NIRMAL BANG
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Institutional Equities

marico

'PARACHUTES' OF GROWTH INTACT

Marico

17 December 2012

Reuters: MRCO.BO; Bloomberg: MRCO IN

Initiating Coverage

'Parachutes' Of Growth Intact

We believe multiple positive levers will play out for Marico over the next three years like: 1) Benefit of correction in key raw material copra's price (down 35% YoY), 2) Improved profitability in international and Kaya businesses (31% of revenue), and 3) Re-investment of a part of gross margin expansion into spending on advertising to spur the launch of new products. Further, the company has managed to gain market share of 500bps-700bps since FY10 in domestic business (69% of revenue), helping it to grow faster than the market. We expect the trend to continue with the addition of high-growth and lower-penetrated product offerings such as body lotion, oats and recently acquired Paras product portfolio. All this would lead to a 26% earnings CAGR over FY12-FY15E, in our view, the highest among its peers. We have assigned a Buy rating to Marico with a target price of Rs260, at 26x FY15E EPS.

Strong market position in domestic business: Marico has gained market share (volume) by 500bps-700bps in Parachute hair oil, Saffola edible oil, and Value added hair oils since FY10. This has helped it to grow faster than the market in the current challenging economic environment and also aided in combating the 100% rise in copra prices over March 2010 to March 2011 without denting the profitability of its Parachute hair oil in absolute terms. Saffola's volume growth trajectory has moderated from 15% to 6% in 2QFY13 due to lower off-take and de-stocking at CSD (Canteen Stores Department), which we believe is likely to pick up with a probable cut in retail prices and normalisation at CSD. Value-added hair oils continue to witness strong volume growth of 20%-25%, thanks to packaging rehaul and participation in more sub-segments. We expect these trends to continue. **Consequently, we expect a 18.6% revenue CAGR in domestic market over FY12-FY15E.**

International business likely to pick up: In 1HFY13, Marico's international business reported weak performance with only a 3% value growth in constant currency terms largely led by price. This was on account of the transporters' strike which hurt its business in South Africa in 2QFY13 apart from challenging conditions in Bangladesh and MENA region. We expect things to improve from 2HFY13 with Marico expanding into non-coconut hair oil business in Bangladesh and political tensions easing in the MENA region improving the overall business environment. **We have factored in a 16% revenue CAGR in its international business over FY12-FY15E.**

Gross margin expansion to spur new product launch: We expect a 316bps gross margin expansion over FY12-FY15E largely led by copra price correction. However, the management's strategy to reinvest a substantial part of margin expansion on advertising to accelerate the launch of new products and gain further market share in existing businesses will limit overall OPM expansion. Further, we expect the margins in international business to move up from the current level (10%) to group margin (13%) over the next three years following improvement in volume and cost rationalisation along with Kaya business swinging to profitabilty. **Consequently, we expect OPM expansion of 210bps over FY12-FY15E.**

Y/E March (Rsmn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	31,260	39,968	48,299	56,374	66,139
YoY (%)	*17.5*	*27.9*	*20.8*	*16.7*	*17.3*
EBITDA	4,181	4,844	6,608	7,948	9,392
EBITDA (%)	*13.4*	*12.1*	*13.7*	*14.1*	*14.2*
Adj. PAT	2,375	3,189	4,121	5,136	6,420
YoY (%)	*(1.6)*	*34.2*	*29.2*	*24.6*	*25.0*
Adjusted EPS	3.7	4.9	6.4	8.0	10.0
RoE (%)	*30.3*	*31.0*	*26.2*	*23.1*	*23.4*
RoCE (%)	*24.6*	*22.5*	*23.7*	*21.2*	*23.7*
P/E (x)	59.7	44.5	34.4	27.6	22.1
P/BV	14.8	11.8	7.1	5.8	4.7
EV/EBITDA (x)	35.0	29.9	22.3	18.0	14.7

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: FMCG

CMP: Rs220

Target Price: Rs260

Upside: 18%

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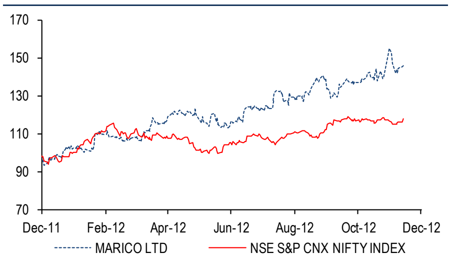
Key Data

Current Shares O/S (mn)	644.7
Mkt Cap (Rsbn/US$bn)	142.3/2.6
52 Wk H / L (Rs)	250/137
Daily Vol. (3M NSE Avg.)	406,719

Share holding (%)	4QFY12	1QFY13	2QFY13
Promoter	62.7	59.8	59.8
FII	25.9	29.4	30.1
DII	4.5	3.6	3.3
Corporate	3.0	3.3	3.2
General Public	3.9	3.8	3.6

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Marico	1.5	28.7	59.9
Nifty Index	5.5	14.4	26.4

Source: Bloomberg

Valuation

We like Marico's strategy of achieving growth through organic as well as inorganic routes. Further, it is heartening to see that the quality of earnings has been maintained through consistent volume despite price hikes by the company, indicating higher pricing power. We expect Marico to further increase its market share in Parachute (conversion from loose oil products), Saffola (gain market share from key competitor Sundrop and unbranded edible oils) and Value added hair oils (by offering more products in the sub-segment and higher brand investment). Further, the company's new product offerings in low-penetrated and high-growth segment in the form of oats, body lotion and recently acquired Paras product portfolio augurs well and puts Marico well ahead of the curve. This is likely to result in a 26% earnings CAGR over FY12-FY15E, the highest among its peers.

At the CMP, Marico trades at 27.6x and 22.1x P/E based on FY14E/FY15E earnings, respectively. Over the past three years, Marico's one-year average forward P/E multiple has been re-rated to 26x i.e at a 13% premium to its five-year average one-year average forward P/E multiple of 23x, thanks to consistent volume, lower dependence on coconut hair oil business, rise in market share, diversification into other products through organic as well inorganic routes and strong earnings growth. We expect the current valuation to sustain given the company's likely strong earnings CAGR of 26% over FY12-FY15E as against 16% earnings CAGR over FY09-FY12. We have assigned a Buy rating to the stock with a target price of Rs260, valuing it at 26x FY15E earnings, in line with its three-year average one-year forward rolling P/E multiple.

Exhibit 1: Comparative valuation

Company	CMP (Rs)	Mkt. cap (Rsbn)	*EPS CAGR (%) (FY12-FY15E)*	PE (x)		EV/EBITDA (x)	
				FY14E	FY15E	FY14E	FY15E
Bajaj Corp	215	32	*19.2*	18.0	15.6	14.6	12.6
Asian Paints	4,263	409	*20.5*	29.1	23.6	18.5	15.2
ITC	294	2,313	*18.7*	26.3	22.2	18.0	15.2
Godrej Consumer Products	716	244	*14.5*	26.2	21.4	18.7	15.6
Dabur India	128	223	*18.9*	24.2	20.6	18.1	15.7
GSK Consumer Healthcare *	3,746	158	*19.5*	30.7	26.0	22.8	19.6
Hindustan Unilever	516	1,115	*15.6*	30.2	26.8	22.7	19.2
Jyothy Laboratories	173	28	*58.8*	23.2	15.6	15.4	11.5
Britannia Industries	499	60	*21.6*	21.8	17.7	14.4	11.9
Colgate Palmolive (India)	1,406	191	*17.2*	30.7	26.6	23.1	20.0
Emami	597	90	*19.7*	24.5	20.4	20.6	17.6
Tata Global Beverages	169	104	*16.0*	20.9	18.8	13.3	11.2
Nestle India	4,820	465	*20.9*	36.1	30.9	21.7	18.3
Marico	**220**	**143**	**26.3**	**27.6**	**22.1**	**18.0**	**14.7**
Industry Weighted Average			**18.6**	**28.1**	**23.9**	**19.5**	**16.5**

*Note: * December financial year-end; Source: Bloomberg, Nirmal Bang Institutional Equities Research*

Our EBITDA estimates are above consensus projections

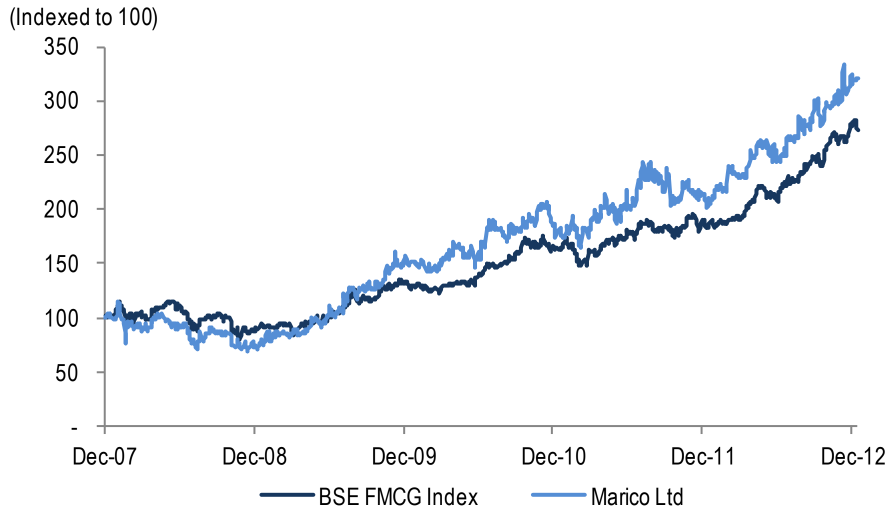
We are 1.5%/3.5%/3.7% above consensus FY13E/FY14E/FY15E EBITDA estimates, respectively, as we have assumed higher operating margin. We have factored in higher OPM as we believe the company will not go for price cut in Parachute hair oil in the wake of recent fall in copra prices as historically it has not reduced retail product prices during the copra downcycle. Meanwhile, we have amortised goodwill over a period of eight years unlike consensus estimates, thereby coming in line with consensus FY14E PAT. Further, we believe the company's tax rate would be lower in FY15E following rising revenue contribution from Saffola and international business which enjoys fiscal benefits. Hence, we are 1.7% above consensus in respect of FY15E PAT.

Exhibit 2: Our estimates versus Bloomberg consensus projections

	Bloomberg consensus estimates			NBIE estimates			*Deviation (%)*		
(Rsmn)	FY13E	FY14E	FY15E	FY13E	FY14E	FY15E	*FY13E*	*FY14E*	*FY15E*
Revenue	47,909	56,308	65,443	48,299	56,374	66,139	*0.8*	*0.1*	*1.1*
EBITDA	6,509	7,669	9,046	6,608	7,948	9,392	*1.5*	*3.5*	*3.7*
OPM (%)	*13.6*	*13.6*	*13.8*	*13.7*	*14.1*	*14.2*	*10bps*	*50bps*	*40bps*
PAT	4,201	5,125	6,312	4,121	5,136	6,420	*(1.9)*	*0.2*	*1.7*

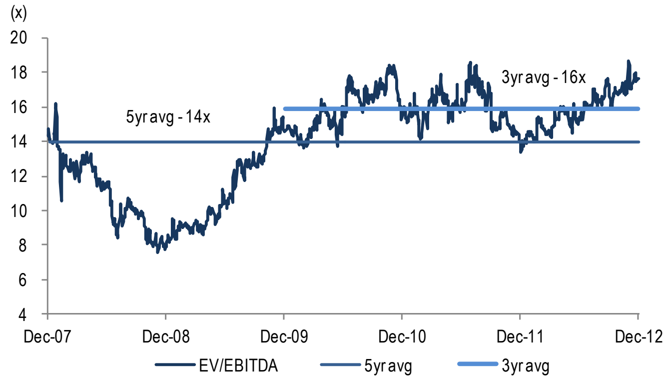
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 3: Marico stock outperforms 20% versus BSE FMCG Index (over past five years)



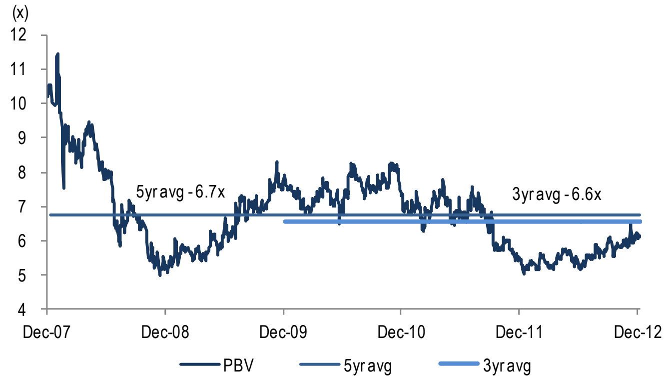
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward EV/EBITDA



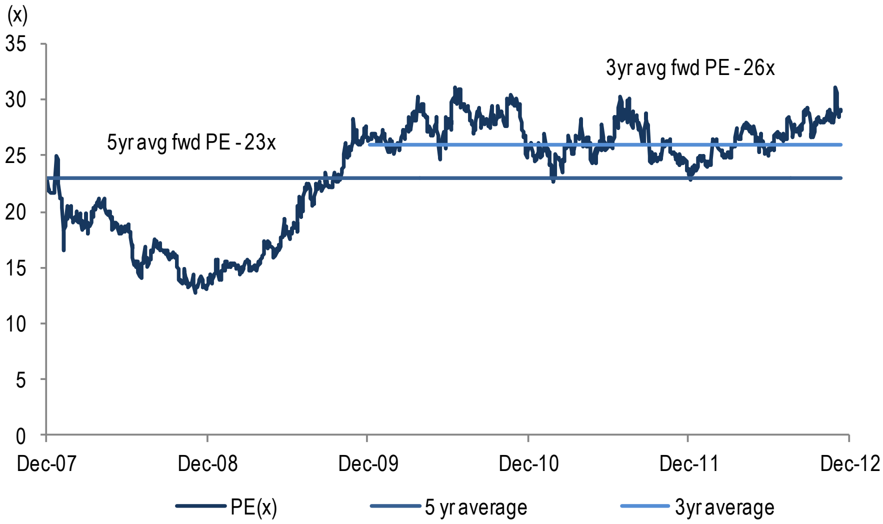
Source:Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 5: One-year forward P/BV



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 6: One-year forward PE



Source: Bloomberg, Nirmal Bang Institutional Equities Research

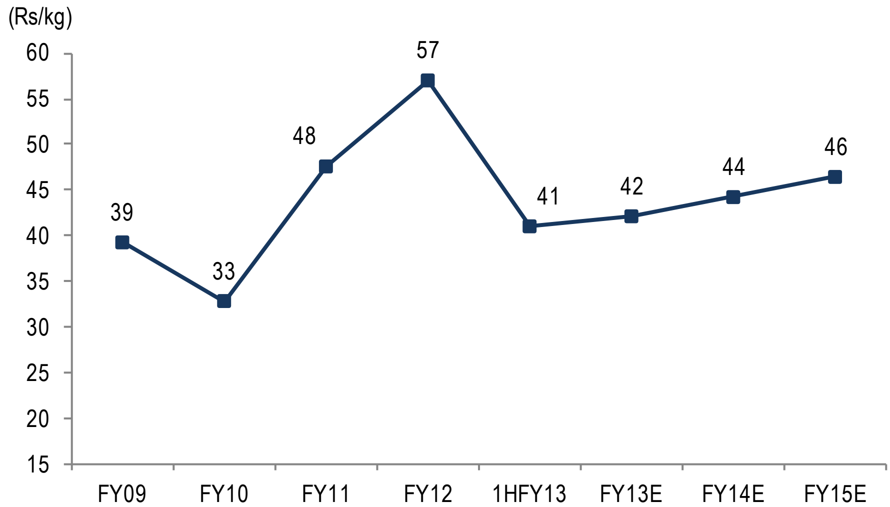
Investment Arguments

Margin expansion likely to sustain

We believe the current expansion in margins will sustain due to the following reasons:

- Prices of copra, which accounts for 40% of Marico's raw material costs, rose 100% YoY in FY11. This resulted in a 30%-40% price hike across its coconut hair oil products. But now copra prices have declined 35% from their peak in August 2011, thereby resulting in a 600bps expansion in gross margin in 1HFY13. Historically, we have witnessed that in case of a fall in copra prices the company does not reduce hair oil prices, especially in larger SKUs (stock keeping units) which account for a major portion of its volume, and therefore likely to keep current margin expansion sustainable. Average copra price stood at Rs57/kg in FY12. **We have factored in a 25% YoY correction in average copra prices in FY13E, at Rs42/kg (Please note average copra price stood at Rs41/kg in 1HFY13) and a 5% YoY increase in FY14E and FY15E each. We believe any rise in copra prices over FY13-FY15 will be compensated by a drop in advertising expenditure, as witnessed historically, and that 1HFY13 margins are largely sustainable.**

Exhibit 7: Copra price trend



Source: Company, Nirmal Bang Institutional Equities Research

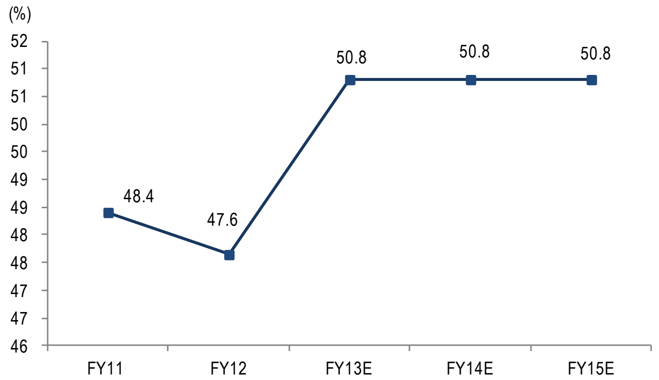
- **We expect the margin in international business to move up from the current level of 10% to the group-level margin (13%) over the next two-three years following normailisation in business**, as it had witnessed headwinds by way of transporters' strike (in South Africa), politcial tensions (MENA region) and challenging economic conditions in Bangaldesh. Further, we expect likely cost rationalisation as FY12 and 1HFY13 had witnessed front-loading of new product launches with higher advertising expenditure.
- We expect Kaya business' profitability to improve through a rising share of high-margin DermaRx (skin-related) products, cost rationlisation through introduction of smaller stores and rising volume at existing stores from various initiatives taken such as introduction of regular skin care services at affordable price points, and **increased focus on high-margin Derma Rx product sales via clinics which has led their contribution to sales to rise from 13% in FY10 to 23% in FY12, and also the shift in product positioning from "cure" to "prevention and cure".**

However, overall margin expansion will be capped owing to the following reasons:

- The management's strategy to re-invest a part of gross margin expansion on advertising to accelerate the launch of new products.
- Likely Saffola price cut in 2HFY13 to improve off-take. On the other hand, prices of Saffola's key raw materials like rice bran and safflower have gone up by 16% and 59%, respectively, YoY.

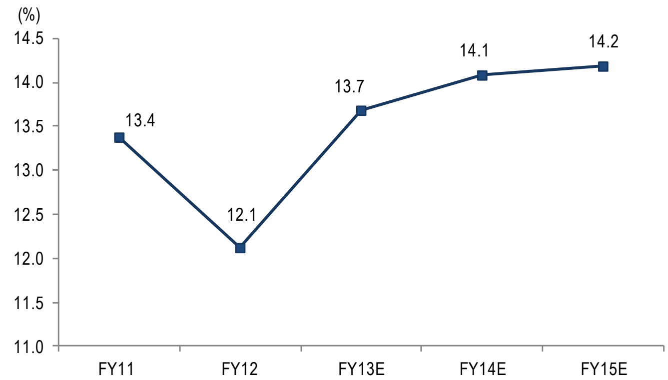
Consequently, we expect gross margin expansion of 316bps and OPM expansion of 210bps over FY12-FY15E.

Exhibit 8: Gross margin expansion largely sustainable...



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9:…but higher ad spending to cap OPM expansion

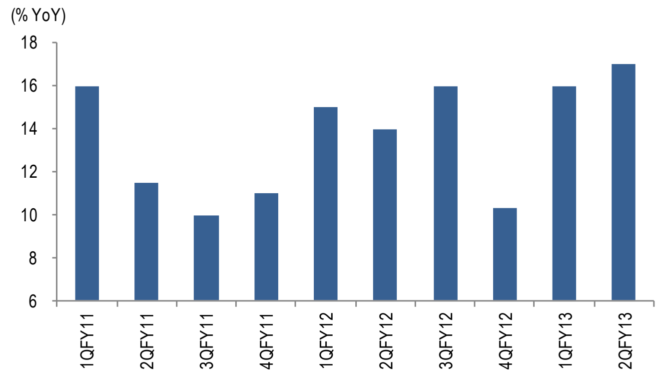


Source: Company, Nirmal Bang Institutional Equities Research

Strong market position in domestic business

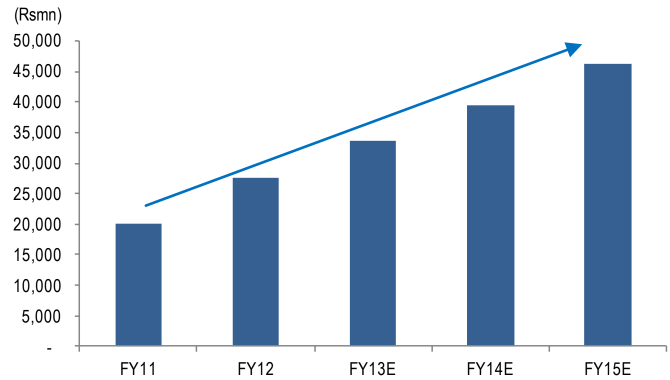
As much as 69% of Marico's FY12 revenue came from its strong domestic consumer business where volume growth was in the range of 10%-16% over the past eight quarters, despite price hikes by the company. Further, it has gained market share (volume) by 500bps-700bps in Parachute, Saffola, and value added hair oils since FY10. This has helped the company to grow faster than the market in the current challenging economic environment and also aided in combating the 100% rise in copra prices over March 2010 to March 2011 without sacrificing profitability of Parachute hair oil in absolute terms. Saffola's volume growth trajectory moderated from 15% to 6% in 2QFY13 due to lower off-take and de-stocking at CSD, which we believe is likely to pick up with a probable cut in retail prices in coming months and normalisation at CSD. Value added hair oils continue to witness strong volume growth of 20%-25%, thanks to packaging rehaul, participation in more sub-segments and a rise in market share. **We expect the trend to continue with the addition of high-growth and lower-penetrated product offerings such as body lotion, oats and recently acquired Paras product portfolio. Consequently, we expect a 18% revenue CAGR in domestic business over FY12-FY15E.**

Exhibit 10: Strong volume growth in domestic business



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Domestic consumer business revenue trend

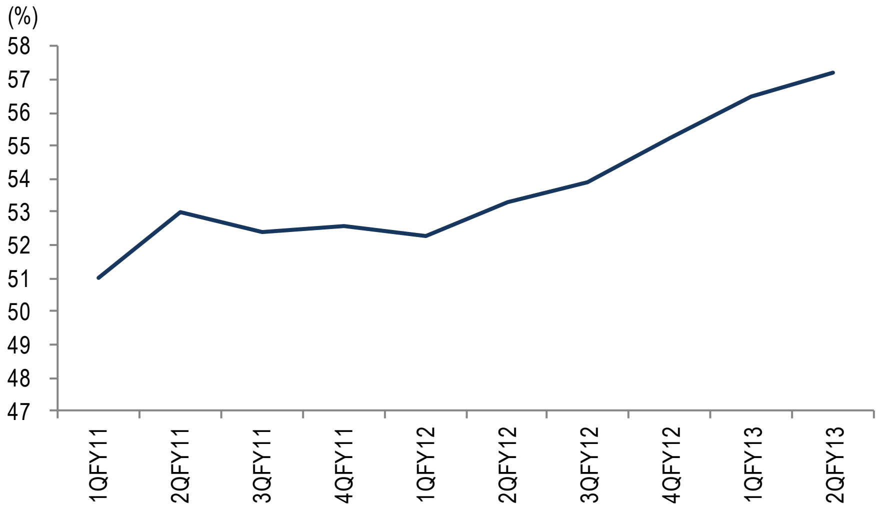


Source: Company, Nirmal Bang Institutional Equities Research

Rural penetration, conversion from loose oil to drive market share in Parachute coconut oil

Parachute is Marico's flagship brand in the coconut oil segment which has been in existence over the past two decades. It contributed 30% to consolidated revenue in FY12 and has a 47% market share (volume). In 2006, the company acquired Nihar brand from Hindustan Unilever (HLL) for Rs2.3bn (~2x sales), which gave it a strong foothold in the eastern region for its coconut oils. **With Nihar, Marico had a 57.2% market share (volume) in the branded coconut oil segment as of end 2QFY13. Over the past two years, Marico has gained ~600bps market share in the branded coconut oil segment, thanks to the shift from loose hair oils to branded oils and more rural market penetration. Currently, 40% (volume) and 25% (value) of the total coconut hair oil market is in the form of loose oil. Further, Marico's market share in rural areas is 40%, thereby leaving enough headroom to sustain growth and further increase its share.**

Exhibit 12: Gains 600bps volume market share in branded coconut hair oil segment

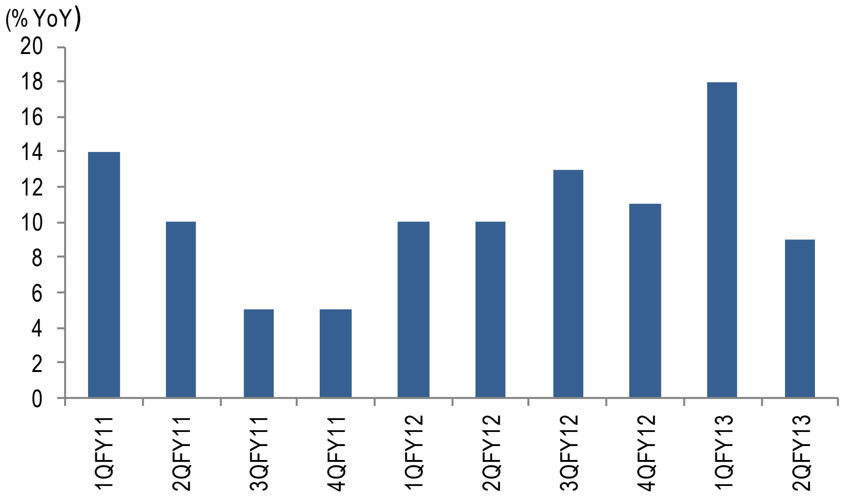


Source: Company, Nirmal Bang Institutional Equities Research

Volume intact despite volatile copra prices

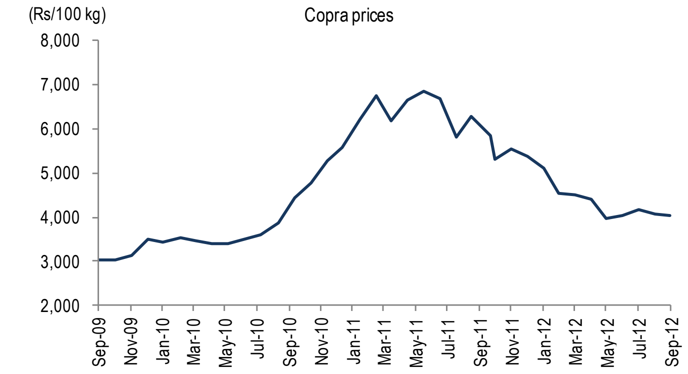
Despite volatility in copra prices, Marico has been able to sustain double-digit volume growth in Parachute hair oil over the past five years, indicating strong franchise creation. It is heartening to see that the market share increased even when copra prices rose 100% between March 2010 and March 2011 and also price hikes by Marico at regular intervals in FY11. Further, it has not cut retail prices post 35% correction in copra prices from their peak. However, in the form of sales promotion, the weighted average cut in prices of coconut oil has been just 3%-5%. **We expect a 12.1% CAGR in value terms at Rs16.9bn over FY12-FY15E in Parachute coconut hair oil, largely led by volume growth (10%). Consequently, Parachute coconut hair oil is likely to contribute 28.4%/26.9%/25.6% to sales in FY13E/FY14E/FY15E, respectively.**

Exhibit 13: Steady volume growth in Parachute hair oil (rigid pack)

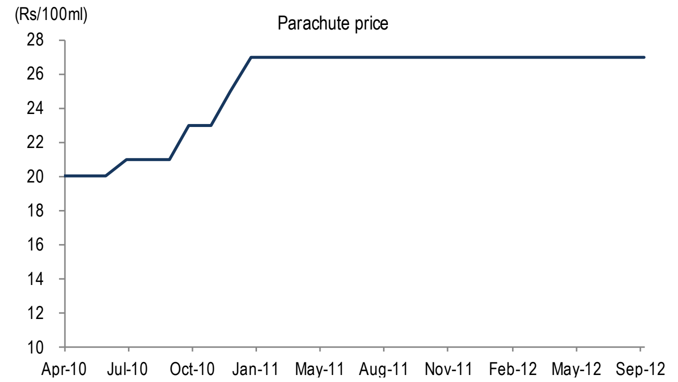


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Retail Parachute prices intact despite fall in copra prices



Source: Company, Nirmal Bang Institutional Equities Research

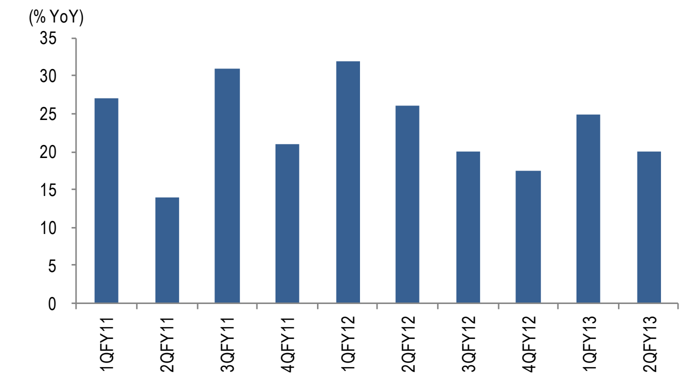


Source: Company, Nirmal Bang Institutional Equities Research

Value-added hair oils continue to grow at a faster pace

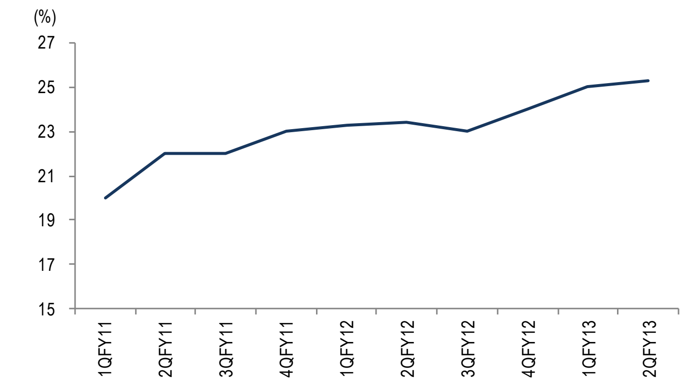
Marico is the market leader in fast-growing value added hair oil segment with a market share of 25.3% (volume) as of end 2QFY13. It contributed 14% to consolidated revenue in FY12. Of the total branded hair oils, coconut-based oils constitute 48%, value/perfumed-based oils 42% (light hair oil or LHO-15%, amla-based oil-15%, cooling oil -12%) and others (hair creams, gels) 10%. The value-based oil segment has grown faster than the overall hair oil market over the past five years following rising urbanisation and changing consumer taste. Marico's basket of value added oils includes Parachute Advanced Cooling, Nihar Shanti Amla, Hair & Care etc. Over the past two years, Marico has gained ~500bps market share from regional as well national players in value added hair oils, thanks to packaging rehaul, aggressive pricing in amla category, participation in more sub-segments and higher brand investment. **We expect the trend to continue and have factored in a 25% CAGR in value terms over FY12-FY15E in value added hair oils at Rs11bn, largely led by volume growth (18%). Consequently, value added hair oils are likely to contribute 14.5%/15.6%/16.6% to sales in FY13E/FY14E/FY15E, respectively.**

Exhibit 15: Strong volume growth in value-added hair oils



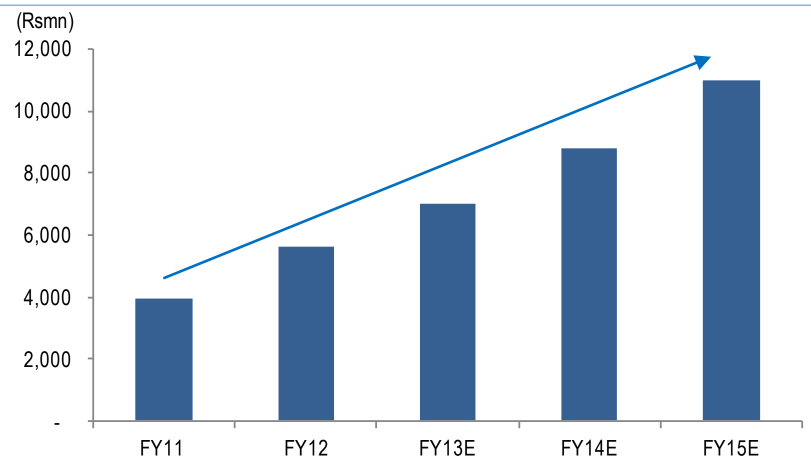
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Gains 500bps volume mkt share in value-added hair oils



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Expect 25% revenue CAGR from value-added hair oils over FY12-FY15E

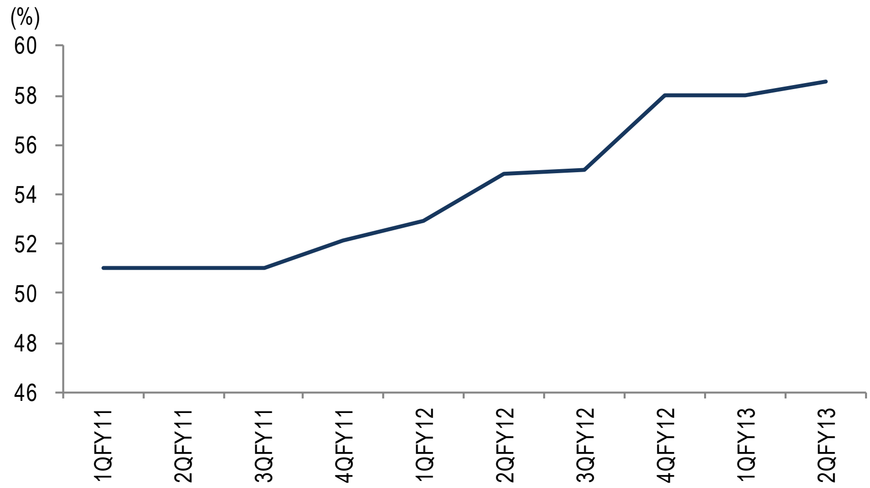


Source: Company, Nirmal Bang Institutional Equities Research

Saffola - Riding on changing consumer preference towards healthy edible oils

According to a Rabo India report, Get Well Soon' – The Progressive Grocer 2011, the domestic edible oil market is estimated at Rs800bn, largely dominated by unorganised players who account for 80%. Further, the per capita consumption of edible oils in India is much lower at 12.7kg than the average per capita global consumption of 20.0kg per annum. This gives enough headroom for branded players like Marico to expand their market share. According to Rabo India, the overall market is expected to grow 6%-7% annually over next five years while the organised market is likely to grow at a much faster pace. Over the past five years, the top-end of the market has witnessed some churning, with refined oils getting progressively replaced by healthier cooking alternatives such as olive oil, canola, rice bran and blends of karadi with sunflower. Marico is the market leader in super premium refined edible oils with a market share of 58.6% (volume) as of end 2QFY13. It contributed 15% to consolidated revenue in FY12 and has gained 760bps market share over the past two years from key competitor Sundrop and unbranded edible oils.

Exhibit 18: Gains 760bps volume market share in super premium refined edible oils

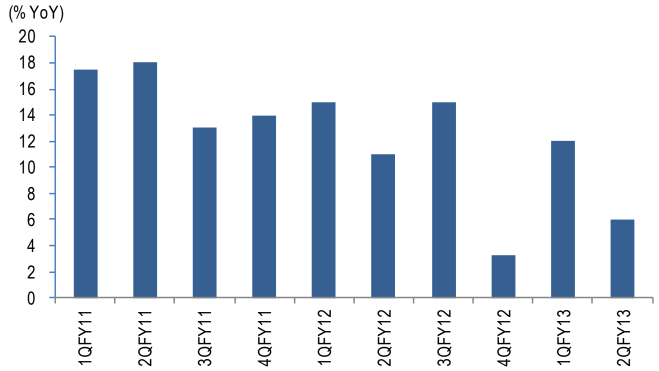


Source: Company, Nirmal Bang Institutional Equities Research

Volume growth trajectory likely to pick up

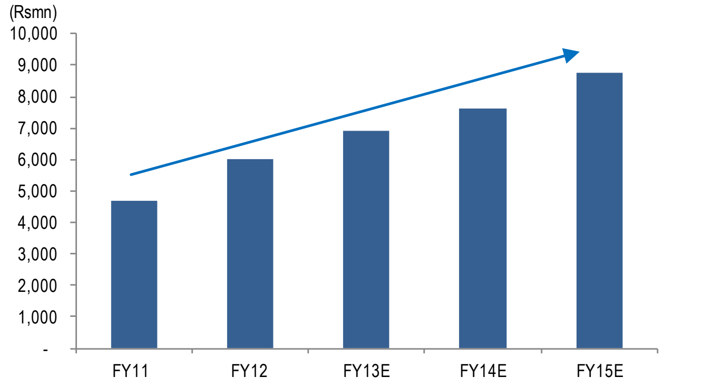
Saffola's volume growth trajectory moderated from double-digit growth (15%) to single-digit (6%) in 2QFY13 on account of lower off-take and volume de-stocking at CSD, which accounts for 15% of Saffola sales. Further, prices of Saffola's key raw materials, rice bran and kardi, have increased 59% YoY and 16% YoY, respectively, which led to price hike of 7%-8% in 4QFY12. This has moderated growth trajectory of Saffola, in our view. We expect the volume at CSD to normalise by the end of FY13, as indicated by the management. On the other hand, the management has indicated a cut in retail prices of Saffola in order to improve off-take because of the product being discretionary in nature unlike hair oils. **Hence, we expect volume growth to remain moderate in FY13E at 10% and likely to rise to 15% in FY14E/FY15E post price cut and normalisation at CSD. However, we have factored in a 13.3% CAGR over FY12-FY15E in value terms at Rs8.7bn by assuming a 5% price cut in 2HFY13E. Consequently, Saffola edible oil is likely to contribute 14.3%/13.5%/13.2% to sales in FY13E/FY14E/FY15E, respectively.**

Exhibit 19: Volume growth likely to pick up post-FY13



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Saffola edible oil business revenue trend

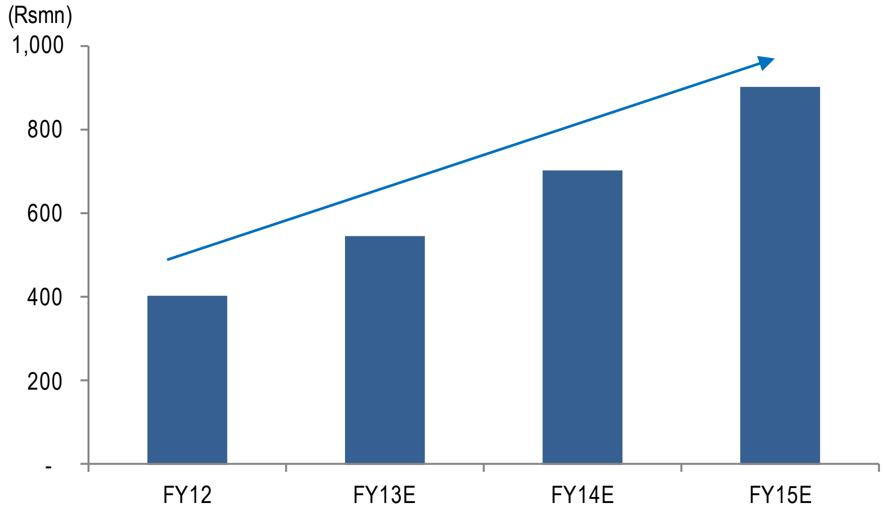


Source: Company, Nirmal Bang Institutional Equities Research

Diversifying its product base under Saffola brand

In order to leverage its strong Saffola brand, Marico has forayed into the healthy foods space with its basket of offerings. The company introduced Saffola Oats in June 2010, which received a good response. The oats market in India is estimated at Rs3,000mn and is growing at a healthy rate of ~40%. Marico has garnered a 14% market share and has emerged as the number two player in the oats category since its launch. Further, it introduced savory oats in southern markets in FY12 which gained critical mass and the company has now rolled them out nationwide with three more flavours. Besides offering oats, Saffola strengthened its position in the breakfast category by introducing Muesli on a national basis, in three variants, where the response was encouraging. The market size of Muesli is estimated at around Rs1bn, growing rapidly in excess of 40%. On the other hand, Saffola Arise, a premium packaged rice brand launched in 4QFY10, did not meet with the desired success and will take some time to scale up. **We have factored in a 31% CAGR over FY12-FY15E in value terms at Rs0.9bn in the Saffola food category.**

Exhibit 21: Oats business to drive revenue in Saffola foods category

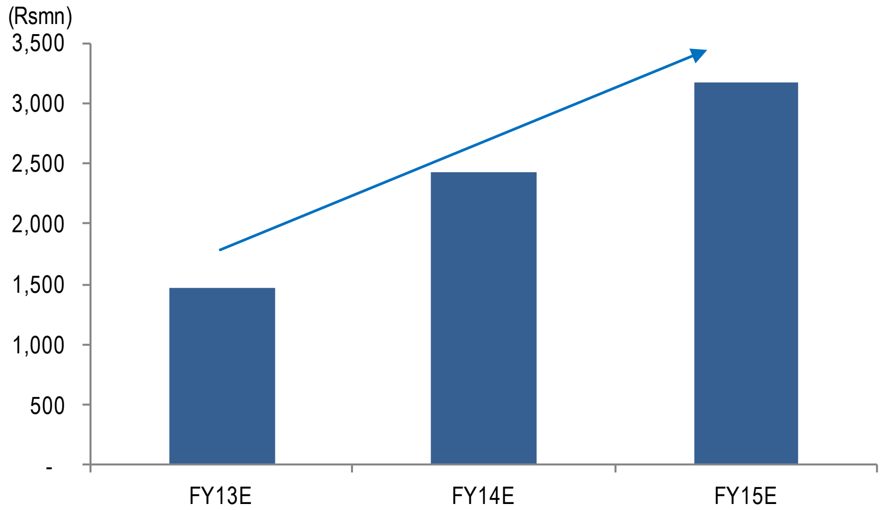


Source: Company, Nirmal Bang Institutional Equities Research

Acquisition of Paras product portfolio to tap growing youth market

Marico acquired Paras product portfolio from Reckitt Benckiser in February 2012 for Rs7.4bn. The acquisition enables Marico to tap the growing youth male grooming market with brands such as Set Wet and Zatak and post-wash hair serum brand Livon. Further, it leads to synergies with international business in Vietnam and the Middle East through cross-sales. The deal is valued at 5x on FY12 sales, which has been funded through a mix of internal accruals and equity dilution to the tune of Rs5bn. All these products enjoy higher gross margin to the tune of 60%, much higher than Marico's existing business and have been growing at 20%-25% over the past two-three years. 2QFY13 was the first full quarter with a revenue of Rs460mn (up 28% YoY) of which the financial results were consolidated to arrive at the group's performance. For 1HFY13, the company reported Rs560mn revenue from Paras product portfolio. **We have factored in Rs1.5bn of revenue in FY13E (10 months of consolidation), Rs2.4bn (up 66% YoY) and Rs3.2bn (up 30% YoY) revenue in FY14E/FY15E, respectively, on account of low base, under-penetrated tailwind categories and access to Marico's strong distribution network. Consequently, Paras product portfolio is likely to contribute 3.4%/4.3%/4.8% to sales in FY13E/FY14E/FY15E, respectively.**

Exhibit 22: Our revenue assumptions for Paras product portfolio



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Low-penetrated and high-growth products

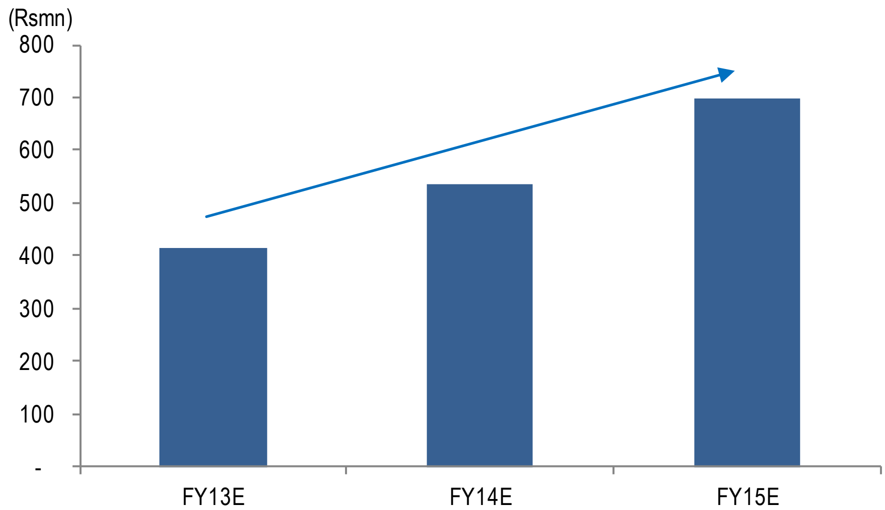
Paras products	Segment	*Revenue contribution FY12 (%)*	*Market share (%)*	*Growth rate (%)*	Rank
Livon	Post-wash hair	*40*	*68*	*20*	1
Set Wet/Zatak	Deodorant	*40*	*6*	*35*	3
Setwet	Hair cream/gel	*20*	*24*	*25*	1

Source: Company, Nirmal Bang Institutional Equities Research

Other product offerings

Marico, under its Parachute brand, launched Parachute Advanced Body Lotion nationally in 2HFY12 whose results were encouraging. The market penetration level in the body lotion category was 20% and is growing at 25% annually. The skin care segment is estimated at around Rs50bn out of which the body lotion segment accounts for around 11% i.e Rs 5.5bn. Marico garnered a market share of about 6% as of end 2QFY13 and within a short span has become the number three player in the market. We expect a 25% revenue CAGR over FY12-FY15E at Rs700mn, largely led by the rise in market share and a low base.

Exhibit 24: Our revenue assumptions for Body Lotion category



Source: Company, Nirmal Bang Institutional Equities Research

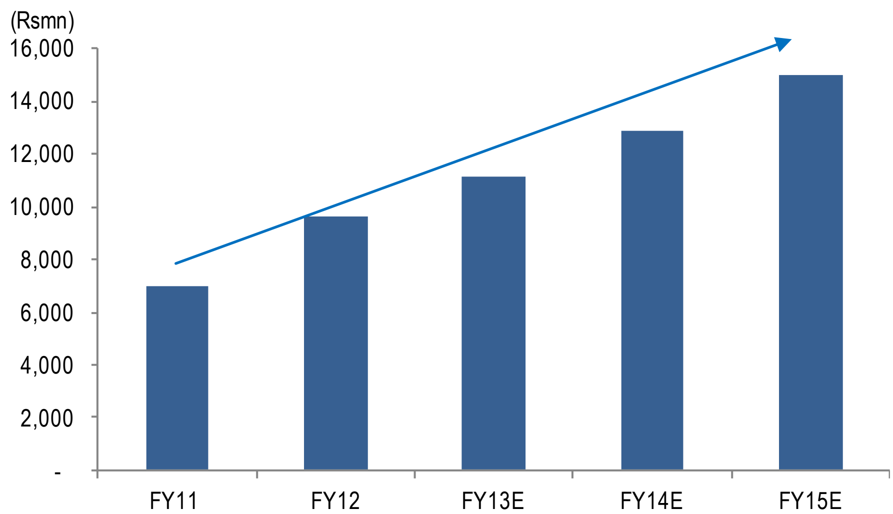
International business likely to pick up in coming quarters

Marico's international business contributed 24% to consolidated revenue in FY12. In 1HFY13, Marico's international business reported weak performance with only a 3% value growth in constant currency terms, largely led by price. This was on account of transporters' strike which impacted business in South Africa in 2QFY13 and challenging economic and political conditions in Bangladesh and MENA region, respectively. We expect the company to report strong growth in the coming quarters on account of various initiatives taken by it in Bangladesh, stability in Egypt with gradual signs of economic revival, drop in inflation in Vietnam and normalisation of transportation services in South Africa in 3QFY13. Further, Marico's market leadership in Bangladesh, Egypt and Vietnam will ensure faster business revival on the back of recovery in the overall economic environment. **We have factored in a 16% revenue CAGR over FY12-FY15E at Rs15bn from international business on account of the following reasons:**

- Bangladesh contributed 39% to international business revenue in FY12. Marico has a dominant 80% market share in the branded coconut hair oil segment in Bangladesh with a penetration level of ~80%. This led to weak growth in 1HFY13 (1% YoY decline in constant currency terms) amid sluggish economic conditions. However, Marico forayed into high-growth valued added hair oils with various product offerings and enjoys a dominant position in the hair dye segment with a 29% market share. This will lead to better revenue growth in the coming quarters, in our view.
- MENA contributed 27% to international business revenue in FY12. The company's business in Egypt witnessed gradual signs of recovery,growing by about 11% YoY in 2QFY13, and also maintaining its market share of 57%. On other hand, Marico has stepped up efforts to manage the pack transition in the Middle East and has witnessed an uptick in secondary sales of Parachute hair cream in September 2012. This momentum is likely to be carried forward in the coming quarters.
- South Africa contributed 19% to international business revenue in FY12. It posted flat YoY revenue growth in 2QFY13 due to transporters' strike in the second fortnight of September 2012 which adversely impacted all businesses. This should get back to normal in 2HFY13.
- South East Asia contributed 11% to international business revenue in FY12. Vietnamese business grew 23% in constant currency terms in 2QFY13 and was the strongest performer within international geographies. X-Men maintained its leadership position in male shampoos and number two position in male deodorants. Further, Marico's Malaysian business continues to grow at a healthy rate through brand rehaul for its product, CODE 10.

Consequently, international business is likely to contribute 23.0%/22.8%/22.7% to sales in FY13E/FY14E/FY15E, respectively.

Exhibit 25: Trend in international business revenue



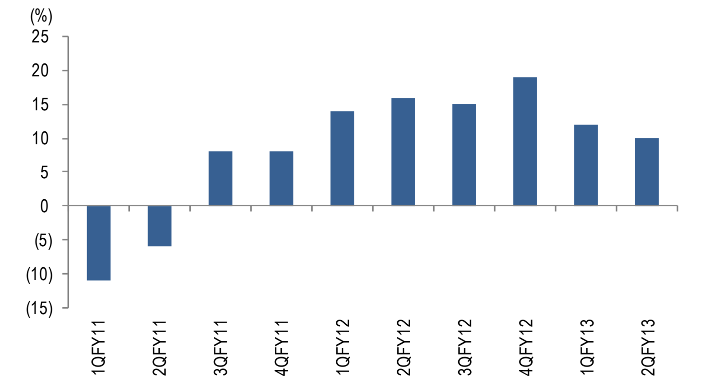
Source: Company, Nirmal Bang Institutional Equities Research

Kaya business shows signs of revival

Kaya offers skin care solutions - its technology-led cosmetic dermatological services and products through 106 clinics: 83 in India across 26 cities and 19 in the Middle East in addition to 4 DermaRx clinics and medispas in Singapore and Malaysia. Kaya business contributed 7% to Marico's consolidated revenue in FY12, but incurred a loss of Rs291mn at the EBIT level. However, things have improved positively at the revenue level, thanks to various initiatives taken by the company like: 1) Introduction of regular skin care services at affordable price points to serve as traffic generators and retain existing customers, 2) Increased focus on high-margin Derma Rx product sales via clinics, which led product contribution to sales to rise from 13% in FY10 to 23% in FY12. 3) Shift in product positioning from "cure" to "prevention and cure", and 4) Kaya Smiles loyalty programme in India designed to recognise and reward customers for their patronage to Kaya. **This has resulted in positive same-sales stores (SSS) growth over the past eight quarters and a rise in revenue per quarter, from Rs415mn in FY10 to Rs915mn in 2QFY13.**

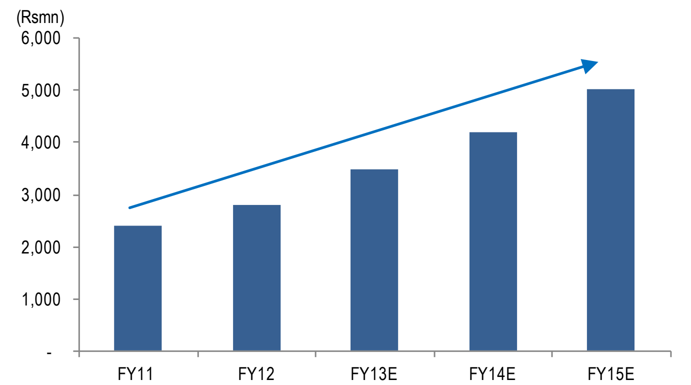
We expect the company to post a 22% revenue CAGR over FY12-FY15E at Rs5bn, largely driven by same store sales growth, addition of three-four clinics every year and higher DermaRx product sales. Further, we expect Kaya to report profit at the EBIT level from FY15 through rising share of high-margin DermaRx products, cost rationlisation via introduction of smaller stores and increased volume from existing stores. Consequently, Kaya business is likely to contribute 7.2%/7.4%/7.6% to sales in FY13E/FY14E/FY15E, respectively.

Exhibit 26: Same-store sales growth positive for past 8 quarters



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 27: Kaya business revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Volume to drive 18% revenue CAGR over FY12-FY14E

As much as 69% of Marico's FY12 revenue came from its strong domestic consumer business where volume growth is in the range of 10%-16% over the past eight quarters, despite price hikes by the company. We expect a similar trend in volume growth and have factored in volume CAGR of 12%/10%/18% in Saffola, Parachute coconut oil and value added oils, respectively, over FY12-FY15E. Further, we have factored in weighted average price cut of 5% in Saffola in 2HFY13E and a 3%-5% price hike in coconut hair oil and value added hair oils each year over FY12-FY15E. We have factored in a 30%-40% revenue CAGR in Paras product portfolio, oats and body lotion on account of low base, under-penetrated tailwind categories and access to Marico's strong distribution network. Consequently, we have factored in a 18.6% revenue CAGR in domestic business over FY12-FY15E. We have factored in a 16% revenue CAGR over FY12-FY15E at Rs15bn from the international business, largely led by volume growth. We have factored in a 22% revenue CAGR over FY12-FY15E at Rs5bn from Kaya business, largely driven by same-store sales growth, addition of three-four clinics every year and higher DermaRx product sales. Consequently, we expect a 18.3% revenue CAGR at Rs66bn over FY12-FY15E.

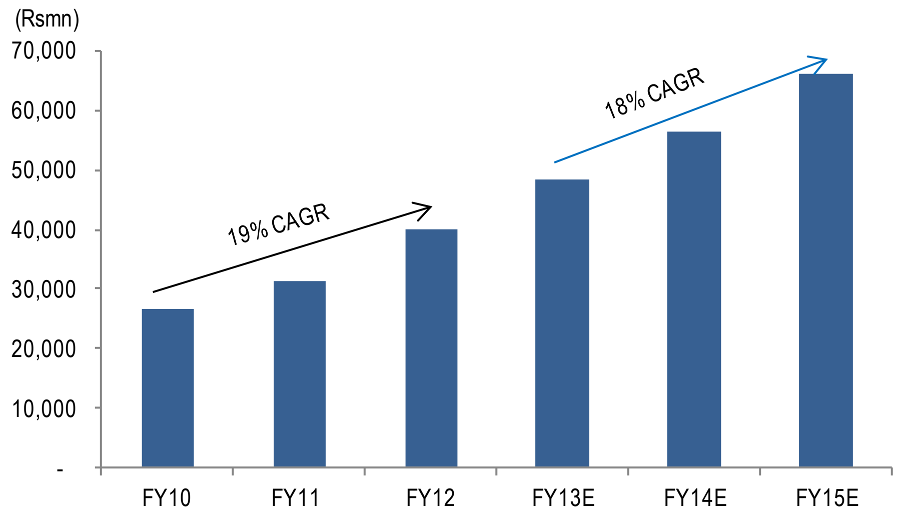
Exhibit 28: Product-wise volume and value assumptions

Particulars	FY12-FY15E (%)	
	Volume growth	Value growth
Parachute coconut halr oil	10.0	12.1
Value added hair oils	18.0	25.0
Saffola edible oils	12.3	13.3
Saffola foods	NA*	30.9
Paras products	NA*	28.3
Body lotion	NA*	46.9
International business	NA*	15.2
Kaya	NA*	21.6

*NA *: Data not available*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: Revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

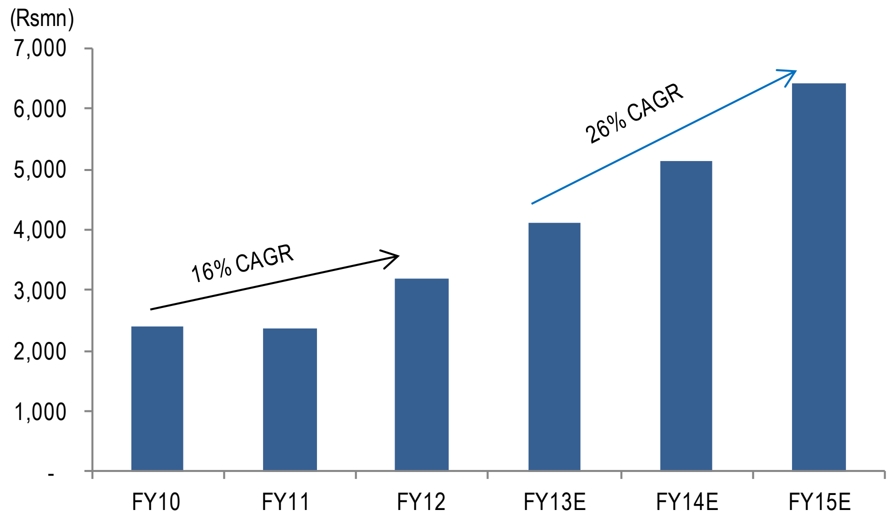
Higher margins to drive earnings

We have factored in gross margin expansion of 316bps and OPM expansion of 210bps over FY12-15E largely driven by fall in copra price, improvement in profitability from international and Kaya businesses. As of end 2QFY13, Marico's' balance sheet had goodwill worth Rs5bn created due to the acquisition of Paras products in February 2012 (financials are consolidated from 2QFY13) and acquisitions in Vietnam, Malaysia and Singapore in 2010 and 2011. The company follows a policy of testing goodwill for impairment annually; around Rs88mn of the goodwill amount has been impaired over FY10-FY12.

As a matter of prudence, we are amortising goodwill over a period of eight years. Consequently, we are factoring goodwill amortisation of Rs172mn/Rs332mn/Rs310mn in FY13E/FY14E/FY15E, respectively.

Further, due to the fall in copra prices, the share of coconut oil revenue will be higher in FY13E which does not enjoy fiscal benefits unlike Saffola and international business, thereby resulting in a higher tax rate in FY13. **Consequently, we expect a 26.3% earnings CAGR at Rs6.4bn over FY12-FY15E.**

Exhibit 30: PAT trend



Source:Company, Nirmal Bang Institutional Equities Research

Key risks

Volatility in raw material prices

Prices of raw materials copra, LLP (Liquid Light Paraffin), HDPE (High Density Polyethylene) and vegetable oil have a strong bearing on Marico's gross margins. The company aims to maintain certain operating margin thresholds owing to which a major portion of cost inflation is transferred to the consumer. We have assumed stable prices of some of its key raw materials like copra. If inflation in raw material prices continues, it will impact margins or lead to downtrading by consumers.

Weak economic environment leading to downtrading

Weak economic environment could lead to reduction in consumer spending on discretionary products such as Saffola in case of Marico. This could result in downtrading to lower cost edible oils and could delay the process of conversion from unbranded edible oils to branded edible oils.

Contingent liability of Rs2bn

Marico has Rs2bn contingent liabilities towards excise duty to be paid on sale of product packs below 200ml. Currently, the case is sub-judice. As per the management, a similar type of case had been filed by another company against the excise department, which was won by that company in a lower court. The excise department has appealed against the case in the Supreme Court and its verdict is awaited, which will also be applicable for Marico, as indicated by the management. **In case of unfavourable ruling, Marico is liable to pay Rs2bn, which will reduce its cash balance and thereby impact our FY14E/FY15E earnings estimates by 2.6%/2.1%, respectively.**

2QFY13 performance

Marico posted strong revenue growth of 19% YoY in 2QFY13. Domestic volume growth was strong at 17% YoY, led by a 20% growth in value added hair oils, a steady 9% growth in Parachute hair oil, strong performance of new products launched and consolidation of Paras products from 2QFY13. However, Saffola's volume growth was moderate at 6% on account of lower off-take and de-stocking at CSD. We expect Saffola volume to pick up in the coming quarters with likely price cuts and normalisation at CSD by the end of FY13. International business continues to post weak performance in constant currency terms at 3% YoY (16% with currency benefits). This was on account of transporters' strike which impacted business in South Africa in 2QFY13 and challenging economic and political conditions in Bangladesh and MENA, respectively. **Gross margins improved 683bps YoY, thanks to a 40% fall in copra prices, but higher A&P (advertising and promotion) spending restricted overall margin expansion. However, the current level of A&P spending at 13.7% is not likely to continue in the second-half of FY13E and is expected to be more around 12%, resulting in strong margin expansion-driven profit growth in 2HFY13.** Tax rate for the quarter was up 440bps at 24.8% due to higher quantum of profits coming from India as compared to international business, which is largely tax exempt. **The company expects tax rate at 24%-25% for FY13E and a lower rate of 22%-23% for FY14E. Consequently, Marico posted a 9.7% YoY growth in profit at Rs859mn.**

Exhibit 31: Quarterly summary

Y/E March (Rsmn)	2QFY12	1QFY13	2QFY13	*YoY (%)*	*QoQ (%)*	1HFY12	1HFY13	*YoY (%)*
Net sales	9,708	12,703	11,595	*19.4*	*(8.7)*	20,194	24,298	*20.3*
Total expenditure	8,519	10,824	10,082	*18.3*	*(6.9)*	17,754	20,907	*17.8*
Raw material consumed	5,357	6,411	5,606	*4.6*	*(12.6)*	10,460	12,017	*14.9*
Advteriing & selling expenses	942	1,559	1,586	*68.4*	*1.8*	1,965	3,144	*60.0*
Employee costs	725	947	967	*33.5*	*2.1*	1,431	1,915	*33.8*
Other expenditure	1,496	1,908	1,923	*28.6*	*0.8*	3,898	3,831	*(1.7)*
EBITDA	1,189	1,879	1,512	*27.2*	*(19.5)*	2,440	3,391	*39.0*
% EBITDAM	*12.2*	*14.8*	*13.0*	*80bps*	*(175bps)*	*12.1*	*14.0*	*187bps*
Other income	96	145	39	*(59.2)*	*(72.9)*	186	184	*(0.9)*
Interest expenses	103.5	170.3	145.3	*40.4*	*(14.6)*	200	316	*57.8*
Depreciation	177.2	193.3	224.6	*26.7*	*16.2*	346	418	*20.7*
Profit before tax (PBT)	1,005	1,660	1,182	*17.6*	*(28.8)*	2,080	2,842	*36.6*
Tax	205	403	293	*42.9*	*(27.2)*	416	696	*67.5*
% tax rate	*20.4*	*24.2*	*24.8*			*20.0*	*24.5*	
Minority Interest	17	19	30	*79.9*	*53.3*	32	49	*55.7*
Reported net profit	783	1,238	859	*9.7*	*(30.6)*	1,633	2,097	*28.4*
EPS	1.2	1.9	1.3	*9.7*	*(30.6)*	*2.5*	3.3	*28.4*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Segmental break-up

Y/E March (Rsmn)	2QFY12	1QFY13	2QFY13	*YoY (%)*	*QoQ (%)*	1HFY12	1HFY13	*YoY (%)*
Consumer products business (CPB)	6,673	9,340	7,930	*18.8*	*(15.1)*	14,293	17,270	*20.8*
International business group (IBG)	2,410	2,550	2,750	*14.1*	*7.8*	4,650	5,300	*14.0*
Kaya	662.0	813.2	915.0	*38.2*	*12.5*	*1,289.0*	1,728.2	*34.1*

Source: Company, Nirmal Bang Institutional Equities Research

Company background

Marico, founded in 1990 by Harsh Mariwala, is among India's leading consumer goods and services companies in the beauty and wellness space. It has presence across 25 countries in Asia and Africa, contributing to a fourth of its revenue. Parachute is the flagship brand of the company and is the market leader in the CNO market, not only in India but also overseas. Marico, over the years, has leveraged the consumer behaviour of a healthy lifestyle with its brand Saffola which is available in four niche variants in the super premium edible oils category. It plans to build on to its breakfast meals, rice and cholesterol management portfolio in the near term. The company's value-added hair oil portfolio includes brands such as Parachute Advansed, Shanti Amla, Jasmine & Scalp Therapy. It offers skin care solutions via Kaya Skin Care Solutions. Kaya now has 106 clinics worldwide along with 4 Derma Rx clinics. Its international brands include Aromatic, Fiancee, HairCode, Eclipse, Xmen, Hercules, Caivil, Code 78 and Black Chic. With its strategic funding approach, the company has launched prototypes of Parachute body lotion along with Saffola Oats. Marico has a direct/indirect distribution reach of 0.8mn/4mn outlets, respectively. Marico's own manufacturing facilities are located at Goa, Kanjikode, Jalgaon, Pondicherry, Dehradun, Baddi, Paonta Sahib and Daman. In Bangladesh, Marico operates through Marico Bangladesh, a wholly-owned subsidiary manufacturing facility at Mouchak, near Gazipur.

Exhibit 33: Product profile

Haircare
- Hair oils
- Pre-wash/post-wash/in-wash

Healthcare
- Healthy refined edible oils
- Functional foods

Skincare
- Cosmetic dermatological
- Services/products
- Body lotion

Male grooming/styling
- Deodorants
- Hair creams/gels

Source: Company

Financials

Exhibit 34: Income statement

Y/E March (Rsmn)	FY11	FY12	FY13E	FY14E	FY15E
Net sales	31,350	40,083	48,299	56,374	66,139
% growth	*17.8*	*27.9*	*20.5*	*16.7*	*17.3*
Raw materials costs	16,176	20,987	23,771	27,736	32,540
Employee costs	2,300	3,073	3,864	4,510	5,291
Advertising & sales promotion exp.	3,460	4,490	6,086	6,822	7,937
Others	5,234	6,689	7,969	9,358	10,979
Total expenditure	**27,169**	**35,239**	**41,691**	**48,426**	**56,747**
EBITDA	**4,181**	**4,844**	**6,608**	**7,948**	**9,392**
% growth	*11.4*	*15.9*	*36.4*	*20.3*	*18.2*
EBITDA margin (%)	*13.3*	*12.1*	*13.7*	*14.1*	*14.2*
Other income	212	326	400	700	750
Interest costs	410	424	567	418	294
Gross profit	**3,983**	**4,746**	**6,441**	**8,230**	**9,848**
% growth	*8.3*	*19.2*	*35.7*	*27.8*	*19.7*
Depreciation & Amortisation	708	725	903	1,556	1,514
Profit before tax	**3,275**	**4,021**	**5,538**	**6,674**	**8,334**
% growth	*6.4*	*22.8*	*37.7*	*20.5*	*24.9*
Tax	850	783	1,357	1,468	1,833
Effective tax rate (%)	25.9	19.5	24.5	22.0	22.0
Net profit	**2,425**	**3,238**	**4,181**	**5,206**	**6,500**
% growth	*(0.3)*	*33.5*	*29.1*	*24.5*	*24.9*
Exceptional items/MI	439	(67)	(60)	(70)	(80)
Reported net profit	**2,864**	**3,171**	**4,121**	**5,136**	**6,420**
% growth	*23.6*	*10.7*	*30.0*	*24.6*	*25.0*
Adjusted EPS (Rs)	3.7	4.9	6.4	8.0	10.0
% growth	*(1.6)*	*34.2*	*29.2*	*24.6*	*25.0*
DPS (Rs)	0.66	0.70	0.75	0.80	0.85
Payout (%)	*16.5*	*15.8*	*13.7*	*11.7*	*10.0*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: Balance sheet

Y/E March (Rsmn)	FY11	FY12	FY13E	FY14E	FY15E
Equity	614	615	644	644	644
Reserves	8,540	10,815	19,342	23,874	29,654
Net worth	**9,146**	**11,421**	**19,977**	**24,510**	**30,289**
Short Term loans	3,925	3,941	3,941	3,441	2,441
Long term Loans	3,817	3,907	4,407	3,407	1,407
Total loans	**7,742**	**7,848**	**8,348**	**6,848**	**3,848**
Minority Interest	219	249	309	379	459
Liabilities	**17,107**	**19,518**	**28,634**	**31,737**	**34,596**
Gross block	7,615	8,648	17,444	18,444	19,444
Depreciation	3,365	4,031	4,612	5,563	6,548
Net block	**4,251**	**4,617**	**12,832**	**12,881**	**12,896**
Capital work-in-progress	327	402	402	402	402
Liquid Investments	889	2,957	1,957	1,957	1,957
Goodwill	3,976	3,955	4,837	4,232	3,703
Deferred tax asset	299	223	223	223	223
Inventories	6,011	7,202	8,147	9,768	11,251
Debtors	1,771	1,816	2,419	2,524	3,275
Cash	2,206	1,588	1,117	3,618	5,589
Loans & advances	1,556	1,995	2,594	2,723	2,859
Other current assets	1,038	1,416	1,487	1,561	1,639
Total current assets	12,581	14,017	15,764	20,194	24,613
Creditors	4,003	5,446	6,181	6,934	7,960
Other current liabilities	1,213	1,206	1,200	1,218	1,237
Total current liabilities	5,216	6,652	7,380	8,152	9,197
Net current assets	**7,365**	**7,365**	**8,383**	**12,042**	**15,415**
Total assets	**17,107**	**19,518**	**28,634**	**31,737**	**34,596**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 35: Cash flow

Y/E March (Rsmn)	FY11	FY12	FY13E	FY14E	FY15E
EBIT	3,473	4,119	5,705	6,392	7,878
(Inc.)/dec. in working capital	(980)	262	(1,483)	(1,177)	(1,422)
Cash flow from operations	**2,493**	**4,381**	**4,222**	**5,215**	**6,456**
Other income	212	326	400	700	750
Depreciation	708	725	903	1,556	1,514
Interest paid (-)	(410)	(424)	(567)	(418)	(294)
Tax paid (-)	(850)	(783)	(1,357)	(1,468)	(1,833)
Dividends paid (-)	(471)	(470)	(571)	(584)	(622)
Net cash from operations	**1,682**	**3,755**	**3,029**	**5,000**	**5,971**
Capital expenditure (-)	(1,319)	(1,013)	(10,000)	(1,000)	(1,000)
Net cash after capex	**363**	**2,742**	**(6,971)**	**4,000**	**4,971**
Inc./(Dec.) in short-term borrowing	589	(540)	-	(500)	(1,000)
Inc./(dec.) in long-term borrowing	2,692	647	500	(1,000)	(2,000)
Inc./(dec.) in borrowings	**3,281**	**107**	**500**	**(1,500)**	**(3,000)**
(Inc.)/dec. in investments	(59)	(2,057)	1,000	-	-
Equity issue/(buyback)	286	31	5,000	-	-
Cash from financial activities	**3,509**	**(1,918)**	**6,500**	**(1,500)**	**(3,000)**
Others	**(2,781)**	**(1,441)**	**-**	**-**	**-**
Opening cash	1,115	2,206	1,588	1,117	3,618
Closing cash	2,206	1,588	1,117	3,618	5,589
Change in cash	**1,091**	**(617)**	**(471)**	**2,500**	**1,971**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 37: Key ratios

Y/E March	FY11	FY12	FY13E	FY14E	FY15E
Per share data (Rs)					
Adj EPS	3.7	4.9	6.4	8.0	10.0
Cash EPS	5.8	6.3	7.8	10.4	12.3
DPS	0.7	0.7	0.8	0.8	0.9
Book value	14.9	18.6	31.0	38.1	47.0
DuPont analysis					
Profit margin	9.1	7.9	8.5	9.1	9.7
Financial leverage	1.8	1.8	1.5	1.4	1.2
Asset turnover (x)	2.2	2.2	2.0	1.9	2.0
RoE	36.5	30.8	26.2	23.1	23.4
Return ratios (%)					
RoE	36.5	30.8	26.2	23.1	23.4
RoCE	24.6	22.5	23.7	21.2	23.7
Dividend payout	16.5	15.8	13.7	11.7	10.0
Valuation ratios (x)					
P/E	59.7	44.5	34.4	27.6	22.1
P/E (cash EPS)	37.8	34.7	28.2	21.2	17.9
P/BV	14.8	11.8	7.1	5.8	4.7
EV /EBITDA	35.0	29.9	22.3	18.0	14.7
EV/sales	4.7	3.6	3.0	2.5	2.1
Turnover ratios (x)					
Asset turnover ratio	2.2	2.2	2.0	1.9	2.0
Debtor days	19.1	16.3	16.0	16.0	16.0
Inventory days	60.9	60.2	58.0	58.0	58.0
Creditor days	65.3	54.6	60.0	60.0	60.0
Solvency ratio(x)					
Debt-equity	0.8	0.7	0.4	0.3	0.1

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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