Loss Ratios		2010A	2011E	2012E	2013E	Cashflow Analysis		2010A	2011E	2012E	2013E
Revenue Growth	%	11.4	16.1	15.0	14.3	EBITDA	m	3,751	4,333	5,156	6,145
EBITDA Growth	%	23.4	15.5	19.0	19.2	Tax Paid	m	-643	-737	-898	-1,082
EBIT Growth	%	17.5	17.9	21.1	21.4	Chgs in Working Cap	m	485	-134	-175	816
Gross Profit Margin	%	52.6	52.0	51.5	51.7	Net Interest Paid	m	-257	-243	-243	-243
EBITDA Margin	%	14.1	14.0	14.5	15.1	Other	m	-19	-0	0	-0
EBIT Margin	%	11.8	12.0	12.7	13.5	Operating Cashflow	m	3,317	3,219	3,840	5,636
Net Profit Margin	%	8.8	9.5	10.1	10.7	Acquisitions	m	0	0	0	0
Payout Ratio	%	22.1	40.1	45.8	51.5	Capex	m	-78	-210	-390	-450
EV/EBITDA	x	18.1	15.7	13.2	11.0	Asset Sales	m	0	0	0	0
EV/EBIT	x	21.5	18.3	15.1	12.4	Other	m	183	212	234	191
Balance Sheet Ratios						Investing Cashflow	m	105	2	-156	-259
ROE	%	44.5	40.9	39.7	39.1	Dividend (Ordinary)	m	-535	-1,181	-1,645	-2,230
ROA	%	26.3	27.2	28.0	28.5	Equity Raised	m	0	0	0	0
ROIC	%	34.1	47.7	60.4	74.5	Debt Movements	m	-1,052	0	0	0
Net Debt/Equity	%	-1.3	-26.3	-41.5	-60.3	Other	m	0	0	-0	0
Interest Cover	x	12.3	15.3	18.5	22.5	Financing Cashflow	m	-1,587	-1,181	-1,645	-2,230
Price/Book	x	10.7	8.4	6.8	5.6	Net Chg in Cash/Debt	m	1,737	2,040	2,040	3,147
Book Value per Share		10.4	13.3	16.5	19.9	Free Cashflow	m	3,239	3,009	3,450	5,186
						Balance Sheet		2010A	2011E	2012E	2013E
						Cash	m	2,780	4,821	6,860	10,007
						Receivables	m	1,233	1,431	1,646	1,881
						Inventories	m	3,086	3,583	4,119	4,603
						Investments	m	0	0	0	0
						Fixed Assets	m	2,588	2,179	1,910	1,676
						Intangibles	m	850	850	850	850
						Other Assets	m	1,940	1,940	1,940	1,940
						Total Assets	m	12,477	14,804	17,325	20,958
						Payables	m	2,769	3,330	3,906	5,442
						Short Term Debt	m	1,500	1,500	1,500	1,500
						Long Term Debt	m	1,198	1,198	1,198	1,198
						Provisions	m	355	355	355	355
						Other Liabilities	m	338	338	338	338
						Total Liabilities	m	6,160	6,721	7,297	8,833
						Shareholders' Funds	m	6,317	8,082	10,028	12,125
						Minority Interests	m	0	0	0	0
						Other	m	0	0	0	0
						Total S/H Equity	m	6,317	8,082	10,028	12,125
						Total Liab & S/H Funds	m	12,477	14,804	17,325	20,958

All figures in INR unless noted.

Source: Company data, Macquarie Research, June 2010

## Important disclosures:

## Recommendation definitions

**Macquarie - Australia/New Zealand**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie First South - South Africa**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
Neutral (Hold) – return within 5% of Russell 3000 index return  
Underperform (Sell) – return >5% below Russell 3000 index return

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ/Canada stocks only

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 31 March 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	50.55%	62.20%	42.25%	42.39%	62.16%	46.74%	(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)
Neutral	36.63%	19.02%	47.89%	50.35%	31.89%	34.78%	(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)
Underperform	12.82%	18.78%	9.86%	7.27%	5.95%	18.48%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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