

MAY 03, 2018
RESULT

Coverage view: **Cautious**

Price (₹): **317**

Target price (₹): **345**

BSE-30: **35,176**

FY2018 ends on a weak note; prognosis for FY2019/20E better. A weak 4QFY18 rounded up the worst year, at least since FY2002, for Marico on yoy operating and net profit growth comps. Sharp copra price inflation was the key drag; however, the company has managed such levels of inflation in the past. To that extent, we believe the weak FY2018 was more on account of weakness in Saffola franchise and what we still think is a soft overall underlying demand environment. FY2019E should benefit from a favorable base and likely correction in copra prices. Retain ADD with an unchanged March 2019E fair value target of ₹345/share.

Company data and valuation summary

Marico

Stock data

52-week range (Rs) (high,low) 349-284

Market Cap. (Rs bn) 402.9

Shareholding pattern (%)

Promoters 59.7

FIs 27.8

MFs 1.8

Price performance (%)

Absolute (4.0) 2.5 (0.9)

Rel. to BSE-30 (8.7) 2.4 (15.6)

Forecasts/Valuations

2018 2019E 2020E

EPS (Rs) 6.3 7.3 8.3

EPS growth (%) 7.4 16.7 13.7

P/E (X) 49.8 42.7 37.5

Sales (Rs bn) 63.2 72.9 82.4

Net profits (Rs bn) 8.1 9.4 10.7

EBITDA (Rs bn) 11.4 13.5 15.3

EV/EBITDA (X) 35.1 29.5 25.6

ROE (%) 33.2 35.7 37.5

Div. Yield (%) 1.3 1.5 1.8

Weak 4QFY18 as Parachute volumes disappoint and weakness in Saffola persists

Marico ended what can perhaps be called a forgettable fiscal on a weak note. Consolidated topline growth of 13% yoy to ₹14.8 bn was in line with our estimate; however, EBITDA (₹2.52 bn, down 3% yoy) and recurring PAT (₹1.83 bn, +9% yoy) were 3-5% below our forecasts. PAT growth, we note, was aided by a sharp yoy decline in ETR (to 26.4% from 31.4% in 4QFY17). PBT declined 1% yoy. Decline in ETR reflected benefits from ramp-up in production from a new plant in a tax-free zone in Assam.

Revenue internals – mixed-bag

Domestic revenues grew 12% yoy to ₹11.6 bn (volume growth subdued at 1%) largely led by price increases in Parachute and healthy 11% volume growth in the VAHO portfolio. Parachute (rigids) volume decline of 5% and Saffola volume decline of 1% were the key weak spots. Management termed the Parachute volume decline as an aberration while acknowledging the need for strategic intervention to revive volume trends in the Saffola franchise. International revenues grew 13% yoy in INR terms to ₹3.2 bn (16% growth in constant currency). Growth was led by Bangladesh, GCC and Egypt while subdued performance in Vietnam continued.

Margins – copra inflation continues to drag GM; not enough leverage to mitigate the impact

Consolidated EBITDA margin declined a sharp 270 bps yoy to 17% (KIE: 17.6%). To be sure, GST benefits and the company's tight leash on overheads mitigated complete flow-through of an even sharper 551 bps GM decline to the EBITDA level. Higher volume/revenue growth in Parachute and Saffola would have aided better margin delivery; this was really the missing piece in the P&L construct Marico has delivered time and again in a copra inflation cycle in the past.

Headwinds still there but fading; management track-record lends confidence on quick revival

Marico management has a stiff task in its hands and needs to overcome growth challenges in parts of its portfolio amid continued pressure on gross margins. Historical track-record lends confidence on the company's ability to deliver. We remain constructive.

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Exhibit 1: Interim consolidated results of Marico (based on Ind-AS), March fiscal year-ends (Rs mn)

	4QFY18	4QFY18E	4QFY17	3QFY18	(% change)			FY2018	FY2017	(chg %.)
					KIE Est	yoy	qoq			
Net operating income	14,801	14,844	13,146	16,243	(0)	13	(9)	63,222	59,186	7
Material cost	(7,896)	(7,764)	(6,290)	(8,688)	2	26	(9)	(33,510)	(28,318)	18
Gross Profit	6,905	7,081	6,856	7,556	(2)	1	(9)	29,712	30,869	(4)
Gross Margin (%)	46.6	47.7	52.2	46.5	-106 bps	-551 bps	13 bps	47.0	52.2	-516 bps
Employee cost	(1,035)	(1,042)	(981)	(1,026)	(1)	5	1	(4,222)	(4,042)	4
Advertising and promotion	(1,175)	(1,238)	(1,107)	(1,439)	(5)	6	(18)	(5,828)	(6,547)	(11)
Other expenditure	(2,172)	(2,194)	(2,174)	(2,070)	(1)	(0)	5	(8,284)	(8,692)	(5)
Total expenditure	(12,278)	(12,237)	(10,551)	(13,223)	0	16	(7)	(51,845)	(47,598)	9
EBITDA	2,523	2,607	2,595	3,021	(3)	(3)	(16)	11,377	11,588	(2)
OPM (%)	17.0	17.6	19.7	18.6	-53 bps	-270 bps	-156 bps	18.0	19.6	-159 bps
Other income	229	315	223	174	(27)	3	31	846	978	(13)
Interest	(53)	(23)	(47)	(39)	135	12	36	(162)	(166)	(3)
Depreciation	(231)	(247)	(273)	(213)	(7)	(15)	8	(891)	(903)	(1)
Pretax profits	2,468	2,652	2,497	2,943	(7)	(1)	(16)	11,171	11,497	(3)
Tax	(642)	(699)	(784)	(709)	(8)	(18)	(9)	(2,896)	(3,377)	(14)
Minority Interest	(20)	(32)	(26)	(29)	(38)	—	(32)	(131)	(134)	(2)
Recurring PAT (after MI)	1,806	1,921	1,687	2,205	(6)	7	(18)	8,145	7,986	2
Extraordinary items	—	—	—	—	—	—	—	—	—	—
Net profit (reported)	1,806	1,921	1,687	2,205	(6)	7	(18)	8,145	7,986	2
EPS	1.4	1.5	1.3	1.7	(6)	7	(18)	6.3	6.2	2
Income tax rate (%)	26.0	26.4	31.4	24.1	-34 bps	-536 bps	194 bps	25.9	29.4	-346 bps
Costs as a % of sales										
Material cost	53.4	52.3	47.8	53.5	105 bps	550 bps	-14 bps	53.0	47.8	515 bps
Employee cost	7.0	7.0	7.5	6.3	-3 bps	-48 bps	67 bps	6.7	6.8	-16 bps
Advertising and promotion	7.9	8.3	8.4	8.9	-41 bps	-48 bps	-93 bps	9.2	11.1	-185 bps
Other expenditure	14.7	14.8	16.5	12.7	-11 bps	-186 bps	193 bps	13.1	14.7	-159 bps

Source: Company, Kotak Institutional Equities

Exhibit 2: Interim standalone results of Marico (based on Ind-AS), March fiscal year-ends (Rs mn)

	4QFY18	4QFY18E	4QFY17	3QFY18	(% change)			FY2018	FY2017	(chg %.)
					KIE Est	yoy	qoq			
Net operating income	12,138	12,477	11,035	13,376	(3)	10	(9)	51,704	48,516	7
Material cost	(6,747)	(6,968)	(5,581)	(7,477)	(3)	21	(10)	(28,697)	(24,751)	16
Gross Profit	5,390	5,508	5,454	5,899	(2)	(1)	(9)	23,007	23,765	(3)
Gross Margin (%)	44.4	44.1	49.4	44.1	26 bps	-502 bps	30 bps	44.5	49.0	-449 bps
Employee cost	(653)	(681)	(624)	(651)	(4)	5	0	(2,743)	(2,509)	9
Advertising and promotion	(848)	(822)	(743)	(1,040)	3	14	(18)	(4,346)	(4,627)	(6)
Other expenditure	(1,754)	(1,804)	(1,746)	(1,683)	(3)	0	4	(6,769)	(7,064)	(4)
Total expenditure	(10,003)	(10,275)	(8,694)	(10,850)	(3)	15	(8)	(42,555)	(38,951)	9
EBITDA	2,135	2,202	2,341	2,526	(3)	(9)	(15)	9,150	9,565	(4)
OPM (%)	17.6	17.6	21.2	18.9	-6 bps	-363 bps	-130 bps	17.7	19.7	-203 bps
Other income	917	381	215	719	141	327	28	2,172	2,619	(17)
Interest	(18)	(6)	(41)	(19)	202	(56)	(2)	(76)	(126)	(40)
Depreciation	(172)	(178)	(193)	(163)	(3)	(11)	6	(669)	(641)	4
Pretax profits	2,861	2,399	2,322	3,063	19	23	(7)	10,577	11,417	(7)
Tax	(831)	(595)	(688)	(662)	40	21	26	(2,563)	(2,990)	(14)
PAT	2,030	1,804	1,634	2,401	13	24	(15)	8,014	8,427	(5)
Extraordinary items	(832)	—	—	—	—	—	—	(832)	0	—
Net profit (reported)	1,198	1,804	1,634	2,401	(34)	(27)	(50)	7,182	8,427	(15)
EPS	1.6	1.4	1.3	1.9	13	24	(15)	6.2	6.5	(5)
Income tax rate (%)	29.1	24.8	29.6	21.6	426 bps	-59 bps	743 bps	24.2	26.2	-33 bps
Costs as a % of sales										
Material cost	55.6	55.9	50.6	55.9	-27 bps	501 bps	-31 bps	55.5	51.0	0 bps
Employee cost	5.4	5.5	5.7	4.9	-8 bps	-28 bps	51 bps	5.3	5.2	448 bps
Advertising and promotion	7.0	6.6	6.7	7.8	39 bps	25 bps	-79 bps	8.4	9.5	13 bps
Other expenditure	14.5	14.5	15.8	12.6	-1 bps	-138 bps	187 bps	13.1	14.6	-114 bps

Source: Company, Kotak Institutional Equities

Exhibit 3: Key changes to earnings model, Marico, March fiscal year-ends, 2019-21E (Rs mn)

	Revised			Earlier			Change (%)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenues (Rs mn)	72,947	82,402	92,587	72,557	81,770	91,642	0.5	0.8	1.0
EBITDA (Rs mn)	13,463	15,347	17,446	13,924	15,805	17,911	(3.3)	(2.9)	(2.6)
EBITDA (%)	18.5	18.6	18.8	19.2	19.3	19.5			
PAT (Rs mn)	9,444	10,741	12,099	10,031	11,335	12,739	(5.9)	(5.2)	(5.0)
EPS (Rs/share)	7.3	8.3	9.4	7.8	8.8	9.9	(5.9)	(5.3)	(5.0)

Source: Company, Kotak Institutional Equities estimates

Key segmental highlights and takeaways from the earnings call

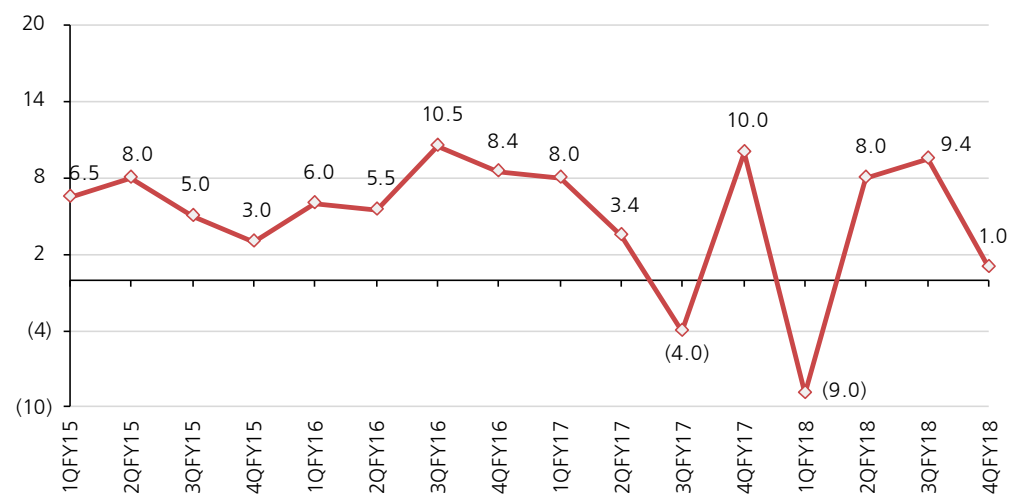
- ▶ **Rural growth outperforms urban growth.** Marico's rural growth continued to outpace urban growth in 4QFY18 – rural grew 12% yoy while urban sales grew by 5% in value terms. MT (11% of turnover) grew by 23% while CSD (7% of turnover) rebounded strongly by growing 32% off a weak base.
- ▶ **Parachute CNO.** Parachute rigids posted a weak quarter – volumes down 5% yoy. The company ascribed the weak performance to two factors (1) sharp price increases – aggregate price increases of ~22% in 2HFY18 and (2) 15% volume growth in 4QFY17 as well as 3QFY18. Company also indicated that the channel started to reduce Parachute inventory in anticipation of a cut in Parachute prices post some temporary easing of copra prices in Feb and Mar 2018. Nevertheless, Marico's CNO franchise is still performing better than the category, witnessing market share gains of 90 bps to ~59%. During FY2018, while copra prices went up by 75%, the company raised consumer prices by just ~22% as management favors protecting the franchise at the cost of short term margin losses. Management expects outlook to improve, forecasting 5-7% volume growth for Parachute in FY2019, in line with medium-term volume growth guidance.
- ▶ **Saffola.** Saffola reported volume decline of 1% yoy (3% decline in value terms); the company attributed weakness in the segment mainly to sluggishness seen in the super premium segment of the edible oils market and also intense competition. Management acknowledged that there have been some shortcomings in its execution and expects a gradual recovery post the corrective measures; full-blown recovery is likely to happen only by 2HFY19.

Other food brands – the healthy foods franchise grew 18% in value terms during the quarter. Saffola Masala Oats maintained its momentum and consolidated its value share to 70% (March, 2018 MAT) in flavored oats category. Recently launched variants of Saffola Masala Oats saw good traction and company is expanding the prototyping of Saffola Masala Oats vending machines in commercial establishments in metro cities (have 150+ operational machines). Management also indicated that initial response to Saffola Active Slimming Nutri-Shake and soups is encouraging.

- ▶ **Value-added hair oils.** Domestic VAHO portfolio grew 11% in volume terms and 9% in value terms. Management highlighted that the overall category growth of VAHO was good partly aided by weak base. Management plans to continue to invest behind its mustard (sarson) oil given the sizeable opportunity of shift from unorganized segment. Nihar Shanti Amla Badam consolidated its market leadership with a gain of ~149 bps in market share during the quarter. Management is also seeing increased off-take of its price-point packs in the segment.

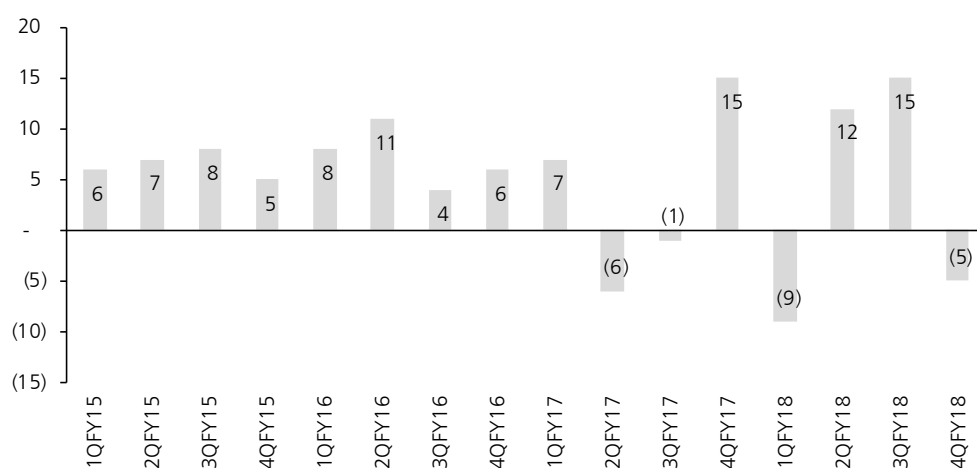
- ▶ **Youth brands.** Male grooming portfolio grew 5% yoy in value terms during the quarter. Given the strong response to its pocket spray, company plans to extend it to beyond the initial launch markets. Company seeks to build a consistent value growth trajectory in the category in FY2019.
- ▶ **International business.** Marico's international business posted a healthy 16% yoy growth in c/c terms (volume growth of 5% yoy and reported growth lower of 13% yoy). International business continued to be impacted by slowdown in Vietnam business. Geography-wise takeaways –
 - **Bangladesh** (45% of turnover) posted 17% c/c growth in revenues led by 3% volume growth – Parachute CNO posted 6% c/c growth (maintaining leadership position with ~87% market share) and non-CNO portfolio grew by 47% in c/c terms.
 - **MENA** (14% of turnover) posted strong 61% c/c growth, largely volume-driven.
 - **Others – (1) SE Asia** (26% of turnover) posted 3% yoy decline in c/c revenue dragged by 4% decline in Vietnam business due to sluggishness in both core categories (male shampoos and male deodorants); management has taken definitive steps to correct its GTM strategy and expects growth to be back on track by 1HFY19. Myanmar business registered over US\$8 mn revenue in FY2018, and **(2) South Africa** (9% of turnover) registered 23% c/c growth aided by good progress in Isoplus.

Exhibit 4: Domestic volume growth trends (yoy %)



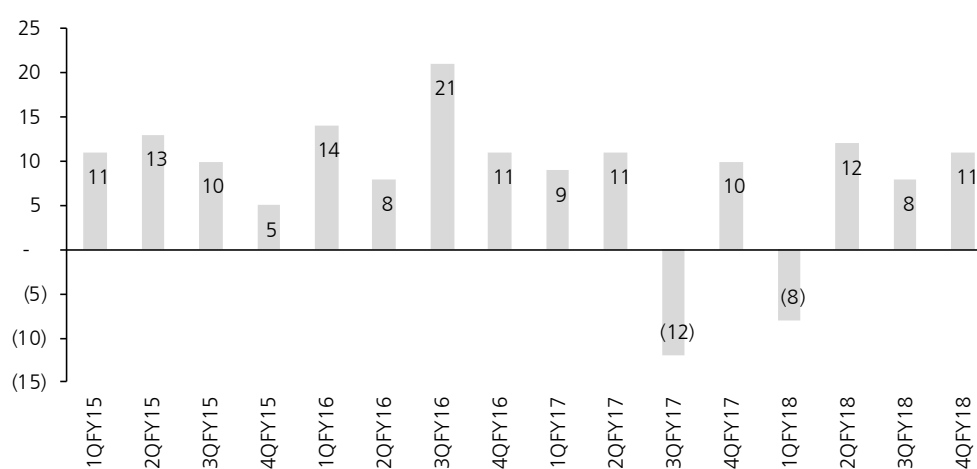
Source: Company, Kotak Institutional Equities

Exhibit 5: Parachute (rigids) volume growth (%)



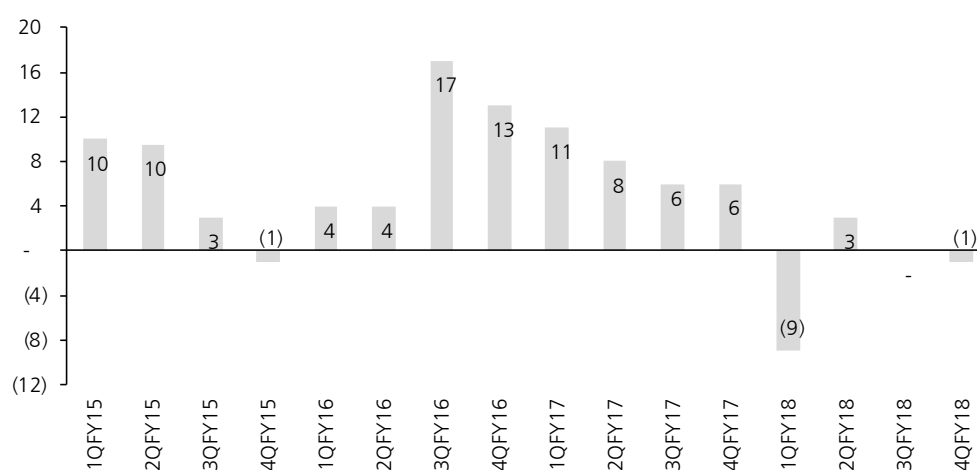
Source: Company, Kotak Institutional Equities estimates, Kotak Institutional Equities

Exhibit 6: Value-added hair oils volume growth trends (in %)



Source: Company, Kotak Institutional Equities

Exhibit 7: Saffola volume growth trends (in %)



Source: Company, Kotak Institutional Equities

Exhibit 8: Consolidated Profit model, balance sheet of Marico (based on Ind-AS), March fiscal year-ends, 2015-21E

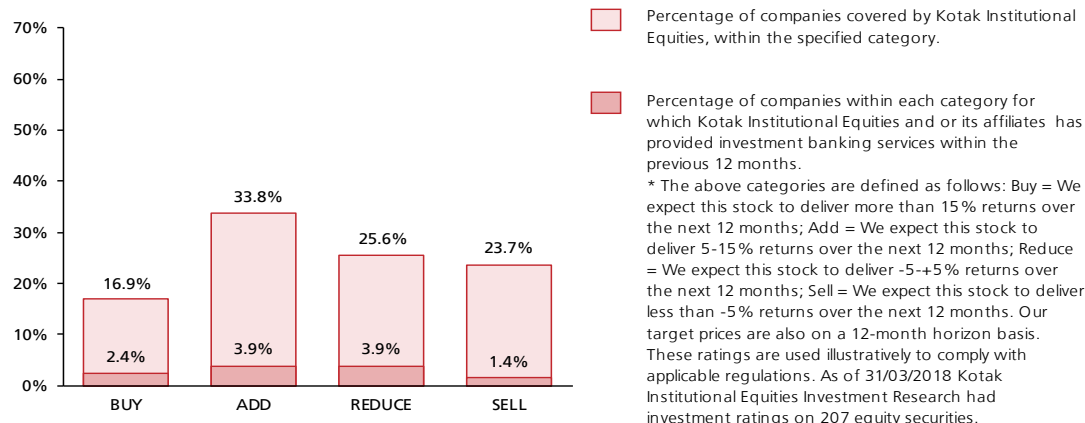
	IGAAP	Ind-AS					
	2015	2016	2017	2018	2019E	2020E	2021E
Profit model							
Net sales	57,203	60,173	59,178	63,222	72,947	82,402	92,587
EBITDA	8,574	10,514	11,593	11,378	13,463	15,347	17,446
Other income	716	933	973	846	810	1,042	1,227
Interest expense	(230)	(206)	(166)	(162)	(162)	(131)	(101)
Depreciation	(843)	(949)	(903)	(891)	(967)	(1,104)	(1,262)
Pretax profits	8,217	10,292	11,497	11,171	13,144	15,154	17,310
Tax	(2,368)	(3,054)	(3,377)	(2,896)	(3,549)	(4,243)	(5,020)
Minority Interest	(114)	(124)	(134)	(131)	(151)	(170)	(192)
Net income	5,735	7,115	7,986	8,145	9,444	10,741	12,099
Extraordinary items	—	—	—	—	—	—	—
Reported Net income	5,735	7,115	7,986	8,145	9,444	10,741	12,099
Earnings per share (Rs)	4.4	5.5	6.2	6.3	7.3	8.3	9.4
Balance sheet							
Total shareholder's equity	18,248	20,174	23,257	25,429	27,514	29,735	32,152
Total borrowings	4,280	3,306	2,388	3,093	2,593	2,093	1,593
Minority interest	137	143	133	125	276	447	638
Total liabilities and equity	22,664	23,623	25,778	28,647	30,383	32,274	34,383
Net fixed assets	5,597	5,917	5,883	5,613	5,959	6,309	6,647
Goodwill	5,193	5,261	5,075	5,463	5,463	5,463	5,463
Investments	2,838	5,132	6,082	5,724	5,724	5,724	5,724
Cash	2,049	3,171	2,273	2,001	3,936	6,785	7,922
Net current assets	7,066	3,720	6,590	10,048	9,504	8,197	8,829
Deferred tax asset (Net)	(79)	421	(125)	(202)	(202)	(202)	(202)
Total assets	22,664	23,623	25,778	28,647	30,383	32,274	34,383
Free cash flow							
Operating cash flow (excl. working capital)	6,817	8,373	8,901	8,482	9,914	11,104	12,426
Working capital changes	(169)	(197)	(2,785)	(3,458)	544	1,308	(633)
Capital expenditure	(581)	(878)	(981)	(464)	(1,313)	(1,454)	(1,601)
Free cash flow	6,068	7,299	5,135	4,560	9,145	10,958	10,193
Ratios							
Sales growth (%)	22.3	5.2	-1.7	6.8	15.4	13.0	12.4
EPS growth (%)	18.1	24.1	12.2	2.0	15.9	13.7	12.6
EBITDA margin (%)	15.0	17.5	19.6	18.0	18.5	18.6	18.8
Gross margin (%)	45.5	49.0	52.2	47.0	49.6	49.9	50.1
A&SP % of sales	11.4	11.5	11.1	9.3	10.7	10.9	10.9
ROE (%)	31.4	35.3	34.3	32.0	34.3	36.1	37.6
ROCE (%)	33.9	41.0	41.0	36.1	40.6	43.5	46.4

Source: Company, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of March 31, 2018

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ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

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SELL. We expect this stock to deliver <-5% returns over the next 12 months.

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