

Skin-care innovations start firing

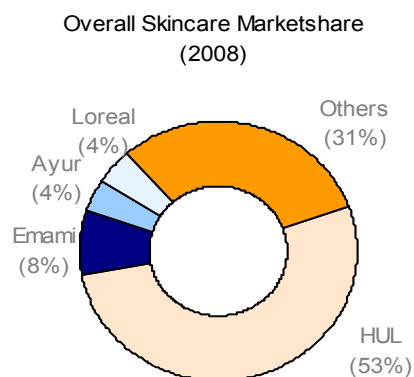
Emami's innovation pipeline in skincare is delivering results, as its niche products in talcum powders, body lotions, petroleum-jelly and glycerine soaps are selling well. *Navratna Cool Talc*, in particular, is shaping up to be a highly successful innovation. For Emami which is already the 2nd largest skin player in India, these new products could add 3pps to its overall revenue CAGR over FY10-12ii. The company's largest brand, *Navratna Cooling Oil*, continues to record strong volume growth, aided by advertising positioned at new consumer groups, such as women. We raise our FY11-12 earnings estimates by c2% to factor in higher sales from these innovations and raise our target price to Rs760 based on 20x one-year-forward earnings. We retain BUY.

Talcum, lotions, petroleum jelly and glycerine soaps are new growth areas: Emami is focussing on niche skin categories such as talcum powder, petroleum jelly and glycerine soaps, whose volume sales are growing at high double-digit rates. One such product is *Navratna Cool Talc*, whose sales we reckon will cross Rs450m in FY11. *Vasocare* (petroleum-jelly-based), *Pure Skin* (glycerine soap) and *Boro Plus* lotion are also ramping up.

High growth rates, deep gross margins and incumbents' lack of innovation make these segments attractive: Most of these categories have seen volume growth rates of 15-20% over the last 2-3 years, and have among the highest gross margins across FMCG products. These categories are currently dominated by large players like Hindustan Unilever, but these players have introduced few innovations in segments such as talcum powders and glycerine soaps—leaving ample scope for a player like Emami to claim a part of the pie.

Cooling oils continue strong growth; Emami targeting new consumer groups: *Navratna* cooling oil continues to see strong growth, with volumes up c20% YoY in FY10. A key driver is Emami's advertising push to position the brand on new claims of therapeutic benefits such as relief from stress and insomnia, and targeting new consumer groups like women. We expect these to help the brand sustain 18-20% revenue growth over 2-3 years.

Emami is the 2nd largest player in skin care



Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	5,789	7,490	10,086	12,003	14,299
EBITDA Margins (%)	16.4	17.0	21.9	22.3	22.7
Reported PAT (Rs m)	902	920	1,569	2,188	2,727
Adj. EPS (Rs)	14.4	14.0	20.8	28.9	36.1
Growth (%)	36.0	-3.3	48.7	39.5	24.6
PER (x)	46.3	47.9	32.2	23.1	18.5
ROE (%)	35.0	31.3	30.9	27.9	28.9
Debt/Equity (x)	0.4	1.4	0.1	-0.1	-0.2
EV/EBITDA (x)	47.8	38.2	23.3	18.8	15.0
Price/Book (x)	15.5	14.7	7.2	6.0	4.9

Price as at close of business on 09 April 2010

Source: Industry sources, IIFL Research

12-mth TP (Rs) 760 (+14%)

Market cap (US\$ m) 1,108

52Wk High/Low (Rs) 751/197

Diluted o/s shares (m) 76

Daily volume (US\$ m) 2

Dividend yield FY10ii (%) 1.1

Free float (%) 24.3

Shareholding pattern (%)

Promoters 75.7

FII's 12.2

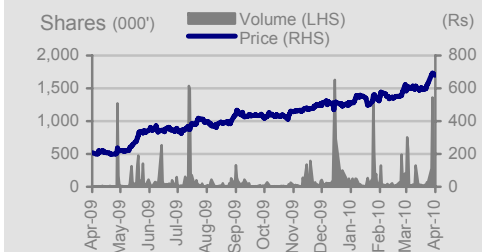
Domestic MFs 5.2

Others 6.8

Price performance (%)

	1M	3M	1Y
Emami	11.0	20.0	206.0
Rel. to Sensex	8.3	19.7	150.0
Colgate	-0.4	4.6	58.8
Dabur	2.2	7.1	85.6
Marico	7.3	11.9	87.2

Stock movement



Arnab Mitra

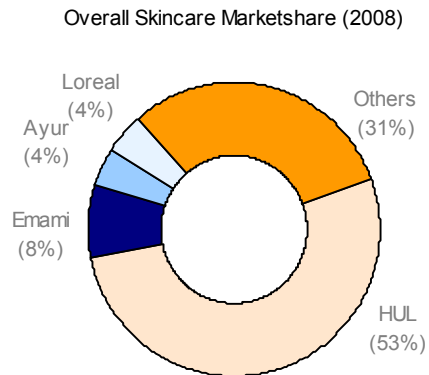
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Skincare is a high-growth, high-margin business; Emami is already number two in the segment

Emami has seeded a number of products in niche skincare segments in the past 1-2 years, and these are now paying off. Most skincare categories have registered volume growth of 15-20% annually in the past 2-3 years, driven by: 1) low penetration of 22%; and 2) rising demand for specific skincare products, thanks to greater awareness and rising disposable incomes. Gross margins on skincare products are high, at 60-80%. Emami is already the 2nd largest skincare player in India, c8% share by volumes; the market leader is HUL.

Figure 1: Emami is already the 2nd largest skin care player in India



Source: Industry sources, IIFL Research

Emami’s game plan is to target more niche segments in skincare and gain share from large incumbents

The skin category is fragmented into various segments, out of which fairness creams are the largest segment, and many other small segments. Emami’s game plan is to target some of these small niche segments, in which large incumbents such as Hindustan Unilever have large market shares, but have introduced few new innovations. Lack of innovation has resulted in HUL’s share coming off in the past two years, with niche players such as Emami gaining share. Emami’s game plan is to maximise its market share at the expense of HUL, the market leader.

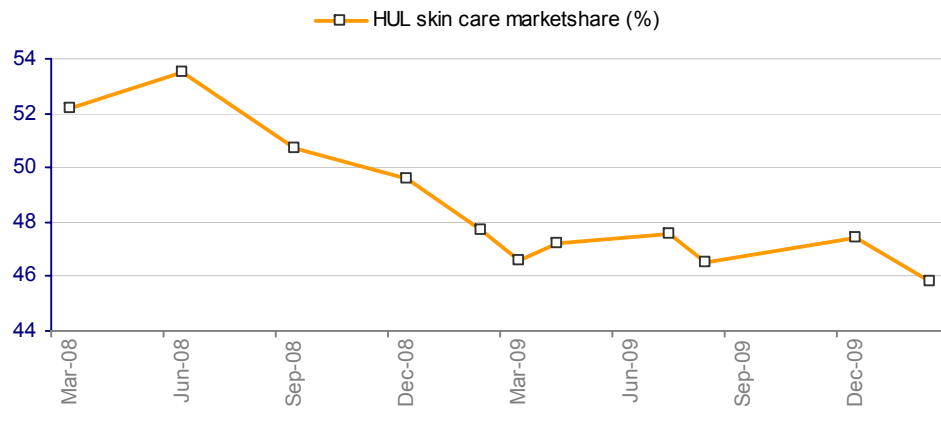
Figure 2: Emami’s recent innovations are ramping up well

Product	Remarks
 <p>Navratna Cool Talc</p>	<ul style="list-style-type: none"> Category size: Talcum powder is a Rs6bn pa category. Product description: ‘Cooling talcum powder’ is a new concept in the category; contains mint and camphor. Sales in FY10ii: Crossed Rs250m; company was unable to meet demand. Competition: HUL has 60% share in the talcum category, but has introduced no innovation in the recent past. Johnson & Johnson is the other large player, with 15% share, but largely operates in the baby powders segment. Management expectation: Expects the brand to cross Rs450m in sales in FY11.
 <p>Emami Vasocare</p>	<ul style="list-style-type: none"> Category size: Winter care is a Rs8bn segment. The segment is very fragmented, with a number of sub-segments such as cold creams, lotions, moisturizers, and petroleum jelly. Product description: Herbal petroleum jelly for winter protection. Sales in FY10ii: Rs70m-80m. Competition: HUL’s <i>Vaseline</i> brand has a near monopoly in petroleum jelly, with cRs1.5bn in sales. Management expectation: Aims to gain c10% of the size of HUL’s <i>Vaseline</i> in 2-3 years.
 <p>emami Pure Skin</p>	<ul style="list-style-type: none"> Category size: Glycerin soap is a Rs4bn-5bn segment in soaps. Product description: Glycerin soap. Sales in FY10ii: Rs40m-50m. Competition: HUL’s <i>Pears</i> has a near-monopoly in this segment, but the company has launched no innovation in the recent past. Godrej has also launched a product in this segment in FY10. Management expectation: Looks to gain 5-10% share in this segment over 2-3 years.
 <p>Boro Plus Lotion</p>	<ul style="list-style-type: none"> Category size: Winter care is a Rs8bn segment. The segment is very fragmented, with a number of sub-segments such as cold creams, lotions, moisturisers, and petroleum jelly. Product description: Winter body lotion. Sales in FY10ii: Crossed Rs140m in sales. Competition: HUL’s <i>Ponds</i> and <i>Lakme</i> have near-monopoly in the segment. Management expectation: Looks to grow sales at c25% over the next 2-3 years.

Source: Company, Industry sources, IIFL Research

Emami’s nimbleness in launching a number of innovations in small niche segments in skincare is helping it gain small shares in these segments, which could grow over significantly over time. HUL has steadily lost share in skincare over the past two years to niche players like Emami.

Figure 3: HUL has lost share in skincare in the past two years to niche players like Emami



Source: Industry sources, IIFL Research

Cooling oils continue robust growth

Emami’s ‘cooling-oil’ brand *Navratna* has seen 20%+ YoY revenue growth in FY10, which is largely volume-led. We believe these high growth rates will sustain, driven by:

- 1. targeting new consumer groups such as women:** Emami’s advertising campaign is now focussing on getting new consumer groups into the category. The product is being positioned at women, with the therapeutic proposition of relief from stress and physical pain caused by household work. Usage of ‘cooling oils’ is at present very low among women, and has scope to grow;
- 2. new therapeutic propositions such as relief from such as insomnia, body ache, headache and stress:** Emami’s recent advertisements pitch new therapeutic propositions for *Navratna*—relief from insomnia, body ache, stress and headache. This is leading to more usage occasions for *Navratna* oil.

- 3. New variant ‘extra thanda’ likely to gain share in Uttar Pradesh over the next year:** Emami holds very low share in India’s largest state, Uttar Pradesh, where a local player Hemgange holds dominant share. Emami has launched a new variant ‘extra thanda’ to counter this local competitor, giving deep trade discounts. With its proposition of ‘extra menthol’, we believe Emami will be able to gain some share in this large market for ‘cooling oils’.

We expect revenue growth to sustain at 18-20% over the next 2-3 years as this marketing and advertising strategy yields results.

We raise earnings estimates and target price, retain BUY

We raise earnings estimates for FY11-12 by c2% to account for higher sales growth in new innovations in skincare. We also factor in higher tax rates from the increase in MAT. We raise our target price to Rs760 (from Rs675) based on 20x 1-year forward earnings, and retain BUY.

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue	5,789	7,490	10,086	12,003	14,299
EBITDA	952	1,274	2,212	2,672	3,243
EBIT	879	1,191	2,102	2,561	3,124
Net Interest expense	105	-210	-294	-43	-8
Other Income	40	78	130	218	293
Profit before tax	1,024	1,059	1,937	2,735	3,408
Taxes	-122	-141	-368	-547	-682
Exceptional items	0	3	0	0	0
Minorities and other	0	-1	0	0	0
Net profit	902	920	1,569	2,188	2,727

Cashflow summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Profit before tax	1,024	1,059	1,937	2,735	3,408
Depr. & amortization	73	84	110	111	119
Tax paid	-122	-141	-368	-547	-682
Working capital Δ	-1,183	1,485	-229	-46	-138
Other operating items	5	-3	0	0	0
Operating cashflow	-203	2,484	1,450	2,254	2,708
Capital expenditure	-183	-5,655	-244	-161	-154
Free cash flow	-386	-3,171	1,206	2,092	2,554
Equity raised	-5	-376	3,093	0	0
Investments	-400	756	0	0	0
Debt financing/disposal	1,004	3,224	-3,500	-700	0
Dividends paid	-327	-398	-544	-772	-961
Other items	-4	40	1	0	0
Net change in cash	-118	75	256	621	1,592

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Cash & equivalents	66	141	397	1,018	2,610
Sundry debtors	388	710	957	1,138	1,356
Inventories - trade	976	738	994	1,183	1,409
Other current assets	1,944	834	1,123	1,336	1,592
Fixed assets	923	6,495	6,628	6,678	6,713
Intangible assets	40	0	0	0	0
Other term assets	1,142	426	426	426	426
Total assets	5,479	9,344	10,525	11,779	14,106
Short-term debt	798	752	752	152	152
Sundry creditors	863	1,269	1,685	1,993	2,361
Other current liabs	468	520	666	897	1,090
Long-term debt/CBs	460	3,731	231	131	131
Other long-term liabs	21	60	60	60	60
Minorities/other equity	5	0	0	0	0
Net worth	2,864	3,013	7,130	8,547	10,312
Total liabs & equity	5,479	9,344	10,525	11,779	14,106

Ratio Analysis

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue growth (%)	12.2	29.4	34.7	19.0	19.1
Op Ebitda growth (%)	45.4	33.9	73.6	20.8	21.4
Op Ebit growth (%)	44.4	35.5	76.5	21.8	22.0
Op Ebitda margin (%)	16.4	17.0	21.9	22.3	22.7
Op Ebit margin (%)	15.2	15.9	20.8	21.3	21.8
Net profit margin (%)	15.6	12.3	15.6	18.2	19.1
Dividend payout (%)	36.3	43.3	34.7	35.3	35.3
Tax rate (%)	11.9	13.3	19.0	20.0	20.0
Net debt/equity (%)	41.6	144.1	8.2	-8.6	-22.6
Return on equity (%)	35.0	31.3	30.9	27.9	28.9
ROCE (%)	27.2	20.7	27.7	32.7	39.2

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%.

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