Equities

6 November 2011 | 13 pages

Marico (MRCO.BO)

In Line 2QFY12 Results

- **In line PAT growth** — Consolidated revenues at Rs9.7bn increased ~26% Y/Y (~14% Y/Y volume growth), a tad lower than expectations. However, better than forecast GMs (down 470bps Y/Y, up 200bps QoQ) led to Rs1.2bn EBITDA, in line with our/street ests. EBITDA margins declined 80bps Y/Y to ~12% as GM decline was offset by lower A&P (flat Y/Y, ~9.7% of sales). A higher tax rate led to ~9% Y/Y PAT growth to Rs783m.
- **Steady domestic business** — Strong 44% Y/Y domestic growth was driven by higher pricing / mix, with a healthy ~14% Y/Y volume growth. Parachute volume growth remained steady at ~10% Y/Y; Saffola and other hair oils growth slightly moderated sequentially to ~11% / 26% Y/Y volume growth respectively. Adjusting for the lower promotional volumes, Saffola growth would be ~14% (34% Y/Y value growth). Growth in value-added hair oils may be lower going forward as the price hikes undertaken in 2HFY11 would now be in the base.
- **Near-term margin pressures** — While copra prices (~40% of raw material costs) have softened by ~11% QoQ, these are still higher by ~50% Y/Y. Other key inputs, safflower prices (~13% of RM costs) increased ~24% Y/Y and rice bran by 46% in 2QFY12. Margin pressures will likely continue, but are baked into consensus estimates to some extent after the mgmt released a profit warning in mid 2QFY12.
- **Mixed international trends** — International business (~25% of revenues) growth of ~19% Y/Y (14% organic + 19% from the Vietnam acquisition – 14% FX translation / accounting changes in VAT in Bangladesh) was relatively slower sequentially. However margins improved QoQ to ~11-12% (~10% in 1Q) due to likely mix / scale benefits. Bangladesh performance remained steady; other countries were impacted by a) depreciation of local currencies, b) food inflation and / or c) political uncertainties.
- **Kaya stabilizing** — Kaya revenues (~7% of overall) rose 7% Y/Y reflecting 16% Y/Y same store growth. 2Q PBT loss of Rs75m remained flat QoQ. Steps to spur demand continue: a) new services (Aqua Advanced Fairness, Indulge), b) milestone programs to bring back customers; & c) more products from Derma Rx (now 23% of revenues).

■ Company Update

Sell	3
Price (04 Nov 11)	Rs149.45
Target price	Rs141.00
Expected share price return	-5.7%
Expected dividend yield	0.4%
Expected total return	**-5.2%**
Market Cap	Rs91,889M US$1,870M

Price Performance
(RIC: MRCO.BO, BB: MRCO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	2,415	3.96	22.6	37.7	13.9	43.6	0.4
2011A	2,563	4.17	5.3	35.8	10.0	32.7	0.4
2012E	3,031	4.93	18.2	30.3	7.8	29.1	0.4
2013E	3,757	6.11	23.9	24.5	6.2	28.2	0.5
2014E	4,493	7.31	19.6	20.4	5.0	27.0	0.9

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	37.7	35.8	30.3	24.5	20.4
EV/EBITDA adjusted (x)	25.2	23.5	20.8	17.3	14.7
P/BV (x)	13.9	10.0	7.8	6.2	5.0
Dividend yield (%)	0.4	0.4	0.4	0.5	0.9
Per Share Data (Rs)					
EPS adjusted	3.96	4.17	4.93	6.11	7.31
EPS reported	3.80	4.66	4.93	6.11	7.31
BVPS	10.73	14.90	19.05	24.22	29.92
DPS	0.66	0.66	0.66	0.81	1.38
Profit & Loss (RsM)					
Net sales	26,608	31,283	37,212	42,920	48,960
Operating expenses	-23,457	-27,894	-33,292	-38,241	-43,538
EBIT	**3,151**	**3,390**	**3,920**	**4,679**	**5,421**
Net interest expense	-257	-393	-470	-380	-257
Non-operating/exceptionals	183	279	340	397	452
Pre-tax profit	**3,077**	**3,275**	**3,789**	**4,696**	**5,617**
Tax	-643	-662	-758	-939	-1,123
Extraord./Min.Int./Pref.div.	-117	251	0	0	0
Reported net income	**2,317**	**2,864**	**3,031**	**3,757**	**4,493**
Adjusted earnings	2,415	2,563	3,031	3,757	4,493
Adjusted EBITDA	3,752	4,098	4,680	5,531	6,348
Growth Rates (%)					
Sales	11.4	17.6	19.0	15.3	14.1
EBIT adjusted	20.6	7.6	15.6	19.4	15.9
EBITDA adjusted	26.3	9.2	14.2	18.2	14.8
EPS adjusted	22.6	5.3	18.2	23.9	19.6
Cash Flow (RsM)					
Operating cash flow	**2,100**	**-624**	**2,632**	**3,568**	**4,318**
Depreciation/amortization	601	708	760	852	926
Net working capital	-1,066	-1,178	-1,159	-1,041	-1,101
Investing cash flow	**-2,192**	**-1,671**	**-1,200**	**-800**	**-800**
Capital expenditure	-1,487	-1,609	-1,200	-800	-800
Acquisitions/disposals	-706	-63	0	0	0
Financing cash flow	**403**	**3,010**	**-1,439**	**-2,380**	**-2,989**
Borrowings	716	3,260	-968	-1,798	-2,000
Dividends paid	-470	-472	-471	-582	-989
Change in cash	**213**	**1,016**	**-7**	**388**	**529**
Balance Sheet (RsM)					
Total assets	**15,260**	**22,267**	**24,551**	**26,686**	**29,011**
Cash & cash equivalent	1,115	2,131	2,124	2,513	3,042
Accounts receivable	1,507	1,880	2,243	2,587	2,951
Net fixed assets	3,997	4,897	5,338	5,285	5,159
Total liabilities	**8,595**	**12,894**	**12,617**	**11,577**	**10,398**
Accounts payable	3,096	3,080	3,565	4,097	4,670
Total Debt	4,459	7,718	6,750	4,953	2,953
Shareholders' funds	**6,665**	**9,374**	**11,934**	**15,109**	**18,613**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.1	13.1	12.6	12.9	13.0
ROE adjusted	43.6	32.7	29.1	28.2	27.0
ROIC adjusted	30.7	22.6	20.1	21.9	23.6
Net debt to equity	50.2	59.6	38.8	16.1	-0.5
Total debt to capital	40.1	45.2	36.1	24.7	13.7

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2QFY12 Results Review

Hair oils – Coconut reports steady growth, value-added portfolio grows at a rapid clip

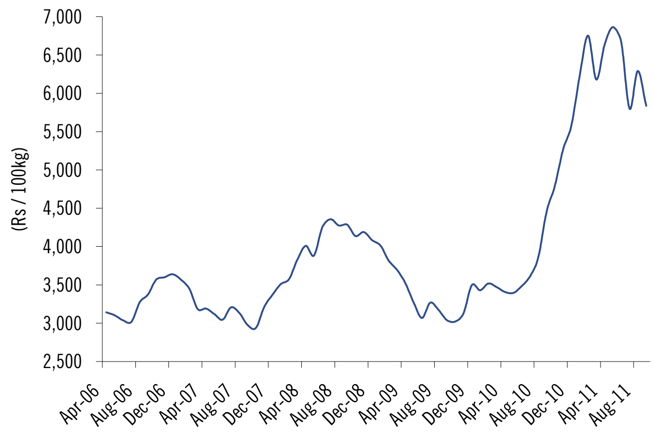
Parachute recorded steady growth over the quarter – rigid packs (the key focus area) grew by ~10% Y/Y in volumes. Overall growth was ~6.4% including flexi packs growth. These growth trends are in line with 1Q trends. Sequentially, pricing remained unchanged across key SKUs. During the 12 months ended September 2011, Marico's volume share in the ~Rs20bn branded coconut oil segment was ~53.3% (~53% in 2Q11).

The value-added hair oil portfolio had volume / value growth of 26% / 48% respectively. Volume market share rose to ~23.4%, driven by new product variants in hot oils, cooling oils (~8-9% market share) and ayurvedic oils (~11% market share), whilst Nihar Shanti Amla with its disruptive pricing garnered ~15.5% volume share (in 12 months ended Sept11).

Saffola – Impacted by high input costs, lower promotional spends

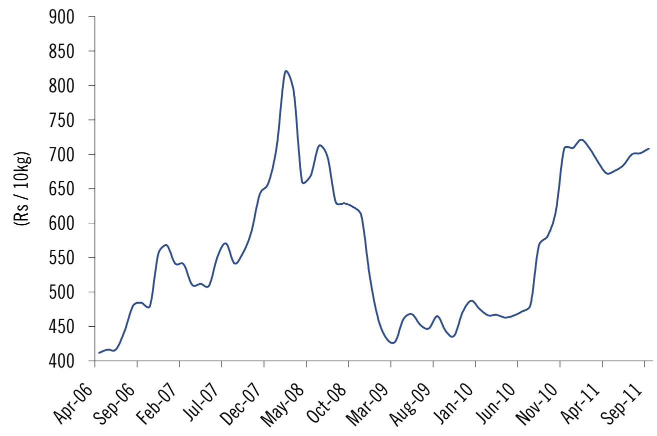
Saffola volumes rose ~11% Y/Y in 2Q. There was a significant reduction (around 39%) in promotional volumes compared to the corresponding quarter in the previous year. Saffola maintained its market leadership in the super premium refined edible oils segment with a market share of ~54.8% (12 months ended Sept 12) vs. ~51% in 2Q11. During 2Q, the average market prices of safflower oil and rice bran oil were up ~24% and 46% respectively (YoY). Product prices were unchanged, given price hikes in prior quarters.

Figure 1. Copra Price Trends



Source: Company Reports

Figure 2. Safflower Oil Prices



Source: Company Reports

Distribution continues to drive rural growth

Marico's rural sales continue to grow at a faster pace than urban sales, and now constitute ~30% of 2Q revenues vs. ~27% in FY11. Marico has taken initiatives to drive greater rural penetration over the past two years or so. Mgmt noted that total reach (direct + indirect) now aggregates around 3.5m outlets (as per AC Nielsen) with direct reach of 800,000 outlets.

New product initiatives – Mass skin goes national, oats achieve double-digit market share

A) Entry into Mass Skin Care

Marico had commenced prototyping Parachute Advansed Body Lotion in West Bengal in September 2010. Post encouraging results, it has been launched nationally in 2QFY12, and has been supported by a high decibel marketing and TVC launch.

B) Oats / Rice – Extending the Saffola franchise

Both oats and rice now aggregate ~Rs400m in revenues. Over the longer term, mgmt envisages that Saffola will be established as a healthy lifestyle brand that offers healthy food options for all meals of the day. Over the short term, Marico is focused on the breakfast space. In FY11, it entered the breakfast cereals market with the introduction of Saffola Oats. That has met with a favorable response, and Marico has now commenced prototyping savory variants of oats in markets like Tamil Nadu. The initial response has been good. Marico now enjoys about 10% market share in the oats category, and is a top 3 player. Within rice, the company has also introduced Saffola Arise, a low GI rice, and added two more variants – long grain and basmati – with the aim of increasing its relevance to consumers in the northern markets. Management noted on the conference call that trade challenges persist within rice, given different margin structures vs. other players (trade margins are typically high, Marico's margins on Saffola rice are relatively lower, in line with margins on Saffola oil as the company tries to establish the brand and create a consumer pull).

International Operations – 14%Y/Y organic revenue growth

Marico's international business reported revenues of Rs2.4bn in 2Q, a growth of ~19% Y/Y, partially reflecting the acquisition of International Consumer Products in Vietnam, mitigated by the impact of adverse FX movements and an accounting change pertaining to VAT in Bangladesh. Organic revenue growth was 14% Y/Y – exhibiting a decelerating trend and down from 20% in 1Q12. Overall EBITDA margins appear to have improved slightly – mgmt noted that margins are ~11-12% vs. ~10% in 1Q. We suspect mix + better operating leverage has resulted in the margin improvement.

Details of key geographies / markets:

- **Bangladesh –** Parachute continues its market expansion strategy of converting loose oil consumers to packed branded coconut oil. The company's market share rose to ~69% – an increase of 1-2ppt over the past 2Qs. Within the value-added hair oils segment, Marico augmented its market presence through increased volumes of Parachute Advansed Beli, a light hair oil with a floral fragrance, and Parachute Advansed Cooling Oil. Per management, the response to Saffola is in line with expectations and the brand is now gaining traction in the modern retail channel.

- **South East Asia –** The business environment in Vietnam remains challenged due to a combination of low double-digit inflation and currency devaluation that impacts COGS (similar to the situation faced by Dabur's Hobi in Turkey). X-Men's market share rose to 41%, aided by the launch of the new 4-Step X-Men campaign. The campaign promotes a full male grooming regimen with X-Men extensions in shower gel, face wash and deodorant.

- **MENA (Middle East and North Africa) –** Overall business environment is steady, though markets like Libya, Yemen and Syria (~5% of MENA operations) continue to experience instability and thus closure of operations. Within the region, Marico has launched a new range of Hair Oils and Hammam Zait under Parachute Secrets. The company has also relaunched Parachute Gold creams and hair oils. In Egypt, the combined market share of Fiancée and Hair Code was held at ~57%.

Kaya – Losses continue, but appear to be stabilizing

Over the quarter, Kaya's footprint was unchanged vs. the previous Q. Revenues of Rs662m (+7% Y/Y) reflected same store collection growth of ~16% Y/Y. The business reported a PBT loss of Rs75m (relatively similar loss levels in 1Q).

Key drivers remain unchanged: a) the introduction of services over the last few quarters at affordable price points to serve as traffic generators (Aqua Advanced Fairness in 1Q, 'Kaya – Indulge' this Q – essentially, Kaya continues to refocus from 'cure' to 'care'), b) it continues to drive product synergies from Derma Rx (23% of revenues vs. 16% in 2Q11 and 19% in 1Q12), c) a milestone program designed to bring back customers who have not interacted with Kaya for the past few quarters.

Results Summary

Figure 3. Marico: Consolidated Results (Rupees in Million, Percent)

	2QFY11	2QFY12	%Y/Y
Net Sales	7,758	9,745	25.6
Expenditure	-6,767	-8,578	26.8
EBITDA	**991**	**1,167**	**17.7**
EBITDA Margin (%)	12.8	12.0	-81 bps
Interest	-65	-91	40.8
Depreciation & Amortisation	-140	-177	26.9
Other Income	73	106	46.6
PBT	**860**	**1,005**	**16.9**
Tax	-126	-205	62.4
Tax Rate (%)	14.7	20.4	573 bps
PAT	**733**	**800**	**9.0**
Exceptional items & Minority Interest	-18	-17	nm
PAT after Exceptionals	**716**	**783**	**9.4**
Cost Details			
Total Raw Material Cost	3,880	5,329	37.4
% of Sales	50.0	54.7	468 bps
Employee/Staff Cost	582	725	24.6
% of Sales	7.5	7.4	-6 bps
Advertising & Sales Promotion Cost	949	941	-0.8
% of Sales	12.2	9.7	-257 bps
Other Expenditure	1,356	1,582	16.6
% of Sales	17.5	16.2	-125 bps

Source: Company Reports

Figure 4. Marico: Parent Results (Rupees in Million, Percent)

	2QFY11	2QFY12	%Y/Y
Net Sales	5,371	7,183	33.7
Expenditure	-4,658	-6,219	33.5
EBITDA	**713**	**964**	**35.1**
EBITDA Margin (%)	13.3	13.4	14 bps
Interest	-49	-58	18.4
Depreciation & Amortisation	-68	-75	11.0
Other Income	24	101	326.1
PBT	**620**	**931**	**50.2**
Tax	-23	-132	466.2
Tax Rate (%)	3.8	14.2	1043 bps
PAT	**597**	**799**	**33.9**
Exceptional items	0	0	nm
PAT after Exceptionals	**597**	**799**	**33.9**
Cost Details			
Total Raw Material Cost	2,928	4,333	48.0
% of Sales	54.5	60.3	580 bps
Employee/Staff Cost	291	298	2.4
% of Sales	5.4	4.1	-127 bps
Advertising Cost	547	627	14.6
% of Sales	10.2	8.7	-146 bps
Other Expenditure	892	962	7.9
% of Sales	16.6	13.4	-321 bps

Source: Company Reports

Figure 5. Marico (Consolidated) – Balance Sheet Summary (Rupees in Million)

As of end	2QFY11	2QFY12
Sources of funds		
Share capital	614	615
Reserves and surplus	7,659	9,775
Total shareholders funds	**8,273**	**10,390**
Minority interest	140	259
Loan funds	4,034	7,308
Deferred tax liabilities	(613)	(256)
Total sources of funds	**11,834**	**17,700**
Application of funds		
Goodwill on consolidation	1,410	3,980
Fixed assets	5,406	5,117
Investments	114	1,462
Current assets		
Inventories	4,066	5,931
Sundry debtors	2,049	2,291
Cash and bank balances	2,198	2,201
Loans and advances	1,996	2,487
Total	**10,310**	**12,910**
Current liabilities	4,549	4,641
Provisions	857	1,127
Net working capital	**4,904**	**7,142**
Total application of funds	**11,834**	**17,700**

Source: Company Reports

Marico

Company description

Marico is a leading consumer-goods company in India with offerings in the hair-care, skin-care, and health and wellness segments. It is a market leader in the coconut-oil category, and dominates most of the other categories in which it operates. Marico acquired two soap brands in the Bangladesh market, Camelia and Aromatic, in 2006 - marking its entry into the global FMCG market. Marico has strengthened its product portfolio through acquisitions in the domestic / international market. It also operates skin care clinics under the Kaya brand. Marico was originally part of Bombay Oil Industries, which was into coconut extraction, vegetable oil refining and chemicals.

Investment strategy

We rate Marico shares as Sell. Marico dominates the hair-oil segment and has a strong presence in the branded edible-oil (safflower oil) segment. Over the years, Marico has re-rated as its dependency on a single product (Parachute coconut oil) has declined, and the company has positioned itself on the health and wellness planks. That said, decelerating domestic revenues in key categories over the medium term is a concern. Further, commodity cost pressures have increased sharply in the recent past - impacting overall gross margins and EPS growth. Political unrest in MENA region also impacts the international business prospects.

Valuation

Our target price of Rs141 is based on 23x Mar13E consolidated EPS, around its trailing 5-year average P/E; justified by the healthy reported profit growth (a two-year CAGR of 21%). If Marico can demonstrate strong profit growth in the Kaya subsidiary over the next 2 years, the stock could re-rate. Conversely, a de-rating is also possible if Kaya's business / profitability trajectory isn't as expected. We ascribe a lower multiple than the peak multiples of ~25x it traded at from mid CY06-Jan08, as growth rates in that period were heightened by inorganic initiatives and also very strong growth in the core hair oils business, which we don't anticipate will recur in the next 12-18 months.

Marico's earnings growth has been steady; therefore, we believe P/E is best suited to value the company.

Risks

Upside risks to our target price include: (1) Considering that a sizeable sum of the consolidated entity's revenues would be from international markets, earnings would benefit from a favorable forex market. (2) Any value-accretive acquisition in emerging markets would aid further earnings growth. (3) Stronger than forecast growth in hair oil volumes (especially coconut oil), (4) Resurgence in Saffola volumes, (5) Kaya reporting a profit growth that is higher than forecasts.

Downside risks include: (1) Further increases in the price of copra, the key raw material; (2) Marico has aggressively acquired companies and brands. Slower-than-expected growth in the key markets would lead to slower growth in the consolidated entity; and (3) Marico recently entered categories such as baby wash, soaps, and health foods, which may be a drag on profitability until critical mass is reached.

Appendix A-1

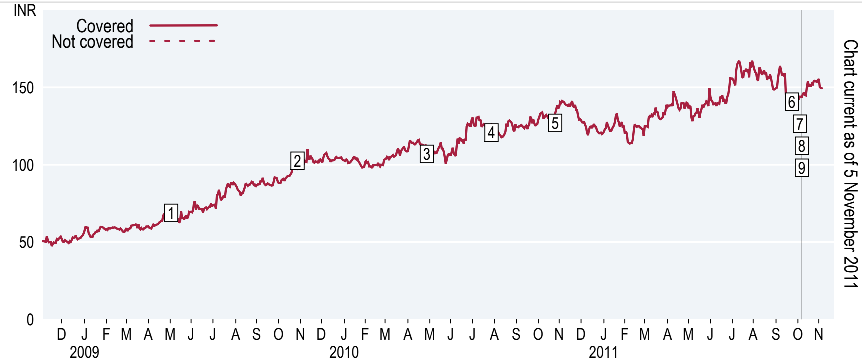
Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Marico (MRCO.BO)

Ratings and Target Price History
Fundamental Research
Analyst: Jamshed Dadabhoy



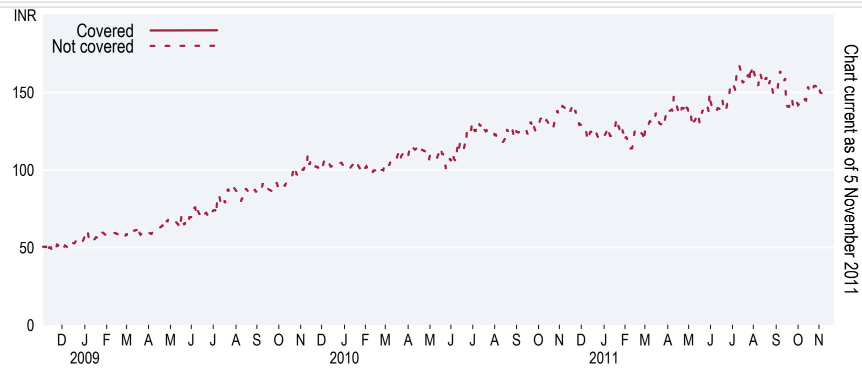
#	Date	Rating	Target Price	Closing Price
1	4-May-09	*3L	*69.00	68.20
2	28-Oct-09	3L	*94.00	97.75
3	28-Apr-10	3L	*104.00	112.25
4	28-Jul-10	3L	*119.00	126.05
5	26-Oct-10	3L	*136.00	133.15
6	23-Sep-11	3L	*145.00	145.10
7	5-Oct-11	3L	*141.00	144.00
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*3	141.00	143.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Marico (MRCO.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)
Analyst: Jamshed Dadabhoy



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			***Relative Rating***		
Data current as of 10 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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