

# MARICO LTD

FMCG

## Premium pricing to hurt growth

We met the senior management of Marico. **Key things** to watch out for:

- High pricing premium to **impact growth in core brands** (Parachute and Saffola), estimated at 8% YoY in FY14. This will **moderate revenue to 12% CAGR** over FY13-15 (15% normalized for Kaya vs. 21% over FY11-13)
- **Margin expansion cycle at peak** for domestic business as base effect of copra behind us and pricing correction effected
- **Youth brands** (including skin lotion and breakfast cereals), the **new growth engine**, could become 18% -20% of group sales in next 3 years
- We cut EPS by 3-5% yet expect **21% earnings CAGR** over FY13-15 led by growth and margin expansion in international business, reduction in interest cost, and performance improvement in youth brands

## Segment-wise growth trend

Rev. Mix (%) *		FY12	Q1'13	Q2'13	Q3'13	Q4'13E	FY13E	FY14E	FY15E
26	Parachute (rigid pack) Vol.	11	18	9	6	8	10	10	11
16	Saffola edible oils Vol.	11	12	6	4	5	7	9	13
15	Value added hair oils Vol.	24	25	20	30	20	24	18	16
4	Youth Brands Val	na	na	28	18	15	20	19	20
	<b>Domestic biz. vol.</b>	<b>14</b>	<b>16</b>	<b>10</b>	<b>9</b>	<b>9</b>	<b>12</b>	<b>11</b>	<b>13</b>
75	<b>Domestic biz. value</b>	<b>26</b>	<b>22</b>	<b>12</b>	<b>10</b>	<b>11</b>	<b>16</b>	<b>12</b>	<b>15</b>
25	<b>Intl. biz. val (post Forex)</b>	<b>30</b>	<b>17</b>	<b>16</b>	<b>0</b>	<b>1</b>	<b>10</b>	<b>9</b>	<b>15</b>
100	<b>Marico group rev. growth</b>	<b>28</b>	<b>22</b>	<b>19</b>	<b>11</b>	<b>10</b>	<b>15</b>	<b>7</b>	<b>16</b>

Company, Axis Capital; \* Revenue mix excludes Kaya FY14 onwards

## FINANCIAL SUMMARY (Consolidated)

Y/E March	FY12	FY13E	FY14E	FY15E
Sales (Rs mn)	40,083	46,057	49,386	57,507
Adj PAT (Rs mn)	3,192	3,900	4,674	5,756
Con. EPS* (Rs.)	-	6.4	7.8	9.6
EPS (Rs.)	5.2	6.1	7.3	8.9
Change YOY (%)	19.4	16.6	19.9	23.1
P/E (x)	33.6	34.4	28.7	23.3
RoE (%)	31.0	25.1	23.1	24.9
RoCE (%)	27.9	24.7	23.8	27.3
EV/EBITDA (x)	22.3	21.7	18.0	15.1
DPS	(0.7)	(0.9)	(1.2)	(1.5)

Source: \*Consensus broker estimates, Company, Axis Capital

## KEY DRIVERS

(%)	FY13E	FY14E	FY15E
Dom. revenue growth	16	12	15
Intl. revenue growth	2	16	21
Gross margin	51.5	49.9	49.8
A&P spends	13.0	12.1	12.0

## PRICE PERFORMANCE



25 MAR 2013 Visit Note

**HOLD**

Target Price: Rs 223

CMP	: Rs 208
Potential Upside	: 7%
Relative to Sector	: Neutral

### MARKET DATA

No. of Shares	: 645mn
Free Float	: 40%
Market Cap	: Rs134bn
52-week High / Low	: Rs250 / Rs160
Avg. Daily vol. (6mth)	: 301,564 shares
Bloomberg Code	: MRCO IB Equity
Promoters Holding	: 60%
FII / DII	: 28% / 2%
BSE Code	: 531642
NSE Code	: MARICO

## Key highlights

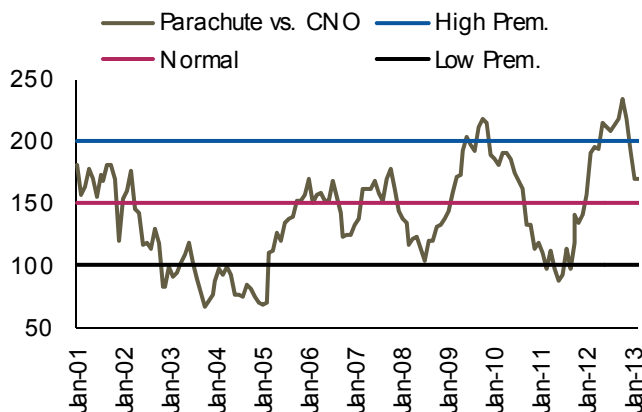
### Core brands to slow down due to rising premium

The retail price for Parachute coconut oil (30% of consolidated revenue) and Saffola edible oil (15% of consolidated revenue) are at their peak levels in comparison to loose commodity prices. In case of Parachute, the premium is now at 200% over loose coconut oil, which has impacted addition of new consumers from unbranded market. In general, the company tries to maintain this premium at the range of 150%. Similarly, in case of Saffola, the pricing premium has risen to all-time high of 100% to competing Sunflower oil.

Thus volume growth for Parachute and Saffola has slowed down to low single digits from 11-15% in last few years. We believe current weakness in volume growth will continue in H1FY14 till pricing differential is restored. The management has undertaken price correction in both Parachute (5-7% on select SKU – 100ml and 250 ml) and Saffola (5-7% on Saffola Gold). Note, in case of Parachute, the premium remains at 170% even after the pricing correction.

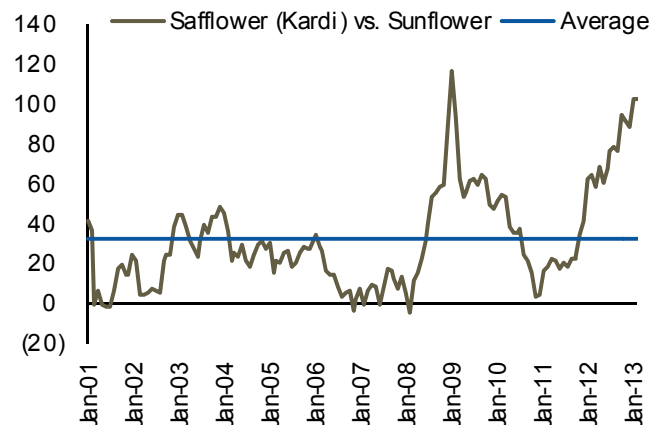
We expect Saffola and Parachute to grow at a combined 8% in value terms in FY14 on weaker volume growth and pricing correction. With pricing corrections, we believe the competitive stance will be restored, aiding to 14% growth in these two brands in FY15. Overall domestic consumer business (~75% of consolidated revenue excluding Kaya) is expected to grow by 13% in FY14 and 15% in FY15.

**Exhibit 1: Parachute premium over coconut oil(%)**



Source: Axis Capital

**Exhibit 2: Safflower premium over Sunflower oil (%)**



Source: Axis Capital

### Youth brands and foods to contribute ~18% of revenue by FY16E

The personal care portfolio at Rs 4.5 bn (10% of consolidated revenue) consists of (a) recently acquired hair gels, hair serum and deodorants brands from Reckitt at

Rs 2 bn, (b) X-men brands male grooming products from hair gels, shampoos and deodorants in Vietnam at Rs 1.5 bn, and (c) Egyptian hair care portfolio of gels and creams at Rs 1 bn. Given the growth potential of these niche and underpenetrated categories, we expect personal care portfolio to become at least 13-15% of revenue in the next 3 years.

The foods portfolio consisting of Saffola oats& muesli and diabetic atta contributes Rs 500 mn currently. Saffola oats has 13% market share in the oats category and has emerged as the number two player in a category growing by 30% CAGR. Saffola Muesli is the 3<sup>rd</sup> largest brand with 9% share. Management expects more launches in foods space which could drive higher contribution from the segment.

In the Rs 5.5 bn body lotion category (sub-segment of skin cream category of Rs 50 bn), Parachute Advanced Body Lotion continues to gain presence. The brand went national in H2FY12 and is now available in 4 variants. Market share now stands at 8% and is the 3<sup>rd</sup> largest brand in the segment. Management believes even though the category is relatively more competitive than the other categories, there is tremendous potential to launch new products in non-main stream segment (i.e. other than fairness and aging creams).

### Cooling oil, Almond oil white gaps in Marico's hair oil portfolio

Marico has posted handsome gains in the value-added hair oil largely driven by strong market share gains in Amla portfolio. However, Cooling hair oil and Almond hair oil continue to be white gaps in Marico's hair oil portfolio. Marico's offering in both the segments have failed to make a mark owing to strong brand equity of the leaders (ie. Bajaj Almond in Almond hair oil and Navratna in cooling hair oil) in these sub-segments.

### Margin expansion cycle has peaked out

The base effect of declining copra prices (~40% of group RM cost), which aided the sharp margin improvement in FY13, is now behind us. Copra price is flat on yoy basis in Q4FY13 and at the 5-year average of Rs 44 /kg. We believe gross margin expansion cycle has peaked as the base effect has caught on and now the company is taking pricing corrections to drive volumes. We are building in no expansion in operating margin for next 2 years for standalone domestic business.

### International business (~25% of group revenue) margin to improve

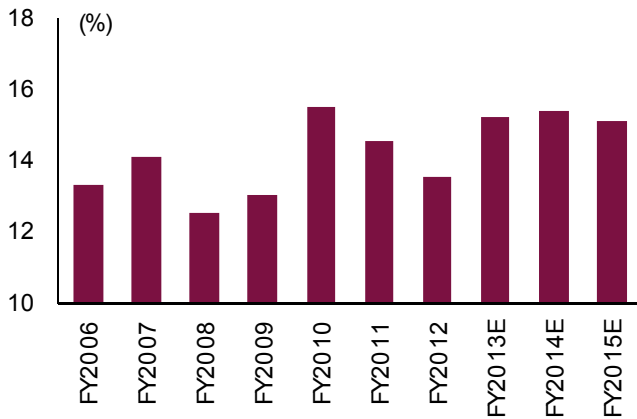
FY13 was one of the toughest years for Marico's international business with revenue growth getting impacted due to volatile economic and socio-political factors. Operating margin at 11% has been at trough level. However, management remains optimistic of margin recovery led by lower inflation and growth pullback in Bangladesh and MENA region. We believe Marico's international margin could improve over 100-150 bps in next 2 years led by 18% CAGR (organic).

### Valuation premium to compress on revenue moderation; maintain HOLD

Marico's valuation premium has expanded over last two years on strong revenue momentum (21% CAGR). However, with expected moderation in revenue growth to 12% CAGR over FY13-15 (15% normalized for Kaya demerger), we believe there is a higher probability for valuation premium to compress. We have lowered our FY14 and FY15 earnings estimates by 3% to Rs 7.3 and 5% to Rs 8.9 to factor in lower volume momentum and pricing correction. Yet 21% earnings CAGR over FY13-15E will be driven by growth and margin expansion in

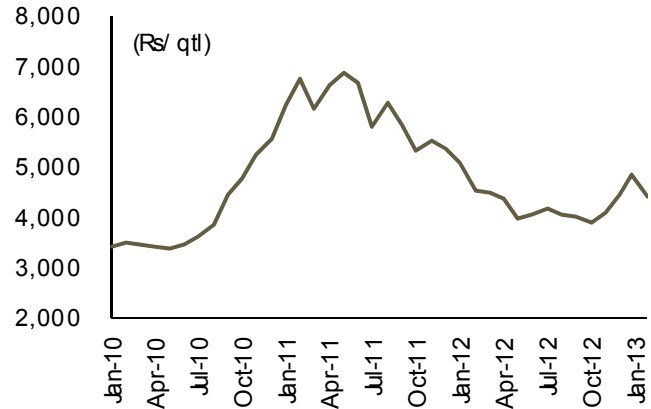
international business, reduction in interest cost, and performance improvement in youth brands. We **maintain HOLD** with revised TP of Rs 223 (25x FY15E vs. 3-year mean of 27x), which implies 7% upside from CMP.

**Exhibit 3: EBITDA margin trend**



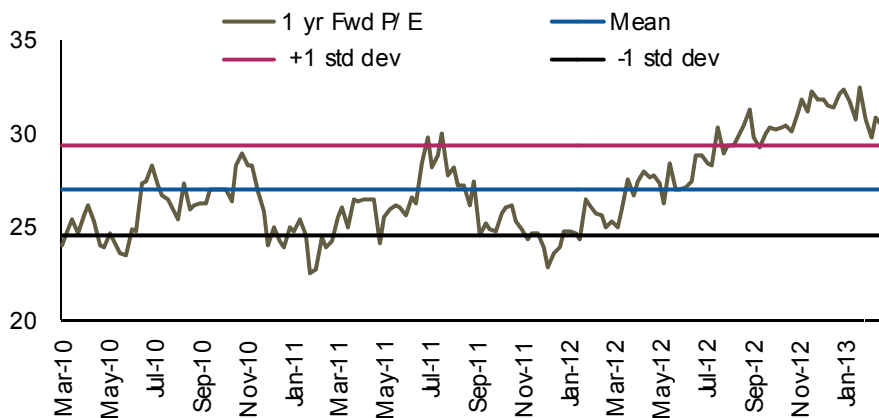
Source: Company, Axis Capital

**Exhibit 4: Copra (~40% of RM) price has bottomed out**



Source: Company, Axis Capital

**Exhibit 5: 1-year forward PE**



Source: Company, Axis Capital

**FINANCIAL SUMMARY (Consolidated)**
**Profit & loss (Rsmn)**

Y/E March	FY12	FY13E	FY14E	FY15E
<b>Net sales</b>	<b>40,083</b>	<b>46,057</b>	<b>49,386</b>	<b>57,507</b>
Other operating income	6	-	-	-
<b>Total operating income</b>	<b>40,089</b>	<b>46,057</b>	<b>49,386</b>	<b>57,507</b>
Cost of goods sold	(20,987)	(22,338)	(24,767)	(28,897)
Gross profit	19,102	23,719	24,619	28,610
Gross margin (%)	47.7	51.5	49.9	49.8
Total operating expenses	(14,235)	(17,415)	(17,289)	(20,077)
<b>EBITDA</b>	<b>4,867</b>	<b>6,304</b>	<b>7,330</b>	<b>8,533</b>
EBITDA margin (%)	12.1	13.7	14.8	14.8
Depreciation	(725)	(855)	(899)	(995)
<b>EBIT</b>	<b>4,142</b>	<b>5,449</b>	<b>6,431</b>	<b>7,538</b>
<b>Net interest</b>	<b>(424)</b>	<b>(656)</b>	<b>(557)</b>	<b>(356)</b>
Other income	306	499	450	600
<b>Profit before tax</b>	<b>4,024</b>	<b>5,292</b>	<b>6,324</b>	<b>7,782</b>
Total taxation	(783)	(1,307)	(1,549)	(1,907)
Tax rate (%)	19.4	24.7	24.5	24.5
Profit after tax	3,241	3,985	4,774	5,876
Minorities	(50)	(85)	(100)	(120)
Profit/ Loss associate co(s)	-	-	-	-
<b>Adjusted net profit</b>	<b>3,192</b>	<b>3,900</b>	<b>4,674</b>	<b>5,756</b>
Adj. PAT margin (%)	8.0	8.5	9.5	10.0
<b>Net non-recurring items</b>	<b>(21)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Reported net profit</b>	<b>3,171</b>	<b>3,900</b>	<b>4,674</b>	<b>5,756</b>

**Balance sheet (Rsmn)**

Y/E March	FY12	FY13E	FY14E	FY15E
Paid-up capital	615	645	645	645
Reserves & surplus	10,815	19,007	20,171	24,796
Net worth	11,679	19,986	21,250	25,994
Borrowing	3,907	7,500	4,230	2,553
Other non-current liabilities	426	553	593	690
<b>Total liabilities</b>	<b>26,170</b>	<b>38,858</b>	<b>37,824</b>	<b>42,495</b>
Gross fixed assets	12,603	22,503	21,403	22,603
Less: Depreciation	(4,031)	(4,886)	(5,785)	(6,780)
Net fixed assets	8,572	17,616	15,618	15,823
Add: Capital WIP	402	450	400	500
Total fixed assets	8,973	18,066	16,018	16,323
Total Investment	2,956	2,957	1,457	1,457
Inventory	7,202	8,010	8,519	9,770
Debtors	1,816	2,095	2,353	2,878
Cash & bank	1,588	3,790	5,202	7,020
Loans & advances	933	921	1,111	1,438
Current liabilities	10,159	10,819	11,752	13,258
Net current assets	1,380	3,997	5,433	7,849
<b>Other non-current assets</b>	<b>2,701</b>	<b>3,019</b>	<b>3,165</b>	<b>3,609</b>
<b>Total assets</b>	<b>26,170</b>	<b>38,858</b>	<b>37,824</b>	<b>42,495</b>

**Cash flow (Rsmn)**

Y/E March	FY12	FY13E	FY14E	FY15E
Profit before tax	4,024	5,292	6,324	7,782
Depreciation & Amortisation	(725)	(855)	(899)	(995)
Chg in working capital	262	(513)	(179)	(775)
<b>Cash flow from operations</b>	<b>4,070</b>	<b>4,544</b>	<b>5,661</b>	<b>5,912</b>
Capital expenditure	(1,021)	(9,948)	1,150	(1,300)
<b>Cash flow from investing</b>	<b>(3,351)</b>	<b>(9,351)</b>	<b>3,255</b>	<b>(522)</b>
Equity raised/ (repaid)	31	5,001	(2,600)	-
Debt raised/ (repaid)	647	3,593	(3,270)	(1,678)
Dividend paid	(470)	(580)	(773)	(967)
<b>Cash flow from financing</b>	<b>(1,187)</b>	<b>7,723</b>	<b>(7,504)</b>	<b>(3,571)</b>
Net chg in cash	(469)	2,915	1,412	1,819

**Key ratios**

Y/E March	FY12	FY13E	FY14E	FY15E
<b>OPERATIONAL</b>				
FDEPS (Rs)	5.2	6.1	7.3	8.9
CEPS (Rs)	6.3	7.4	8.6	10.5
DPS (Rs)	(0.7)	(0.9)	(1.2)	(1.5)
Dividend payout ratio (%)	(13.6)	(14.9)	(16.5)	(16.8)
<b>GROWTH</b>				
Net sales (%)	27.9	14.9	7.2	16.4
EBITDA (%)	15.7	29.5	16.3	16.4
Adj net profit (%)	19.5	22.2	19.9	23.1
FDEPS (%)	19.4	16.6	19.9	23.1
<b>PERFORMANCE</b>				
RoE (%)	31.0	25.1	23.1	24.9
RoCE (%)	27.9	24.7	23.8	27.3
<b>EFFICIENCY</b>				
Asset turnover (x)	3.4	2.6	2.4	2.9
Sales/ total assets (x)	1.7	1.4	1.3	1.4
Working capital/ sales (x)	-	-	-	-
Receivable days	16.5	16.6	17.4	18.3
<b>Inventory days</b>	<b>74.6</b>	<b>73.5</b>	<b>73.9</b>	<b>72.8</b>
Payable days	97.2	91.3	93.1	89.8
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	0.4	0.5	0.2	0.1
Net debt/ equity (x)	0.1	0.2	(0.1)	(0.2)
Current ratio (x)	1.1	1.4	1.5	1.6
Interest cover (x)	9.8	8.3	11.5	21.2
<b>VALUATION</b>				
PE (x)	33.6	34.4	28.7	23.3
EV/ EBITDA (x)	22.3	21.7	18.0	15.1
EV/ Net sales (x)	2.7	3.0	2.7	2.2
PB (x)	9.4	6.8	6.4	5.3
Dividend yield (%)	(0.4)	(0.4)	(0.6)	(0.7)
Free cash flow yield (%)	2.8	(4.0)	5.1	3.4

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