Sharekhan by BNP PARIBAS

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Stock Update

Marico Ltd

Decent Q2; Margin pressure to ease sequentially

Consumer Goods			Sharekhan code: MARICO		
Reco/View	Reco: **Buy**	↔	CMP: **Rs. 563**	Price Target: **Rs. 645**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 31.74

Updated Oct 08, 2021

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

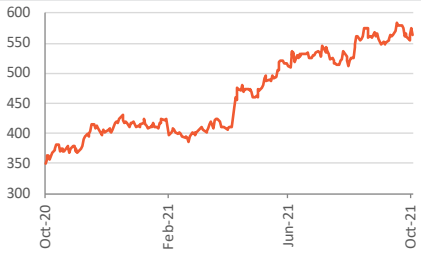
Company details

Market cap:	Rs. 72,859 cr
52-week high/low:	Rs. 606 / 350
NSE volume: (No of shares)	27.4 lakh
BSE code:	531642
NSE code:	MARICO
Free float: (No of shares)	52.3 cr

Shareholding (%)

Promoters	59.5
FII	26.3
DII	8.5
Others	5.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.4	3.2	37.7	55.5
Relative to Sensex	1.9	-10.8	17.2	5.2

Sharekhan Research, Bloomberg

Summary

- Marico's Q2FY2022 performance was largely inline with expectations, with revenue growing by 22% (driven by 8% volume growth in the domestic business) to Rs. 2,419 crore; OPM decreased by 207 bps to 17.5%; PAT grew by 7% to Rs. 316 crore.
- Management expects to achieve low double-digit revenue growth in H2 due to moderating rural demand and high base of H2FY2021, which will be mitigated by improving performance of out-of-home products.
- The company has maintained its medium-term target of achieving an 8-10% volume growth in the domestic business. *Copra* prices have corrected by 11% sequentially and are expected to remain flat in FY2023. Gross margin will improve sequentially.
- We like the company's strategy to improve the product mix by scaling up the contribution of less-commoditised product to drive growth in the long run. We retain a Buy on the stock with a revised PT of Rs. 645.

Marico's Q2FY2022 performance was largely inline with expectations, with revenue growing by 20%+, while sustained raw-material inflation led to 7% growth in reported PAT. Volume growth of India business came in at 8%. *Parachute* portfolio registered y-o-y growth of 18% and VAHO portfolio reported y-o-y growth of 16%. *Saffola's* revenue growth came in at 46% (entirely price-led growth) for the quarter. The international business grew by 13% (CC growth) during the quarter on account of 16% and 20% (constant currency) growth in Bangladesh and MENA region, respectively. About 90% of the company's product portfolio gained market share during the quarter. Management has maintained its thrust on achieving mid-teen revenue growth in the medium term with OPM of about 19% in the medium term.

Key positives

- *Parachute* rigid pack sales volume grew by 7%; market share improved by 180 bps.
- Value-added hair oil portfolio registered double-digit volume-led growth of 16%.
- Decline in *copra* prices led to a 143 bps sequential improvement in gross margins.
- OPM of the international business stood at 24.1% versus 23.3% in Q2FY2021.

Key negatives

- *Saffola* edible oil registered muted volume growth led mainly due to trade destocking and partly due to lower in-home consumption.
- Rural demand moderated in September-October largely due to rising food inflation.

Management Commentary

- Management has given cautious outlook with rural demand slowing down for the past few months. However, with improving sales in out-of-home premium categories, volume growth is expected at mid-single digits in H2 (revenue growth of low double digits). With receding *copra* prices, gross margins are expected to sequentially improve in the quarters ahead.
- The company maintained its guidance of mid-teens revenue growth in the domestic business with volume growth of 8-10%. *Parachute* to grow by 5-7%; VAHO to grow in double digits along with increased contribution from new ventures. The company is targeting consolidated OPM of 19-20% in the medium term.
- Foods business will contribute around Rs. 800-1,000 crore by FY2024 (Rs. 500 crore in FY2022), while digital brands are expected to contribute Rs. 450-500 crore (*Beardo* to reach Rs. 100 crore in FY2022).

Revision in estimates – We have revised downwards our earnings estimates for FY2022/FY2023 to factor in sustained margin pressure caused by higher packaging and edible oil prices.

Our Call

View: Retain Buy with a revised PT of Rs. 645: Gaining market share in the core domestic portfolio through new launches, scaling up the food business, and improving growth prospects in countries such as Bangladesh and Vietnam are some of the key growth levers for Marico in the near to medium term. Inflationary trends are receding and OPM is expected to see improvement from Q4FY2022. We have introduced FY2024 estimates in this note. The stock is currently trading at 45.3x/40.5x its FY2023E/FY2024E earnings. We like the company's focus on de-risking its business model by premiumisation of the core, expansion of foods portfolio, scaling up digital brands, and cost management. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 645.

Key Risks

Any significant increase in key input prices from current levels or heightened competition in core categories would act as a key risk to our earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	8,048	9,398	10,488	11,487
OPM (%)	19.7	18.8	19.9	20.3
Adjusted PAT	1,183	1,339	1,605	1,795
Adjusted EPS (Rs.)	9.2	10.4	12.4	13.9
P/E (x)	61.4	54.2	45.3	40.5
P/B (x)	22.4	20.8	18.5	15.9
EV/EBIDTA (x)	44.9	40.3	34.0	30.3
RoNW (%)	37.8	39.8	43.2	42.3
RoCE (%)	41.0	46.0	53.2	52.4

Source: Company; Sharekhan estimates

Domestic volumes grew by 8%; Margins impacted by input cost inflation:

Marico's consolidated revenues grew by 21.6% y-o-y to Rs. 2,419 crore, largely in line with our expectation of Rs. 2,405.6 crore and higher than the street's expectation of Rs. 2,392 crore. Strong revenue growth can be attributed to robust performance of the India business (77% of overall revenues), which grew by 24% y-o-y. The India business' volumes grew by 8%, in line with the street's expectation of 8-9%. The *Parachute* portfolio registered an 18% y-o-y growth, while the VAHO portfolio reported a 16% y-o-y growth. *Saffola's* revenues grew by 46% for the quarter. The international business grew by 13% (CC growth) during the quarter due to a 16% and 20% (constant currency) growth in Bangladesh and the MENA region, respectively. Gross margins fell to 42.5%, down from 48% in Q2FY2021, impacted by high oil prices. OPM declined by 207 bps y-o-y to 17.5%, slightly higher than our expectation of 17% and lower than the street's expectation of 18%. Operating profit grew by 8.7% y-o-y to Rs. 423 crore, which along with lower other income and high interest costs led to a 7.5% increase in adjusted PAT to Rs. 316 crore versus Rs. 294 crore in Q2FY2021 versus our expectation of Rs. 308 crore.

Core portfolio reported strong double-digit y-o-y growth across categories

- **Coconut Oil – Parachute Rigids packs gained market share of 180 bps:** *Parachute Rigids* registered y-o-y volume growth of 7% and value growth of 18% in Q2FY2022. The brand delivered growth in both core and non-core markets coupled with increased penetration. The brand maintained its stronghold in the branded coconut oil market with the rigid packs gaining volume market share of 180 bps. The brand is well poised to sustain its good run over the medium term with focused distribution drives and continued traction in both core and non-core markets. Marico expects to grow volumes in the range of 5-7% over the medium term, given the market's construct and strengthening brand equity.
- **Saffola registered 46% y-o-y growth across segments:** The Saffola franchise, comprising refined edible oils and foods, grew by 46% y-o-y in value terms. Saffola refined edible oils performance was subdued mainly due to trade destocking and partly due to lower in-home consumption. *Saffola* foods grew by ~70% y-o-y in value terms. The oats franchise continued to anchor the performance with value growth of 36% in Q2FY2022, led by penetration gains. *Saffola* honey continued to expand its presence across all channels. Saffola Mealmaker Soya Chunks has been scaling ahead of internal targets. Marico launched *Saffola Immuniveda Chyawanprash* in September 2021 across all channels, including *Saffola* Store direct-to-consumer portal. Saffola *Oodles* is scaling up well in general as well as modern trade. The company expects to deliver high single-digit volume growth in *Saffola* edible oils over the medium term and eyes revenue of Rs. 500 crore for the foods franchise in FY2022.
- **Volume-led 16% y-o-y growth in VAHO portfolio:** Value Added Hair Oils (VAHO) grew by 16%, primarily driven by volumes. The mid and premium segment brands led growth during the quarter. The company gained ~40 bps in volume market share in overall hair oils category. In the VAHO category, the company aims to sustain double-digit value growth over the medium term and plans to focus on value share gains, which is expected to be ahead of volume share gains in the overall portfolio through mix improvement and innovations in the premium segment.
- **Premium personal care reported strong double-digit growth in key segments:** The premium personal care portfolio, comprising premium hair nourishment and male grooming, reported a robust quarter with Livon serums and male grooming reporting double-digit growth. The Beardo franchise is on track to end FY2022 with revenues exceeding Rs. 100 crore. *Just Herbs'* performance is in line with internal expectations. Premium personal care portfolios is expected to deliver double-digit value growth over the medium term. *Marico* aims to accelerate its digital transformation journey by building a portfolio of at least three digital brands, organically or inorganically, with a combined turnover of Rs. 450-500 crore by FY2024.

International markets reported 14% revenue growth across geographies

The international business delivered revenue of Rs. 549 crore, up 14% y-o-y with constant currency growth of 13%. OPM of the international business was at 24.1% in Q2FY2022 versus 23.3% in Q2FY2021. The Bangladesh business reported a 16% constant currency growth on a y-o-y basis. New launches are scaling up well and the company aims to maintain double-digit constant currency growth trajectory over the medium term. South East Asia (SEA) business declined by 2% y-o-y in constant currency terms. The Home and Personal Care (HPC) category in Vietnam was affected by a surge in COVID-19 infections and the resultant strict lockdown, while the foods business was relatively insulated due to in-home consumption tailwinds during these times. In the SEA region, Marico plans to continue to invest in the male grooming category and aims to sustain momentum in foods over the medium term. MENA business grew by 20% y-o-y in constant currency terms, albeit on a low base, as both the Middle East and Egypt grew healthily. In the MENA region, the company will focus on judicious investment behind brands and go-to market initiatives. The South Africa business grew by 8% y-o-y in constant currency terms, driven by the healthcare portfolio. In South Africa, Marico expects to protect the core franchise of ethnic hair care and healthcare over the medium term.

Other key highlights

- With rising mobility, Marico witnessed healthy demand trends across 90% of its portfolio comprising daily-use items, while discretionary and out-of-home consumption also picked up to some extent. Traditional trade stayed firm on a high base. Rural growth exceeded urban during the quarter and on a two-year CAGR basis but has slowed down sequentially. Alternate channels grew in double digits and CSD recovered smartly on a low base.
- Advertising and sales promotion spends were at 8% of sales, as the company maintained its investments in core franchises and recent foods innovations. Management has guided that advertising and sales promotion spends will rise in the forthcoming quarters.
- *Copra* price was down 11% q-o-q and 5% y-o-y. With the supply outlook improving, prices are expected to remain rangebound in the near term. COVID-19 led disruptions and major weather anomalies in key growing regions led to sustained inflation in global vegetable oil prices. As a result, rice bran oil was up 59% y-o-y and 7% q-o-q, in line with global trends. Reduction in import duty on vegetable oils is yet to reflect in domestic vegetable oil prices, but the company expects some correction in the coming quarters. Crude derivatives such as Liquid Paraffin (LLP) and HDPE were also up 30% and 26% y-o-y, respectively. Both are expected to remain firm in the near term.
- The company expects to deliver double-digit revenue growth in the domestic business on account of mid-single digit volume growth in H2, which will translate into a healthy double-digit two-year CAGR in volume terms. In the international business, the company expects to deliver double-digit constant currency growth in H2 and will continue to monitor the evolving COVID situation in Vietnam, which could remain soft in the immediate near term. Over the medium term, the company aims to deliver 13-15% revenue growth due to 8-10% domestic volume growth in the domestic business and double-digit constant currency growth in the international business.
- The company expects gross margin to improve sequentially in Q3 and Q4. However, OPM improvement would be visible only in Q4, given that ad spends will rise from Q3 itself and a large part of the benefits of a second round of cost rationalisation measures will start accruing in Q4. The company aims to maintain consolidated operating margin above the threshold of 19% over the medium term.

Results (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	y-o-y (%)	Q1FY22	q-o-q (%)
Net sales	**2,419.0**	**1,989.0**	**21.6**	**2,525.0**	**-4.2**
Raw Material Consumed	1,392.0	1,034.0	34.6	1,489.0	-6.5
Employee Expenses	153.0	137.0	11.7	150.0	2.0
Ad & Sales promotion expenses	194.0	189.0	2.6	175.0	10.9
Other Expenses	257.0	240.0	7.1	230.0	11.7
Total Expenditure	1,996.0	1,600.0	24.8	2,044.0	-2.3
Operating profit	**423.0**	**389.0**	**8.7**	**481.0**	**-12.1**
Other income	25.0	27.0	-7.4	27.0	-7.4
Interest expenses	10.0	8.0	25.0	8.0	25.0
Depreciation	33.0	33.0	0.0	33.0	0.0
PBT	**405.0**	**375.0**	**8.0**	**467.0**	**-13.3**
Tax	89.0	81.0	9.9	102.0	-12.7
Extraordinary items	0.0	21.0	-	0.0	-
Reported PAT	**316.0**	**273.0**	**15.8**	**365.0**	**-13.4**
Adjusted EPS	2.4	2.3	7.5	2.8	-13.4
			Bps		**bps**
GPM (%)	42.5	48.0	-556	41.0	143
OPM (%)	17.5	19.6	-207	19.0	-156
NPM(%)	13.1	14.8	-172	14.5	-139
Tax rate (%)	17.5	19.6		19.0	

Source: Company; Sharekhan Research

Result snapshot (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	y-o-y (%)	Q1FY22	q-o-q (%)
Net Sales	1916.0	1550.0	23.6	2043.0	-6.2
Operating profit	296.0	279.0	6.1	341.0	-13.2
Adjusted PAT	329.0	339.4	-3.1	263.0	25.1
			Bps		**Bps**
GPM(%)	37.2	43.3	-613	35.5	167
OPM(%)	15.4	18.0	-255	16.7	-124

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Demand trends will improve ahead

After the disruption of the second wave of COVID-19 in April-May 2021, companies witnessed faster recovery in performance in June-July 2021. With improving mobility, there are signs of a pick-up in the demand for discretionary and out-of-home categories. Rural demand has softened a bit in the past few weeks due to higher inflationary pressure but is expected to come back with better agricultural production and government support. Thus, we expect consumer goods companies to post better sales volume in the quarters ahead. Raw material inflation would sustain in the medium term and would put pressure on the margins of consumer goods companies. However, improving revenue mix and better operational efficiencies would help in mitigating inflationary pressures. Lower penetration in key categories, improving per capita income, a shift to branded products, and improving penetration in rural India are some of the key growth drivers for Marico in the medium term.

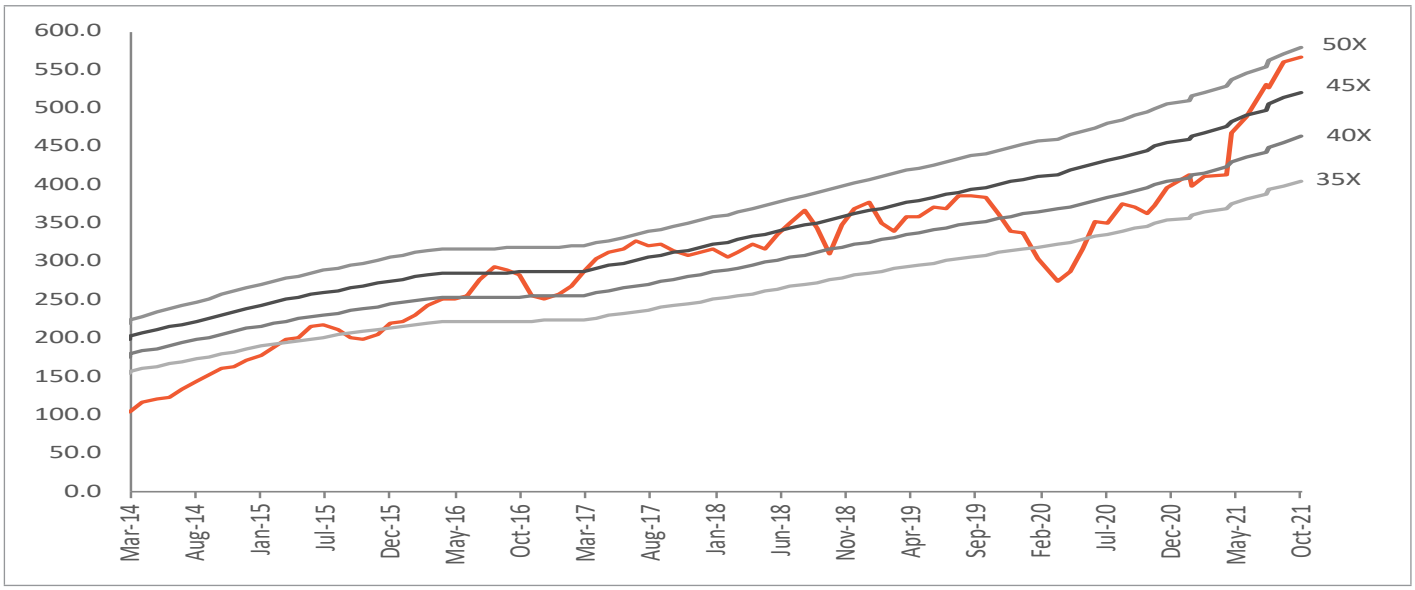
■ Company outlook – Maintain volume growth target of 8-10% for the medium term

The company aims to deliver 13-15% revenue growth due to 8-10% domestic volume growth in the domestic business and double-digit constant currency growth in the international business in the medium term. The core portfolio is expected to grow strongly in the medium term with Parachute Rigid packs expected to deliver 5-7% volume growth, VAHO portfolio to sustain double-digit value growth momentum, and Saffola oils to deliver high single-digit volume growth. Market share gains and increased distribution in rural India (scaling distribution reach by 25% p.a.) would help the company achieve steady growth in the medium term. Copra prices corrected by 11% sequentially and are expected to further correct because of better supply in the market. Further, edible oil prices are expected to stabilise and correct in the quarters ahead. This would lead to raw material inflation staying flat in FY2022 and be lower in FY2023. OPM is likely to stand at 19-20% in the medium term.

■ Valuation – Retain Buy with a revised PT of Rs. 645

Gaining market share in the core domestic portfolio through new launches, scaling up the food business, and improving growth prospects in countries such as Bangladesh and Vietnam are some of the key growth levers for Marico in the near to medium term. Inflationary trends are receding and OPM is expected to see improvement from Q4FY2022. We have introduced FY2024 estimates in this note. The stock is currently trading at 45.3x/40.5x its FY2023E/FY2024E earnings. We like the company's focus on de-risking its business model by premiumisation of the core, expansion of foods portfolio, scaling up digital brands, and cost management. We maintain our Buy recommendation on the stock with a revised PT of Rs. 645.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Dabur	61.5	52.7	42.3	50.0	41.2	32.7	26.4	29.1	32.6
Hindustan Unilever	13.3	19.8	11.8	54.2	45.3	40.5	40.3	34.0	30.3
Marico	61.4	54.2	45.3	44.9	40.3	34.0	41.0	46.0	53.2

Source: Company, Sharekhan estimates

About company

Marico is one of India's leading consumer products companies in the domestic hair and wellness market with a turnover of over Rs. 8,000 crore. Marico is present in the categories of hair care, skin care, edible oils, health foods, and male grooming, with a vast portfolio of brands such as Parachute, Saffola, Hair & Care, Nihar, Livon, Kaya Youth, and Coco Soul. The company is currently present in 25 countries across emerging markets of Asia and Africa, including Middle East, Bangladesh, Vietnam, Egypt, and South Africa, which constitute 22% of the total revenue. The company has a retail reach of over 5 million outlets in the domestic market.

Investment theme

Marico is a leading player in the domestic hair and wellness market with a leadership position in categories such as branded hair oil (~63% market share), value-added hair oil (~37% market share), and branded edible oil (~77% market share). The company has a three-pronged strategy of driving growth through key categories, innovations/entrance into the niche category, and scaling up its presence in international geographies. In recent times, the company has entered into niche categories such as male grooming, premium hair nourishment, and healthy foods, which will not only improve the revenue growth trajectory but would help in boosting margins in the long run due to their premium nature. Consistent innovations, a wide distribution network, and expansion in new-age channels such as modern trade and e-commerce would be key platforms to achieve good growth in the near term.

Key Risks

- **Demand slowdown:** Slowdown in key product categories would affect overall demand and revenue growth.
- **Higher input prices:** A significant increase in prices of key raw materials such as copra (~40% of input costs) would affect profitability and earnings growth.
- **Increased competition in highly penetrated categories:** Increased competition in highly penetrated categories such as VAHO and edible oils would threaten revenue growth.

Additional Data

Key management personnel

Harsh Mariwala	Chairman& Non-Executive Director
Saugata Gupta	Managing Director and CEO
Pawan Agrawal	Chief Financial Officer
Hemangi Ghag	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	First State Investment ICVC	5.3
2	First State Global Umbrella Fund	4.0
3	Life Insurance Corporation of India	3.7
4	Blackrock Inc.	1.3
5	Vanguard Group Inc.	1.3
6	Arisaig India Fund Limited	1.3
7	Mitsubishi UFJ Financial Group Inc.	0.6
8	Aditya Birla Sunlife Asset Management	0.6
9	UTI Asset Management Co. Ltd.	0.6
10	Bajaj Allianz Life Insurance Co. Ltd.	0.4

Source: Bloomberg (Old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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