Stock Update

One-off quarter, early recovery expected, maintain Hold with revised TP of Rs340

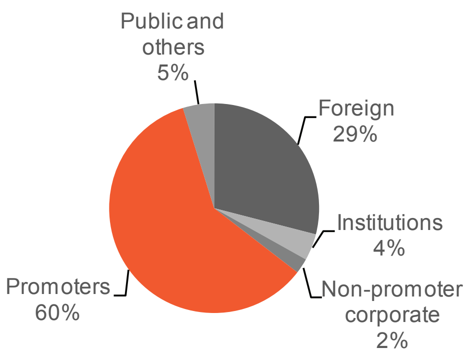
Marico

Reco: Hold | CMP: Rs326

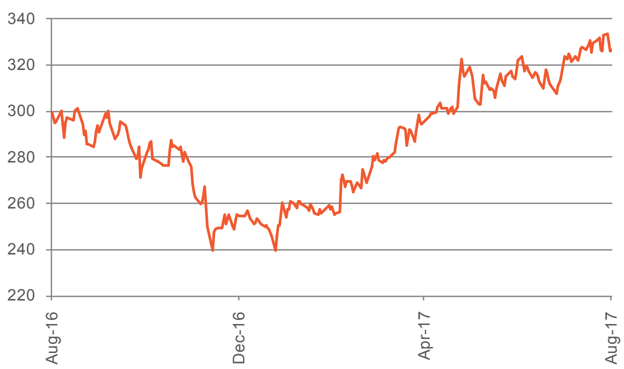
Company details

Price target:	Rs340
Market cap:	Rs42,069 cr
52-week high/low:	Rs335/234
NSE volume: (No of shares)	11.6 lakh
BSE code:	531642
NSE code:	MARICO
Sharekhan code:	MARICO
Free float: (No of shares)	52.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	3.5	27.2	15.4
Relative to Sensex	-1.7	-5.6	8.8	-2.1

Key points

- **Volumes declined by 9% and higher raw material prices affected profitability:** Marico's Q1FY2018 consolidated revenue declined by 3.5% YoY due to pipeline correction across all channels prior to GST implementation. Revenue of the domestic business decreased by 4% YoY mainly on account of 9% volume decline during the quarter. Primary sales witnessed a steep decline as wholesalers (especially in North and East India) went for high inventory de-stocking in June 2017. Further, CSD sales declined by 15% in Q1FY2018. Revenue of the international business stood almost flat on a YoY basis. The sharp surge in copra prices led to a 454BPS decline in gross margin. However, lower ad spends restricted the significant fall in OPM to 215BPS at 19.2%. Operating profit declined by 13.3% YoY to Rs.324.3 crore and PAT declined by 11.9% to Rs.235.9 crore.

- **Key domestic brands witnessed volume decline; International business ex-MENA stood flat:** Performance of Marico's Indian business was impacted by inventory de-stocking by various trade channels in Q1FY2018. Parachute rigid packs, Saffola edible oil and value-added hair oil portfolio witnessed a volume dip of 9%, 9% and 8%, respectively, during the quarter. The youth portfolio witnessed more than 20% decline in sales during the quarter. OPM of the domestic business stood at 21.8% in Q1FY2018 as against 25.4% in Q1FY2017, affected by higher input prices. Revenue of the international business stood flat on a YoY basis [grew by 6% on constant currency (CC) basis], largely on account of currency devaluation in key international geographies and bleak macro-economic environment in the Middle East. OPM of the international business stood lower at 20.9% in Q1FY2018 as against 20.4% in Q1FY2017.

- **Outlook – Early recovery in sales expected; Higher input price to keep margins under stress:** Except for wholesale channels, other key trade channels have started re-stocking the goods. Further, the company has initiated price cut to pass on the benefit of lower GST in hair oils (by 5%) and edible oil (by 2-3%). This should help early recovery in sales in the coming quarters. Except for MENA, other international regions (including Bangladesh) are performing well. We expect revenue growth to come back to low double digits in H2FY2018 and should improve in FY2019. OPM is expected to remain low on a YoY basis due to higher raw-material prices. The recovery in sales will drive bottom-line growth in the coming quarters.

- **Downward revision in estimates; Strong growth prospects ahead:** We have revised downwards our earnings estimates for FY2018 and FY2019 by 8% and 6%, respectively, to factor in the impact of pipeline correction in the domestic market and muted performance in MENA region. We believe Marico would see one of the fastest recoveries post normalisation in the domestic market. The impact of price cuts in hair oil and edible oil will be positive in the near term. Sustained new product launches and increased distribution reach would improve growth prospects in the long run. We maintain our Hold recommendation on the stock with a revised price target of Rs.340 (valuing the stock at 41x its FY2019E earnings). The stock is currently trading at 39.4x its FY2019E earnings.

Valuations (consolidated) Rs cr

Particulars	FY16	FY17	FY18E	FY19E
Net sales	6024.5	5935.9	6481.0	7547.3
OPM (%)	17.5%	19.5%	18.3%	19.2%
Adjusted PAT	710.6	811.0	881.5	1069.4
EPS (Rs)	5.5	6.3	6.8	8.3
PER (x)	59.3	52.0	47.8	39.4
P/BV (x)	20.1	18.1	16.0	13.4
EV/EBITDA (x)	39.4	35.9	34.9	28.4
RoCE (%)	46.0	47.2	45.2	48.6
RoNW (%)	36.2	36.7	35.5	37.0

Result (consolidated) Rs cr

Particulars	Q1 FY18	Q1 FY17	YoY %	Q4 FY17	QoQ %
Net sales	1692.4	1754.3	-3.5	1322.2	28.0
Expenditure	1368.1	1380.3	-0.9	1062.7	28.7
Operating profit	324.3	374.0	-13.3	259.5	25.0
Other income	22.9	27.5	-16.8	22.3	2.8
Interest expenses	3.5	5.4	-35.1	4.7	-26.8
Depreciation	21.1	20.8	1.7	27.3	-22.6
PBT	322.6	375.3	-14.1	249.7	29.2
Tax	86.6	107.2	-19.2	78.4	10.5
Adjusted PAT (before MI)	236.0	268.1	-12.0	171.3	37.7
Minority Interest (MI)	0.1	0.2	-	0.4	
Reported PAT	235.9	267.9	-11.9	170.9	38.0
Adjusted EPS	1.8	2.1	-11.9	2.6	-31.0
GPM (%)	47.5	52.0	-454	51.9	-440
OPM (%)	19.2	21.3	-215	19.6	-46

Domestic business – Volume growth declined by 9% YoY

Marico's consumer business in India declined by 4% YoY to Rs.1,328 crore in Q1FY2018. The volume decline in India was 9% for the quarter. This lower growth can be attributed to the transitionary impact of GST and the subsequent pipeline reduction in trade, especially in rural, wholesale channel and CSD. Volume growth for Parachute Rigid Coconut Oil was down by 9% YoY. Volume growth for value-added hair oil was down by 8% YoY, while that for Saffola was down by 9% YoY. Operating margin during Q1FY2018 was 21.8% as against 25.4% in Q1FY2017 (which was higher on account of a very benign input cost environment). Margins witnessed a decrease in this quarter due to a significant increase in input costs. Although copra prices have increased by more than 60% YoY, the company held back the price increase in Parachute Rigid portfolio in the wake of GST roll out. In the near term, as input costs are likely to rise further, Marico can hike the prices of its products. For the medium term, management is comfortable with EBITDA margin at about 20%.

- **Parachute coconut oil: Volumes decline due to transitional impact of GST, but market share gain after four quarters is reassuring**
  - In Q1FY2018, Parachute's rigid pack volumes declined by 9% YoY. This was due to transitional impact of GST, as trade inventory went down.
  - Despite the decline, Parachute has outperformed the category's growth, which is evident from the fact that during the 12 months ended June 2017, Parachute along with Nihar and Oil of Malabar increased its market share by more than 37BPS to 58%, a reversal after four quarters of market share loss.
  - While copra prices increased by 7% on a sequential basis (YoY increase of more than 60%), the company did not take any price increases momentarily. Management expects copra prices to go up further in Q2FY2018 and, thus, will take price hikes in the near term, considering inflation in commodity prices.
  - With Parachute having strong pricing power, any price hike in near future will not have any significant impact on sales volume in the coming quarter. Volume growth is likely to recover in the coming quarters as we expect consumers to shift from non-branded to branded products under the GST regime.
- **Saffola edible oil: Price decline in edible oil to see early recovery in sales**
  - The Saffola refined edible oils franchise witnessed a decline of 9% in volume terms during the quarter due to destocking in anticipation of GST. The higher dependence on the CSD channel further plagued category growth for the quarter. The brand launched its new packaging with relevant benefit positioning for each of the variants derived from factors affecting heart health.

- The Saffola range of blended refined oils (available in five variants) operates in the premium niche of the refined edible oils market. With rising awareness about healthy living in the country, this provides significant headroom for Marico's growth. The brand gained market share of 203BPS and further strengthened its leadership position in the super-premium refined edible oils segment to 66% during the 12 months ended June 2017. The near-term outlook for blended oil franchise is positive with double-digit volume growth prospects. Further, the price decline in the portfolio would help faster recovery in sales in the coming quarters.
- Saffola Oats continued to consolidate its strong second position in the oats category with a value market share of 27%. Saffola Masala Oats launched a new exciting flavour (Pongal Surprise) during June 2017 in the markets in South India as well as Modern Trade across India.
- Marico is going to expand the category by new innovations in its products and packaging and by investing in its distribution reach.

- **Value-added hair oil — Volume portfolio impacted by higher dependence on rural and wholesale channels but market share gains continue**
  - Marico's value-added hair oil brands registered a volume decline of 8% YoY during the quarter. The decline was largely due to correction in inventory across trade channels, although off-takes continued to grow ahead of category.
  - Marico continued to grow faster than the overall value-added hair oil market. The company further strengthened its market leadership by 178BPS to a 33% market share in volume terms, while its market share in value terms grew by 130BPS to 26%.
  - Nihar Shanti Amla continued to gain market share and achieved a volume market share of 40% for FY2017 in the amla hair oil category. The exit market share of Nihar Shanti Amla was at 40% for the 12 months ended June 2017. The company aims to become the volume market leader in the amla hair oil category in FY2018.
  - In May 2017, the company launched an exciting and super nourishing range of fruit-based hair oils under the hair and care brand available in two variants with extracts of (1) olive, lime and green apple and (2) orange, pomegranate and strawberry. Parachute Advansed Aloe Vera Hair Oil, which is now available in Maharashtra, Andhra Pradesh, Telangana and Tamil Nadu, continued to show traction and grew healthily.
  - As an endeavour to further strengthen the value-added hair oil portfolio position in the rural market, the company has been prototyping with sachet and spout packs of its hair oil brands. Nihar Naturals Sarson Kesh Tel continues to expand its reach in the northern and eastern parts of India. The company will continue to invest behind the brand as it sees a big opportunity in a large source pool of the unorganised mustard oil market. The company's Rural Go-To-Market initiatives will aid in further scaling up of these initiatives.
  - Hair fall control (including brands such as Parachute Advanced Ayurvedic Oil and Parachute Advanced Ayurvedic Gold Hair Oil) is expected to achieve revenue of Rs.100 crore by the end of FY2019.
  - Overall, we believe the value-added hair oil portfolio has a strong potential to grow in high teens in the near to medium term.

- **Male grooming – GST impacts growth in this quarter; Slew of exciting new launches; Near-term looks promising**
  - Being discretionary in nature, the male grooming portfolio witnessed a decline in value terms by 23% YoY, as destocking impacted the portfolio due to comparatively higher trade pipeline.
  - The Set Wet Gel portfolio (constitutes 55-60% of total male grooming portfolio) continued to gain market share by 255BPS in the last 12 months, which currently stands at 58%.
  - The Set Wet deodorant portfolio achieved a volume market share of ~3.2% for the 12 months ended June 2017 in the deodorants category as against 3% in Q1FY2017.
  - During this quarter, Marico launched Parachute Advansed Men Range, a nourishing range of hair care products (cream and oil) specially formulated for men.
  - Marico has defined a multi-pronged strategy for long-term sustainable growth of the male grooming business. The strategy is to drive penetration and category growth (for Set Wet Gels) to gain market share through a differentiated imagery and in-store presence (for Set Wet Deodorants) and to tap the need of men looking for nourishing styling options (for Parachute Advansed Men Range). Given the initiatives rolled out for all the

three verticals, the company is confident of double-digit value growth for the balance part of the year.

- **Premium hair nourishment – Destocking impact felt the most in this category but MS gains continue**
  - Overall, during this quarter, this portfolio comprising Livon and Silk-n-Shine declined by 25% in value terms as destocking impacted the portfolio due to comparatively higher trade pipeline.
  - The company has chalked out a strategy to drive growth in the premium hair nourishment business to drive trials and repeats through efficacious product offering (for Livon Hair gain) and to drive affordability, penetration and relevance in the niche segment of hair serums (for Livon Hair serum).
  - Though the categories of leave-in conditioners (Livon and Silk-n-Shine) and hair gain tonics are at a very nascent stage, being market leaders, Marico is determined to innovate and grow the market. Overall, it is confident of double-digit value growth for the balance part of the year.

International business performance - Revenue declined by 1% due to weak macro environment in MENA

Marico's international business delivered CC growth of 6% YoY (volume growth of 1%) in Q1FY2018. The severe macro-economic headwinds in the MENA region led to a decline in overall international business in Q1FY2018. Bangladesh business grew by 12% YoY in Q1FY2018 in CC terms (volume growth of 4% YoY). Parachute coconut oil reported growth of 10% in CC terms (volume growth of 1%) during the quarter and maintained its leadership position with 86% share. With inflation in input prices, the company took price hikes of 10% in the coconut oil portfolio towards the end of FY2017. This will aid in reducing pressure on margins. MENA region's revenue declined by 14% YoY (in CC terms) in Q1FY2018 due to macroeconomic headwinds. Middle East business declined by 6% in Q1FY2018 on CC basis, while Egypt business declined by 27% in CC terms, as down-trading continued in both the markets. Currency devaluation-led hyper-inflationary scenario continues to hurt the Egyptian economy. South East Asia business grew by 7% YoY in Q1FY2018 (of which Vietnam is a significant contributor). Myanmar is poised to be an $8 million business by year-end. In South Africa, the business reported CC sales growth of 5% YoY in Q1FY2018 despite challenging macroeconomic conditions. Expansion in adjacent markets such as Sri Lanka, Nepal, Bhutan and exports to diaspora markets is expected to contribute ~$13 million (~Rs.85 crore) this fiscal. These markets showed a strong growth trajectory in FY2017 and continued the momentum as we entered Q1FY2018.

Going ahead, the scope of growth in the coconut hair oil segment in Bangladesh is limited, as the category has matured. However, Marico is confident of growing this franchise at a single-digit CC rate in FY2018. The non-coconut hair oil portfolio is likely to reach 30-40% of the total Bangladesh business over the next 2-3 years from the current level of ~19%. South Africa and South East Asia regions are expected to post better revenue growth (in low double digits), while for MENA region, Marico's management remains cautiously optimistic in the near term.

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