India I Equities

Consumer

Thematic Report

19 October 2015

India Consumer

Home advantage

Sensex: 27215

Nifty: 8238

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Our in-depth study of FMCG companies in India shows that domestic firms have outpaced many MNCs in growth and market cap. Domestic FMCG companies have, over the years, grown from single-product companies to multi-product, multi-category firms. Their margins and return ratios have improved. They have used steady cash-flows to invest in products and distribution to drive growth.

Niche to mainstream. Domestic FMCG players have grown their product portfolios, from niche offerings such as chyawanprash to more mainstream offerings such as skincare products and beverages. Domestic players have utilised cash flows from these niche products to expand into new product categories.

Four 'I's driving growth for domestic companies. Better India-consumer connect, innovation, inorganic growth and international forays have been the prime growth drivers for domestic firms. Barring innovation, most domestic firms have been able to leverage the other three 'I's far better than MNCs.

Margin gains, structural. According to our study, in the past 5-10 years domestic FMCG firms' margins have grown faster than those of MNCs. This has been assisted by a better sales mix, scaled-up benefits and greater cost controls. We expect the margin gains to persist, especially for small and midcap FMCG operators, which have yet to gain from the scaled-up benefits.

Valuations. TINA effect ("there is no alternative") playing out? Despite rich valuations and slowing demand, most FMCG companies have outstripped the broader indices. This has been driven by rising defensive premiums amidst the continuing subdued earnings performance by cyclical stocks. We initiate coverage on Godrej Consumer Products (Buy), Bajaj Corp (Buy), DFM Foods (Buy) and Zydus Wellness (Buy).

Also, we are upgrading our recommendations on Dabur, Marico and Emami from Holds to Buys.

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Key Data

					EPS (₹)			PE (x)			RoE (%)	Dividend Yield
	Reco	M cap (₹ bn)	Price (₹)	TP (₹)	FY16e	FY17e	FY18e	FY16e	FY17e	FY18e	FY16e	FY16e (%)
Dabur	Buy	479	273	330	7.3	8.6	10.1	37.2	31.5	27.0	34.4	0.9
Godrej Consumer Products	Buy	412	1,207	1,450	32.9	39.7	47.1	36.8	30.4	25.6	23.7	0.6
Britannia	Hold	387	3,227	3,400	64.6	81.3	95.7	50.0	39.7	33.7	52.1	0.6
Marico	Buy	258	400	500	10.9	13.2	15.7	36.7	30.4	25.5	34.1	0.8
Emami	Buy	244	1,073	1,450	28.2	34.9	41.1	38.0	30.7	26.1	47.6	0.7
Bajaj Corp	Buy	61	414	600	17.9	20.9	24.3	23.1	19.8	17.0	54.9	3.3
Jyothy Labs	Hold	56	311	340	8.1	10.1	12.6	38.2	30.9	24.7	18.2	1.4
Zydus Wellness	Buy	34	871	1,050	31.1	35.4	40.6	28.0	24.6	21.4	26.9	0.8
DFM Foods	Buy	5	518	650	17.4	21.0	27.0	29.8	24.7	19.2	32.8	0.5

Source: Bloomberg, Anand Rathi Research *All share prices as on 16th October 2015*

Domestic firms have outpaced MNCs

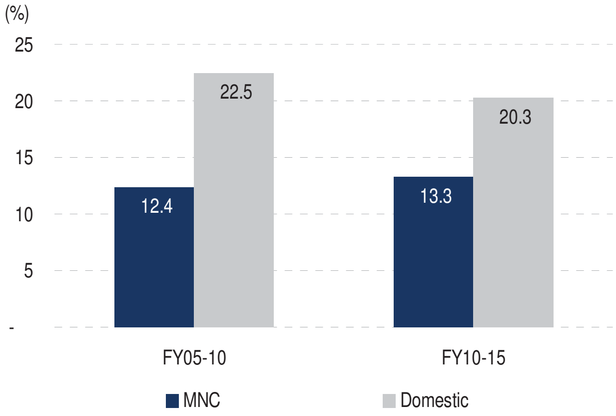
Our study of FMCG companies in India over 10 years shows that domestic firms have outstripped many MNCs in growth and market cap. Domestic FMCG companies have, over the years, grown from single-product companies to multi-product, multi-category firms. Their margins and return ratios have improved.

Domestic FMCG players' revenue at a 21% CAGR in the last 10 years

FMCG: Domestic vs. MNC (CAGR FY05-15)
Revenue: 21% vs. 13%
PAT: 24% vs. 14%
Market cap: 37% vs. 19%

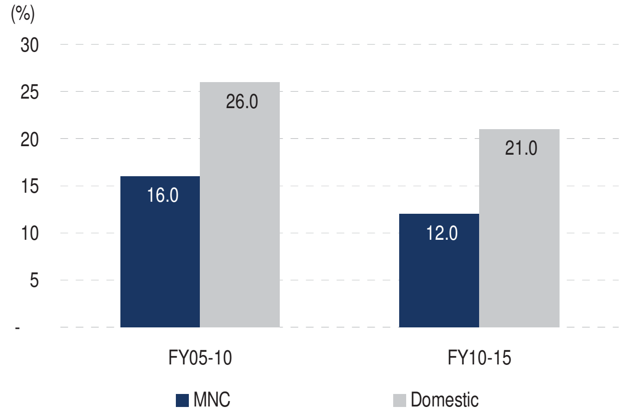
Domestic FMCG companies' revenues have registered a 21% CAGR over FY05-15 (a 20% CAGR in the last five years), while their profits have come at a 24% CAGR (21%). The listed FMCG MNCs have, during that period, registered a lower, 13%, CAGR in revenue, while their profits have come at a 14% CAGR. Consequently, the market cap of home-grown companies has experienced a 23x rise—from ₹78bn to ~₹1,800bn (at a 37% CAGR).

Fig 1 – Revenue momentum - domestic vs. MNCs in 10 yrs



Source: Industry, Anand Rathi Research

Fig 2 – Profit growth - domestic vs. MNCs over 10 years



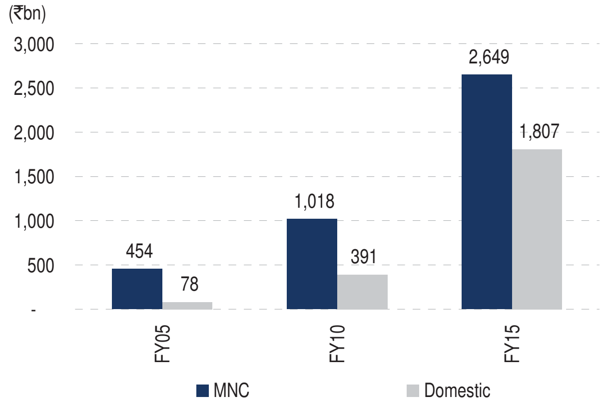
Source: Industry, Anand Rathi Research

Consequently, domestic FMCGs' market caps have grown 23x

The market cap of the domestic FMCG companies we cover has registered 23x growth—from ₹78bn in FY05 to ~₹1,800bn in FY15 (a 37% CAGR)—while that of MNCs has grown just ~6x. Thus, from less than a fourth of HUL's market cap, domestic FMCG companies have grown to 1.4x of HUL's market cap.

Domestic FMCG companies we cover have grown 23x—from ₹78bn in FY05 to ~₹1,800bn in FY15 (a 37% CAGR)

Fig 3 – Market cap growth for domestic FMCG firms faster than FMCG MNCs



Source: Bloomberg, Anand Rathi Research Note: Coverage companies include – Dabur, GCP, Britannia, Marico, Emami, Bajaj Corp, Jyothy Labs, Zydus Wellness and DFM Foods. MNCs include : HUL, Colgate, Nestle, GSK Consumer, Gillette, P&G Health & Hygiene and Agro Tech Foods

Niche to mainstream

Domestic FMCG players have broadened their product portfolios from niche offerings such as chyawanprash to more mainstream ones such as skincare products and beverages. Domestic players have utilised cash flows from these niche products to expand into new product categories.

Positioning and platform provide the growth planks

In the past, domestic FMCG companies were more focused on niche segments which are small...

...while MNCs stayed away from these niche segments, focusing on larger categories...

...and domestic FMCG firms generated cash from niche segments and utilised it to enter larger categories to compete with MNCs

Domestic FMCG players have focused on well-defined yet unexploited arenas such as the herbal and *ayurved* sub-segments, and are largely positioned as "value-for-money". The platform and positioning that these companies operate on have enabled them to build initial scale without direct competition from MNC majors. Furthermore, a few segments (hair oil, health supplements, balms, biscuits) are dominated by Indian players and have very little MNC presence.

In fact, MNCs have been least interested in some of the categories domestic FMCG firms operate in, owing to the smaller size of these segments. However, over the years, these segments have grown into fairly large categories such as coconut hair oil for Marico, digestives and chyawanprash for Dabur and balms and antiseptic creams for Emami.

Today, these categories are cash cows for domestic FMCG companies, driving FMCG firms to venture into more mainstream product categories and gain market share, sometimes in direct competition with MNCs. Thus, they have grown and maintained market share in their core franchises while extending into adjacent categories such as body lotions, talcs, etc., which gels with their positioning.

Fig 4 – Platform and proposition, key differentiators for domestic FMCG players

Company	Platform	Value proposition
Dabur	Herbal and *ayurved*	Popular, premium
Emami	Herbal and *ayurved*	Value-for-money
Marico	Beauty and wellness	Popular, premium
Jyothy Labs	Daily cleaning and household care	Value-for-money
Godrej Consumer	Affordable homecare, personal care and hygiene products	Value-for-money
Bajaj Corp	Light hair oil	Popular, premium
DFM Foods	Healthy kids snacks	Value-for-money
Britannia	Healthy food	Popular, premium

Source: Anand Rathi Research.

Strengthening core…

The core for domestic FMCG players has been their cash-cow segments such as chyawanprash, hair oils, baked goods, whiteners and traditional *ayurved* healthcare ranges. Domestic FMCG players, while diversifying to other segments, haven't lost focus on their core and have in fact further strengthened their brands. Thus, the market shares of these brands have risen over the last 5-10 years.

Fig 5 – Strong market position in core categories for domestic FMCG (%)

	Categories	2005	2010	2015
Dabur	Chyawanprash	56	63	62
Marico	Coconut oils	50	53	57
	Value-added hair oils	18	21	29
Godrej Consumer	Soaps	8	10	10
Emami	Cooling hair oils	47	49	67
	Antiseptic creams	65	74	81
	Balms*	13	61	57
Bajaj Corp	Light hair oils	30	48	60

*Source: Industry, Anand Rathi Research * post Zandu acquisition*

... while gaining share in mainstream categories

The Indian FMCG sector has registered a 15% CAGR in the last five years and is pegged at ₹2,380bn. Despite strong growth over the last 5-10 years, penetration in many FMCG segments is still below 30%. These segments are deodorants, utensil cleaners, floor cleaners, skin creams, hair dyes, etc. They offer strong growth potential and opportunities. Many domestic players have spotted these opportunities and grown into significant, sometimes dominant, players in these segments.

Not only have the domestic FMCG companies entered large categories but have also given the MNCs fair competition and gained market share

Thus, benefitting from a first-mover advantage, Dabur has turned leader in juices, Emami in men's fairness creams, and Marico No.2 in oats. Consequently, apart from dominance in traditional segments (hair oils, health supplements, balms and biscuits) domestic players have created a strong presence in certain mainstream categories despite MNCs.

Fig 6 – Gaining share in more mainstream categories (%)

Company	Segment	FY05	FY10	FY15
GCP	Household insecticides	31	33	50
Dabur	Fruit juices	55	52	60
	Toothpastes	7	13	14
	Glucose-D	15	24	30
Jyothy Lab	Dish-washes	4	10	13
Emami	Men's fairness creams	-	84	59
	Talcs	-	10	27
Marico	Oats	-	-	21
	Body Lotions	-	-	6

Source: Industry, Anand Rathi Research

Four 'I's drive domestic player growth

Better Indian consumer connect, innovation, inorganic growth and international forays have been key growth drivers for domestic firms. Our analysis reveals that, barring innovation, most domestic firms have leveraged the other three 'I's more than MNCs have.

What's driving domestic FMCG companies?

The favourable macro-economic factors of strong per-capita income growth, deeper penetration in new categories, high rural consumption, etc., have helped toward the strong growth of domestic FMCG players. However, we believe a four-pronged strategy has been the key growth driver for domestic FMCG players: innovation, inorganic growth, international foray and India connect.

India connect

We have broken up the India-connect factor into distribution expansion and local consumer connect.

Distribution expansion

Domestic FMCG companies have been successful in penetration despite being late entrants...

According to Nielsen, there are ~8m FMCG outlets throughout the country. However, many of them are located in the far-flung hinterland. Even the FMCG behemoth HUL reaches just 6.5m outlets, while domestic players such as Dabur and Britannia have a reach of about 4–5m. In fact, domestic players have improved their distribution reach (both direct and indirect) over the last 5-10 years. For instance, Marico has broadened its overall reach from 1.7m outlets in FY10 to 3.6m in FY15, while Emami's direct reach has risen from 370,000 outlets to 650,000.

...despite the distribution success, there is still a large gap in the coverage of domestic and FMCG MNCs

Nevertheless, despite the broader reach, many domestic players don't even cover half the number of outlets in the country. Moreover, there is tremendous scope to improve the assortments. and up-trade consumers within the currently serviced outlets.

Thus our view that opportunities for domestic FMCGs are greater

The rise in modern retailing and the mushrooming *paan* shops have helped in volume growth. Foods companies, especially, have benefitted from the growth in modern retail and *paan* shops, reflected in strong growth in dairy, beverages, salted snacks and biscuits. With the advent of online retailers, the premium brands, especially in personal care, are expected to see broader reach and greater off-take.

Fig 7 – Scope for wider distribution reach of domestic FMCG players (m outlets)

2010	Company	2015
6.3	HUL	6.5
3.2	Nestle	4.5
2.8	Dabur	5.3
2.4	GCPL	4.6
3.3	Marico	3.6
2.6	Emami	4
3.5	Britannia	4
1.6	Bajaj Corp	2.8
2.7	Jyothy Labs	2.7
0.2	Zydus Wellness	0.3

Source: Industry, Anand Rathi Research

Local consumer connect

Domestic firms (Dabur, Emami, Bajaj Corp, Marico) largely attribute their rise to traditional categories such as hair oils, chyawanprash, natural/ *ayurvedic* healthcare, etc. In fact, many domestic players understand traditional Indian preferences better and have offerings to address these preferences. Case in point: Godrej Consumer Products' introduction of Nupur Coconut Henna Crème Cream hair colour and Marico's launch of Masala oats reflect their understanding of consumer preferences. Further, many of these domestic firms imbibe an Indian ethos and management style, reflected in their work culture. Yet, most of them are professionally managed, with the promoter role restricted to mere overseeing.

Domestic FMCG companies have been transformed into professionally-driven organisations —from promoter-driven ones. While most players have a restricted promoter-family role in execution, for succession planning some encourage family involvement

Fig 8 – Domestic FMCG companies going professional

Companies	Promoter stake		Professional in key roles	Comment
	Now	5 yrs back		
Dabur	68.1	68.7	Yes	Professional organisation with separate family council to oversee business functions
Marico	59.7	63.0	Yes	Promoters in non-executive role
GCPL	63.3	67.7	Yes	Promoters involved in certain executive roles
Bajaj Corp	66.9	84.7	Yes	Promoter in non-executive role
Emami	72.7	72.7	Yes	Promoters involved in select executive roles but with succession planning could see their roles elevated to strategic involvement
Jyothy Labs	66.8	63.1	Yes	Limited executive role
Zydus Wellness	72.5	72.5	Yes	Promoters involved in certain executive roles
DFM Foods	44.2	69.3	Yes	Promoters involved in certain executive roles
Britannia	50.7	51.0	Yes	Promoters in non-executive roles

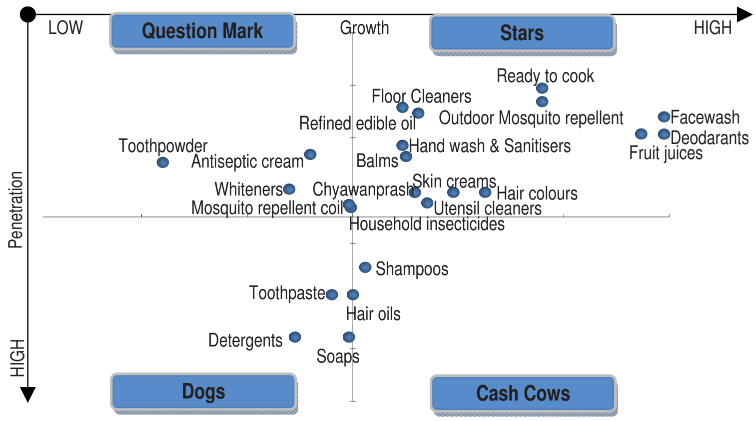
Source: BSE website, Anand Rathi Research

Innovation and growing stars in the portfolio

Be it the 'sachets' revolution (by Chic shampoos) or first-mover strategy in male grooming (by Emami through Fair and Handsome), domestic FMCG players have been leading from the front

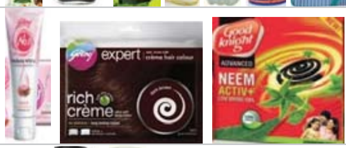
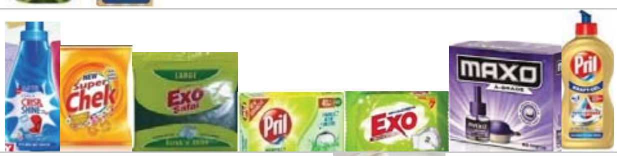
Innovation (sometimes, disruptive innovation) has been a major weapon for many industry players. Domestic FMCG players have used this to increase their 'Star' portfolios. Thus, most FMCG companies have added a new curve to their growth largely assisted by their secure 'cash cow' segments. New product launches contributed 5-6% of Emami's revenue in FY15. Some of the recent innovations undertaken by domestic players are Marico's foray into premium hair oil with Livon Moroccan Silk Serum, GCPL's entry into LuvIt chocolates in southern India, Dabur's foray into ethnic-flavoured beverages under Hajmola Yoodley, Jyothy Labs' foray into paper format insecticide under its Maxo brand, Emami launching Zandu Balm junior

Fig 9 – Category-wise BCG matrix for domestic FMCG firms



Source: Industry, Anand Rathi Research

Fig 10 – A few recent innovations by domestic FMCG players

Company	New product launches	
Dabur	Dabur Anmol coconut oil, Keratex, Odomos roll-on, re-launch of Dabur Amla, Hajmola Chatpata, Dabur baby massage oil	
GCPL	Godrej No 1 face wash, Godrej Expert Rich hair cream, Neem Active low-smoke coil	
Marico	Parachute Advanced Body Lotion, new variant in Set Wet & Livon Moroccan silk serum, Parachute aloe vera enriched coconut hair oil, Parachute advanced aloe vera enriched coconut hair oil.	
Emami	HE Deodorant, She Comfort, Fair & Handsome instant fairness facewash, Zandu Balm ultra power, Zandu Vigorex, Zandu Nityam, Emami 7 oils in one, Zandu gel balm junior.	
Britannia	Nutri choice heaven, Good Day chunkies, Nut & Raisin romance cake	
Bajaj Corp	Bajaj Amla Hair Oil & Kailash Parbat cooling oil	
Jyothy Labs	Henko LINTelligent, Mr.White & Chek, Pril Kraft Gel, Margo Glycerine soap, Ujala Crisp & Shine, Exo Safai Scrubber, Maxo Coil Combo pack, Exo Antibacterial bar, Pril Perfect, Margo glycerine soap	
Zydus Wellness	Fairness peel off, Tulsi turmeric face wash, Nutralite Omega 3, Advanced hydroactive scrub, Advanced refreshing face wash	

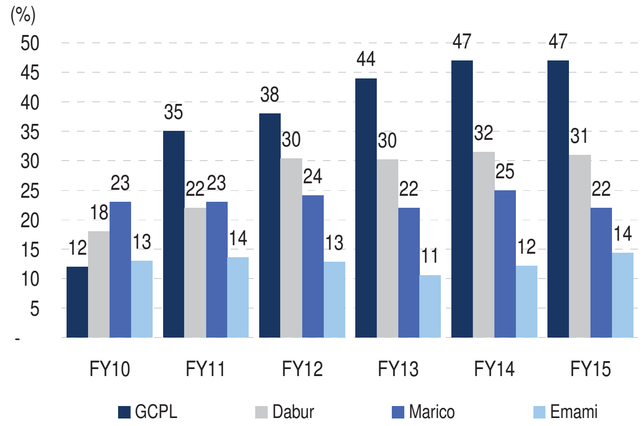
Source: Media, Industry, Anand Rathi Research

International business beckons

For most domestic FMCG companies, their international business started as exports, which gathered pace with a distributor model and later through setting up manufacturing capacities. Further, the inorganic route has been tapped to capture a larger slice of the international pie. The concentration of these businesses lies in emerging economies such as Africa, the Middle East, South-East Asia and South America, indicating the growth potential.

Domestic FMCG companies have undertaken a slew of acquisitions internationally. These have resulted in their mounting international sales. While EBITDA margins in certain areas have been lower than in Indian markets, the focus on the margin in the past few years has led to greater profitability in their international businesses. For instance, Marico's international operating margin has improved from single digits to 17% in FY15. Similarly, GCPL has bettered its margin in its South American operations by cost-saving measures through 'Project Iceberg'.

Fig 11 – Rising share of the international business



Source: Industry, Anand Rathi Research
Note: GCPL had a string of international acquisitions in the last five years. Also, Dabur made a few acquisitions, which have helped to greater contribution

Inorganic growth

Another key driver of growth has been acquisitions. While MNCs have been very careful with acquisitions owing to steep valuations and an uncomfortable fit with their portfolios, many domestic players have been aggressive on inorganic growth. In fact, many of them have turned around businesses and grown them fast. For instance, Jyothy Labs acquired and successfully turned around the loss-suffering Henkel India unit. Similarly after acquisition of Zandu, Emami has scaled it up substantially and extended the brand (Zandu Balm to Zandu Balm Ultra Power).

Fig 12 – Major FMCG acquisitions in the last five years

Company	Target acquired	Country/ Region	Category	Year of Acquisition	Size of the deal	Comment
GCPL	Tura	Nigeria	Soaps	2010	NA	~40% of revenue in FY15
	Megasari	Indonesia	Homecare	2010	₹12bn	
	Issue + Argencos	South America	Hair care	2010	$49m	
	Darling Group	Africa	Hair care	2011	NA	
	Cosmetica Nacional	Chile	Hair care	2012	NA	
	Soft & Gentle	UK	Personal care	2013	₹1bn	
Marico	Code10	Malaysia	Hair care	2010	₹150m	~10% of revenue in FY15
	ICP	Vietnam	Personal care	2011	NA	
	Paras Personal Products	India	Personal care	2012	₹7.4bn	
Dabur	Hobi Kosmetiz	Turkey	Personal care	2010	$69m	~12% of revenue in FY15
	Namaste Group	US, Africa	Hair care	2010	$100m	
Emami	SAE	Egypt	NA	2011	NA	To contribute ~10-12% of revenue in FY16
	Kesh King	India	Hair care	2015	₹16bn	
Bajaj Corp	Nomarks	India	Personal care	2013	₹1.5bn	7% of revenue in FY15
Jyothy Labs	Henkel India	India	Home & personal care	2011	₹8bn	~35% of revenue in FY15

Source: Industry, Anand Rathi Research

No longer 'margin'al; structural gains here to stay

Greater pricing power, a better product mix and scale & sourcing benefits have driven consistent gross-margin gains for domestic players, driving ~390bps yoy increase over the last 10 years.

While a part of this gain has been re-invested in the business through higher brand spends, consistent cost savings have aided in EBITDA margin gain of ~300bps over the last 10 years.

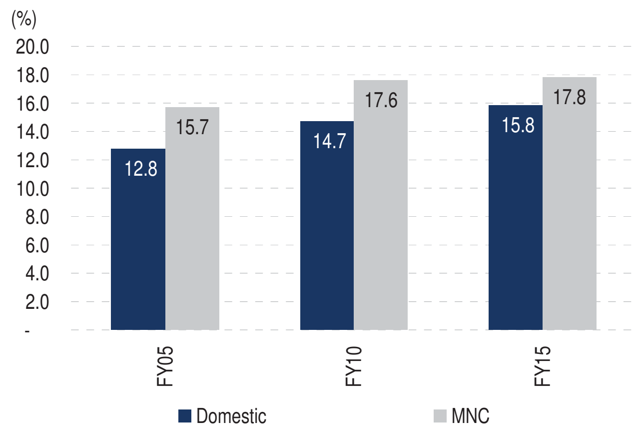
Margins have improved despite advertising spends increasing

Margins of most Indian FMCG companies have widened despite the rise in spending on advertising. This has largely been achieved through the benefits of scale and cost efficiencies. Some of the factors leading to margin improvement are:

- Economies of scale: growing scale in India and international markets
- Improving mix and shift toward premium products: (a) better product mix and (b) entering high-margin categories
- Efficiencies in procurement: deployment of technology such as e-sourcing
- Operational efficiencies: (a) stable overheads and staff costs, (b) improvement in the supply chain and (c) S&D efficiencies
- No royalty payments levied.

In the last 10 years the EBITDA margin gap has narrowed from 290bps to 200bps

Fig 13 – EBITDA margin trend of domestic FMCG firms



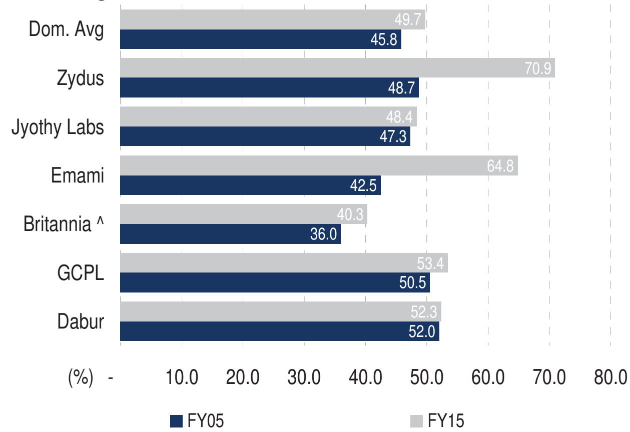
Source: Industry, Anand Rathi Research

Healthy gains in gross margins

Greater pricing power, a better product mix and scale & sourcing benefits have driven consistent gross-margin gains for domestic players. This has driven a gross margin expansion for ~390bps of the domestic players we cover. We are optimistic of the gains continuing given the premiumisation of portfolios and scaled-up benefits that many of the mid-size FMCG players are likely to enjoy.

Weighted average gross margin for domestic FMCG players have expanded ~390bps in the last 10 years

Fig 14 – Gross margin for domestic FMCG firms

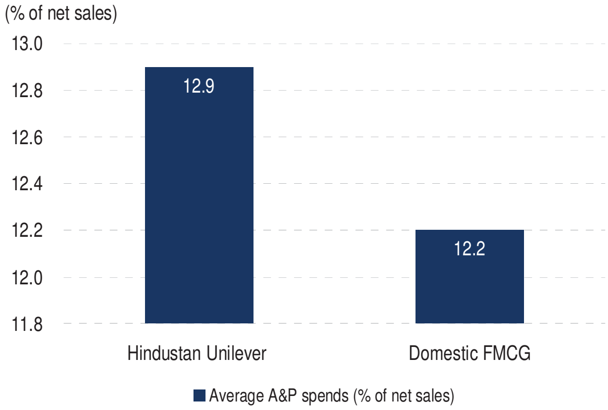


Source: Companies, Anand Rathi Research , ^FY10

Advertising spends lower than HUL's; but returns better

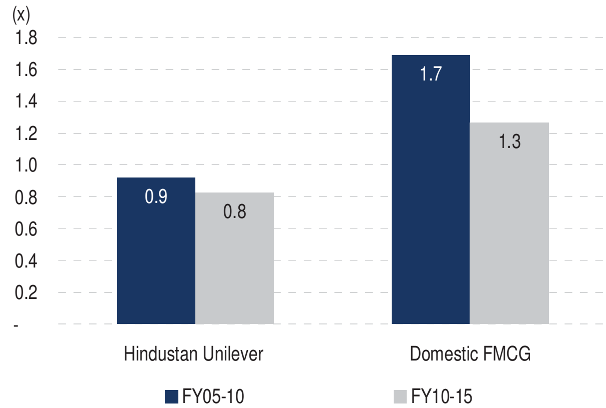
Over the last decade, HUL has seen A&P spends rising faster than the sector, resulting in higher A&P spending (as percent of net sales). HUL's average A&P spend in the last five years was 12.9% of net sales vs. 12.2% for domestic players. In fact, in the last 10 years HUL has spent ₹240bn cumulatively to generate incremental revenue of just ₹209bn. This, against domestic FMCG players together spending ₹225bn on A&P to generate revenue of ~₹310bn. Thus, delivering better returns for the money spent.

Fig 15 – HUL's avg. A&P spend (% of net sales) has been higher than domestic players put together



Source: Companies, Anand Rathi Research

Fig 16 – Incremental revenue generated for every ₹1 of A&P spend suggests better returns by domestic players



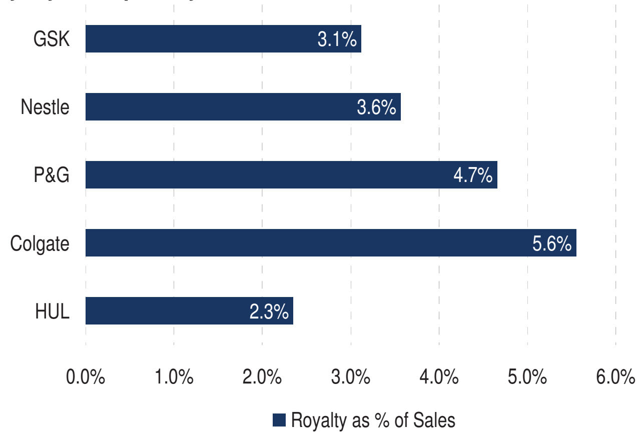
Source: Companies, Anand Rathi Research

"No-royalty payments" provides the added advantage

Most FMCG MNCs, including Hindustan Unilever, pay 2-6% to their parent as royalty for brands and technology. Domestic FMCG firms save on this and, thereby, pass on the benefit to consumers (or it is reflected in operating margins). We believe that best practices/ technology are essential for growth and improve the profitability of MNCs. However, the royalty payments should be based on defined quantitative benefits and duration, rather than being charged for life.

Further, many MNCs are raising royalty rates. Hindustan Unilever plans to increase royalty to 3.15% by FY18 (from 2.3% in FY15). Similarly, Nestle India plans to raise royalty paid to its parent from 3.5% in CY13 to 4.5% in CY18.

Fig 17 – Royalty rates paid by various MNCs



Source: Companies, Anand Rathi Research

Near-term weak; long-term steady

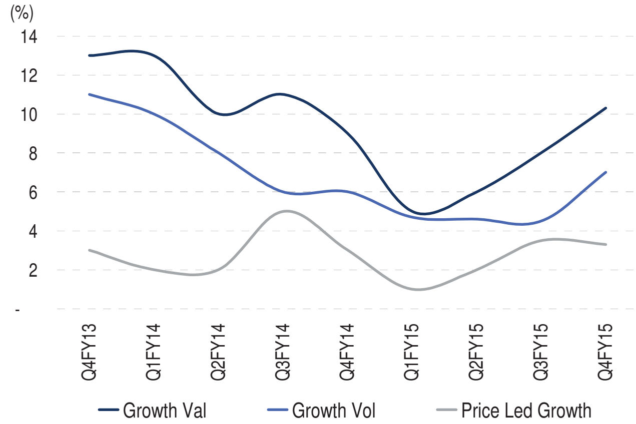
Weaker rural demand could have a bearing on growth in the FMCG sector. We anticipate the FMCG companies we cover to post 14% revenue growth in FY16 vs. 13% in FY15 (excl. Emami).

Also, we project a 22% earnings CAGR over FY15-18 (vs. 21% over FY12-15) for the companies we cover, aided by margin tailwinds and robust earnings from Emami and Jyothy Labs.

Demand has bottomed out but earnings-downgrade to continue

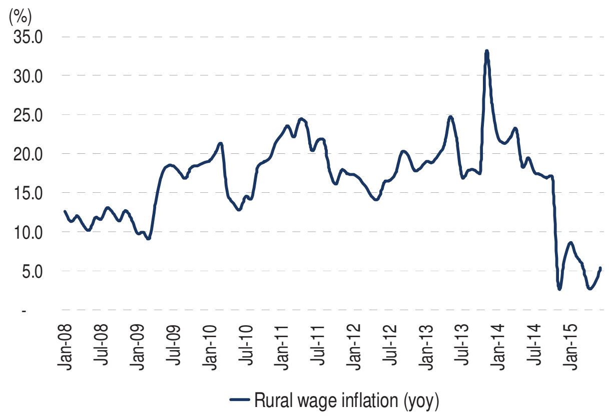
Consumer demand has bottomed out in H1 FY15 as suggested by Nielsen (Fig 18). However, we haven't seen any meaningful volume uptick for most of the listed FMCG players. Also, improvement in consumer sentiment hasn't translated into better off-take, which, in our opinion, will follow with a lag and is linked to an uptick in the broader economy. In fact, weakness in employment, declining rural growth and rural wages have resulted in deceleration in rural FMCG off-take. We anticipate the FMCG companies we cover to post 14% revenue growth in FY16 vs. 13% in FY15 (excl. Emami). This is slower than the average 20% growth over FY10-15, primarily impacted by the slowdown in rural markets and lower pricing growth (input-cost-deflationary environment).

Fig 18 – FMCG sector growth trend; has demand bottomed out?



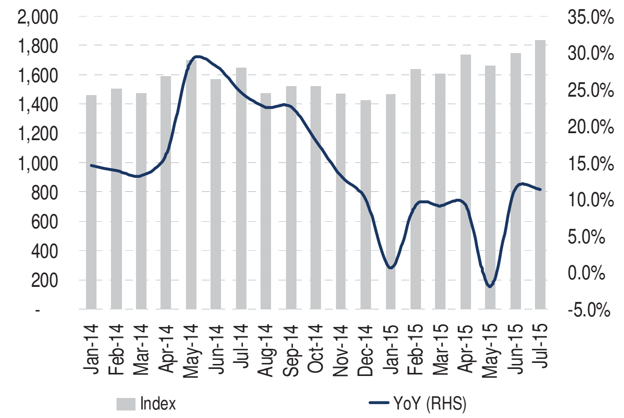
Source: Dabur, Nielsen, Anand Rathi Research

Fig 19 – Rural wage inflation has decelerated



Source: RBI

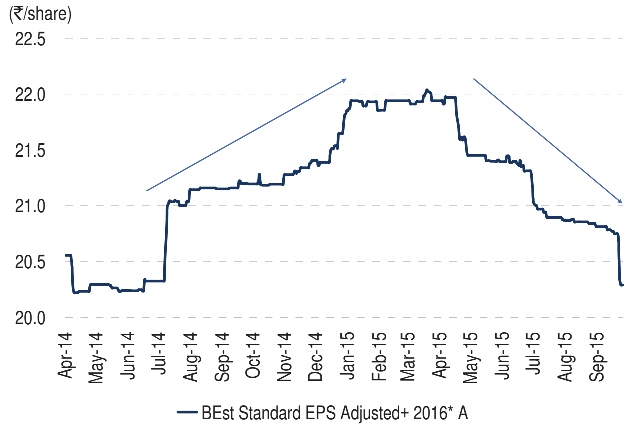
Fig 20 – Job index has moderated in FY16



Source: Naukri Jobspeak

The consensus had been overly optimistic in its earnings estimates for consumer stocks. This was partly driven by a valuation-justification hypothesis as analysts built inflated figures to justify stretched valuations. While we are optimistic of margin tailwinds emanating from lower crude prices, price deflation and weak volume momentum are expected to result in modest earnings growth for the sector. For instance, HUL's consensus estimate has recently been downgraded after the overly-optimistic crude-fall-led earnings upgrade in Q3 FY15. We project a 22% earnings CAGR over FY15-18 (vs. 21% over FY12-15) for the companies we cover, aided by robust earnings from Emami and Jyothy Labs. Thus, we expect FMCG stocks, despite their rich valuations, to continue to outstrip the broader market.

Fig 21 – HUL's earnings revision in the last few quarters



Source: Bloomberg consensus

Fig 22 – Our estimates vs. consensus estimates for FY16

FY16 e (₹)	Anand Rathi Research	Consensus	Difference (%)
Dabur	7.3	7.4	0.6
GCPL	32.9	34.0	3.3
Britannia	64.6	69.2	7.1
Marico	10.9	11.1	1.8
Emami	28.2	23.9	-15.3
Bajaj Corp	17.9	16.6	-7.4
Jyothy Labs	8.1	8.7	7.2
Zydus Wellness	31.1	29.9	-3.9

Source: Bloomberg, Anand Rathi Research

Valuations

TINA effect?

Most defensives are currently trading at elevated valuations, driven by the TINA effect ("there is no alternative"). However, we believe the present situation is unlikely to change in the short term. Thus, consumer valuations are likely to persist. At best they could see a valuation correction over a period of time. Having said that, weaker-than-average and sharply weaker performances could result in interim volatility in most consumer stocks. After having put on a good show in Q4 FY15, DFM Foods rose sharply (2x in three months); GCP rose as much as 20% after a strong showing in Q1 FY16. But Colgate slipped 5% after disappointing Q1 FY16 results.

Our preferred picks of the FMCG stable are **Bajaj Corp, Emami, Marico, DFM Foods and Dabur**.

Fig 23 – In four of the last five years, the FMCG sector has outrun broader market

Index Name (%)	FY11	FY12	FY13	FY14	FY15	FY16 (YTD)
BSE Auto	21.2	8.3	(1.4)	33.9	45.0	(5.0)
BSE Bankex	24.1	(10.9)	10.9	11.1	44.9	(4.2)
BSE Cap Goods	(7.3)	(24.9)	(10.1)	31.0	44.4	(7.1)
BSE FMCG	**27.3**	**24.4**	**31.7**	**17.8**	**11.4**	**1.3**
BSE Healthcare	12.7	9.4	20.9	24.7	70.5	2.7
BSE Metal	(11.3)	(30.6)	(22.8)	16.3	(6.3)	(20.4)
BSE Oil & Gas	(0.2)	(20.6)	3.0	13.4	(2.9)	(0.8)
BSE Power	(12.8)	(23.6)	(21.3)	3.6	23.1	(9.6)
BSE PSU	(1.2)	(18.6)	(11.4)	(2.4)	19.6	(7.8)
BSE Realty	(29.4)	(25.9)	0.2	(21.7)	14.3	(15.9)
BSE Smallcap	(6.1)	(20.7)	(12.4)	19.1	53.2	3.1
CNX IT	19.5	(8.4)	10.8	28.0	28.0	(5.1)
CNX Midcap 100	3.4	(5.1)	(4.0)	15.0	51.4	1.4
Nifty	**10.3**	**(9.1)**	**7.3**	**17.5**	**26.3**	**(4.1)**
Sensex	**9.9**	**(10.4)**	**8.2**	**18.7**	**24.6**	**(3.7)**

Source: Bloomberg, Anand Rathi Research

Fig 24 – FMCG sector valuation chart

Key Data					EPS			PE (x)			RoE (%)	3 yr CAGR	Dividend yield
	Reco	M cap (₹ bn)	Price (₹)	TP (₹)	FY16e	FY17e	FY18e	FY16e	FY17e	FY18e	FY16e	(%)	FY16e (%)
Dabur	Buy	479	273	330	7.3	8.6	10.1	37.2	31.5	27.0	34.4	18.5	0.9
Godrej Consumer Products	Buy	412	1,207	1,450	32.9	39.7	47.1	36.8	30.4	25.6	23.7	21.0	0.6
Britannia	Hold	387	3,227	3,400	64.6	81.3	95.7	50.0	39.7	33.7	52.1	28.5	0.6
Marico	Buy	258	400	500	10.9	13.2	15.7	36.7	30.4	25.5	34.1	20.8	0.8
Emami	Buy	244	1,073	1,450	28.2	34.9	41.1	38.0	30.7	26.1	47.6	23.9	0.7
Bajaj Corp	Buy	61	414	600	17.9	20.9	24.3	23.1	19.8	17.0	54.9	17.8	3.3
Jyothy Labs	Hold	56	311	340	8.1	10.1	12.6	38.2	30.9	24.7	18.2	42.1	1.4
Zydus Wellness	Buy	34	871	1,050	31.1	35.4	40.6	28.0	24.6	21.4	26.9	13.3	0.8
DFM Foods	Buy	5	518	650	17.4	21.0	27.0	29.8	24.7	19.2	32.8	20.8	0.5

Source: Bloomberg, Anand Rathi Research *All share prices as on 16th October 2015*

Godrej Consumer – Indian consumer MNC; initiating, with a Buy

Godrej Consumer Products' evolution as an Indian consumer-products MNC hasn't come at the expense of its India business. In fact, management has strengthened its position in the domestic market and plans to re-energise the business with a host of marketing and supply-chain measures. A strong new-product pipeline and brand investment would continue to power above-industry growth. Further, benign input costs and cost-efficiency efforts would drive a 21% earnings CAGR over FY15-18. We initiate coverage on GCPL with a Buy recommendation and a target price of ₹1,450 (based on 33x Sep'17e).

Bajaj Corp – Well-oiled; initiating, with a Buy

Strong pricing power, a wide distribution network and one of the best margins in the sector are expected to aid in Bajaj Corp's earnings impetus to an 18% CAGR over FY15-18. The stock has consistently traded at a 30-35% discount to larger peers (Dabur, GCP, Marico, Emami). However, the company's consistent and ahead-of-market performance would narrow the gap. We ascribe 27x to its Sep'17e earnings to arrive at a price target of ₹600.

Zydus Wellness – Sweet, nevertheless healthy; initiating, with a Buy

In the under-penetrated health and wellness arena, Zydus Wellness offers niche products, which are leaders in their segments. We believe that the management thrust on wider distribution, product launches and greater investment in brand building would revive the revenue momentum to a 14% CAGR over FY15-18 (9% over FY12-15). This should aid in a healthy (13%) earnings CAGR over that period. We ascribe 27x on Sep'17e to arrive at our target price of ₹1,050. Hence, we initiate coverage on Zydus Wellness, with a Buy recommendation and a target price of ₹1,050 (21% potential from the present price).

DFM Foods – Play on kid-snacking; initiating, with a Buy

With its flagship brand Crax & Natkhat, DFM Foods has established itself in North India with a more-than-20% share in the extruded-snacks market. Its national expansion plan for greater scale and cost-efficiency and the benign input costs would drive a 21% earnings CAGR over FY15-18. We believe that earnings growth could surprise because of the benign input-cost environment and higher-than-expected revenue growth. We initiate coverage on DFM Foods, with a Buy rating and a price target of ₹650 (based on 27x Sep'17e).

Dabur - Consistent performer; upgrading, to a Buy

Despite a slowing market, Dabur has held to its 8%+ volume momentum. This, along with a strong launch pipeline, distribution initiatives and re-positioning on a health platform are expected to drive continuing medium-term growth (forecast 18% earnings growth over FY15-18). The stock has slipped ~10% in the last three months, which along with consistent growth delivery makes it a worthy play in the consumer arena. Hence, we upgrade our recommendation to a Buy, with a ₹330 price target, implying ~20% potential.

Britannia – Baking a premium story; Hold

Near market leadership in the biscuits segment driven by shifting consumer preferences towards the fast-growing health and premium cookies sub-segment and margin tailwinds offer earnings assurance. Britannia's consistent performance and strong earnings have driven a re-rating (trading at ~40x FY17e). We believe the premium valuation will persist, and maintain a Hold rating on the stock, with a price target of ₹3,400 (based on 38x Sep'17e).

Marico – Set for two-fold growth in four years; upgrading, to a Buy

Marico has set itself a stiff 2x revenue target by FY18 (having posted a 17% revenue CAGR over FY11-15). This would be driven by high single-digit volume growth in its domestic business, premiumisation in its core hair-oil range, and launches in its food and youth portfolios. Margin tailwinds assure earnings growth more than revenue momentum. Further, the recent 10% dip in the last three months has brought down valuations to a more reasonable level, offering a good entry opportunity. Hence, we upgrade the stock to a Buy, with a target price of ₹500 (a 25% potential).

Emami - Growing franchise; upgrading, to a Buy

Emami's growing tribe of products, which includes a recent foray into male grooming to the acquired niche *ayurved* hair oil, provides it with a strong medium-term growth platform. Market-share gains in core brands, persistent industry-leading gross margins and consistent earnings performance render Emami a compelling portfolio stock. In the last few months the stock has slid ~20% from its recent peak, affording an attractive entry opportunity. Hence, we are upgrading our recommendation from a Hold to a Buy, with a target price of ₹1,450 (based on 38x Sep'17e).

Jyothy Labs - 'Option' premium; Hold

Jyothy Labs has transformed itself from a single-brand entrepreneurial firm into a multi-brand, professionally-managed FMCG company. The new management's focus on a better sales mix, volume-led growth and efficiency in the supply chain has turned around the loss-suffering Henkel acquisition and improved margins. Triggers such as a possible Henkel stake buy and the sale of land assets could lead to a re-rating of the stock. Hence, we retain our Hold recommendation, with a target price of ₹340 (30x Sep'17e).

Company Section

19 October 2015

Godrej Consumer Products

Indian consumer MNC; initiating, with a Buy

Rating: **Buy**
Target Price: ₹1,450
Share Price: ₹1,207

Godrej Consumer Products' evolution as an Indian consumer-products MNC hasn't come at the expense of its India business. In fact, management has strengthened its position in the domestic market and plans to re-energise the business with a host of marketing and supply-chain measures. A strong new-product pipeline and brand investment would continue to power above-industry growth. Further, benign input costs and cost-efficiency efforts would drive a 21% earnings CAGR over FY15-18. We initiate coverage, with a Buy recommendation.

Changing tracks in domestic marketing. Given its burgeoning brands and SKUs, for better retail servicing the company plans to split its sales line. It has also undertaken a distribution initiative (e-cube) to widen its reach and improve its efficiency in urban outlets. These measures show management's intent to regain 15%+ revenue growth domestically (53% of revenue).

Winning share, distribution expansion, innovations to drive the international business. The strategy in the company's regional markets internationally (47% of revenue) has been different. In LATAM it focuses on market-share gains; in Asia and Africa, a mix of distribution, innovation and cross-pollination. We are optimistic about growth in its international market and project a 15% CAGR over FY15-18.

Margins set to improve. Cost-efficiency measures (Project Pi and Project Iceberg) have aided profitability (18% PAT growth in FY15 vs. 12% over FY12-14). These measures, along with the better product-mix and benign input prices, are likely to drive an EBITDA margin gain of 180bps over FY15-18.

Valuation. We initiate coverage on GCPL with a target of ₹1,450 (based on 33x Sep'17e). At the ruling price of ₹1,207, it trades at 37x FY16e and 30x FY17e. We are optimistic on its earnings fuelled by margin tailwinds and cost-saving measures. **Risks:** Input cost inflation, failure to scale up new product launches and keener competition.

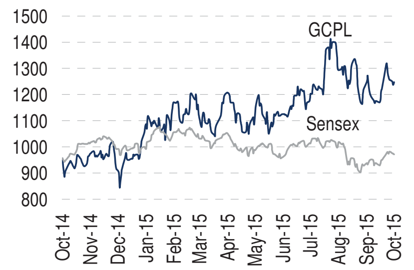
Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	76,198	83,197	94,638	108,698	125,828
Net profit (₹ m)	7,644	9,048	11,183	13,506	16,027
EPS (₹)	22.5	26.6	32.9	39.7	47.1
Growth (%)	12.9	18.4	23.6	20.8	18.7
PE (x)	53.8	45.4	36.8	30.4	25.6
PBV (x)	10.9	9.5	8.0	6.7	5.6
RoE (%)	21.6	22.4	23.7	24.0	23.9
RoCE (%)	18.7	20.7	23.0	24.2	25.0
Dividend yield (%)	0.4	0.5	0.6	0.7	0.9
Net gearing (x)	0.4	0.3	0.1	-0.1	-0.2

Source: Company, Anand Rathi Research

Key data	GCPL IN / GOCP.BO
52-week high / low	₹1,459 / ₹830
Sensex / Nifty	27215 / 8238
3-m average volume	$5.2m
Market cap	₹412bn / $6.4bn
Shares outstanding	341m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	63.3	63.3	63.3
- of which, Pledged	-	-	-
Free Float	36.7	36.7	36.7
- Foreign Institutions	28.7	28.8	29.0
- Domestic Institutions	2.0	1.9	1.9
- Public	6.0	6.0	5.9

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	76,198	83,197	94,638	108,698	125,828
Revenue growth (%)	18.8	9.2	13.8	14.9	15.8
- Op. expenses	64,127	69,111	77,636	88,638	102,327
EBIDTA	**12,070**	**14,087**	**17,003**	**20,060**	**23,501**
EBITDA margin (%)	15.8	16.9	18.0	18.5	18.7
- Interest expenses	1,199	1,002	1,073	1,062	1,062
- Depreciation	819	908	1,041	1,097	1,153
+ Other income	290	287	350	575	750
- Tax	2,104	2,723	3,352	4,157	5,068
Effective tax rate (%)	21.6	23.1	23.1	23.5	24.0
+ Associates/(Minorities)	595	694	703	813	941
Adjusted PAT	7,644	9,048	11,183	13,506	16,027
+ Extraordinary items	-46	23	-	-	-
Reported PAT	7,598	9,071	11,183	13,506	16,027
Adj. FDEPS (₹/share)	22.5	26.6	32.9	39.7	47.1
Adj. FDEPS growth (%)	12.9	18.4	23.6	20.8	18.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	340	340	340	340	340
Reserves & surplus	37,414	42,767	50,962	60,884	72,530
Net worth	37,754	43,107	51,302	61,224	72,871
Total debt	24,022	22,002	21,795	21,879	21,981
Minority interest	2,251	1,620	2,324	3,137	4,077
Def. tax liab. (net)	-203	-312	-25	-25	-25
Capital employed	**63,824**	**66,417**	**75,396**	**86,215**	**98,904**
Net fixed assets	17,360	4,910	6,123	8,525	10,872
Intangible assets	35,525	52,846	52,846	52,846	52,846
Investments	1,363	1,857	1,857	1,857	1,857
- of which, Liquid	-	-	-	-	-
Working capital	2,529	-2,138	-1,208	-2,850	-5,134
Cash	7,048	8,942	15,779	25,837	38,463
Capital deployed	**63,824**	**66,417**	**75,396**	**86,215**	**98,904**
WC days	12	-9	-5	-10	-15
Book value (₹/sh)	111	127	151	180	214

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	7,644	9,047	11,183	13,506	16,027
+ Non-cash items	819	908	1,041	1,097	1,153
Cash profit	8,462	9,955	12,224	14,604	17,180
- Incr./(decr.) in WC	-2,335	-4,667	930	-1,642	-2,284
Operating cash-flow	10,798	14,623	11,294	16,246	19,464
- Capex	7,334	5,779	2,254	3,500	3,500
Free-cash-flow	3,464	8,843	9,040	12,746	15,964
- Dividend	2,091	2,240	2,987	3,584	4,381
+ Equity raised	-728	-2,109	703	813	941
+ Debt raised	-877	-2,130	81	84	102
- Investments	1,363	494	-	-	-
- Misc. items	-46	23	-	-	-
Net cash-flow	-1,640	1,894	6,837	10,058	12,626
+ Op. cash & bank bal.	8,688	7,048	8,942	15,779	25,837
Cl. cash & bank bal.	7,048	8,942	15,779	25,837	38,463

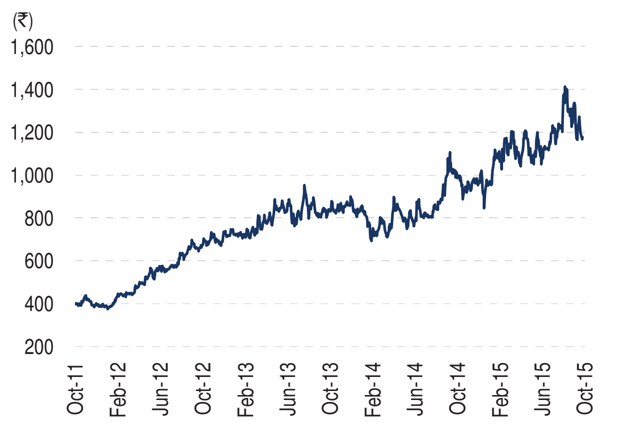
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹1,207

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	53.8	45.4	36.8	30.4	25.6
Cash P/E (x)	48.6	41.3	33.6	28.1	23.9
EV/EBITDA (x)	36.0	31.1	25.3	20.9	17.3
EV/sales (x)	5.6	5.1	4.4	3.7	3.1
P/B (x)	10.9	9.5	8.0	6.7	5.6
RoE (%)	21.6	22.4	23.7	24.0	23.9
RoCE (%)	18.7	20.7	23.0	24.2	25.0
Dividend yield (%)	0.4	0.5	0.6	0.7	0.9
Dividend payout (%)	23.5	20.6	22.8	22.7	23.4
Net debt/equity (x)	0.4	0.3	0.1	-0.1	-0.2
Debtor (days)	34	35	34	31	29
Inventory (days)	52	47	46	45	45
Payables (days)	92	108	101	103	106
Fixed asset T/O (x)	1.4	1.4	1.6	1.8	2.0
Oth Income/PBT (%)	2.8	2.3	2.3	3.1	3.4

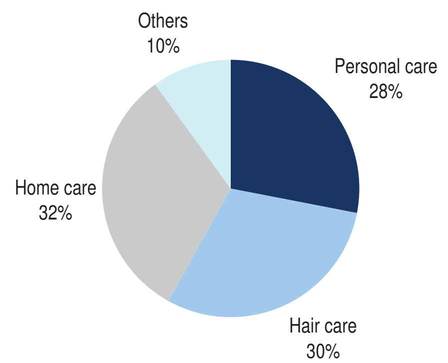
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Consolidated revenue break-up (FY15)



Source: Company

Emerging Indian consumer MNC

In the last few years, Godrej Consumer Products has evolved into a multinational consumer company with operations in four continents and more than 60 countries. Under its 3x3 strategy, it plans to focus on three emerging markets (Asia, Africa and Latin America) in three major categories (homecare, hair-care and personal-wash). Today, its international operations generate 47% of its revenue, and it has a strong position in its key regional markets. In fact, here it is a market leader in many categories: (a) air-fresheners and wet wipes in Indonesia, (b) hair colour and extensions in many African nations and (c) hair colour in many LATAM countries. Besides, it is No.2 in (a) home insecticides in Indonesia and (2) medicated soaps in Nigeria.

Fig 7 – Global footprint: four continents, three major categories

	India	Indonesia	Africa	LATAM	United Kingdom
Hair care	No.1 in hair colour		No.1 in hair extensions and ethnic hair colour in sub-Saharan Africa	No.1 in hair colour in Argentina, Uruguay, Paraguay, Bolivia	
			No.3 in hair colour in South Africa	No.2 in hair colour & hair extensions in Chile	
Personal care	No. 2 in soaps			No.2 in colour cosmetics in Chile	No.4 in feminine deodorants
Household insecticides	No.1 in home insecticides	No.2 in home insecticides			
Others	No.1 in liquid detergents	No.1 in air fresheners			No.1 in anti-stretch marks
		No.2 in wet tissues			No.2 in sanitisers
Contribution (%)	53	20	14	7	6

Source: Company, Anand Rathi Research

International growth not at expense of India business

Its rise as a global emerging-market operator though, hasn't come at the expense of its domestic market. In fact it has gained market share in most of its segments domestically such as a gain of 150-200bps in household insecticides and hair colour in the last 12-18 months. The gain has further strengthened its leading position in both segments. These gains have been primarily driven by its thrust into innovation through its (a) Good Knight Fast Card, (b) Good Knight Low-Smoke coil and (c) Expert Rich Crème hair colour. It has maintained its No.2 position in soaps in India, aided by its premiumisation focus in the segment. In fact, its new Cinthol soap range and Godrej No.1 soap have beaten market growth in recent quarters.

Despite its international business burgeoning, yet in its India business it has gained a market share of 150-200bps in household insecticides and hair colour in the last 12-18 months

Fig 8 – Strong market position and rising share reflect domestic strength

Segment	Key Brands	Domestic revenue share, %	Market share (%) FY10	Market share (%) FY15	Market position	Expected growth rate - FY15-18, %
Household insecticides	Good Knight, Hit, Jet	48	33	50	1	15.2
Soaps	Godrej No 1 & Cinthol	33	10	10	2	13.6
Hair colour	Godrej Expert, Nupur, Renew	13	34	28	1	14.7
Others *	Aer, Ezee	6	-	-	1	15.0

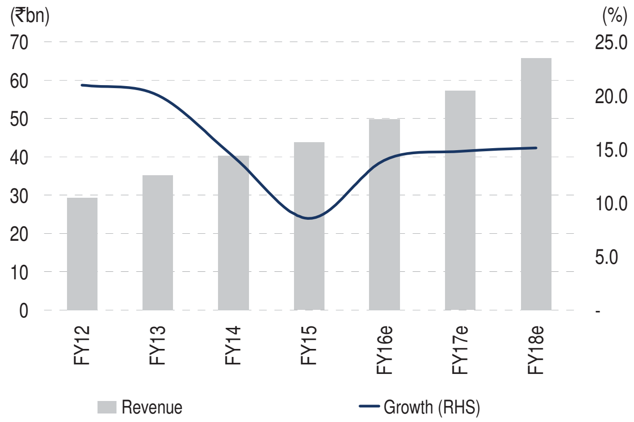
Source: Company, Anand Rathi Research **Ezee is No. 1 in liquid detergent*

Re-invigorating its India business

With revenue growth decelerating to 11% over FY13-15 (21% over FY11-13), its domestic business (53% of revenue) has been hit by the general market slowdown. The slowdown notwithstanding, we expect it to regain its revenue momentum in coming months, driven by a host of measures such as (a) focused distribution, (b) innovations and (c) enhanced sales & marketing measures. Thus, we expect domestic revenue to grow 15% in the next three years.

Domestic growth to rebound at a 15% CAGR over FY15-18, vs. 11% in FY13-15

Fig 9 – Revenue growth to rebound at a ~15% CAGR (FY15-18), from 9% in FY15



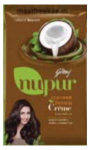
Source: Company, Anand Rathi Research

Innovation

GCPL has been a consistent innovator, with many firsts to its name: a paper format mosquito repellent under Good Knight Fast Card, crème colours in sachets under Expert Rich Crème hair colour, to name a few. In fact, almost 40% of its incremental growth comes from new product launches. It plans to accelerate its innovation pipeline, ramping up internal capabilities, investing in R&D, and cross-geographical sharing of technology and products. Some of the segments such as outdoor mosquito repellents, niche hair care and health-positioned personal-care are key themes the company has been working on.

Almost 40% of incremental revenue growth arises from new product launches

Fig 10 – Innovation fast gaining scale and contributing to growth

Segment	New brands launched in last few years			Comments
Household insecticides	 GoodKnight low-smoke coils	 GoodKnight Active	 GoodKnight Fast Card	Fast Card is a ₹1bn brand
Soaps	 Godrej No.1 variants	 Cinthol Alive	 Cinthol Confidence	-
Hair care	 Expert rich crème sachets	 Nupur Coconut Heena crème colour	 B:Blunt range	Expert rich crème hair colour is a ₹2bn brand
Others *	 Aer	 Protekt Handwash	 Godrej Dishwash	Aer nears ₹1bn in brand size

Source: Company, Anand Rathi Research

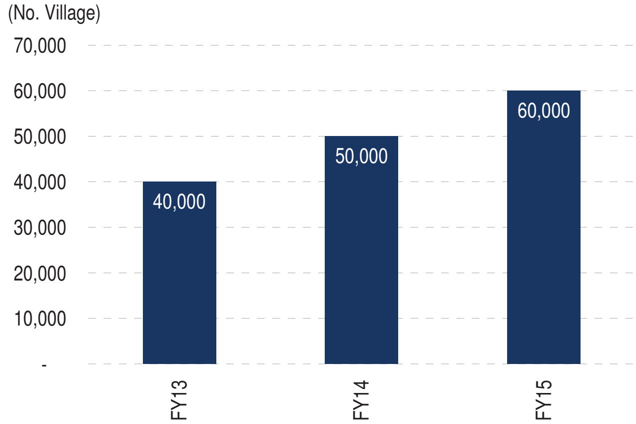
Distribution initiatives

One Rural

The company has created a separate team to spearhead its rural marketing efforts under its 'One Rural' initiative. Through this, it plans to leverage cross-functional efforts from sales, marketing and the media. The programme would help it fine-tune its rural marketing and distribution efforts and hasten decision-making. For instance, media investment in rural markets and the returns would be analysed for future investment decisions. Further, it plans to increase the number of villages covered, from 60,000 now. The project 'One Rural' is already being piloted in select villages in north and central India.

Distribution measures such as (a) One Rural, (b) project e-cube, (c) sales split and (d) digital marketing are likely to aid in recovery of its growth momentum

Fig 11 – GCPL's improving rural reach

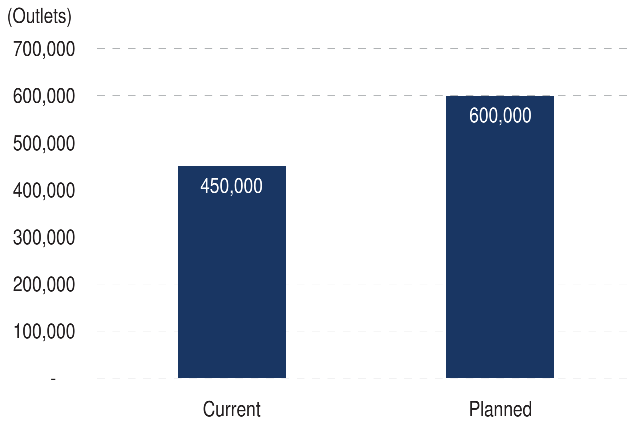


Source: Company, Anand Rathi Research

Project e-cube

Project e-cube is more an urban-focused initiative. While it envisages distribution expansion in urban markets, the major thrust would be on improving efficiencies (higher throughput per store). Under this programme, management plans to increase its direct coverage from 450,000 outlets to 600,000.

Fig 12 – GCPL plans to increase its direct reach in urban markets by 30%

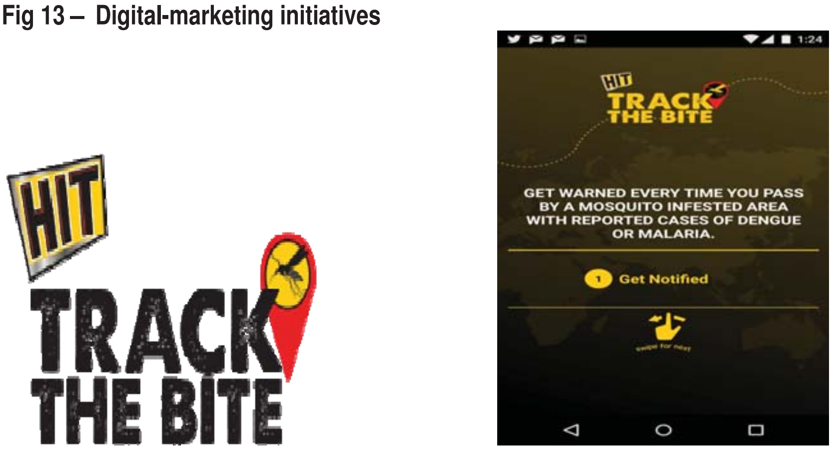


Source: Company, Anand Rathi Research

Sales split and digital marketing

GCPL plans to split its sales functions, with two salespersons servicing one outlet in urban areas. This would help improve throughput in its urban market. The model has already been tried by Hindustan Unilever and Britannia. Further, it plans to improve its digital marketing and has started exploring platforms, and developing digital content. One such effort has been the 'Hit - track the bites' app.

Fig 13 – Digital-marketing initiatives



Source: Company, Anand Rathi Research

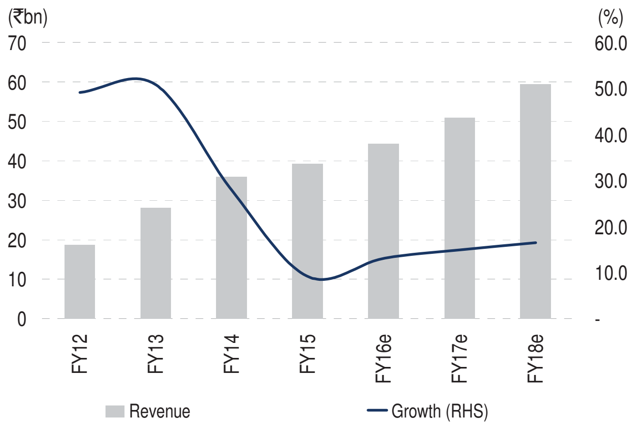
Burgeoning international business

International business at ~35% CAGR (FY11-15), aided by acquisitions

Africa's share in international business increased from 23% in FY12 to 30% in FY15, led by the acquisition of the Darling group

The company's international business in FY15 grew to 47% of revenue (from 34% in FY11). A large part of this increase was driven by inorganic growth: the Darling group in Africa was acquired in 2011, the Cosmetica Nacional of Chile in 2012. This burgeoning business prompted management to organise it into clusters: Africa, Latin America and Europe, and the Rest of Asia. This would lead to greater regional focus and agility, and enable cross-pollination of brands/ technology across areas.

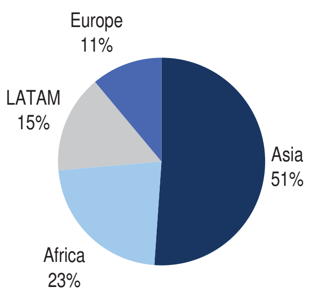
Fig 14 – International business driven by inorganic growth opportunities



Source: Company, Anand Rathi Research

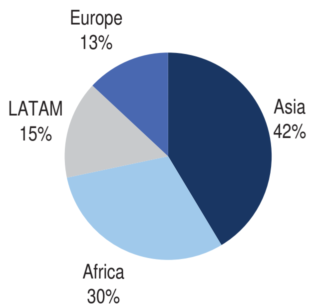
Fig 15 – Africa's share in the international business has risen due to the gradual acquisition of the Darling group

FY12



Source: Company, Anand Rathi Research

FY15



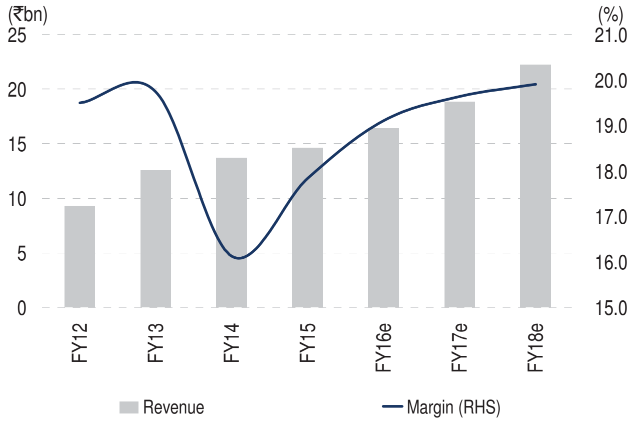
Source: Company, Anand Rathi Research

Rest of Asia (41% of the international business)

Megasari, acquired in 2010, constitutes most of the RoA cluster. It primarily deals in household insecticides (the Hit brand), air care (Stella) and baby wipes (Mitu) in Indonesia, which complement GCPL's domestic portfolio. In fact, the company is the market leader in air care and baby care while being a challenger (No.2) in household insecticides. Also, the paper-format mosquito repellent was first introduced in Indonesia and later in India. Growth in Megasari would be driven by the three-pronged strategy (distribution expansion, market-share gains, innovations).

The burgeoning international business has led management to organise it into three clusters: Africa, Latin America and Europe, and the Rest of Asia. This would lead to greater regional focus and agility and enable cross-pollination of brands/ technology across clusters

Fig 16 – Better margin due to price hikes in Indonesia

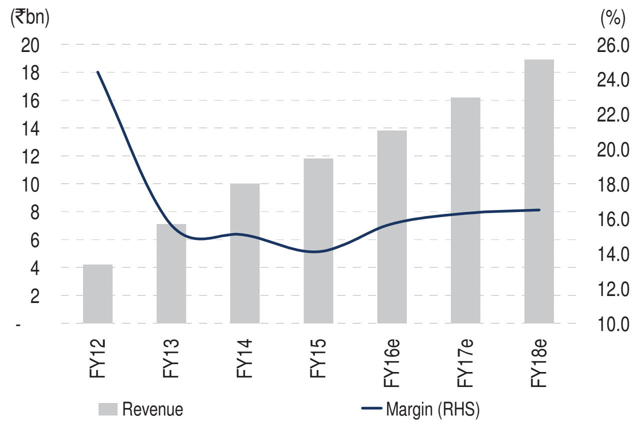


Source: Company, Anand Rathi Research

Africa (30% of international)

On acquiring Rapidol, GCPL made a foray into Africa in 2006. However, the Darling group acquisition was key to greater access to the African market. Hair-care products (hair colour, artificial hair, hair extensions) constitute most of the company's products in Africa. However, it has rolled out household insecticides in select markets such as Nigeria. Further, expansion into other hair-care ranges such as hair straighteners, relaxers (with market potential of $1bn) are on the company's radar to grow its Africa business. We are optimistic of growth in Africa and project a 17% revenue CAGR over FY15-18, with greater profitability helped by the cost-saving measures.

Fig 17 – African revenue driven by the Darling group amalgamation



Source: Company, Anand Rathi Research

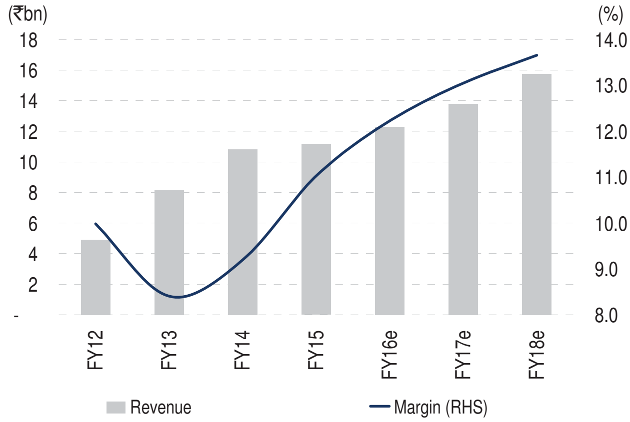
LATAM and Europe (28% of the international business)

On acquiring the Issue Group of Argentina, GCPL entered the Latin American market. Later it acquired Argencos and Cosmetica Nacional of Chile. The business outlook in LATAM has improved since GCPL manufactures products in these markets (competitors import products; hence, are faced with sharp currency devaluation issues, increasing product costs). Thus, GCPL has been gaining share in many of the regional markets of LATAM.

GCPL's Europe business is primarily UK-based and constitutes 13% of its international revenue. In 2013, it acquired Soft & Gentle to further improve its product offerings in the UK market. It also markets certain brands for third parties in the UK. Being a developed economy, growth in this business has been subdued compared with other areas.

For LATAM and the Europe cluster, we project a lower, 12%, revenue CAGR (31% over FY12-15, through inorganic growth), driven primarily by market-share gains in LATAM.

Fig 18 – LATAM, Europe to register a 12% CAGR, affected by currency volatility



Source: Company, Anand Rathi Research

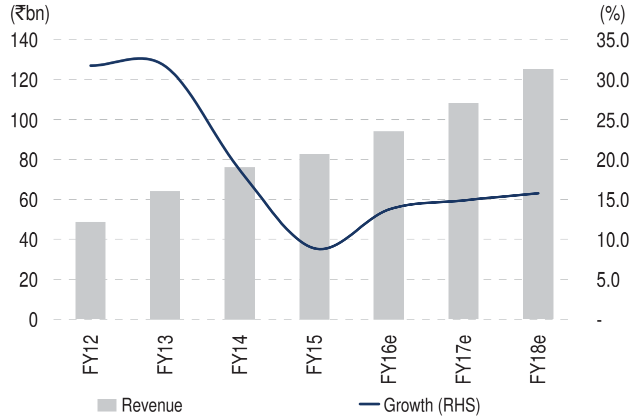
Financials

Consolidated revenue at a 15% CAGR over FY15-18

Domestic revenue is expected to register a 15% CAGR, helped by better-than-market growth in key brands, an improved mix and innovations. Also, we expect international revenue to record a 15% CAGR, driven by 17% growth in Africa and 15% in Indonesia.

Expect a steady 15% revenue CAGR over FY15-18 for the consolidated entity

Fig 19 – Consolidated revenue growth to be aided by revival in domestic operations

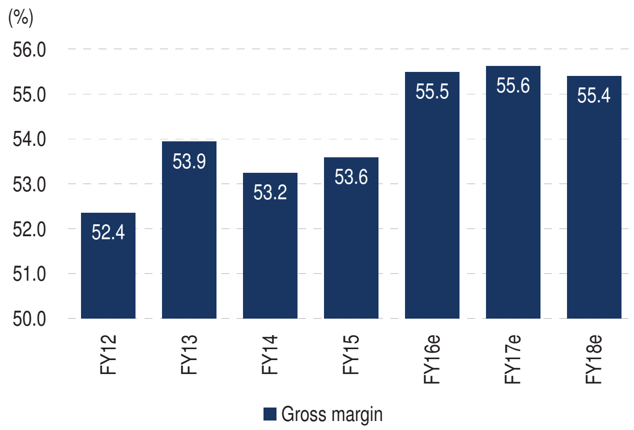


Source: Company, Anand Rathi Research

Benign input costs, better mix domestically to drive gross-margin gain

GCPL's key costs (for palm oil and packaging) are directly or indirectly linked to crude oil, which has slid by nearly half from a year ago. This, along with the consistent improvement in the mix in its domestic business with the launch of premium products such as new Cinthol soap, Expert Rich Crème hair colour, has helped expand the gross margin. We expect both the above tailwinds to persist in the medium term and expect a gross-margin gain of 180bps over FY15-18.

Fig 20 – Benign input costs to aid gross-margin expansion



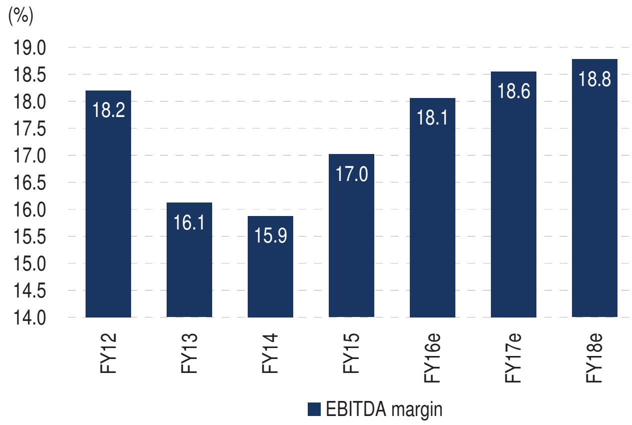
Source: Company, Anand Rathi Research

Cost-saving measures to drive margin gain

Cost-saving measures (through 'Project Pi' domestically and 'Project Iceberg' for LATAM) have helped expand margins. In fact, these measures helped the LATAM operations' EBITDA margin almost double to ~13% in FY15 (from ~7% in FY13). Also, management estimates ₹2.5bn in savings domestically from 'Project Pi' in FY16 by changing product formulations and packaging, measures to improve yields, sourcing and procurement benefits, lower inventories and optimising marketing spends.

Cost-saving measures (Projects Pi and Iceberg) would help margin expansion. Management expects to save ₹2.5bn from Project Pi domestically

Fig 21 – EBITDA margin to expand 180bps over FY15-18

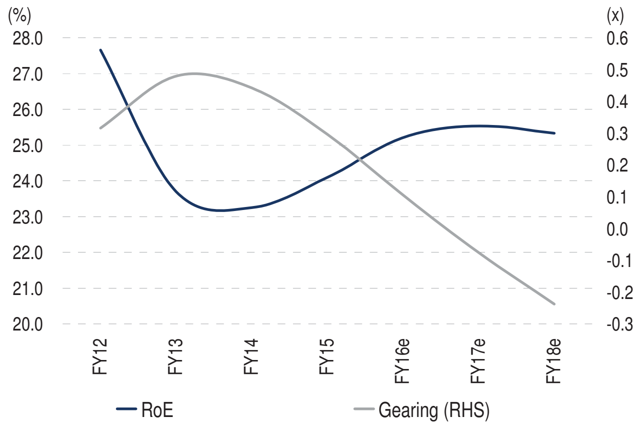


Source: Company, Anand Rathi Research

Better return ratios; gearing well within comfort zone

The better margin augurs well for the company's return ratios. We expect the RoE to climb to 25% in FY17 (from FY14's 22%). Higher goodwill on the balance sheet (due to the series of acquisitions) has contained the return ratios. However, the debt position is comfortable, reduced from ₹24.5bn in FY13 to ₹21.7bn in FY15, implying a debt-to-equity ratio of 0.3x (down from 0.5x in FY13).

Fig 22 – Comfortable debt-to-equity; return ratios to improve



Source: Company, Anand Rathi Research

Fig 23 – Income statement (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	76,024	82,764	94,145	108,132	125,172
Other op revenues	173	433	493	566	655
Revenues	**76,198**	**83,197**	**94,638**	**108,698**	**125,828**
Growth (%)	*18.8*	*9.2*	*13.8*	*14.9*	*15.8*
Material cost	-35,547	-38,415	-41,908	-47,980	-55,826
Employee cost	-7,489	-7,770	-8,944	-10,273	-11,891
Manufacturing cost	-1,958	-2,982	-3,389	-3,893	-4,444
Marketing cost	-14,858	-15,978	-18,641	-21,032	-23,971
Administrative cost	-2,127	-1,514	-1,977	-2,271	-2,503
Energy cost	-1,032	-1,099	-1,318	-1,514	-1,752
Other cost	-1,117	-1,353	-1,459	-1,676	-1,940
EBITDA	**12,070**	**14,087**	**17,003**	**20,060**	**23,501**
Growth (%)	*16.9*	*16.7*	*20.7*	*18.0*	*17.1*
EBITDA margin (%)	*15.8*	*16.9*	*18.0*	*18.5*	*18.7*
Other income	290	287	350	575	750
Operating profit	**12,360**	**14,373**	**17,353**	**20,635**	**24,251**
Depreciation	-819	-908	-1,041	-1,097	-1,153
EBIT	**11,542**	**13,465**	**16,311**	**19,538**	**23,098**
Interest cost	-1,199	-1,002	-1,073	-1,062	-1,062
PBT	**10,343**	**12,464**	**15,238**	**18,477**	**22,036**
Tax	-2,104	-2,723	-3,352	-4,157	-5,068
Effective tax rate	*20.3*	*21.8*	*22.0*	*22.5*	*23.0*
PAT	**8,239**	**9,741**	**11,886**	**14,319**	**16,968**
Minority interest	-595	-694	-703	-813	-941
Consol PAT	**7,644**	**9,048**	**11,183**	**13,506**	**16,027**
Growth (%)	*12.9*	*18.4*	*23.6*	*20.8*	*18.7*
PAT margin (%)	*10.0*	*10.9*	*11.8*	*12.4*	*12.7*
Extra-ordinary income	-46	23	-	-	-
Dividends (incl Tax)	-2,091	-2,240	-2,987	-3,584	-4,381
Transferred to reserves	**5,508**	**6,831**	**8,196**	**9,922**	**11,646**
Per share data					
FDEPS (₹)	22.5	26.6	32.9	39.7	47.1
DPS (₹)	5.2	5.5	7.5	9.0	11.0
Adj BV (₹)	117.5	131.4	157.5	189.1	226.1
CEPS (₹)	24.9	29.2	35.9	42.9	50.5
Valuation ratio					
P/E (x)	53.8	45.4	36.8	30.4	25.6
P/adj BV (x)	10.3	9.2	7.7	6.4	5.3
P/C (x)	48.6	41.3	33.6	28.1	23.9
Dividend yield (%)	0.4	0.5	0.6	0.7	0.9
EV/S (x)	5.6	5.1	4.4	3.7	3.1
EV/E (x)	35.4	30.1	24.5	20.3	16.8
Quality ratio					
Dividend payout (%)	27.4	24.8	26.7	26.5	27.3
Other income/PBT (%)	2.8	2.3	2.3	3.1	3.4
Interest cover (x)	9.6	13.4	15.2	18.4	21.8
Operating CF/EBITDA (x)	0.9	1.0	0.7	0.8	0.8

Source: Company, Anand Rathi Research

Fig 24 – Balance Sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Equity	340	340	340	340	340
Reserves	37,414	42,767	50,962	60,884	72,530
Minority interests	2,251	1,620	2,324	3,137	4,077
Networth	**40,005**	**44,727**	**53,626**	**64,361**	**76,948**
Equity (% of CE)	*62.7*	*67.3*	*71.1*	*74.7*	*77.8*
LT debt	23,728	21,697	21,230	21,230	21,230
ST debt	294	305	565	649	751
DTL (net)	-203	-312	-25	-25	-25
Total debt	**23,819**	**21,689**	**21,770**	**21,854**	**21,956**
Net D/E (x)	*0.4*	*0.3*	*0.1*	*-0.1*	*-0.2*
Capital employed	**63,824**	**66,417**	**75,396**	**86,215**	**98,904**
Gross block	58,035	63,331	66,831	70,331	73,831
Acc depreciation	-6,821	-7,821	-8,863	-9,960	-11,113
Net block	**51,214**	**55,510**	**57,968**	**60,371**	**62,718**
CWIP	1,671	2,246	1,000	1,000	1,000
Fixed assets	**52,884**	**57,756**	**58,968**	**61,371**	**63,718**
Investments	1,363	1,857	1,857	1,857	1,857
Cash equivalents	7,048	8,942	15,779	25,837	38,463
Inventories	10,821	10,717	11,821	13,545	15,561
Debtors	7,113	8,046	8,860	9,338	9,978
Loans & advances	2,181	1,677	1,977	2,325	2,754
Other current assets	1,588	2,082	2,354	2,703	3,129
Current assets	**28,751**	**31,464**	**40,791**	**53,748**	**69,885**
Creditors	-18,615	-23,683	-25,254	-29,609	-35,197
Provisions	-559	-977	-965	-1,151	-1,359
Current liabilities	**-19,174**	**-24,659**	**-26,219**	**-30,760**	**-36,555**
Net current assets	**9,577**	**6,804**	**14,571**	**22,987**	**33,330**
Capital deployed	**63,824**	**66,417**	**75,396**	**86,215**	**98,904**
FA/CE (%)	*82.9*	*87.0*	*78.2*	*71.2*	*64.4*
Investments/CE (%)	*2.1*	*2.8*	*2.5*	*2.2*	*1.9*
Liquid assets/CE (%)	*11.0*	*13.5*	*20.9*	*30.0*	*38.9*
Working capital/CE (%)	*4.0*	*-3.2*	*-1.6*	*-3.3*	*-5.2*

Source: Company, Anand Rathi Research

Fig 25 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Cash profit	8,462	9,955	12,224	14,604	17,180
Chg in WC	2,335	4,667	-930	1,642	2,284
Operating CF	**10,798**	**14,623**	**11,294**	**16,246**	**19,464**
Capex	-7,334	-5,779	-2,254	-3,500	-3,500
Free CF	**3,464**	**8,843**	**9,040**	**12,746**	**15,964**
Equity	-728	-2,109	703	813	941
Debt	-877	-2,130	81	84	102
Investments	-1,363	-494	-	-	-
Dividends	-2,091	-2,240	-2,987	-3,584	-4,381
Misc inflows	-46	23	-	-	-
Net change in cash	**-1,640**	**1,894**	**6,837**	**10,058**	**12,626**
Opening cash	8,688	7,048	8,942	15,779	25,837
Closing cash	**7,048**	**8,942**	**15,779**	**25,837**	**38,463**

Source: Company, Anand Rathi Research

Fig 26 – Ratio analysis @ ₹1,207

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Dupont Analysis					
Margins (%)	15.1	16.2	17.2	18.0	18.4
Capital turn (x)	1.2	1.3	1.3	1.3	1.4
RoCE (%)	18.7	20.7	23.0	24.2	25.0
Leverage factor(x)	1.7	1.6	1.5	1.4	1.4
Interest burden (x)	0.9	0.9	0.9	0.9	1.0
Tax burden (x)	0.8	0.8	0.8	0.8	0.8
Consol factor (x)	0.9	0.9	0.9	0.9	0.9
RoE (%)	21.6	22.4	23.7	24.0	23.9
Working capital (days)					
Inventories	52	47	46	45	45
Debtors	34	35	34	31	29
Loans & advances	10	7	8	8	8
Other CA	8	9	9	9	9
Creditors	-89	-104	-97	-99	-102
Provisions	-3	-4	-4	-4	-4
Net WC	12	-9	-5	-10	-15
Other ratios					
Op CF/Rev (%)	14.2	17.6	11.9	14.9	15.5
FCF/Rev (%)	4.5	10.6	9.6	11.7	12.7
Intangibles/GB (%)	61.2	83.4	79.1	75.1	71.6
Intangibles/CE (%)	55.7	79.6	70.1	61.3	53.4
Revenue/GB (x)	1.3	1.3	1.4	1.5	1.7
Revenue/FA (x)	1.4	1.4	1.6	1.8	2.0
CWIP/GB (x)	0.0	0.0	0.0	0.0	0.0

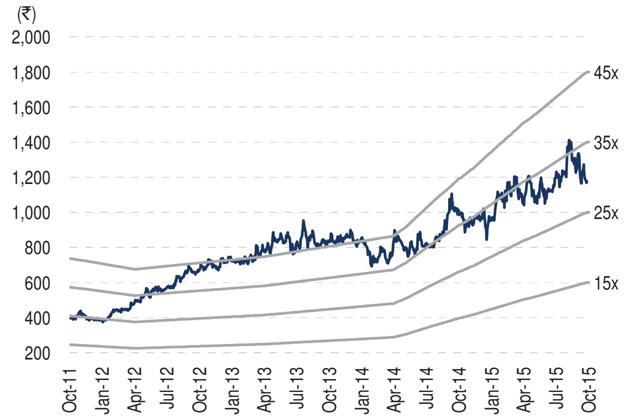
Source: Company, Anand Rathi Research

Valuations

An emerging market play

A strong new-product pipeline and brand investment will continue to drive above-industry growth. Further, the benign input costs and cost-efficiency efforts would drive a 21% earnings CAGR over FY15-18. We initiate coverage on Godrej Consumer Products with a Buy recommendation and a target price of ₹1,450 (based on 33x Sep'17e). At the ruling market price of ₹1,207, the stock trades at 37x FY16e EPS of ₹32.9 and 30x FY17e EPS of ₹39.7.

Fig 27 – PE band chart



Source: Bloomberg, Anand Rathi Research

Key Risks

- Sharp rises in prices of the key input (palm oil) and in packaging cost.
- Stiff competition in key categories and/or failure to scale up its new product launches.

Company Background & Management

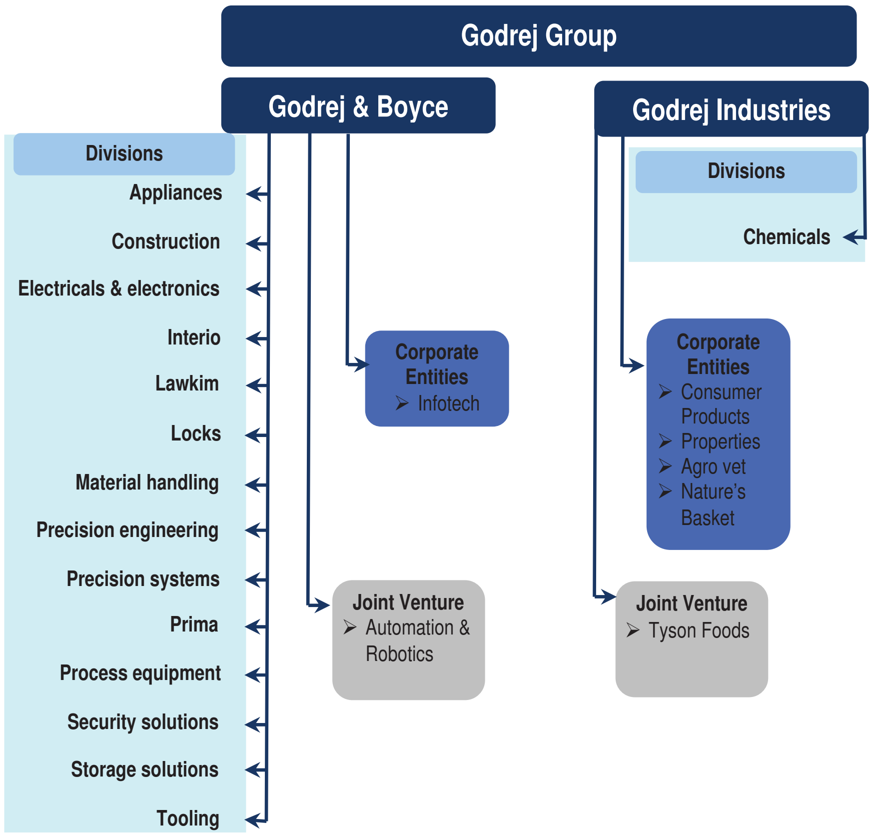
Godrej Consumer Products is part of the Godrej Group, which has interests in chemicals, consumer goods, real estate and agribusiness. The group's annual turnover was over $4bn

A part of the Godrej Group with interests in chemicals, consumer goods real estate and agribusiness and an annual turnover of over $4bn, Godrej Consumer Products is an Indian consumer major with strong global operations in the emerging markets of Asia, Africa and Latin America. It leads in household insecticides and hair-colour among Indian FMCG firms. Also, it is No. 2 in the India soaps market. Its major soap brands are Godrej No.1, Cinthol and FairGlow; its major hair-care brands are Renew, Coloursoft, Godrej Expert Rich Crème hair colour, Godrej Hair Dye (liquid and powder), Godrej Kesh Kala oil and Nupur Mehendi.

In 2012, it completed the acquisition of a 51% stake in Godrej Sara Lee, thus gaining several leading household insecticide brands such as GoodKnight, JET, HIT. It also acquired a 30% stake in the premium B:Blunt salon services and products.

To expand its geographical operations, it has made a slew of acquisitions in the past few years. These include (a) Megasari (2010), an Indonesian leader in household insecticides, air fresheners and baby care, (b) Rapidol (2006), Kinky (2008) and Frika hair (2015) in South Africa, Tura (2010) in Nigeria and the Darling group (2011) in the larger sub-Saharan Africa, (c) Issue (2010), Argencos (2012) in Argentina and Cosmetica Nacional (2012) in Chile for the larger LATAM market access and (d) Keyline brands (2005) and Soft & Gentle (2013) in the UK.

Fig 28 – Godrej group structure



Source: Company

Management

Promoter-Chairman Adi Godrej is chairman of the Godrej Group and several entities that are part of one of India's leading conglomerates. These are Indian companies like Godrej Industries, Godrej Consumer Products and Godrej Properties, as well as international companies such as Godrej UK, Godrej South Africa and Godrej Argentina.

As a director of numerous firms, including Godrej & Boyce, Godrej Agrovet, Godrej International and Godrej Global MidEast FZE, Adi Godrej is responsible for shaping the long-term strategy of these organisations and driving the focus on value creation.

Adi Godrej holds Bachelor's and Master's degrees in management from the Massachusetts Institute of Technology.

Managing director Vivek Gambhir joined Godrej Industries in 2009 as chief strategy officer, responsible for enhancing strategic capabilities within group companies, guiding overall group strategy, conducting portfolio analyses, leading mergers and acquisitions, and driving special projects.

Prior to joining, he was a partner at Bain & Company, one of the world's leading business-consulting firms, in Boston, Singapore and New Delhi. He was a founding member of Bain's consulting operations in India and led the firm's FMCG practice in India.

Vivek Gambhir has an MBA from the Harvard Business School and a BS (in computer science) and a BA (in economics) from Lafayette College.

19 October 2015

Bajaj Corp

Well-oiled; initiating coverage, with a Buy

Rating: **Buy**
Target Price: ₹600
Share Price: ₹414

We initiate coverage on Bajaj Corp, with a Buy recommendation and a price target of ₹600, implying 45% potential from the current price. The company has firmly established itself as the leader in the light hair-oil sub-segment, benefiting from both up-trading and the consumer tilt towards the aspiration segment. Strong pricing power, a wide distribution network and one of the best margins in the sector provide the company with the ideal platform to expand to other segments. We expect an 18% earnings CAGR over FY15-18 led by 16% revenue CAGR.

A star performer in hair oils. Bajaj Almond hair oil has grown into the second-largest-selling hair-oil brand in the country, with a 10.3% market share. In the light-hair-oil segment, the company gained 10ppt market share (to 60%) in the past five years, strengthening its dominance in the category.

Enjoys strong pricing power and one of the best margins. The company has regularly hiked prices 7-8%, even in a weak macro-environment, reflecting its strong pricing power. This pricing power has boosted its margin, pegging it as one of the most profitable FMCG companies (with a 29% EBITDA margin in FY15).

Gradually diversifying its portfolio. It acquired the 'Nomarks' cream and soaps brand in FY13. The brand has been pushed, with sales rising from ₹270m in FY13 to ₹580m in FY15, aided by distribution leverage and brand spends. The company plans to position Nomarks as a personal-care brand (from a problem-solution positioning). Similarly, the scaling-up of the mass Bajaj Amla hair oil and Kailaash Parbhat oil would lower the company's dependence on almond oil.

Valuation. Bajaj's consistent and ahead-of-market performance should help to a re-rate. Thus, the valuation discounts to its peers, of 30-35%, should narrow in coming quarters. **Risks:** A prolonged slowdown in hair oil and a sharp rise in competition in the core light-hair-oil sub-segment.

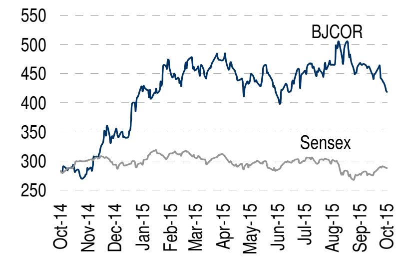
Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	6,717	8,256	9,564	11,058	12,787
Net profit (₹ m)	1,775	2,196	2,639	3,081	3,586
EPS (₹)	12.0	14.9	17.9	20.9	24.3
Growth (%)	6.8	23.7	20.1	16.8	16.4
PE (x)	34.4	27.8	23.1	19.8	17.0
PBV (x)	11.8	12.5	12.9	12.3	11.3
RoE (%)	35.4	43.6	54.9	63.7	69.1
RoCE (%)	44.2	52.7	68.0	78.9	85.6
Dividend yield (%)	1.6	2.8	3.3	3.7	4.3
Net gearing (x)	-0.6	-0.7	-0.7	-0.7	-0.8

Source: Company, Anand Rathi Research

Key data	BJCOR IN / BACO.BO
52-week high / low	₹522 / ₹260
Sensex / Nifty	27215 / 8238
3-m average volume	$1.1m
Market cap	₹61bn / $940m
Shares outstanding	148m

Shareholding pattern (%)	Sep '15	Jun '15	Mar '15
Promoters	66.9	66.9	66.9
- of which, Pledged	22.4	22.4	22.4
Free Float	33.1	33.1	33.1
- Foreign Institutions	25.0	23.7	24.5
- Domestic Institutions	1.9	2.3	1.6
- Public	6.2	7.2	7.1

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	6,717	8,256	9,564	11,058	12,787
Revenue growth (%)	10.7	22.9	15.8	15.6	15.6
- Oper. expenses	4,857	5,864	6,594	7,589	8,740
EBIDTA	**1,860**	**2,392**	**2,969**	**3,469**	**4,047**
EBITDA margin (%)	27.7	29.0	31.0	31.4	31.6
- Interest expenses	59	1	1	1	1
- Depreciation	43	49	50	52	55
+ Other income	401	316	350	400	450
- Tax	384	462	630	735	855
Effective tax rate (%)	17.8	17.4	19.3	19.3	19.2
+ Associates/(Minorities)	-	-	-	-	-
Adjusted PAT	1,775	2,196	2,639	3,081	3,586
+ Extraordinary items	-286	-470	-470	-184	-
Reported PAT	1,489	1,727	2,169	2,897	3,586
Adj. FDEPS (`/share)	12.0	14.9	17.9	20.9	24.3
Adj. FDEPS growth (%)	6.8	23.7	20.1	16.8	16.4

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	148	148	148	148	148
Reserves & surplus	5,045	4,738	4,577	4,799	5,279
Net worth	5,192	4,886	4,725	4,947	5,427
Total debt	-	-	-	-	-
Minority interest	-	-	-	-	-
Def. tax liab. (net)	4	5	-	-	-
Capital employed	**5,196**	**4,891**	**4,725**	**4,947**	**5,427**
Net fixed assets	2,366	1,854	1,957	2,054	2,150
Intangible assets	-	-	-	-	-
Investments	1,568	1,837	1,837	1,837	1,837
- of which, Liquid	1,568	1,837	1,837	1,837	1,837
Working capital	-30	-142	-600	-702	-818
Cash	1,292	1,342	1,531	1,758	2,258
Capital deployed	**5,196**	**4,891**	**4,725**	**4,947**	**5,427**
WC days	-2	-6	-23	-23	-23
Book value (₹/sh)	35.2	33.1	32.0	33.5	36.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	1,775	2,196	2,639	3,081	3,586
+ Non-cash items	43	49	50	52	55
Cash profit	1,819	2,245	2,689	3,133	3,641
- Incr./(decr.) in WC	75	-112	-458	-102	-116
Operating cash-flow	1,744	2,357	3,147	3,236	3,757
- Capex	1,188	-463	153	150	150
Free-cash-flow	556	2,820	2,995	3,086	3,607
- Dividend	1,122	2,035	2,330	2,675	3,106
+ Equity raised	-1	2	-0	0	-0
+ Debt raised	-11	2	-5	-	-
- Investments	-264	268	-	-	-
- Misc. items	-286	-470	-470	-184	-
Net cash-flow	-600	50	189	227	501
+ Op. cash & bank bal.	1,892	1,292	1,342	1,531	1,758
Cl. cash & bank bal.	1,292	1,342	1,531	1,758	2,258

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹414

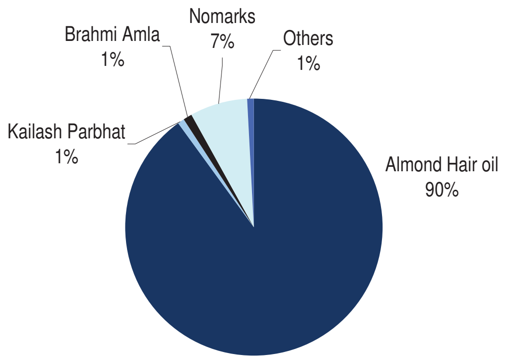
Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	34.4	27.8	23.1	19.8	17.0
Cash P/E (x)	33.6	27.2	22.7	19.5	16.8
EV/EBITDA (x)	31.3	24.2	19.4	16.6	14.1
EV/sales (x)	8.7	7.0	6.0	5.2	4.5
P/B (x)	11.8	12.5	12.9	12.3	11.3
RoE (%)	35.4	43.6	54.9	63.7	69.1
RoCE (%)	44.2	52.7	68.0	78.9	85.6
Dividend yield (%)	1.6	2.8	3.3	3.7	4.3
Dividend payout (%)	63.2	92.7	88.3	86.8	86.6
Net debt/equity (x)	-0.6	-0.7	-0.7	-0.7	-0.8
Debtor (days)	5	6	6	7	7
Inventory (days)	21	17	17	17	17
Payables (days)	32	35	51	52	53
Fixed asset T/O (x)	2.8	4.5	4.9	5.4	5.9
Oth Income/PBT (%)	18.6	11.9	10.7	10.5	10.1

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Revenue break-up (FY15)



Source: Company

Star performer in hair oils

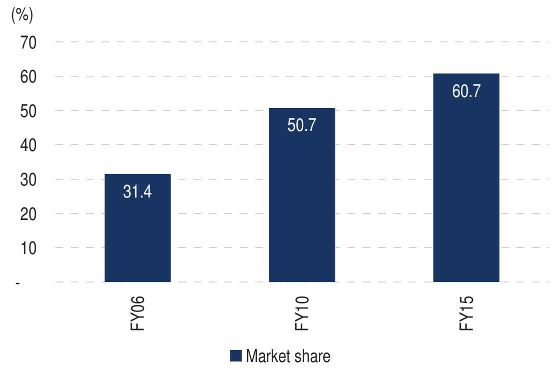
Bajaj Almond hair oil has grown 2.5x in five years

The flagship Bajaj Almond drops hair oil has seen a 22% CAGR in the past five years, ahead of the industry's mere 12%. This was because of market development, product sampling, targeted advertising and distribution expansion. Given its aspirational positioning, the brand benefited from the shift in consumer preference toward light hair oils.

Thus, Bajaj Almond hair oil has strengthened its market leadership in the light-hair-oil category with a more than 60% share, a 10ppt increase in the last five years and ~30ppt in the last 10. This indicates its strong brand equity and wider distribution gains. Management plans to further increase this proportion to more than 65% by FY16.

Flagship brand Bajaj Almond hair oil has grown 2.5x in the last five years, making it the second-largest-selling hair-oil brand. It is fast approaching ₹10bn in retail sales

Fig 7 – Consistent gain in market share in light hair oil



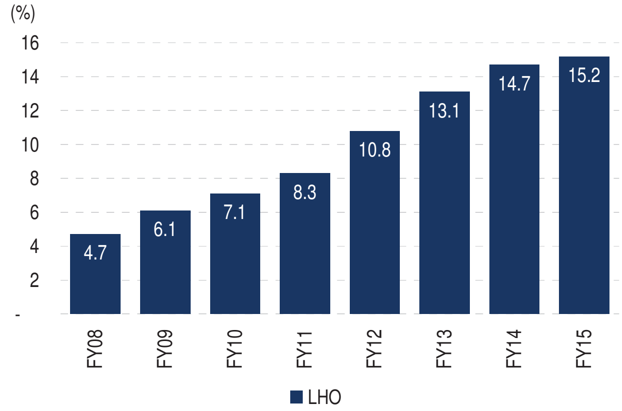
Source: Company

Light hair oil, better placed to weather sector slowing

The broader hair-oil-market-slowdown notwithstanding, the light-hair-oil sub-segment has grown 12% in the last three years (vs. 9% for the overall hair-oil market). The higher growth rate for the light-hair-oil sub-segment could be attributed to (a) youth and aspiration-led positioning of the segment, (b) consumer shift towards light hair oil (from other hair oils), and (c) newcomers directly entering the light-hair-oil category.

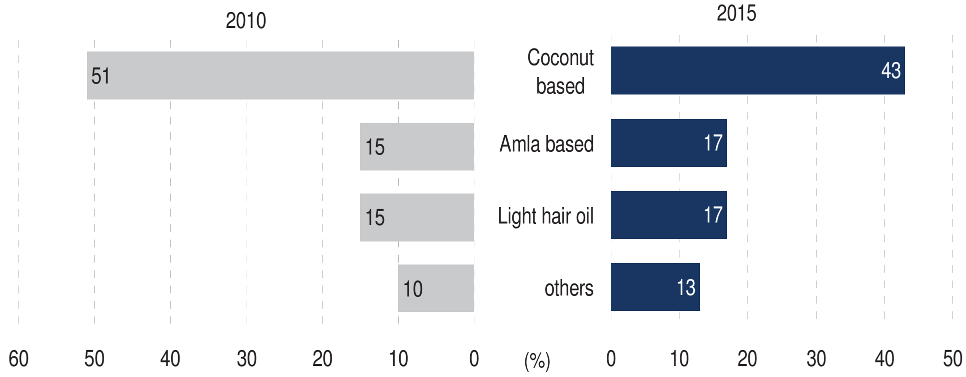
The light-hair-oil sub-segment has grown 4.5x in the last eight years, making it the second-largest hair-oil sub-segment (with a 17% share of hair oils) after the coconut-based-hair-oil sub-segment. Given the consistent shift in consumer preference, we expect the share of light hair oils to continue to rise in the years ahead.

Fig 8 – Light-hair-oil sub-segment registered a 16% CAGR in the last five years



Source: Company

Fig 9 – Shift in consumer preference to light hair oil and other value-added hair oil sub-segments



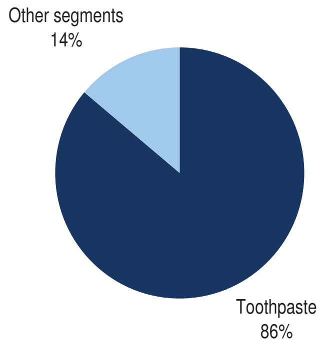
Source: Company

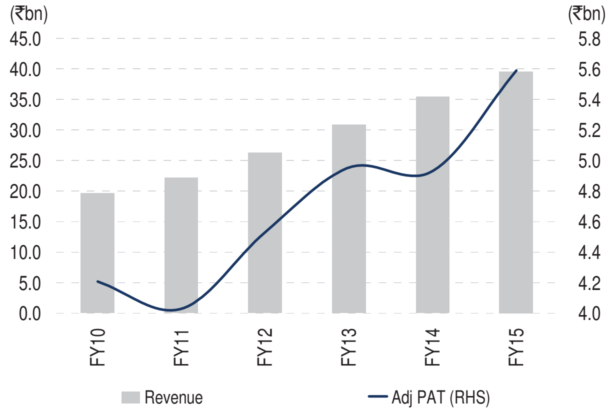
Single-product company drives sharper brand focus

The management's single-minded focus to grow the almond-oil brand has helped its rapid growth, and weather stiff competition in the segment. The company's dependence on the hair-oil sub-segment has been more than 90%, which is unlikely to go down in the near term. However, management has been keen to explore the larger personal-care space under Nomarks and its other brands. Despite this, high profitability and large scale lead us to believe that hair oil would be the company's core in years to come.

Case in point: Despite being a single-product company with over 85% of revenue arising from toothpaste, Colgate's revenue in the last 10 years has seen a robust 15% CAGR (and a 17% CAGR in profit). Similarly with Britannia, which obtains more than 75% of its revenue from biscuits. Its revenue in the last 10 years has seen a 17% CAGR (with an 18% CAGR in profits).

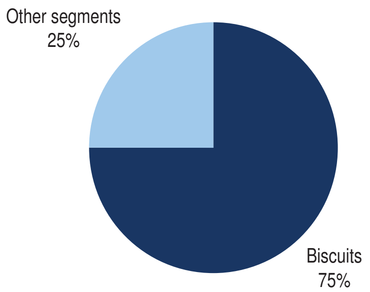
Fig 10 – Colgate's revenue at a 15% CAGR in the last 10 years; earnings at a 17% CAGR

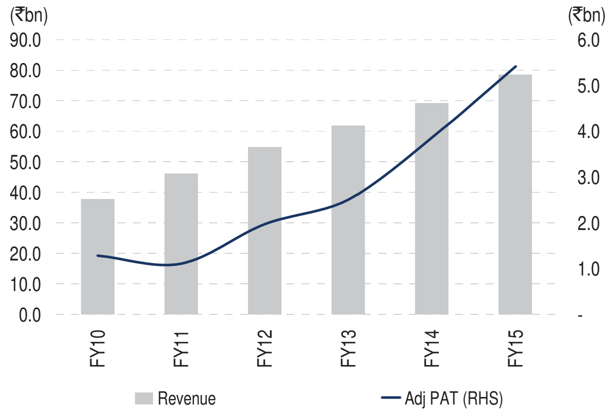




Source: Company

Fig11 – Britannia's revenue at a 17% CAGR in the past 10 years; earnings at an 18% CAGR





Source: Company

Superior pricing power

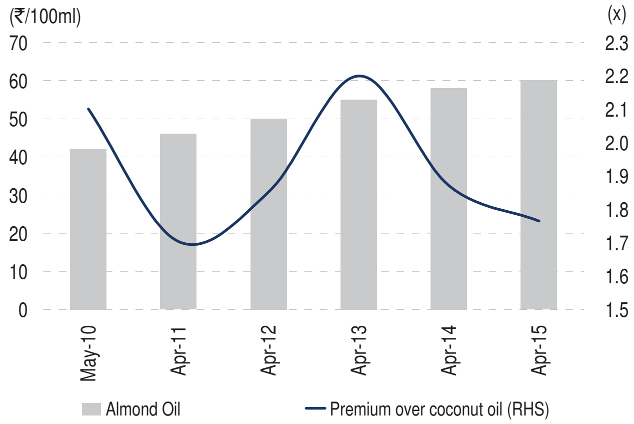
Consistent price increases indicate high pricing power

Every year Bajaj Corp has consistently raised prices of its flagship brand, Bajaj Almond Hair Oil, ~7%. These hikes have not materially affected volume growth or market share, reflecting the company's strong pricing power.

Despite the consistent price increases, the premium to branded coconut oil has narrowed in the last few years because of the sharp rise in copra prices. This has helped the company's volume growth.

Despite the consistent price increase in hair oil, the premium to coconut oil has narrowed, aiding strong volume growth

Fig1 2 – Consistent price increase, yet premium to coconut hair oil is narrowing

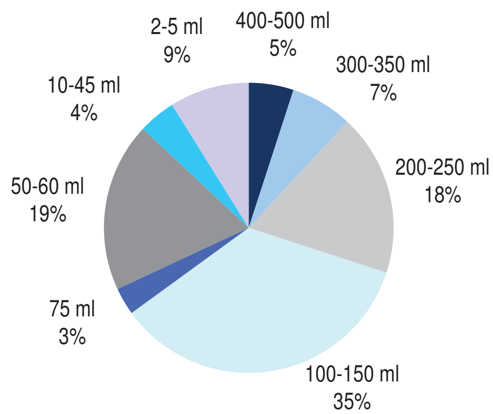


Source: Company, Anand Rathi Research

Favourable SKU mix

Lower-priced SKUs (packets at ₹1 and ₹5) bring just ~10% revenue to the company. While low-price units have gained from the rural-market expansion (price-sensitive and low price spur trials), the company continues to promote its bottle packs with extra grammage, price offs, or gift items such as soaps, toothpastes or pens, etc. These freebies have not only ensured that loyal customers are rewarded but have also lured lower SKU customers to uptrade, maintaining a healthy mix in favour of higher-margin SKUs.

Fig 13 – Less than 45ml SKUs constitute just 13% of almond oil sales



Source: Company

Diversification to play out—gradually

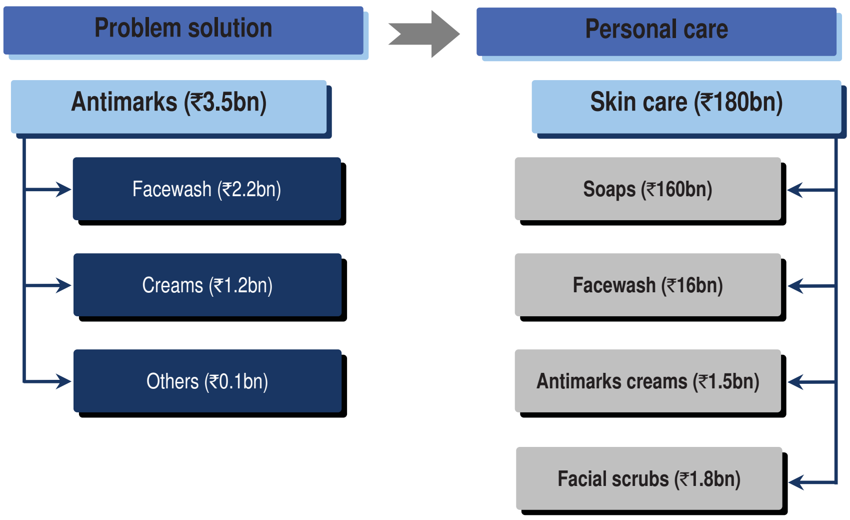
Positioning Nomarks as a personal-care brand

Nomarks has strong brand equity in anti-marks skin-care, a more-than-₹3.5bn market. Nomarks is the second-largest brand in the category with a 12% share. In fact, Nomarks is No.1 in anti-mark creams in the country with a 17% market share, and No.2 in the anti-marks face-wash segment. It commands a more-than-60% gross margin. After the acquisition, Bajaj Corp has almost tripled Nomarks' distribution (to ~0.42m outlets) from just 0.16m when it was acquired, improving its sales turnover to ~ ₹600m in FY15 from just ₹260m at acquisition. This has also been driven by the brand re-launch with new packaging and reducing the tail SKUs to focus on core ones.

Bajaj Corp has a reach of 2.8m outlets, providing a strong platform to launch new products

Having achieved the initial planned success with Nomarks, management now plans to re-position the brand—from a problem-solution to a daily-skincare regime. The company has enrolled Saina Nehwal as its brand ambassador and launched a high-voltage campaign to push the brand in the larger skin-care space—creams, facewashes, soaps and facial scrubs.

Fig 14 – Re-positioning of Nomarks

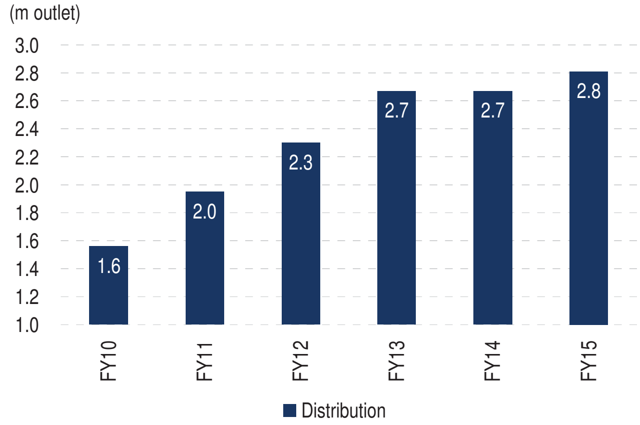


Source: Company, Anand Rathi Research

Distribution reach of 2.8m waiting to be levered

In the last five years, Bajaj Corp's distribution reach has broadened from 1.6m outlets to 2.8m. The increase has been driven solely by Bajaj Almond hair oil. This widespread distribution (with a rural-retail-outlet reach of 1.7m) could be levered by the company to launch several (new) brands in the larger personal-care space. In fact, the company has been test-marketing its (new) product range and scouting for good complementary buys in India. This would further drive diversification and boost growth. Similarly, the scaling-up of the mass Bajaj Amla hair oil and Kailaash Parbhat oil would lower the company's dependence on almond oil.

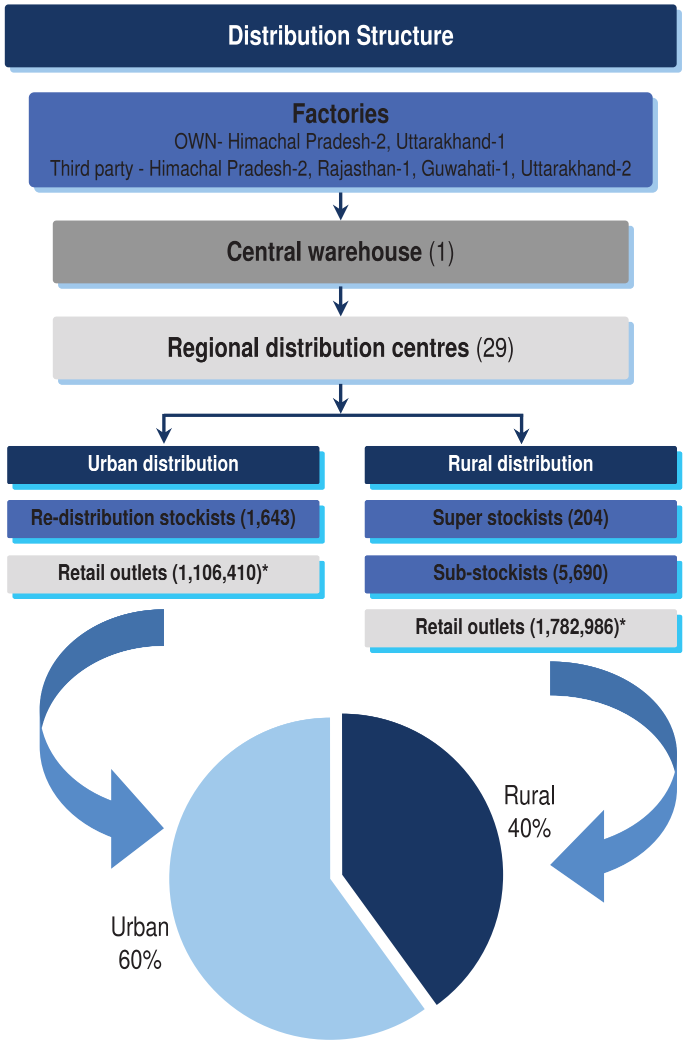
Fig 15 – Rising distribution reach



Source: Company

Fig 16 – Strong distribution structure

Bajaj Corp has a widespread distribution reach across the country, aiding in generating more than 60% revenue from urban areas and 40% from rural areas



Source: Company

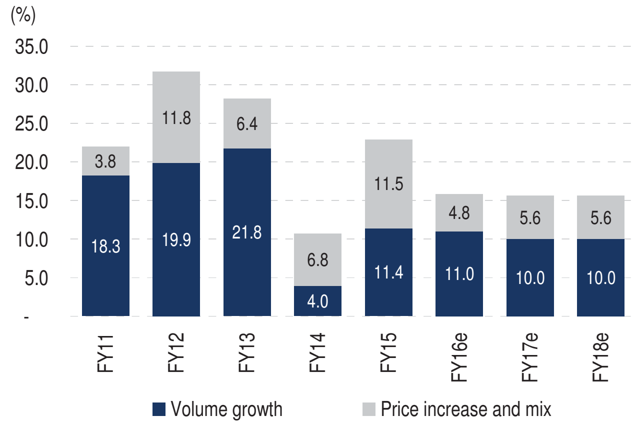
Financials

Revenue to register a 16% CAGR over FY15-18

Over FY12-15 revenue came at a 21% CAGR, driven by growth in its flagship Bajaj Almond hair-oil brand and the acquisition of the Nomarks brand. The market slowdown and the marked deceleration in the hair-oils segment is expected to pull down volume growth. We forecast a 16% revenue CAGR over FY15-18, aided by double-digit volume growth.

We expect volume growth to average 10% over FY15-18 (vs. 15% in the last five years)

Fig 17 – Volume-led revenue growth



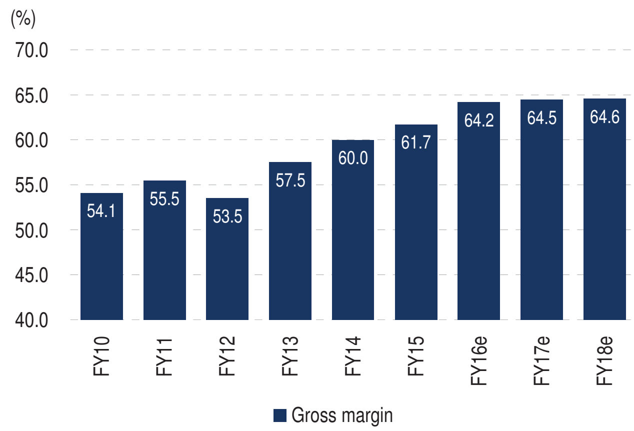
Source: Company, Anand Rathi Research

Sharp reduction in key input prices

The company has been attempting to reduce its dependence on glass bottles even as it encourages PET bottles. This has reduced packaging costs (as percent of sales) to 9% in FY15 vs. 11% in FY11. The lower cost has helped expand the gross margin from 55% in FY11 to 62% in FY15.

Crude-linked inputs (HDPE, LLP) comprise ~50% of the company's raw material cost. The sharp drop in crude-oil prices has slashed prices of these inputs as well, with LLP falling ~30% yoy in Q1 FY16. The benefit of the fall in these inputs is expected to drive a gross margin expansion of 250bps, to 64.2% in FY16e.

Fig 18 – Gross margin – heading towards 65%



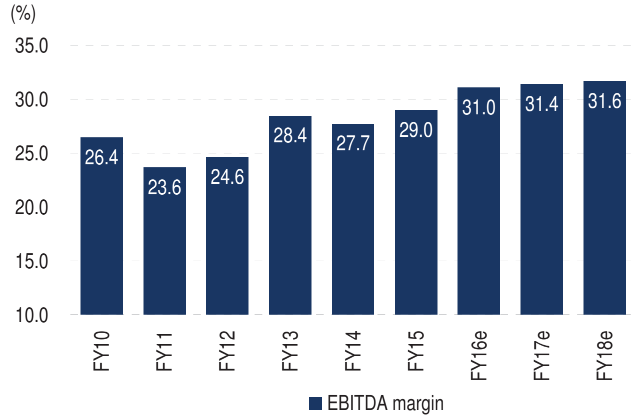
Source: Company, Anand Rathi Research

The best EBITDA margin in the sector

At ~30%, Bajaj Corp has the best EBITDA margin of the companies we cover, and in the sector

The EBITDA margin, at 29%, is the highest of any FMCG company in the sector. We expect the margin over FY15-18 to expand by a further 260bps, to 31.6%, aided by benign input costs and scaled-up benefits. We expect the company to maintain its A&P spends of 17-18% of net sales.

Fig 19 – EBITDA margin to improve further

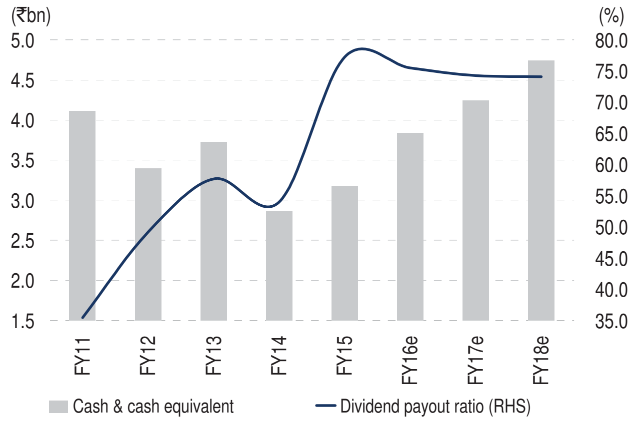


Source: Company, Anand Rathi Research

Cash chest to ward off competition, drive inorganic growth

The company had more than ₹3bn in cash & cash equivalents. This cash balance deters a competition from coming out with price cuts and sharp A&P spends in the light hair-oil sub-segment. Further, management continues to seek a reasonable and strategic inorganic growth opportunity. In fact, with free-cash-flow generation averaging ~₹3bn a year for the next three years, and with no major capital expenditure in the pipeline, we expect the cash balances to rise further. Thus, the greater amount of cash could either be used for acquisition or higher dividend payouts.

Fig 20 – Rising cash and dividend payouts



Source: Company, Anand Rathi Research

Fig 21 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Revenues	**6,717**	**8,256**	**9,564**	**11,058**	**12,787**
Growth (%)	*10.7*	*22.9*	*15.8*	*15.6*	*15.6*
Material cost	-2,688	-3,162	-3,424	-3,929	-4,527
Employee cost	-342	-391	-454	-531	-614
Manufacturing cost	-33	-50	-57	-66	-77
Marketing cost	-1,390	-1,778	-2,085	-2,389	-2,743
Administrative cost	-368	-403	-478	-564	-652
Energy cost	-8	-8	-10	-11	-13
Other cost	-28	-73	-86	-100	-115
EBITDA	**1,860**	**2,392**	**2,969**	**3,469**	**4,047**
Growth (%)	*7.8*	*28.6*	*24.1*	*16.8*	*16.7*
EBITDA margin (%)	*27.7*	*29.0*	*31.0*	*31.4*	*31.6*
Other income	401	316	350	400	450
Operating profit	**2,261**	**2,708**	**3,319**	**3,869**	**4,497**
Depreciation	-43	-49	-50	-52	-55
EBIT	**2,218**	**2,659**	**3,269**	**3,817**	**4,442**
Interest cost	-59	-1	-1	-1	-1
PBT	**2,159**	**2,658**	**3,268**	**3,816**	**4,441**
Tax	-384	-462	-630	-735	-855
Effective tax rate	*17.8*	*17.4*	*19.3*	*19.3*	*19.2*
PAT	**1,775**	**2,196**	**2,639**	**3,081**	**3,586**
Consol PAT	**1,775**	**2,196**	**2,639**	**3,081**	**3,586**
Growth (%)	*6.8*	*23.7*	*20.1*	*16.8*	*16.4*
PAT margin (%)	*26.4*	*26.6*	*27.6*	*27.9*	*28.0*
Extraordinary income	-286	-470	-470	-184	-
Dividends (incl. tax)	-1,122	-2,035	-2,330	-2,675	-3,106
Transferred to reserves	**368**	**-309**	**-161**	**222**	**480**
Per share data					
FDEPS (₹)	12.0	14.9	17.9	20.9	24.3
DPS (₹)	6.5	11.5	13.5	15.5	18.0
Adj BV (₹)	35.2	33.1	32.0	33.5	36.8
CEPS (₹)	12.3	15.2	18.2	21.2	24.7
Valuation ratio					
P/E (x)	34.4	27.8	23.1	19.8	17.0
P/adj BV (x)	11.8	12.5	12.9	12.3	11.3
P/C (x)	33.6	27.2	22.7	19.5	16.8
Dividend yield (%)	1.6	2.8	3.3	3.7	4.3
EV/S (x)	8.7	7.0	6.0	5.2	4.5
EV/E (x)	31.3	24.2	19.4	16.6	14.1
Quality ratio					
Dividend payout (%)	63.2	92.7	88.3	86.8	86.6
Other income/PBT (%)	18.6	11.9	10.7	10.5	10.1
Operating CF/EBITDA (x)	0.9	1.0	1.1	0.9	0.9

Source: Company, Anand Rathi Research

Fig 22 – Balance Sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Equity	148	148	148	148	148
Reserves	5,045	4,738	4,577	4,799	5,279
Minority interests	-	-	-	-	-
Net worth	**5,192**	**4,886**	**4,725**	**4,947**	**5,427**
Equity (% of CE)	*99.9*	*99.9*	*100.0*	*100.0*	*100.0*
LT debt	-	-	-	-	-
ST debt	-	-	-	-	-
DTL (net)	4	5	-	-	-
Total debt	**4**	**5**	**-**	**-**	**-**
Net D/E (x)	*-0.6*	*-0.6*	*-0.7*	*-0.7*	*-0.8*
Capital employed	**5,196**	**4,891**	**4,725**	**4,947**	**5,427**
Gross block	2,782	2,789	2,939	3,089	3,239
Acc depreciation	-424	-942	-992	-1,044	-1,099
Net block	**2,359**	**1,847**	**1,947**	**2,044**	**2,140**
CWIP	7	7	10	10	10
Fixed assets	**2,366**	**1,854**	**1,957**	**2,054**	**2,150**
Investments	1,568	1,837	1,837	1,837	1,837
Cash equivalents	1,292	1,342	1,531	1,758	2,258
Inventories	395	393	438	504	581
Debtors	84	133	159	201	256
Loans & advances	82	114	143	166	192
Other current assets	7	7	8	9	10
Current assets	**1,859**	**1,988**	**2,280**	**2,638**	**3,298**
Creditors	-597	-788	-877	-1,031	-1,216
Provisions	-	-	-472	-551	-641
Current liabilities	**-597**	**-788**	**-1,349**	**-1,582**	**-1,857**
Net current assets	**1,262**	**1,200**	**931**	**1,056**	**1,440**
Capital deployed	**5,196**	**4,891**	**4,725**	**4,947**	**5,427**
FA/CE (%)	*45.5*	*37.9*	*41.4*	*41.5*	*39.6*
Investments/CE (%)	-	-	-	-	-
Liquid assets/CE (%)	*55.0*	*65.0*	*71.3*	*72.7*	*75.5*
Working capital/CE (%)	*-0.6*	*-2.9*	*-12.7*	*-14.2*	*-15.1*

Source: Company, Anand Rathi Research

Fig 23 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Cash profit	1,819	2,245	2,689	3,133	3,641
Chg in WC	-75	112	458	102	116
Operating CF	**1,744**	**2,357**	**3,147**	**3,236**	**3,757**
Capex	-1,188	463	-153	-150	-150
Free CF	**556**	**2,820**	**2,995**	**3,086**	**3,607**
Equity	-1	2	-0	0	-0
Debt	-11	2	-5	-	-
Investments	264	-268	-	-	-
Dividends	-1,122	-2,035	-2,330	-2,675	-3,106
Misc inflows	-286	-470	-470	-184	-
Net change in cash	**-600**	**50**	**189**	**227**	**501**
Opening cash	1,892	1,292	1,342	1,531	1,758
Closing cash	**1,292**	**1,342**	**1,531**	**1,758**	**2,258**

Source: Company, Anand Rathi Research

Fig 24 – Ratio analysis @ ₹414

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Dupont Analysis					
Margins (%)	33.0	32.2	34.2	34.5	34.7
Capital turn (x)	1.3	1.6	2.0	2.3	2.5
RoCE (%)	44.2	52.7	68.0	78.9	85.6
Leverage factor(x)	1.0	1.0	1.0	1.0	1.0
Interest burden (x)	1.0	1.0	1.0	1.0	1.0
Tax burden (x)	0.8	0.8	0.8	0.8	0.8
Consol factor (x)	1.0	1.0	1.0	1.0	1.0
RoE (%)	35.4	43.6	54.9	63.7	69.1
Working capital (days)					
Inventories	21	17	17	17	17
Debtors	5	6	6	7	7
Loans & advances	4	5	5	5	5
Other CA	0	0	0	0	0
Creditors	-32	-35	-33	-34	-35
Provisions	-	-	-18	-18	-18
Net WC	-2	-6	-23	-23	-23
Other ratios					
Op CF/Rev (%)	26.0	28.5	32.9	29.3	29.4
FCF/Rev (%)	8.3	34.2	31.3	27.9	28.2
Intangibles/GB (%)	-	-	-	-	-
Intangibles/CE (%)	-	-	-	-	-
Revenue/GB (x)	2.4	3.0	3.3	3.6	3.9
Revenue/FA (x)	2.8	4.5	4.9	5.4	5.9
CWIP/GB (x)	0.0	0.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

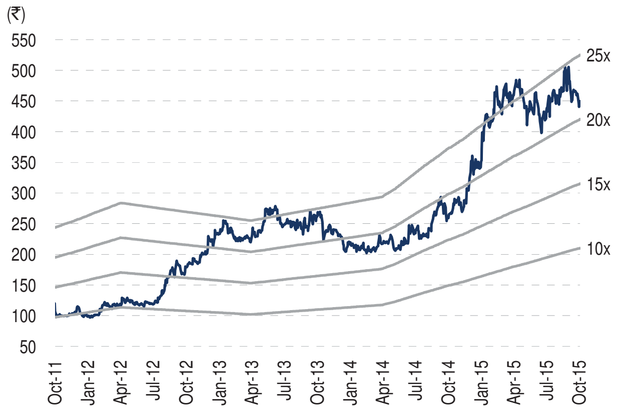
Valuation

Discount to peers to narrow

Bajaj Corp trades at a 30-35% discount to its larger peers (Dabur, GCPL, Marico and Emami). On Bajaj Corp's consistent performance, we expect this discount to narrow

The stock has consistently traded at a 30-35% discount to larger peers (Dabur, GCP, Marico, Emami). However, Bajaj Corp's consistent and ahead-of-market performance would narrow the gap. We ascribe 27x to its Sep'17e earnings to arrive at a price target of ₹600. At the ruling market price of ₹414, the stock trades at 23x FY16e EPS of ₹17.9 and 20x FY17e EPS of ₹20.9.

Fig 25 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- A prolonged slowdown in the hair-oil segment and a sharp rise in competition in the core light-hair-oil sub-segment.

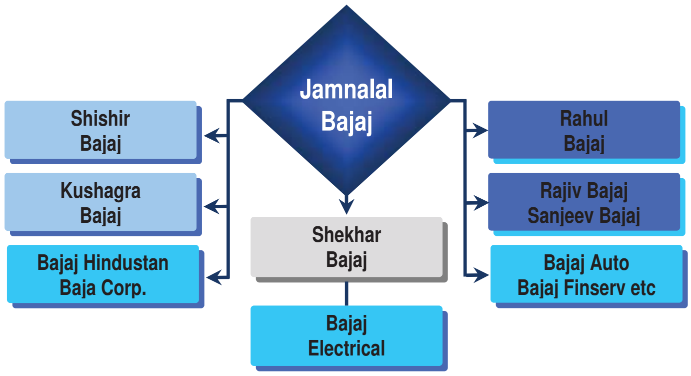
Company Background & Management

A part of the Shishir Bajaj group (with interests in sugar, FMCG, infrastructure and power), Bajaj Corp is an FMCG company focused on personal care. In fact, prior to acquiring the Nomarks brand it primarily focused on hair care. It has emerged dominant in the premium light-hair-oil sub-segment with its Almond Drops commanding a ~60% market share.

With its strong brand positioning, distribution strength and healthy cash flows, it is poised to grab larger opportunities in the home consumer-goods market. It acquired Nomarks, a skin-care brand, in 2013 to diversify from a single-brand operator to a multi-brand one.

Its strategy aims at broadening its distribution reach, currently at 2.8m retail outlets, serviced by 7,200 distributors and 15,000 wholesalers. It generates about 60% of its revenue from the urban market; 75% of its revenues arise from the North and West regions.

Fig 26 – The Jamnalal Bajaj Family group structure



Source: Anand Rathi Research.

Management

The strong leadership of Sumit Malhotra and the wide distribution reach have helped the company transform itself into a FMCG operator to reckon with

Sumit Malhotra: MD since 2011; president (sales and marketing) since 2004; director since 2008; over 28 years' experience in FMCG; honours graduate in pharmacy from the Institute of Technology, Benaras Hindu University, Varanasi; post-graduate diploma in business management from IIM, Ahmedabad

V.C. Nagori: CFO; over 25 years' experience in finance, audit, taxation and legal compliance; joined Bajaj Corp in 2007 and held various positions including VP (finance), compliance officer and company secretary. Elevated to CFO in Nov'11; a qualified chartered accountant from the Institute of Chartered Accountants of India

![ANAND RATHI]

India I Equities

Consumer

Initiating Coverage

19 October 2015

Zydus Wellness

Sweet, nevertheless healthy; initiating, with a Buy

Rating: **Buy**
Target Price: ₹1,050
Share Price: ₹871

We initiate coverage on Zydus Wellness with a Buy recommendation and a target price of ₹1,050, implying ~20% potential from the present price. In the under-penetrated health and wellness arena, the company offers niche products, which are leaders in their segments. We believe that the management thrust on wider distribution, product launches and greater investment in brand building would revive the revenue momentum to a 14% CAGR over FY15-18 (9% over FY12-15).

Near monopoly in under-penetrated artificial sweeteners; leader in niche segments. With more than a 92% share, the flagship brand, Sugar Free (~45% of revenue), is a market leader in artificial sweeteners. The non-Sugar-Free brands—Nutralite, EverYuth—are market leaders as well; Nutralite enjoys a 40% share in the retail margarine category; EverYuth, 92% in peel-offs and 31% in scrubs.

Go-to-market, aggressive product launches to renew growth thrust. The company has re-jigged its distribution set-up and enrolled more sales people at the distributor level. This is expected to drive a wider distribution reach, with the company targeting doubling of that reach over the next five years. Further, aggressive brand launches and higher brand spend would aid growth.

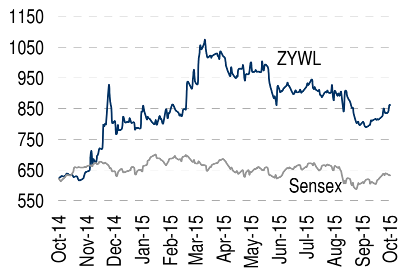
Higher brand spends could soften margins, yet be one of the sector's best. Lower crude-oil prices could help the gross margin. However, an increase in A&P spending (by 250bps) to drive new products and revive volume growth could weigh down on the EBITDA margin. We expect the EBITDA margin to moderate 120bps over FY15-18 to 22%.

Valuation. We ascribe 27x to Zydus Wellness on Sep'17e to arrive at our target price of ₹1,050. At the present price the stock trades at 28x FY16e EPS of ₹31.1 and 25x FY17e EPS of ₹35.4. **Risks:** Failure of the launches, regulatory issues and keener competition in existing categories.

Key data	ZYWL IN / ZYDS.BO
52-week high / low	₹1,130 / ₹606
Sensex / Nifty	27215 / 8238
3-m average volume	$0.3m
Market cap	₹34bn / $528m
Shares outstanding	39m

Shareholding pattern (%)	Sep '15	Jun '15	Mar '15
Promoters	72.5	72.5	72.5
- of which, Pledged	-	-	-
Free Float	27.5	27.5	27.5
- Foreign Institutions	7.5	8.1	9.1
- Domestic Institutions	5.3	5.3	5.3
- Public	14.6	14.1	13.1

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	4,036	4,307	4,733	5,505	6,356
Net profit (₹ m)	1,043	1,090	1,214	1,382	1,587
EPS (₹)	26.7	27.9	31.1	35.4	40.6
Growth (%)	7.4	4.5	11.4	13.9	14.8
PE (x)	32.6	31.2	28.0	24.6	21.4
PBV (x)	10.5	8.4	6.9	5.7	4.8
RoE (%)	35.8	29.8	26.9	25.3	24.2
RoCE (%)	37.2	31.8	29.1	27.6	26.7
Dividend yield (%)	0.7	0.7	0.8	0.9	1.0
Net gearing (x)	-0.8	-0.8	-0.8	-0.8	-0.9

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	4,036	4,307	4,733	5,505	6,356
Revenue growth (%)	4.0	6.7	9.9	16.3	15.4
- Op. expenses	3,063	3,308	3,621	4,261	4,957
EBIDTA	**974**	**999**	**1,112**	**1,244**	**1,398**
EBITDA margin (%)	24.1	23.2	23.5	22.6	22.0
- Interest expenses	1	1	1	1	1
- Depreciation	47	77	82	84	85
+ Other income	189	276	320	385	470
- Tax	53	85	135	162	196
Effective tax rate (%)	4.9	7.2	10.0	10.5	11.0
+ Associates/(Minorities)	-19	-22	-0	-0	-
Adjusted PAT	1,043	1,090	1,214	1,382	1,587
+ Extraordinary items	-	-	0	0	-
Reported PAT	1,043	1,090	1,214	1,382	1,587
Adj. FDEPS (₹/share)	26.7	27.9	31.1	35.4	40.6
Adj. FDEPS growth (%)	7.4	4.5	11.4	13.9	14.8

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	391	391	391	391	391
Reserves & surplus	2,865	3,670	4,564	5,580	6,756
Net worth	3,256	4,060	4,954	5,971	7,146
Total debt	8	9	10	11	13
Minority interest	47	69	69	69	69
Def. tax liab. (net)	49	46	49	49	49
Capital employed	**3,359**	**4,184**	**5,082**	**6,100**	**7,277**
Net fixed assets	954	846	832	800	766
Intangible assets	-	-	-	-	-
Investments	50	-	-	-	-
- of which, Liquid	-	-	-	-	-
Working capital	-274	-53	184	258	314
Cash	2,628	3,390	4,066	5,042	6,197
Capital deployed	**3,359**	**4,184**	**5,082**	**6,100**	**7,277**
WC days	-25	-4	14	17	18
Book value (₹/sh)	83.3	103.9	126.8	152.8	182.9

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	1,043	1,090	1,214	1,382	1,587
+ Non-cash items	47	77	82	84	85
Cash profit	1,090	1,167	1,296	1,466	1,671
- Incr./(decr.) in WC	-64	220	237	74	56
Operating cash-flow	1,153	946	1,059	1,392	1,615
- Capex	58	-31	68	51	51
Free-cash-flow	1,095	977	992	1,340	1,564
- Dividend	274	282	320	366	412
+ Equity raised	-60	19	-0	-0	1
+ Debt raised	10	-2	4	2	2
- Investments	50	-50	-	-	-
- Misc. items	-	-	0	0	-
Net cash-flow	720	762	676	976	1,154
+ Op. cash & bank bal.	1,908	2,628	3,390	4,066	5,042
Cl. cash & bank bal.	2,628	3,390	4,066	5,042	6,197

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹871

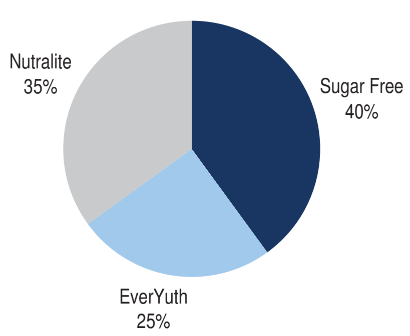
Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	32.6	31.2	28.0	24.6	21.4
Cash P/E (x)	31.2	29.2	26.3	23.2	20.4
EV/EBITDA (x)	32.3	30.7	26.9	23.3	19.9
EV/sales (x)	7.8	7.1	6.3	5.3	4.4
P/B (x)	10.5	8.4	6.9	5.7	4.8
RoE (%)	35.8	29.8	26.9	25.3	24.2
RoCE (%)	37.2	31.8	29.1	27.6	26.7
Dividend yield (%)	0.7	0.7	0.8	0.9	1.0
Dividend payout (%)	26.3	25.9	26.3	26.4	26.0
Net debt/equity (x)	-0.8	-0.8	-0.8	-0.8	-0.9
Debtor (days)	2	1	2	2	2
Inventory (days)	25	22	20	20	20
Payables (days)	80	76	53	49	48
Fixed asset T/O (x)	-24.7	-4.5	14.2	17.1	18.0
Oth Income/PBT (%)	17.0	23.1	23.7	24.9	26.4

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up (FY15)



Source: Company

Near monopoly in artificial sweeteners

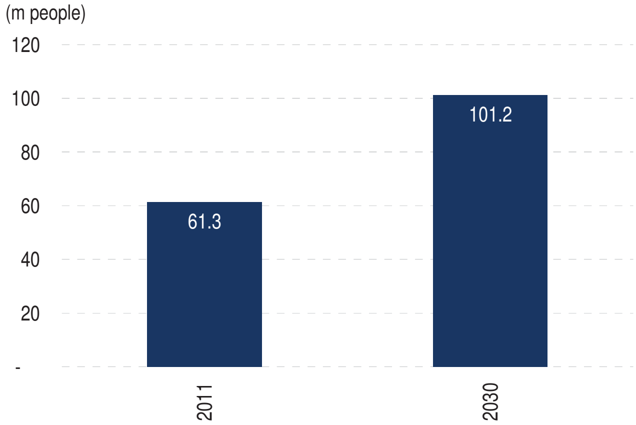
Vast market potential

India has one of the highest diabetic populations in the world, approximately 60m-70m. However, barely ~5% use low-calorie artificial sweeteners or natural-sugar substitutes. This could be attributed to low per-capita income, lack of consumer awareness and a perceived price premium of substitutes. Nevertheless, rising affluence, heightened awareness and greater affordability of the products are driving growth of artificial sweeteners in India.

Artificial sweeteners have very low penetration in India. Even the leading brand Sugar Free is available in just 0.3m outlets (largely chemists). Further, despite more sales, the artificial-sweetener market in India is just $50m (approx. $8bn globally). We believe advocacy, distribution and greater brand spending could drive strong growth in the category, which could double in five years.

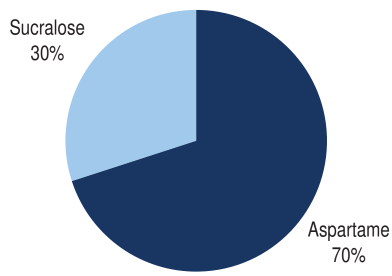
Low penetration of just ~4% or a reach of just 0.3m stores indicates the vast growth potential for the brand in coming years

Fig 7 – Diabetics in India



Source: IDF Diabetes Atlas, Industry, Anand Rathi Research

Fig 8 – Sugar substitute market in India (₹3bn) based on variants



Source: Industry, Anand Rathi Research

Sugar Free, a near monopoly; products give it an edge

Sugar Free has become a generic in India for the artificial sugar-sweetener sub-segment (a 92% market share) in much the same way Maggi was to the noodles sub-segment. Such high brand recall reflects the strong brand equity and a near monopoly of the Sugar Free brand in India. Despite the highly-underpenetrated market, competitors have failed to etch a place in the sugar-substitute market. Key competitors are Equal and Splenda, which together have less than an 8% market share. Even though Sugar Free is available over the counter, Zydus Wellness is exploring the doctor-advocacy route to generate consumer awareness of such products and their benefits. This is expected to be one of the key drivers, together with the growing health consciousness of Indian consumers.

Over the years Sugar Free has straddled price points and variants. Sugar Free Gold is a table-top artificial sweetener based on Aspartame; Sugar Free Natura is a sucrolose-based sweetener positioned for culinary purposes. The former is available in packs of 25 to 500 pellets.

The company is test-marketing Sugar Free Stevia, a natural sugar substitute, perceived as a better sugar substitute globally. Thus, wider distribution, mounting awareness, new products and greater affordability would drive faster growth for Sugar Free.

Fig 9 – Artificial sweetener variants and brand-wise price ladder

Artificial sweetener variants	Brands	300 pellets (₹)	Remarks
Table top (Aspartame)	Sugar Free Gold	175	Retails at a 5% discount to competition
	Equal	185	
Culinary (Sucralose)	Sugar Free Natura	195	Retails at a 7% discount
	Splenda Sweet minis	210	

Source: Industry, Anand Rathi Research

Non-Sugar Free portfolio, a mixed bag

EverYuth – Niche skincare offering

EverYuth was one of the first skincare brands in the country to come out with offerings of niche scrubs and peel-off facemasks. The company is a leader in both the sub-segments, with a small presence in the ₹16bn face-wash market. While the latter has been experiencing more than 15-25% growth annually, the other two segments have been growing 5-10%. In all the three sub-segments, the company plans to introduce several differentiated products (such as EverYuth Tulsi-Turmeric Facewash) to drive growth. In fact, it has positioned the product in the mass segment, selling at ₹1 SKUs and ₹35 for a 50g pack.

We expect the new product launches and the wider distribution to drive a double-digit, 16%, CAGR over FY15-18 (6-7% in the past three years) in this sub-segment.

Targeting a market opportunity of over ₹18bn, with a healthy market position in two of the three sub-segments

Fig 10 – EverYuth – niche leadership

Brand	Category	Market size (₹m)	Market share (%)	Competition
EverYuth	Peel-offs	800	92	Ayur, Himalaya
	Scrubs	1,750	31	Himalaya Neem Scrub, Garniers
	Face washes	16,000	2	Himalaya Neem, HUL's Ponds, Garnier

Source: Industry, Anand Rathi Research

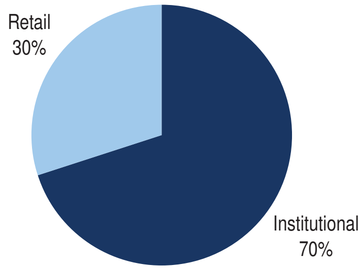
Nutralite – keen competition and market growth a drag

Nutralite, a premium table spread, is the company's dairy-based health offering, free of cholesterol and hydrogenated fats. The butter substitute includes PUFA (poly-unsaturated fatty acids) and MUFA (mono-unsaturated fatty acids), known cholesterol fighters. The table-spread (margarine) market is about ₹5bn-6bn, with more than two-thirds coming from institutions, the rest from retail consumers.

The segment is faced with growth issues due to stiff competition between the dominant Nutralite and Amul's Lite and Delicious brands in the retail sub-segment. Both Amul's offerings retail at a 10-60% discount to Nutralite; the latter retails at a strategic 15-30% discount to major butter brands.

We expect the restricted market growth in the segment could be the overhang for the Nutralite brand as well. However, distribution expansion could boost growth for the brand and drive a 16% CAGR over FY15-18, in our view.

Fig 11 – Channel-wise margarine sales in India



Source: Industry, Anand Rathi Research

Fig 12 – Nutralite vs. competition

Segment	Brand	500 gm (₹)	100 gm (₹)	Remarks
Margarine	Nutralite	145	32	10-120% premium to other margarine brands
	Amul Delicious	71	15	
	Amul Lite	130	27	
Butter	Amul butter	187	38	Nutralite sells at a 15-30% discount to butter
	Britannia Milkman butter	195	40	
	Mother Dairy butter	204	41	

Source: Industry, Anand Rathi Research

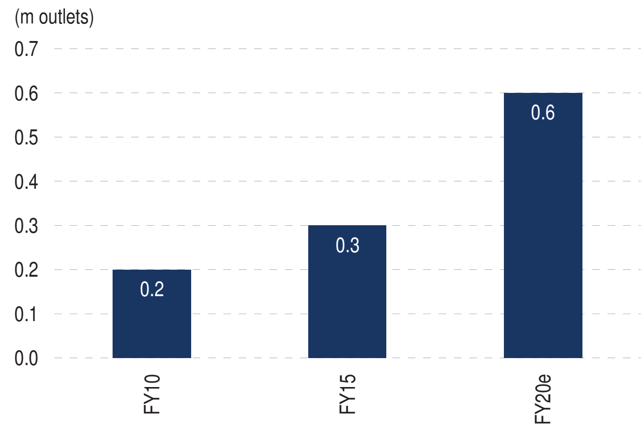
Distribution, new product initiatives

Go-to-Market strategy to revamp distribution

Zydus Wellness has embarked on a go-to-market distribution structure. In this, a distributor has sales staff on its payroll and the company's sales representatives oversee the ground staff and product promotions in order to better serve the market. This, along with distribution widening, would drive the increase in outlet reach by 10-15% annually. In fact, the company plans to double its distribution reach over the next five years. Thus, we expect the Go-to-Market strategy to improve volume momentum.

Over the last five years, Zydus' distribution reach has increased 8-10% annually. Nevertheless, it plans to double that to 0.6m outlets

Fig 13 – Increase in distribution over the last five years



Source: Company, Anand Rathi Research

Aggressive new products lined up

A few of the recent launches have been:

- EverYuth Tulsi Turmeric Facewash
- EverYuth Advanced Hydroactive Walnut Apricot Scrub
- Nutralite with Omega C benefits
- EverYuth Advanced Refreshing Facewash, and
- Sugar Free Stevia (in restricted areas).

Zydus Wellness has been test-marketing several new products across sub-segments and plans in due course to roll them out nationally.

The distribution re-jigs and Go-to-Market strategy would drive a rapider and more efficient roll-out of the new product launches.

Fig 14 – A few recent new product launches

Source: Company, Anand Rathi Research

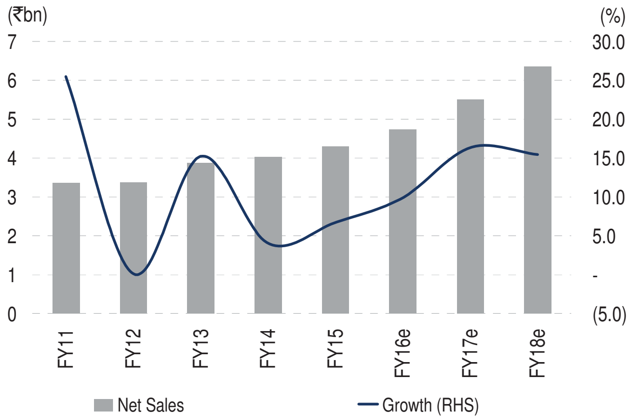
Financials

Revenue at a 14% CAGR over FY15-18

Over FY12-15, Zydus Wellness' revenue has registered a subdued 9% CAGR, primarily due to Sugar Free; intense competition has been a drag on Nutralite, which grew in single digits during that period. We expect Sugar Free to maintain its double-digit volume growth, while the wider distribution is expected to drive faster growth for both Nutralite and EverYuth. Consequently, we build in a higher (14%) revenue CAGR over FY15-18.

Expect revenue growth to revive to a 14% CAGR over FY15-18 (from 9% over FY12-15)

Fig 15 – Revenue growth trend

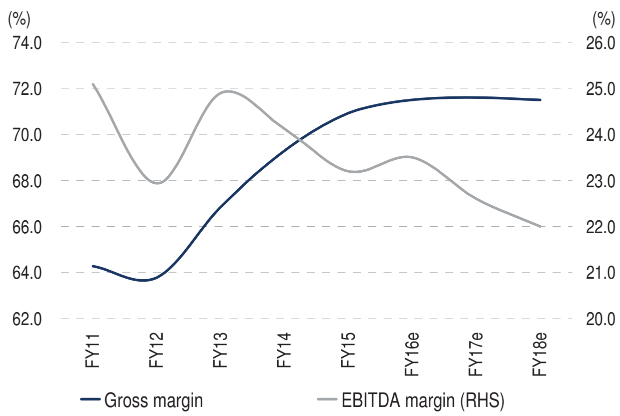


Source: Company, Anand Rathi Research

EBITDA margin to shrink due to higher brand spends

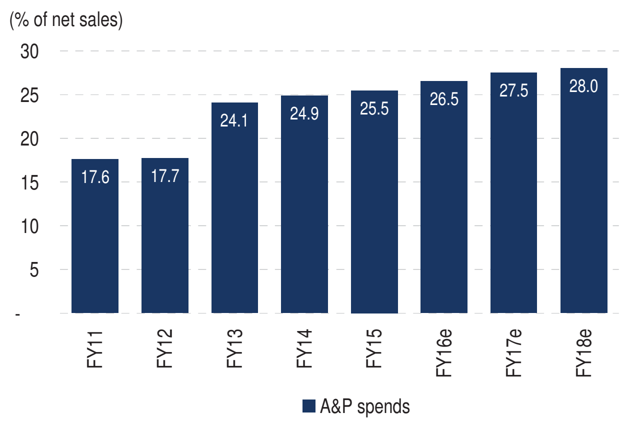
The sharp, ~30% yoy, fall in crude and crude-based derivatives is likely to aid in expanding gross margins as packaging cost constitutes 35-40% of raw material cost. However, higher A&P spending (rising 250bps over FY15-18) could push down the EBITDA margin. Thus, we expect the EBITDA margin to decline by 120bps over FY15-18, to 22%. Despite the decline, we expect the EBITDA margin to be one of the highest in the sector. Adjusted PAT is expected to come at a 13% CAGR over FY15-18, impacted by a higher tax rate and the shrunken margins, in our view.

Fig 16 – Gross margin and EBITDA margin



Source: Company, Anand Rathi Research

Fig 17 – Mounting A&P spends (as percent of net sales)

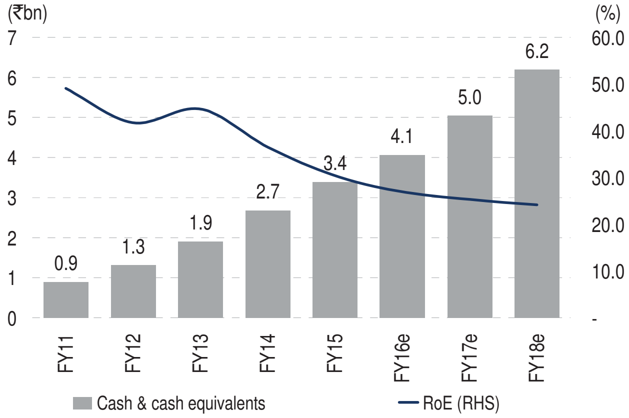


Cash to be levered for health and wellness buyouts

The company has ~₹3.4bn cash on its books. It plans to utilise this toward acquiring health and wellness brands. In fact it has been evaluating a few. The acquisition of brands could help drive faster growth.

However, the rising cash and cash equivalents have led to lower return on equity, which has slid from ~50% in FY11 to 30% in FY15

Fig 18 – Rising cash balance, declining return ratios



Source: Company, Anand Rathi Research

Fig 19 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	4,036	4,307	4,733	5,505	6,356
Other oper. revenues	-	-	-	-	-
Revenues	**4,036**	**4,307**	**4,733**	**5,505**	**6,356**
Growth (%)	*4.0*	*6.7*	*9.9*	*16.3*	*15.4*
Material cost	-1,239	-1,252	-1,349	-1,563	-1,811
Employee cost	-307	-332	-355	-413	-477
Manufacturing cost	-103	-110	-118	-138	-159
Marketing cost	-1,090	-1,187	-1,349	-1,624	-1,907
Administrative cost	-291	-313	-341	-396	-458
Energy cost	-33	-36	-38	-44	-51
Other cost	-	-78	-71	-83	-95
EBITDA	**974**	**999**	**1,112**	**1,244**	**1,398**
Growth (%)	*0.8*	*2.6*	*11.3*	*11.9*	*12.4*
EBITDA margin (%)	*24.1*	*23.2*	*23.5*	*22.6*	*22.0*
Other income	189	276	320	385	470
Operating profit	**1,163**	**1,275**	**1,432**	**1,629**	**1,868**
Depreciation	-47	-77	-82	-84	-85
EBIT	**1,116**	**1,198**	**1,350**	**1,546**	**1,784**
Interest cost	-1	-1	-1	-1	-1
PBT	**1,115**	**1,197**	**1,349**	**1,545**	**1,783**
Tax	-53	-85	-135	-162	-196
Effective tax rate	*4.9*	*7.2*	*10.0*	*10.5*	*11.0*
PAT	**1,062**	**1,112**	**1,214**	**1,382**	**1,587**
Minority interest	-19	-22	-0	-0	-
Consol PAT	**1,043**	**1,090**	**1,214**	**1,382**	**1,587**
Growth (%)	*7.4*	*4.5*	*11.4*	*13.9*	*14.8*
PAT margin (%)	*25.8*	*25.3*	*25.7*	*25.1*	*25.0*
Extraordinary income	-	-	0	0	-
Dividends (incl. tax)	-	-282	-320	-366	-412
Transferred to reserves	**-**	**807**	**894**	**1,017**	**1,174**
Per-share data					
FDEPS (₹)	26.7	27.9	31.1	35.4	40.6
DPS (₹)	6.0	6.0	7.0	8.0	9.0
Adj BV (₹)	84.5	105.7	128.6	154.6	184.7
CEPS (₹)	27.9	29.9	33.2	37.5	42.8
Valuation ratios					
P/E (x)	32.6	31.2	28.0	24.6	21.4
P/adj BV (x)	10.3	8.2	6.8	5.6	4.7
P/C (x)	31.2	29.2	26.3	23.2	20.4
Dividend yield (%)	0.7	0.7	0.8	0.9	1.0
EV/S (x)	7.8	7.1	6.3	5.3	4.4
EV/E (x)	32.3	30.7	26.9	23.3	19.9
Quality ratios					
Dividend payout (%)	26.3	25.9	26.3	26.4	26.0
Other income/PBT (%)	17.0	23.1	23.7	24.9	26.4
Operating CF/EBITDA (x)	1.2	0.9	1.0	1.1	1.2

Source: Company, Anand Rathi Research

Fig 20 – Balance Sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Equity	391	391	391	391	391
Reserves	2,865	3,670	4,564	5,580	6,756
Minority interests	47	69	69	69	69
Net worth	**3,303**	**4,129**	**5,023**	**6,040**	**7,215**
Equity (% of CE)	*98.3*	*98.7*	*98.8*	*99.0*	*99.1*
LT debt	-	-	0	0	0
ST debt	8	9	9	11	13
DTL (net)	49	46	49	49	49
Total debt	**57**	**55**	**59**	**60**	**62**
Net D/E (x)	*-0.8*	*-0.8*	*-0.8*	*-0.8*	*-0.9*
Capital employed	**3,359**	**4,184**	**5,082**	**6,100**	**7,277**
Gross block	1,160	1,129	1,179	1,229	1,279
Accum. depreciation	-206	-285	-367	-449	-533
Net block	**954**	**844**	**812**	**780**	**746**
CWIP	0	2	20	20	20
Fixed assets	**954**	**846**	**832**	**800**	**766**
Investments	50	-	-	-	-
Cash equivalents	2,628	3,390	4,066	5,042	6,197
Inventories	279	260	266	308	357
Debtors	26	15	20	26	33
Loans & advances	50	186	201	234	267
Other current assets	260	382	388	426	495
Current assets	**3,244**	**4,233**	**4,941**	**6,036**	**7,349**
Creditors	-611	-610	-607	-641	-732
Provisions	-279	-286	-84	-94	-107
Current liabilities	**-889**	**-896**	**-691**	**-736**	**-838**
Net current assets	**2,355**	**3,337**	**4,250**	**5,301**	**6,511**
Capital deployed	**3,359**	**4,184**	**5,082**	**6,100**	**7,277**
FA/CE (%)	*28.4*	*20.2*	*16.4*	*13.1*	*10.5*
Investments/CE (%)	*1.5*	-	-	-	-
Liquid assets/CE (%)	*78.2*	*81.0*	*80.0*	*82.7*	*85.2*
Working capital/CE (%)	*-8.1*	*-1.3*	*3.6*	*4.2*	*4.3*

Source: Company, Anand Rathi Research

Fig 21 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Cash profit	1,090	1,167	1,296	1,466	1,671
Change in WC	64	-220	-237	-74	-56
Operating CF	**1,153**	**946**	**1,059**	**1,392**	**1,615**
Capex	-58	31	-68	-51	-51
Free CF	**1,095**	**977**	**992**	**1,340**	**1,564**
Equity	-60	19	-0	-0	1
Debt	10	-2	4	2	2
Investments	-50	50	-	-	-
Dividends	-274	-282	-320	-366	-412
Misc inflows	-	-	0	0	-
Net change in cash	**720**	**762**	**676**	**976**	**1,154**
Opening cash	1,908	2,628	3,390	4,066	5,042
Closing cash	**2,628**	**3,390**	**4,066**	**5,042**	**6,197**

Source: Company, Anand Rathi Research

Fig 22 – Ratio analysis @ ₹871

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
DuPont Analysis					
Margins (%)	27.7	27.8	28.5	28.1	28.1
Capital turn (x)	1.3	1.1	1.0	1.0	1.0
RoCE (%)	37.2	31.8	29.1	27.6	26.7
Leverage factor(x)	1.0	1.0	1.0	1.0	1.0
Interest burden (x)	1.0	1.0	1.0	1.0	1.0
Tax burden (x)	1.0	0.9	0.9	0.9	0.9
Consol factor (x)	1.0	1.0	1.0	1.0	1.0
RoE (%)	35.8	29.8	26.9	25.3	24.2
Working capital (days)					
Inventories	25	22	20	20	20
Debtors	2	1	2	2	2
Loans & advances	5	16	16	16	15
Other CA	24	32	30	28	28
Creditors	-55	-52	-47	-43	-42
Provisions	-25	-24	-6	-6	-6
Net WC	-25	-4	14	17	18
Other ratios					
Op CF/revenue (%)	28.6	22.0	22.4	25.3	25.4
FCF/revenue (%)	27.1	22.7	21.0	24.3	24.6
Intangibles/GB (%)	-	-	-	-	-
Intangibles/CE (%)	-	-	-	-	-
Revenue/GB (x)	3.5	3.8	4.0	4.5	5.0
Revenue/FA (x)	4.2	5.1	5.7	6.9	8.3
CWIP/GB (x)	0.0	0.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Valuation

Expect steady returns

We believe management's emphasis on wider distribution, new-product launches and greater investment in brand-building would revive revenue momentum to a 14% CAGR over FY15-18 (9% over FY12-15). This should aid in a healthy (13%) earnings CAGR over that period. We ascribe 27x on Sep'17e to arrive at our target price of ₹1,050. At the present price, it trades at 28x FY16e EPS of ₹31.1 and 25x FY17e EPS of ₹35.4. Hence, we initiate coverage on Zydus Wellness, with a Buy recommendation and a target price of ₹1,050 (21% potential from the present price).

Fig 23 – PE band

Source: Bloomberg, Anand Rathi Research

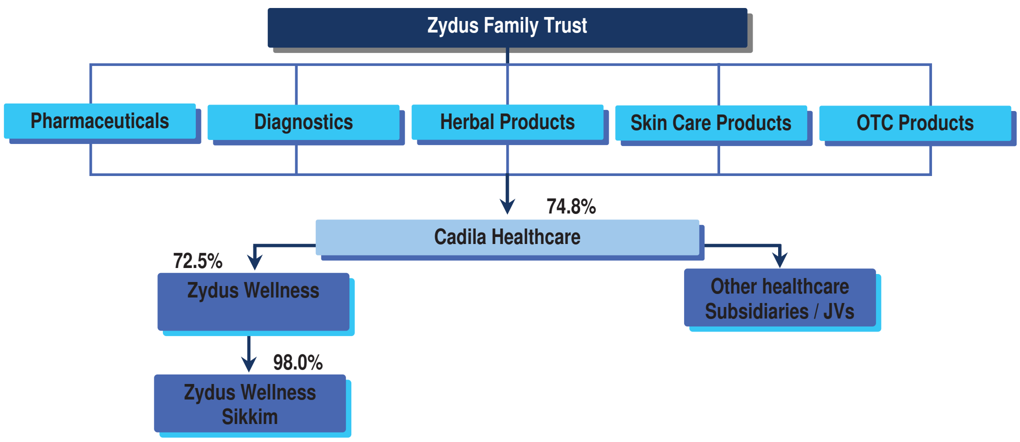
Key Risks

- **Failure of the new launches, stiff competition in existing categories:** Zydus has launched several products such as Actilife, Sugar Free D'lite, etc. These have not captured the attention of the market. Similarly, a surge in competition in existing categories, especially artificial sweeteners, could have a detrimental effect on revenue growth and margins.
- **Adverse regulations or studies:** Any adverse studies and/or regulations could have a bearing on the artificial sweetener categories and the company.
- **A sharp rise in input cost:** An adverse commodity cost environment could cut into margins.

Company Background & Management

A Cadila group company, Zydus Wellness (registered office: Ahmedabad, Gujarat) operates in the Indian health and wellness sector. It combines healthcare, nutrition and cosmeceuticals to offer consumers an array of health and wellness products to enrich their lives. With its brands (Sugar Free, EverYuth, Nutralite, Actilife), it is a niche but significant player in India's consumer healthcare market. For Sugar Free and EverYuth, it has a state-of-the-art plant in Sikkim. Its widespread distribution reach enjoys not only a very strong brand recall but also a healthy market share in each of its niche segments. It holds 98% equity in its Sikkim-partnered unit.

Fig 24 – Cadila group structure



Source: Company

Management

The new leadership under Tarun Arora (appointed May'15) is expected to revive the revenue growth momentum

Chairman Dr Sharvil Patel is deputy managing director of Cadila Healthcare, the parent company, one of the leading global healthcare firms. He specialised in chemical & pharmaceutical sciences from the University of Sunderland, U.K., and has a doctorate from the same university for his research in breast cancer at John Hopkins, Bayview Medical Centre, USA. He has brought in new ideas and dimensions by building for the company a larger positioning in the wellness arena.

COO Tarun Arora is a bachelor of science and post-graduate diploma in business management from IMT, Ghaziabad. He has more than two decades of experience in FMCG. He has handled general management and leadership roles with outstanding business growth for large FMCG companies along with playing a pivotal role in business transformation and integration projects. Prior to joining Zydus, he was CEO at Danone Waters, India. He has also worked with various FMCG companies like Wipro, Bharti Walmart and the Godrej group.

India I Equities

Consumer

Initiating Coverage

19 October 2015

DFM Foods

Play on kid-snacking; initiating, with a Buy

Rating: **Buy**
Target Price: ₹650
Share Price: ₹518

DFM Foods is a niche player, focused on ready-to-eat snacks for children. With its flagship brands Crax and Natkhat, it has established itself in North India with a more than 20% share in the extruded-snacks market. Its national expansion plan for greater scale and cost-efficiency and the benign input costs would drive a 21% earnings CAGR over FY15-18. We initiate coverage on DFM Foods with a Buy rating and a ₹650 price target.

Targeting healthy kid-snacking. With its corn-based extruded snacks, considered healthier than other packaged snacks, DFM caters primarily to children. Focused customer-targeting (kids snacking), differentiated positioning (a free toy with every pack) and value proposition (95% of sales at ₹5 SKUs) have driven its strong and consistent, ~25%, sales growth in the last four years.

Expands into the south. The company is focused on widening its distribution reach of 235,000 retail outlets and deepening its penetration into other regional markets (the east and the west). In Q4 FY15 it made a foray into the southern market. It is also increasing capacity at its Noida unit by ~30%, or 5,000 tons, to cater to mounting demand.

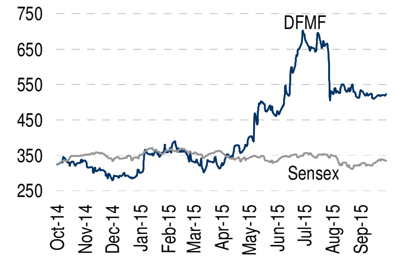
Margin expansion. Despite the sluggish environment, the EBITDA margin has almost doubled from FY09. The company generally hikes prices indirectly by reducing grammage. It plans to retain ~40% gross margin in the near future, even in case of cost inflation. Lower raw material prices and promotions would boost the EBITDA margin in the near term.

Valuation. At the ruling market price of ₹518, the stock trades at 30x FY16e and 25x FY17e. We believe earnings growth could surprise, given the benign input-cost environment and high sensitivity of earnings to small margin changes. **Risks:** Fresh competition and a sharp rise in input costs.

Key data	DFMF IN / DFMF.BO
52-week high / low	₹747 / ₹270
Sensex / Nifty	27215 / 8238
3-m average volume	$0m
Market cap	₹5bn / $79.9m
Shares outstanding	10m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	44.2	44.2	44.2
- *of which, Pledged*	-	-	-
Free Float	55.8	55.8	55.8
- Foreign Institutions	10.0	10.0	10.0
- Domestic Institutions	0.0	0.0	0.0
- Public	45.9	45.9	45.9

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	2,633	2,893	3,234	3,751	4,351
Net profit (₹ m)	95	153	174	210	270
EPS (₹)	9.5	15.3	17.4	21.0	27.0
Growth (%)	51.0	60.8	13.3	20.8	28.8
PE (x)	54.3	33.8	29.8	24.7	19.2
PBV (x)	13.7	11.3	8.6	6.6	5.1
RoE (%)	26.7	36.7	32.8	30.3	29.9
RoCE (%)	22.0	28.8	28.0	27.6	29.8
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5
Net gearing (x)	0.7	0.3	0.3	0.1	-0.1

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	2,633	2,893	3,234	3,751	4,351
Revenue growth (%)	16.9	9.9	11.8	16.0	16.0
- Op. expenses	2,406	2,583	2,868	3,321	3,843
EBIDTA	**226**	**310**	**366**	**430**	**509**
EBITDA margin (%)	8.6	10.7	11.3	11.5	11.7
- Interest expenses	85	57	74	83	76
- Depreciation	58	59	69	78	82
+ Other income	39	22	25	30	35
- Tax	27	62	74	90	116
Effective tax rate (%)	22.1	28.7	30.0	30.0	30.0
+ Associates/(Minorities)	-	-	-	-	-
Adjusted PAT	95	153	174	210	270
+ Extraordinary items	-24	-43	-	-	-
Reported PAT	71	110	174	210	270
Adj. FDEPS (₹/share)	9.5	15.3	17.4	21.0	27.0
Adj. FDEPS growth (%)	51.0	60.8	13.3	20.8	28.8

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	100	100	100	100	100
Reserves & surplus	277	357	502	683	924
Net worth	377	457	602	783	1,024
Total debt	444	468	618	622	527
Minority interest	-	-	-	-	-
Def. tax liab. (net)	65	75	75	75	75
Capital employed	**886**	**1,001**	**1,295**	**1,479**	**1,625**
Net fixed assets	911	882	938	1,061	1,079
Intangible assets	-	-	-	-	-
Investments	140	308	308	308	308
- of which, Liquid	140	308	308	308	308
Working capital	-188	-199	-100	-104	-112
Cash	23	9	148	214	350
Capital deployed	**886**	**1,001**	**1,295**	**1,479**	**1,625**
WC days	-26	-25	-11	-10	-9
Book value (₹/sh)	37.7	45.7	60.2	78.3	102.4

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	95	153	174	210	270
+ Non-cash items	58	59	69	78	82
Cash profit	153	212	242	288	352
- Incr./(decr.) in WC	-199	-11	98	-4	-8
Operating cash-flow	353	223	144	291	360
- Capex	-5	30	125	200	100
Free-cash-flow	357	193	19	91	260
- Dividend	29	30	29	29	29
+ Equity raised	0	-	0	0	0
+ Debt raised	-158	35	149	4	-95
- Investments	140	168	-	-	-
- Misc. items	-24	-43	-	-	-
Net cash-flow	6	-14	140	66	136
+ Op. cash & bank bal.	17	23	9	148	214
Cl. cash & bank bal.	23	9	148	214	350

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹518

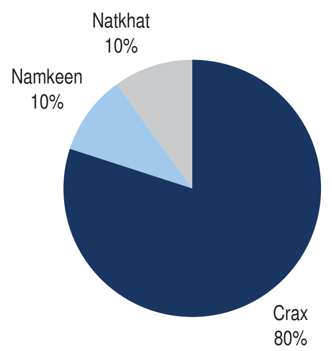
Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	54.3	33.8	29.8	24.7	19.2
Cash P/E (x)	33.8	24.4	21.4	18.0	14.7
EV/EBITDA (x)	24.1	17.2	14.6	12.3	9.9
EV/sales (x)	2.1	1.8	1.7	1.4	1.2
P/B (x)	13.7	11.3	8.6	6.6	5.1
RoE (%)	26.7	36.7	32.8	30.3	29.9
RoCE (%)	22.0	28.8	28.0	27.6	29.8
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5
Dividend payout (%)	30.6	19.6	16.8	13.9	10.8
Net debt/equity (x)	0.7	0.3	0.3	0.1	-0.1
Debtor (days)	0	0	0	0	0
Inventory (days)	21	23	23	23	23
Payables (days)	53	53	46	45	45
Fixed asset T/O (x)	2.9	3.3	3.4	3.5	4.0
Oth Income/PBT (%)	31.7	10.0	10.1	10.0	9.1

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Revenue break-up (FY15)



Source: Company

Play on the growing snacks market

In the last five years India snacks market doubles

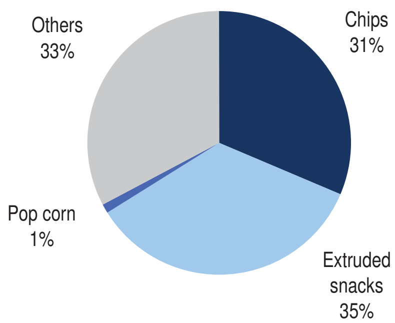
The India snacks market, estimated at ~₹150bn in 2014, has seen a 15% CAGR in the last five years. Key players are MNCs (Pepsico, Agrotech), domestic players (Haldiram, Balaji Wafers, ITC) and regional players (DFM Foods, Prakash Snacks). The Indian consumers' taste preferences and value consciousness have meant domestic and regional players have grown ahead of the market and gained market share in such a highly competitive context.

Product launches, increasing disposable incomes (due to lower inflation) and distribution expansion would drive the snacks market by a 12-13% CAGR over 2014-17, in our view.

DFM Foods primarily operates in the extruded-snacks sub-segment, estimated at ₹50bn. Crax corn rings were launched in 1984 but has only gained management focus in recent years. Despite this, the company has been able to scale the brand to ₹3bn-3.5bn giving it a market share of over 20% in the North Indian market.

Extruded snacks constitute a third of the overall snacking market in India, estimated at ₹150bn. DFM Foods enjoys a ~7% share in this market

Fig 7 – India snacks market (₹150bn) – break-up



Source: Industry, Anand Rathi Research

Fig 8 – Brand positioning across the snacks category

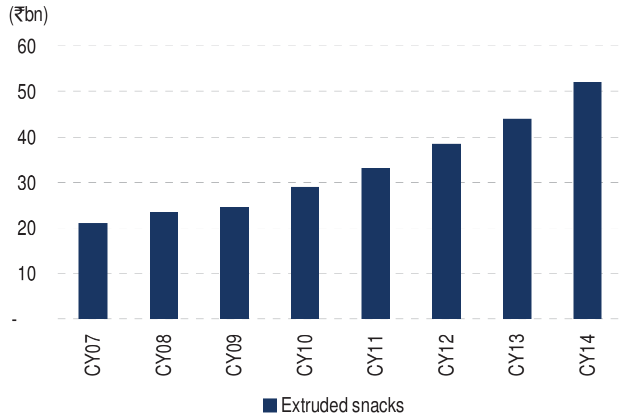
Company	Brands	Target customers / positioning
DFM Foods	Crax	Children
Pepsico	Lays, Kurkure	Young customers / family consumption
ITC	Bingo	No customer preference
Haldirams	Haldirams	Family consumption
Balaji Wafers	Balaji	Value-for-money offering
Prakash Snacks	Yellow Diamond	No customer preference
Agro-tech	ACT-II	Corn-based snacks

Source: Anand Rathi Research

Targeting healthy kid-snacking

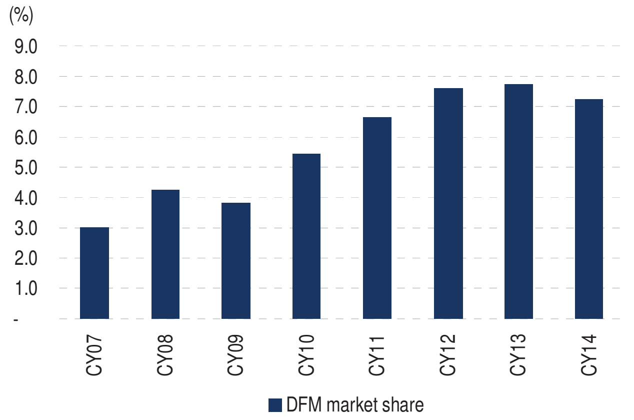
DFM offers corn rings and wheat puffs marketed under the Crax and Natkhat brands, respectively. Corn rings and *namkeen* packs are sold at ₹5 and ₹10 price points, while Natkhat retails at ₹2, which makes all its products affordable to targeted customers, children. In fact, children, given little purchasing power, prefer to spend more on low-ticket impulse purchases. Thus, more than 95% of sales of Crax rings arises from the ₹5 SKU, reflecting its high popularity and affordability among children, driving sales growth. Also, being a corn-based extruded snack, it is considered healthier than other packaged snacks; even adults don't mind children indulging in them.

Fig 9 – Extruded snacks have grown 2.5x in seven years



Source: Industry, Anand Rathi Research

Fig 10 – DFM gains ~7% of the market in extruded snacks

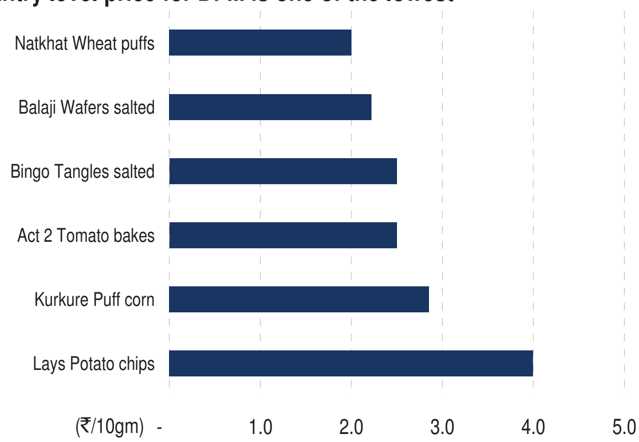


Source: Industry, Anand Rathi Research

Amongst the lowest-priced snacks

The company's flaghip product, Crax - Corn Rings and Namkeens, are sold in ₹5 and ₹10 packs. Natkhat is at an entry price of ₹2. This renders all its products affordable to customers at the bottom of the pyramid. Also, these lower points have widened the target customer base significantly and helped the company in the last few years gain market share in extruded snacks.

Fig 11 – Entry level price for DFM is one of the lowest



Source: Industry, Anand Rathi Research

Niche operator, innovative marketing

Innovative marketing keeps A&P low

Corn rings is a relatively untouched sub-segment by larger brands. Hence, DFM Foods has successfully exploited this. It has positioned Crax Corn Rings as children-snacking products (for ages 6-14 years) and concentrated all its marketing around this.

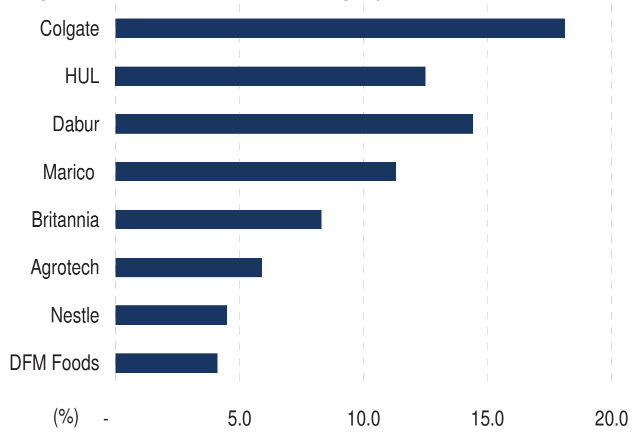
It advertises largely on kids channels (Cartoon Network, Pogo, etc.), so as to maximise its reach to its target customer group. This has helped it create brand awareness and equity in a crowded snacks market.

Also, in terms of products, Crax attracts kids because of flavours and structure (rings on their fingers). To retain young consumers (kids), the strategy of giving free gifts (toys) in each pack was adopted. The company also involves below-the-line promotional activity such as school contact programmes, on the ground activity, etc., to increase engagement with target customers, children.

DFM Foods has low A&P spends, just 5% of net sales, owing to innovative marketing and targeted kid-based ad spends

Thus, its innovative strategy of free gifts, promotions and advertising on the low-media-cost kids channels have helped the company hold its A&P spends low, at just ~5% of net sales. This makes DFM's A&P spending one of the lowest in the industry.

Fig 12 – A&P spends less than other FMCG players



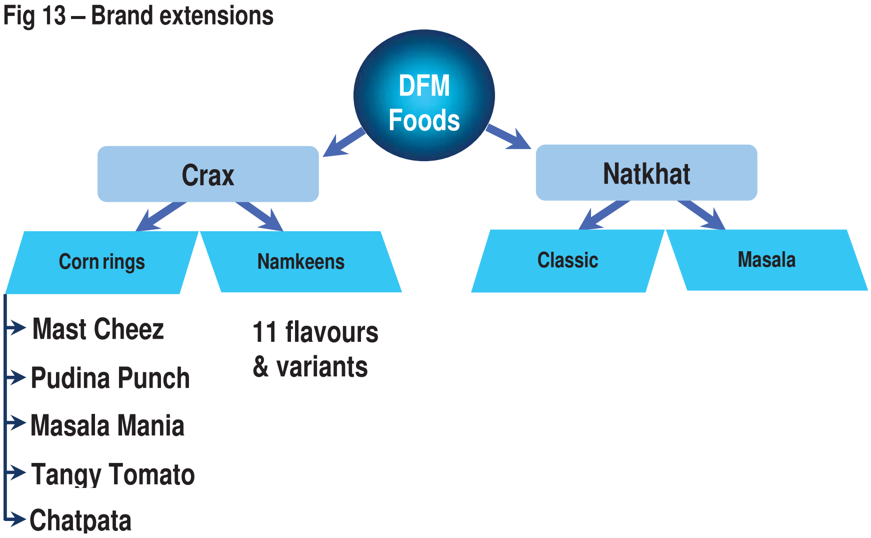
Source: Companies

Driving brand extensions

The company plans to introduce flavours and variants within its existing brands. It has five variants under the Crax brand, two under its Natkhat brand and 11 in Namkeens, including *bhujiyas, daals*, mixtures and nut-mixes. Brand extensions such as Crax Krunchoids and the recently-introduced Crax Corn Rings Mast Cheez have been tried and tested in the market.

The company also plans to launch brand extensions/ variants for adults / higher age groups. This would help it tap a broader market.

Fig 13 – Brand extensions



Source: Company

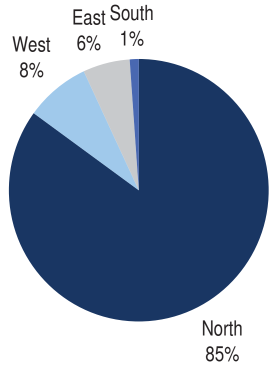
Distribution expansion

Strong presence in the north

DFM Foods has gained a ~21% market share in north India and will continue to grow in that region through the capacity expansion of its manufacturing unit in Noida and by deepening penetration. It has been widening its operations to new areas through its network of 235,000 retail outlets. It plans to increase its capacity at the Noida unit by ~30%, or 5,000 tons, to cater to mounting demand.

Looking to broaden its distribution into the east and west of India. Has recently made a foray into the south

Fig 14 – The northern region contributes predominantly



Source: Company

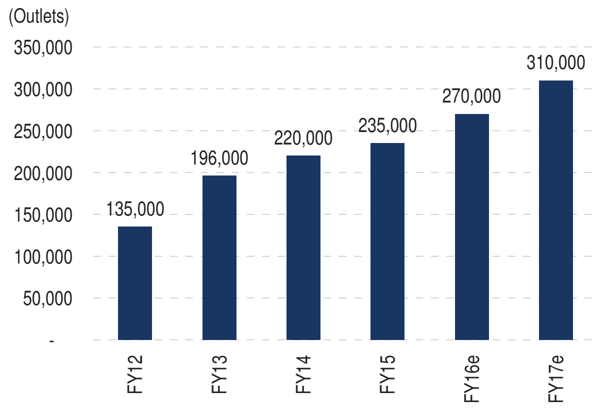
Foray into the south to aid growth impetus

DFM has been an under-leveraged brand. While all its marketing has been on national platforms such as Cartoon Network and Pogo, its retail operations were only in north India. Hence, company investments are not fully exploited. There is healthy scope for it to expand its distribution in east and west India. It continues, therefore, to focus on deepening its penetration in the east and the west, and plans to expand distribution there by 15–20% every year.

It plans to set up more units near its markets. Also it is offering high distributor margins in new zones (~15%, vs. 7% in the north) to push its products.

Recently, it entered the southern market with a Crax launch in Hyderabad, Bangalore and Chennai.

Fig 15 – Distribution network



Source: Company, Anand Rathi Research

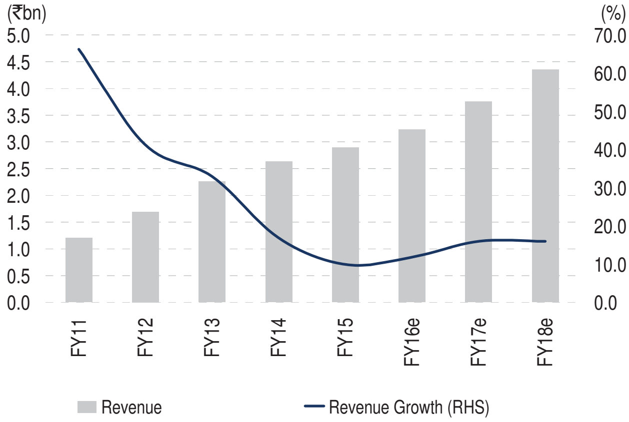
Financials

Revenue at a 15% CAGR over FY15-18

In the past four years DFM has posted a 25% CAGR in revenue, driven by robust growth in snacks. However, the recent slowdown in the broader FMCG market and capacity constraints had led to subdued, 10%, growth in FY15. With the new brownfield capacity expansion, distribution expansion and expected urban demand upturn in H2 FY16, we expect it to post a 15% CAGR in revenue over FY15-18.

We expect DFM Foods to post 15% revenue growth over FY15-18, assisted by the brownfield capacity expansion, distribution expansion and expected revival in urban demand

Fig 16 – Revenue momentum to rebound

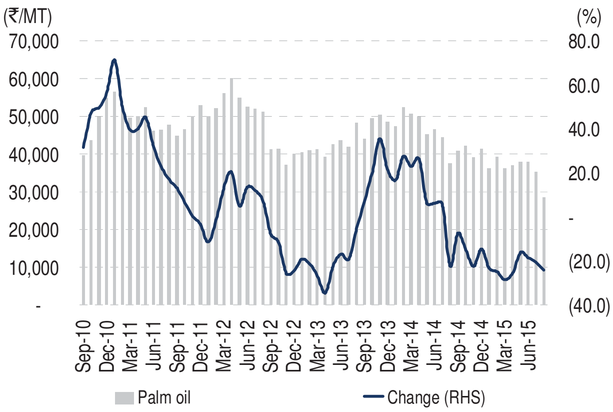


Source: Company, Anand Rathi Research

Healthy margin expansion

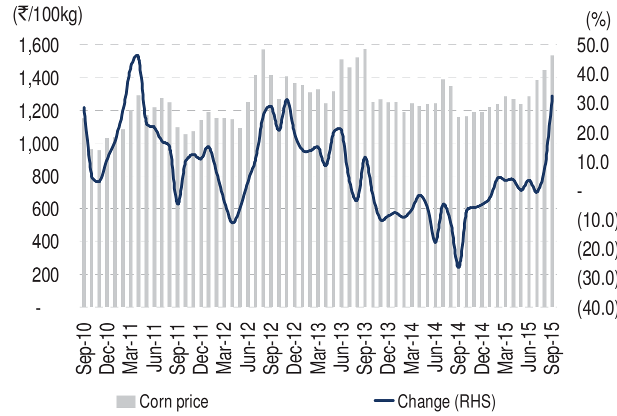
Despite the tough environment and volatility in raw material prices, the company has expanded its gross margin by ~300bps in the last four years, to ~39%. The fall in prices of its major raw materials (corn, HDPE, palm oil) has led to its gross margin further expanding to ~41% in Q1 FY16 (the highest quarterly margin in six years). Management expects to maintain the gross margin at 40%+, even in case of raw material price inflation, helped by the grammage reduction in packs, which would constitute indirect price hikes.

Fig 17 – Palm oil prices continue to slide



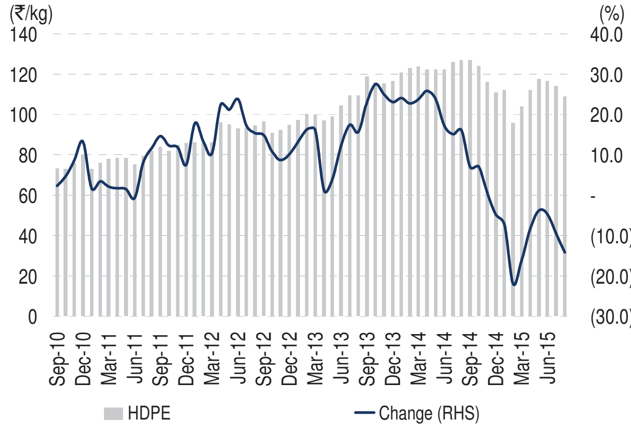
Source: Bloomberg, Anand Rathi Research

Fig 18 – Maize (corn) prices have risen recently



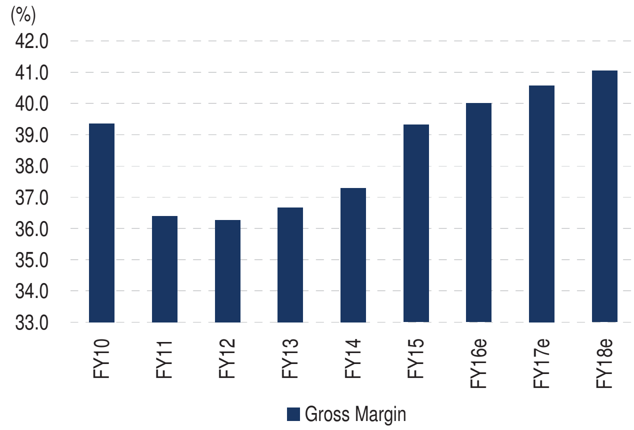
Source: Bloomberg, Anand Rathi Research

Fig 19 – HDPE prices benign



Source: Marico, Anand Rathi Research

Fig 20 – The gross margin has expanded ~300bps from the FY11 low

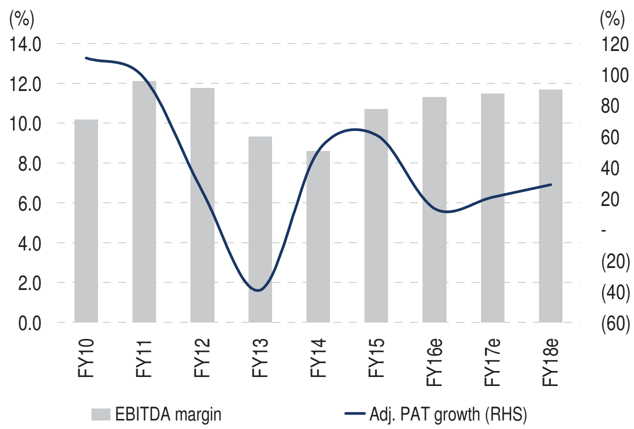


Source: Company, Anand Rathi Research

Targeted brand spends drive low A&P spends; EBITDA margin to rise 100bps over FY15-18

Targeted ad-spends addressing children led to A&P spends sliding from 9.5% of net sales in FY11 to just 4.1% in FY15. While expansion into new markets would drive higher ad-spends, low media rates for kids channels are expected to keep A&P spending low, at ~5%. Thus, much of the gross-margin gain (~170bps over FY15-18) would flow to the EBITDA margin.

Fig 21 – EBITDA margin to improve further

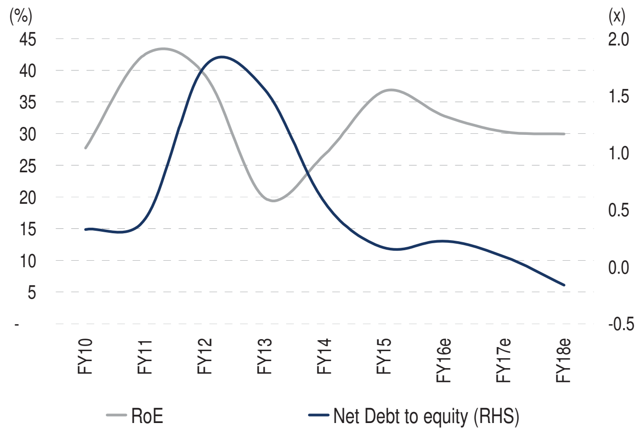


Source: Company, Anand Rathi Research

Negative working capital, comfortable debt, healthy return ratios

The company works on negative working capital, with strong advances from customers, reflecting its brand strength and demand for its products. It has a very strong balance sheet, with comfortable leverage (net-debt-to-equity for FY15 at 0.2x). For the last five years it has paid dividends and the FY15 RoE has come at a healthy 37%.

Fig 22 – Return ratios to be healthy, at over 30%; debt to come off



Source: Company, Anand Rathi Research

Fig 23 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Revenues	**2,633**	**2,893**	**3,234**	**3,751**	**4,351**
Growth (%)	*16.9*	*9.9*	*11.8*	*16.0*	*16.0*
Material cost	-1,651	-1,755	-1,940	-2,229	-2,566
Employee cost	-230	-262	-291	-341	-396
Manufacturing cost	-216	-289	-323	-375	-435
Marketing cost	-137	-119	-136	-169	-207
Administrative cost	-76	-71	-81	-94	-109
Energy cost	-61	-58	-65	-75	-87
Other cost	-34	-29	-32	-38	-44
EBITDA	**226**	**310**	**366**	**430**	**509**
Growth (%)	*7.7*	*36.8*	*18.0*	*17.7*	*18.2*
EBITDA margin (%)	*8.6*	*10.7*	*11.3*	*11.5*	*11.7*
Other income	39	22	25	30	35
Operating profit	**265**	**331**	**391**	**460**	**544**
Depreciation	-58	-59	-69	-78	-82
EBIT	**207**	**272**	**322**	**382**	**462**
Interest cost	-85	-57	-74	-83	-76
PBT	**122**	**215**	**248**	**300**	**386**
Tax	-27	-62	-74	-90	-116
Effective tax rate	*22.1*	*28.7*	*30.0*	*30.0*	*30.0*
PAT	**95**	**153**	**174**	**210**	**270**
Minority interest	-	-	-	-	-
Consol PAT	**95**	**153**	**174**	**210**	**270**
Growth (%)	*51.0*	*60.8*	*13.3*	*20.8*	*28.8*
PAT margin (%)	*3.6*	*5.3*	*5.4*	*5.6*	*6.2*
Extraordinary income	-24	-43	-	-	-
Dividends (incl Tax)	-29	-30	-29	-29	-29
Transferred to reserves	**42**	**80**	**144**	**180**	**241**
Per-share data					
FDEPS (₹)	9.5	15.3	17.4	21.0	27.0
DPS (₹)	2.5	2.5	2.5	2.5	2.5
Adj BV (₹)	37.7	45.7	60.2	78.3	102.4
CEPS (₹)	15.3	21.2	24.2	28.8	35.2
Valuation ratio					
P/E (x)	54.3	33.8	29.8	24.7	19.2
P/adj BV (x)	13.7	11.3	8.6	6.6	5.1
P/C (x)	33.8	24.4	21.4	18.0	14.7
Dividend yield (%)	0.5	0.5	0.5	0.5	0.5
EV/S (x)	2.1	1.8	1.7	1.4	1.2
EV/E (x)	24.1	17.2	14.6	12.3	9.9
Quality ratio					
Dividend payout (%)	30.6	19.6	16.8	13.9	10.8
Other income/PBT (%)	31.7	10.0	10.1	10.0	9.1
Interest cover (x)	2.4	4.8	4.4	4.6	6.1
Operating CF/EBITDA (x)	1.6	0.7	0.4	0.7	0.7

Source: Company, Anand Rathi Research

Fig 24 – Balance Sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Equity	100	100	100	100	100
Reserves	277	357	502	683	924
Minority interests	-	-	-	-	-
Net worth	**377**	**457**	**602**	**783**	**1,024**
Equity (% of CE)	*42.6*	*45.7*	*46.5*	*52.9*	*63.0*
LT debt	374	392	592	592	492
ST debt	70	77	26	30	35
DTL (net)	65	75	75	75	75
Total debt	**509**	**543**	**692**	**697**	**601**
Net D/E (x)	*0.9*	*0.5*	*0.4*	*0.2*	*-0.1*
Capital employed	**886**	**1,001**	**1,295**	**1,479**	**1,625**
Gross block	1,092	1,118	1,218	1,418	1,518
Acc depreciation	-183	-236	-304	-382	-464
Net block	**909**	**882**	**913**	**1,036**	**1,054**
CWIP	3	0	25	25	25
Fixed assets	**911**	**882**	**938**	**1,061**	**1,079**
Investments	140	308	308	308	308
Cash equivalents	23	9	148	214	350
Inventories	149	183	205	238	279
Debtors	0	0	0	0	0
Loans & advances	31	36	49	56	65
Other current assets	11	-	58	68	78
Current assets	**215**	**227**	**460**	**576**	**773**
Creditors	-335	-358	-397	-451	-520
Provisions	-45	-59	-15	-15	-15
Current liabilities	**-380**	**-417**	**-412**	**-466**	**-535**
Net current assets	**-166**	**-190**	**48**	**111**	**238**
Capital deployed	**886**	**1,001**	**1,295**	**1,479**	**1,625**
FA/CE (%)	*102.9*	*88.2*	*72.5*	*71.7*	*66.4*
Investments/CE (%)	*0.0*	*0.0*	-	-	-
Liquid assets/CE (%)	*18.4*	*31.7*	*35.2*	*35.3*	*40.5*
Working capital/CE (%)	*-21.2*	*-19.9*	*-7.7*	*-7.0*	*-6.9*

Source: Company, Anand Rathi Research

Fig 25 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Cash profit	153	212	242	288	352
Chg in WC	199	11	-98	4	8
Operating CF	**353**	**223**	**144**	**291**	**360**
Capex	5	-30	-125	-200	-100
Free CF	**357**	**193**	**19**	**91**	**260**
Equity	0	-	0	0	0
Debt	-158	35	149	4	-95
Investments	-140	-168	-	-	-
Dividends	-29	-30	-29	-29	-29
Misc inflows	-24	-43	-	-	-
Net change in cash	**6**	**-14**	**140**	**66**	**136**
Opening cash	17	23	9	148	214
Closing cash	**23**	**9**	**148**	**214**	**350**

Source: Company, Anand Rathi Research

Fig 26 – Ratio analysis @ ₹518

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Dupont Analysis					
Margins (%)	7.9	9.4	10.0	10.2	10.6
Capital turn (x)	2.8	3.1	2.8	2.7	2.8
RoCE (%)	22.0	28.8	28.0	27.6	29.8
Leverage factor(x)	2.6	2.3	2.2	2.0	1.7
Interest burden (x)	0.6	0.8	0.8	0.8	0.8
Tax burden (x)	0.8	0.7	0.7	0.7	0.7
Consol factor (x)	1.0	1.0	1.0	1.0	1.0
RoE (%)	26.7	36.7	32.8	30.3	29.9
Working capital (days)					
Inventories	21	23	23	23	23
Debtors	0	0	0	0	0
Loans & advances	4	5	5	5	5
Other CA	2	-	7	7	7
Creditors	-46	-45	-45	-44	-44
Provisions	-6	-7	-2	-1	-1
Net WC	-26	-25	-11	-10	-9
Other ratios					
Op CF/Rev (%)	13.4	7.7	4.5	7.8	8.3
FCF/Rev (%)	13.6	6.7	0.6	2.4	6.0
Intangibles/GB (%)	-	-	-	-	-
Intangibles/CE (%)	-	-	-	-	-
Revenue/GB (x)	2.4	2.6	2.7	2.6	2.9
Revenue/FA (x)	2.9	3.3	3.4	3.5	4.0
CWIP/GB (x)	0.0	0.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Valuation

Potential remains

The company's national expansion plan through greater scale, cost-efficiency measures and benign input costs would drive a 21% earnings CAGR over FY15-18. We believe that earnings growth could surprise because of the benign input cost environment and higher-than-expected revenue growth. We initiate coverage on DFM Foods, with a Buy rating and a price target of ₹650 (based on 27x Sep'17). At the ruling market price of ₹518, it trades at 30x FY16e EPS of ₹17.4 and 25x FY17e EPS of ₹21.

Fig 27 – PE band

Source: Bloomberg, Anand Rathi Research

Key Risks

- A sharp rise in input costs
- Aggressive competition in the kids sub-segment could impact growth and profitability.

Company Background & Management

DFM Foods is a niche player, focused on ready-to-eat snacks for children. For the past several years it had been into wheat and wheat-flour trading. However, in 2009 management shifted focus to the high-growth snacks business by ceasing its wheat business, a drag on profit. The experience of its wheat and wheat-flour business helped it in backward integration and provided it with a sourcing edge.

The company introduced Crax corn rings in 1984. Corn rings and wheat puffs are marketed under the Crax and Natkhat brands, respectively. Both these have become extremely popular snacks, especially among children. In the *namkeen* sub-segment, it offers a complete range of products consisting of 11 product variants including *bhujiyas, daals*, mixtures and nut-mixes. These are sold in several pack sizes to cater to both casual/impulse consumption as well as consumption at home.

Fig 28– DFM Foods products

Source: Company

Management

Mohit Jain: CMD since 1994, has 40 years' experience and expertise in the industry and has played a major role in the growth and development of this business. He has a B.A. Hons. in economics and is responsible for overall strategy and business administration.

Son **Rohan Jain** (32 years old): Deputy MD has a B.Sc. in economics from The Wharton School, University of Pennsylvania, USA. He heads operations, focusing on marketing and branding.

Rajiv Raina: Executive director since 1995 is chief operating officer and vice-president. He worked at the Madhya Pradesh Consultancy Organisation. He holds a Masters in Business Administration (MBA).

19 October 2015

Dabur

Rating: **Buy**
Target Price: ₹330
Share Price: ₹273

Consistent performer; upgrading to a Buy

Despite a slowing market, Dabur has held to its more than 8% volume momentum. This, with its strong launch pipeline, distribution initiatives and health-platform re-positioning, is expected to drive continuing medium-term growth. We forecast 18% earnings growth driven by 15% revenue growth and an EBITDA-margin gain of 140bps over FY15-18. We upgrade the stock to a Buy, with a ₹330 target (~21% potential).

New health positioning, a catalyst for growth. Dabur aims to re-invent itself—from a traditional FMCG company to consumer healthcare relevant to new-age consumers. It plans to formulate its consumer communication aiming at younger generations. The re-positioning is likely to benefit a large part of its revenue with links to a health platform (Chayawnprash, Hajmola, toothpastes and Real Active).

Urban-market focus paying off as rural market slows. Dabur was one of the first consumer companies to focus on the urban market (better distribution abilities) last year, aiming to benefit from an anticipated rebound in urban consumption. With rural-market growth decelerating and visible signs of a small rise in urban demand, its urban-market focus seems to have paid off.

Favourable input tailwinds to drive an EBITDA-margin gain of 140bps. Dabur has diversified its input basket, helping guard against input inflation. However, broad-based commodity drops are expected to drive a gross-margin gain of 80bps. We expect part of this would be ploughed back in the business in terms of higher A&P spending to support launches and volume growth.

Valuation. At ₹273, the stock quotes at 37x FY16e EPS of ₹7.3 and 32x FY17e EPS of ₹8.6. It has dropped ~10% in the last three months. Along with consistent growth, this makes it an interesting play. Hence, we upgrade it to a Buy. **Risk:** The poor monsoon could impact rural demand and drive input-cost inflation.

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	70,734	78,064	88,671	102,799	119,381
Net profit (₹ m)	9,128	10,654	12,883	15,190	17,731
EPS (₹)	5.2	6.1	7.3	8.6	10.1
Growth (%)	18.9	15.9	20.9	17.9	16.7
PE (x)	52.1	44.9	37.2	31.5	27.0
PBV (x)	17.9	14.3	11.6	9.5	7.9
RoE (%)	38.2	35.5	34.4	33.2	31.9
RoCE (%)	33.1	34.3	36.5	37.3	37.3
Dividend yield (%)	0.6	0.7	0.9	1.1	1.3
Net gearing (x)	-0.2	-0.4	-0.5	-0.6	-0.6

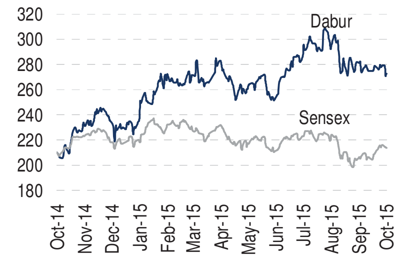
Source: Company, Anand Rathi Research

Key data	DABUR IN / DABU.BO
52-week high/low	₹317 / ₹196
Sensex/Nifty	27215 / 8238
3-m average volume	$6.8m
Market cap	₹479bn / $7.4bn
Shares outstanding	1,757m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	68.1	68.2	68.2
- of which, Pledged	0.0	0.0	0.0
Free Float	31.9	31.8	31.8
- Foreign Institutions	21.0	21.1	21.0
- Domestic Institutions	4.4	4.6	4.7
- Public	6.5	6.1	6.2

Estimates revision (%)	FY16e	FY17e
Sales	-	0.5
EBITDA	-2.0	-1.4
EPS	-	0.1

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	70,734	78,064	88,671	102,799	119,381
Revenue growth (%)	15.1	10.1	13.7	15.9	16.1
- Op. expenses	59,387	65,111	73,042	84,321	97,922
EBIDTA	**11,347**	**12,953**	**15,628**	**18,478**	**21,459**
EBITDA margin (%)	16.0	16.6	17.6	18.0	18.0
- Interest expenses	542	401	321	238	163
- Depreciation	975	1,150	1,170	1,294	1,403
+ Other income	1,514	1,788	2,010	2,210	2,518
- Tax	2,191	2,509	3,230	3,927	4,650
Effective tax rate (%)	19.4	19.1	20.0	20.5	20.8
+Associates/(Minorities)	-25	-26	-35	-40	-30
Adjusted PAT	9,128	10,654	12,883	15,190	17,731
+ Extraordinary items	12	-	-	-	-
Reported PAT	9,139	10,654	12,883	15,190	17,731
Adj. FDEPS (₹/share)	5.2	6.1	7.3	8.6	10.1
Adj. FDEPS growth (%)	18.9	15.9	20.9	17.9	16.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	1,744	1,757	1,757	1,757	1,757
Reserves & surplus	24,816	31,785	39,530	48,555	59,092
Net worth	26,560	33,541	41,287	50,311	60,849
Total debt	9,920	7,798	5,943	4,514	3,097
Minority interest	159	182	217	257	287
Def. tax liab. (net)	448	587	671	771	871
Capital employed	**37,087**	**42,108**	**48,118**	**55,853**	**65,103**
Net fixed assets	17,886	19,274	20,401	22,208	24,004
Intangible assets	-	-	-	-	-
Investments	10,765	18,134	18,134	18,134	18,134
- of which, Liquid	10,751	18,120	18,120	18,120	18,120
Working capital	3,242	1,939	1,891	1,210	1,637
Cash	5,194	2,760	7,692	14,302	21,328
Capital deployed	**37,087**	**42,108**	**48,118**	**55,853**	**65,103**
WC days	17	9	8	4	5
Book value (₹/sh)	15.2	19.1	23.5	28.6	34.6

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	9,128	10,654	12,883	15,190	17,731
+ Non-cash items	975	1,150	1,170	1,294	1,403
Cash profit	10,103	11,804	14,053	16,483	19,134
- Incr./(decr.) in WC	-3,362	-1,303	-49	-681	427
Operating cash-flow	13,465	13,107	14,102	17,164	18,707
- Capex	2,117	2,538	2,297	3,100	3,200
Free-cash-flow	11,348	10,569	11,805	14,064	15,507
- Dividend	3,052	3,509	5,138	6,165	7,193
+ Equity raised	-733	-141	35	40	30
+ Debt raised	-3,063	-1,984	-1,770	-1,329	-1,317
- Investments	4,446	7,369	-	-	-
- Misc. items	12	-	-	-	-
Net cash-flow	66	-2,433	4,932	6,610	7,027
+ Op. cash & bank bal.	5,128	5,194	2,760	7,692	14,302
Cl. cash & bank bal.	5,194	2,760	7,692	14,302	21,328

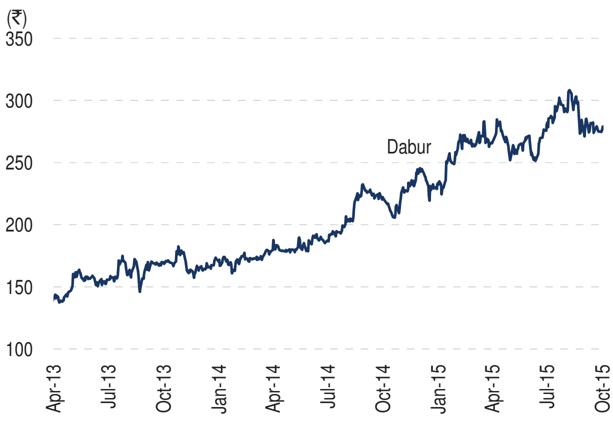
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @₹273

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	52.1	44.9	37.2	31.5	27.0
Cash P/E (x)	47.0	40.6	34.1	29.0	25.0
EV/EBITDA (x)	41.7	35.9	29.4	24.4	20.6
EV/sales (x)	6.7	6.0	5.2	4.4	3.7
P/B (x)	17.9	14.3	11.6	9.5	7.9
RoE (%)	38.2	35.5	34.4	33.2	31.9
RoCE (%)	33.1	34.3	36.5	37.3	37.3
Dividend yield (%)	0.6	0.7	0.9	1.1	1.3
Dividend payout (%)	33.4	32.9	39.9	40.6	40.6
Net debt/equity (x)	-0.2	-0.4	-0.5	-0.6	-0.6
Debtor (days)	35	33	33	31	28
Inventory (days)	50	45	45	45	45
Payables (days)	82	88	87	87	85
Fixed asset T/O (x)	4.0	4.1	4.4	4.6	5.0
Oth Income/PBT (%)	10.5	12.0	10.5	9.7	9.4

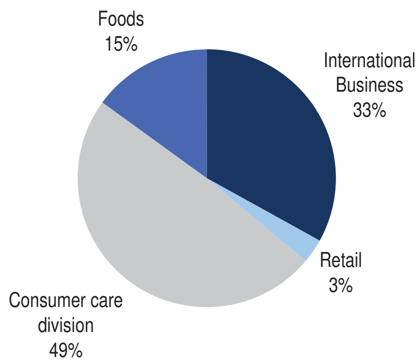
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue break up (FY15)



Source: Company

Health positioning, a growth catalyst

The strategy of "getting the future ready" Project LEAD and Project CORE are part of Dabur's larger brand re-positioning towards a health and youth platform

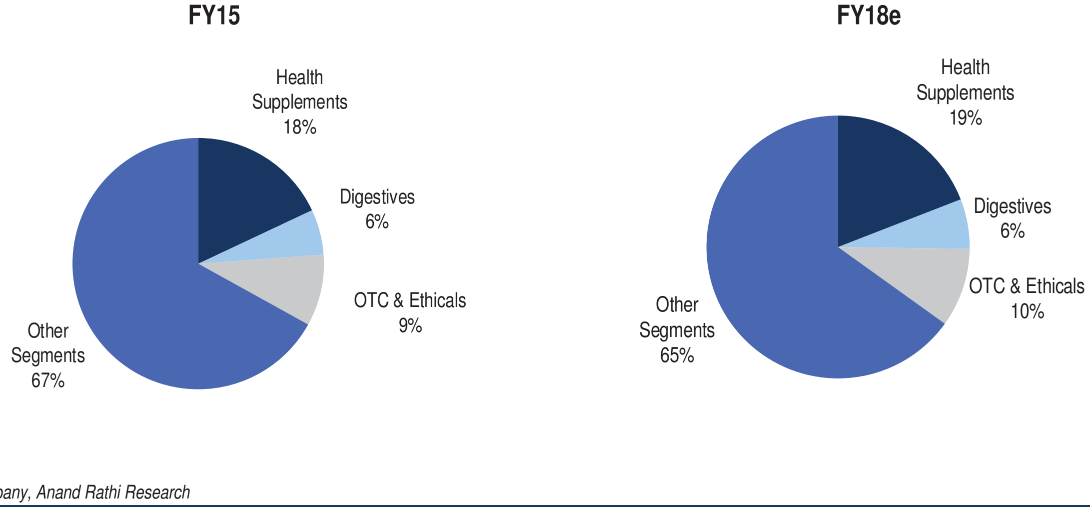
Re-inventing itself as less traditional

Dabur is re-inventing itself—from a general FMCG company rooted in the old world to a less traditional consumer-healthcare company, relevant to new-age consumers. It plans to re-brand its product range, with Pudin Hara, Chyawanprash, Hajmola and Dashmularishta (earlier largely catering to middle-agers) as more youth-oriented under its *'Getting the future ready'* strategy. Further, health will be a key attribute that would inform the entire product range.

At present, ~33% of its domestic revenue arises from health-positioned brands, which management plans to increase gradually over time. Thus, even brands such as Amla hair oil and Odonil air-freshener will have some health benefits. For instance, air-fresheners could come on a germ-killing-properties plank.

In fact, the new project 'LEAD', envisaging separate sales teams (medical representatives) for healthcare to advocate and generate demand from doctor prescriptions, would further enhance the healthcare positioning. The company has recruited already 170 medical representatives to reach *ayurved* and allopath doctors. The strength of the team will be increased to 275 by end-FY16.

Fig 7 – Proportion of health-positioned brands to grow to 35% in FY18



Source: Company, Anand Rathi Research

Focus on innovations and re-launches

Dabur has a strong set of brands; three generate more than ₹10bn revenue each (Amla, Real and Vatika); another 11 bring in at least ₹1bn each. This hasn't stopped the efforts at innovation/re-innovation or re-positioning. Thus, the company is targeting several youth-centric products and categories such as milk shakes and drinking yoghurt, now being test marketed. These could soon be rolled out nationally. In fact, in the recent past it has successfully rolled out several products/variants (Chyawanprash Sugar Free, Hajmola Anardana and Odomos roll-on and wear-on patches to name a few).

Fig 8 – Recent new products / variants launched

Source: Company

Urban market paying off, rural slows

Broad focus on urban markets through various measures

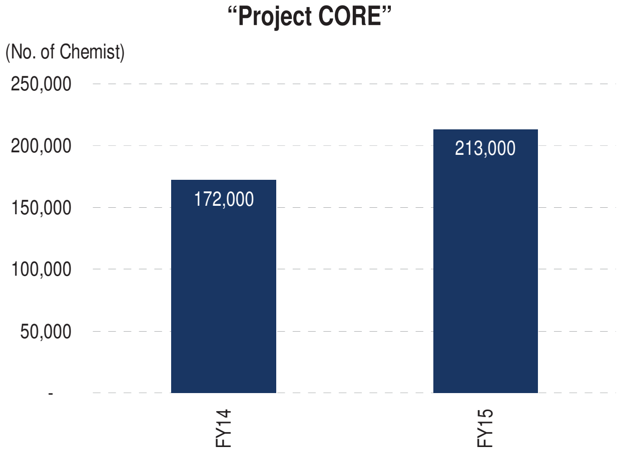
Dabur's Q1 FY16 domestic revenue growth was led by 12% urban growth vs. 10.5% rural growth. This indicates that its efforts in regard to urban distribution are paying off

'Project Double' increased rural penetration ~three times in the past four years (from 15,000 outlets in FY11 to 44,000 in FY15). So now Dabur India has launched *'Project CORE'* (Chemist Outlet & Range Expansion) to drive penetration of its healthcare portfolio in urban chemist outlets. It intends to widen its reach by 75,000 chemists (35% yoy growth) to drive its over-the-counter (OTC) healthcare, health supplements and personal-care products via the chemist channel. At present, it covers 5.3m outlets.

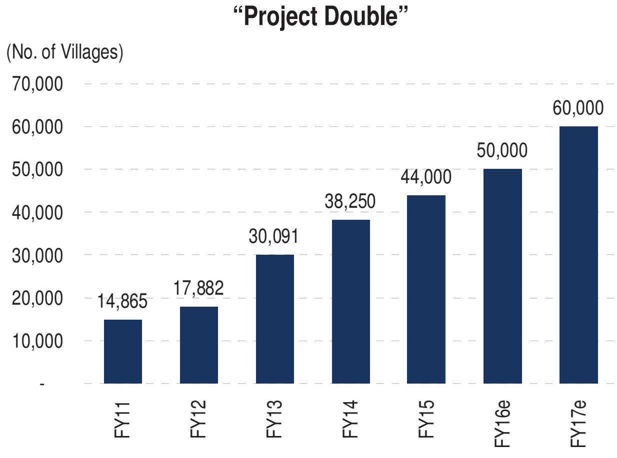
Another initiative called *'Project 50-50',* aims at leveraging the potential of the top 130 towns, which bring in 50% of urban consumption. The project includes segregating the grocery channel teams—for wholesale and for retail. This measure has been in line with the renewed focus on urban markets. Also, Dabur has commenced e-commerce with all key operators in market places and e-grocers.

Its Q1 FY16 domestic revenue growth was driven by 12% urban growth vs. 10.5% rural growth. This indicates that its efforts regarding urban distribution are paying off.

Fig 9 – Increase in distribution reach



Source: Company



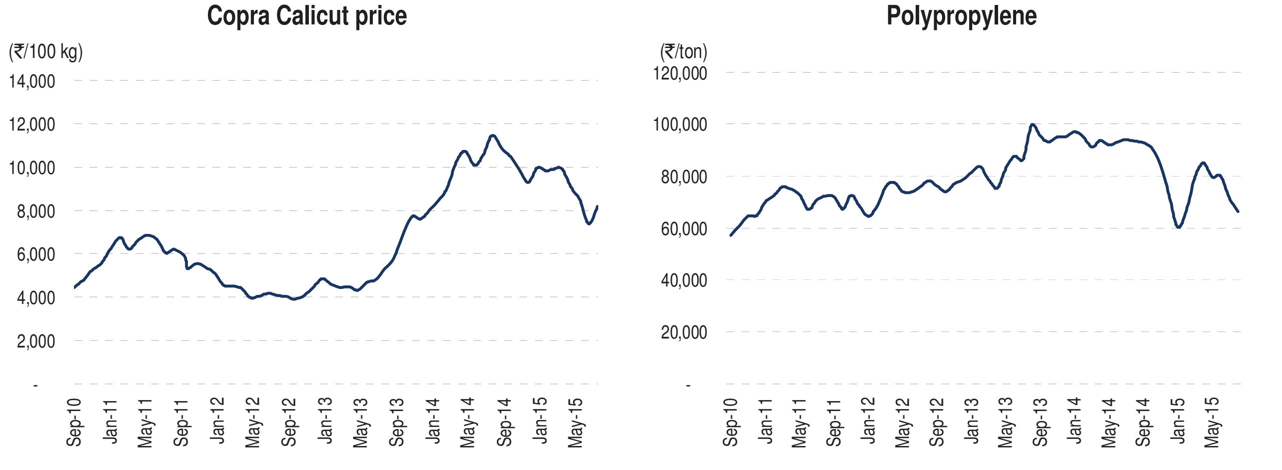
Source: Company, Anand Rathi Research

Margin expansion on the cards

Favourable input prices aiding gross-margin gain

Dabur has diversified its input basket, helping guard against input inflation. However, broad-based commodity price drops (copra down 30% yoy, packaging cost down 25-30% yoy) are expected to drive a gross-margin gain of ~100bps over FY15-18. In Q1 FY16, the company posted a yoy gross-margin gain of 320bps.

Fig 10 – Benign input cost



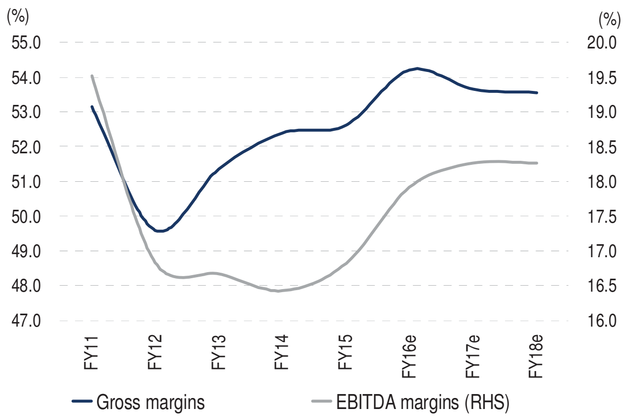
Source: Marico, Anand Rathi Research

Source: Bloomberg, Anand Rathi Research

EBITDA margin to expand 145bps over FY15-18

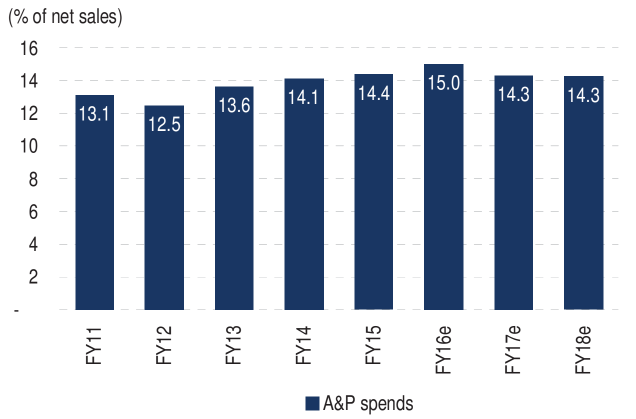
A part of the above gross-margin gain could be ploughed back into the business in terms of higher A&P spending to support launches and volume growth in FY16. Thus, we expect A&P spends to rise 60bps yoy to 15% in FY16 and soften thereafter. We project a yoy EBITDA-margin expansion of 140bps over FY15-18, to 18.2%, helped by a gross-margin gain of 80bps. This would thus drive a 19% CAGR in earnings over FY15-18.

Fig 11 – Margins to expand



Source: Company, Anand Rathi Research

Fig 12 – Ad-spend to be high



Source: Company, Anand Rathi Research

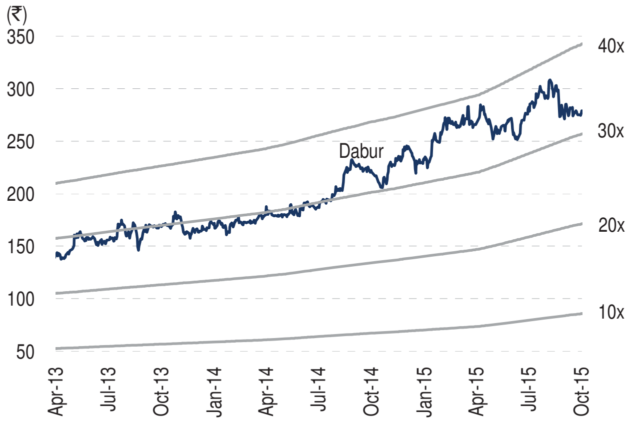
Valuations

Consistent showing drives the upgrade

Despite a slowing market, Dabur has held to its 8%+ volume momentum. This, along with a strong launch pipeline, distribution initiatives and re-positioning on a health platform, is expected to drive continuing medium-term growth. We forecast 18% earnings growth, driven by 15% revenue growth and an EBITDA-margin gain of 140bps over FY15-18.

The stock has slipped ~10% in the last three months, which along with consistent growth delivery makes it a worthy play in the consumer arena. Hence, we upgrade our recommendation to a Buy, with a ₹330 price target, implying ~20% potential. At the ruling market price of ₹273, it quotes at 37x FY16e EPS of ₹7.3 and 32x FY17e EPS of ₹8.6.

Fig 13 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- The inadequate rainfall could impact rural demand and drive input-cost inflation.

19 October 2015

Britannia

Rating: **Hold**
Target Price: ₹3,400
Share Price: ₹3,227

Baking a premium story; Hold

Britannia's perseverance over the last few years to premiumise its portfolio and create a health niche has paid off. Today, it not only enjoys a formidable lead in the fast-growing health and premium cookies sub-segment but shifting consumer preferences have meant it narrows its focus on biscuit leadership (a ~28% market share vs. leader Parle's 28%). With margin tailwinds likely to persist, we maintain a Hold recommendation on the stock.

A complete foods company in the making. While its non-biscuits sub-segment already generates ~25% of revenue, Britannia has set its sights on becoming a complete foods company. To begin with, it is aiming at the regulated dairy market (size: ₹750bn) and the snacking sub-segment (market size: ₹300bn).

Affordable premiums driving consistent mix improvement. Britannia's strategy of selling premium brands in smaller SKUs at popular price points of ₹5 and ₹10 not only attracts trials but also boosts on-the-go consumption. This, along with the shifting consumer preference for non-glucose biscuits, has benefited Britannia the most (the leader in the non-glucose sub-segment).

Margin gain to persist; could clock 14% in FY17. Margin tailwinds emanating from (a) a consistent mix-led gain (gross margins in premium biscuits are 1.2x–1.5x the regular variants), (b) cost-saving measures and (c) benign input costs are likely to propel the EBITDA margin beyond 14% by FY17.

Valuation. Britannia's consistent performance and strong earnings assurance have driven a re-rating (it quotes at ~40x FY17e). We believe the premium valuation will continue, and maintain a Hold rating on the stock, with a ₹3,400 target price (based on 38x Sep'17e). **Risks:** Keener competition and a rise in prices of key inputs: wheat, palm oil and sugar.

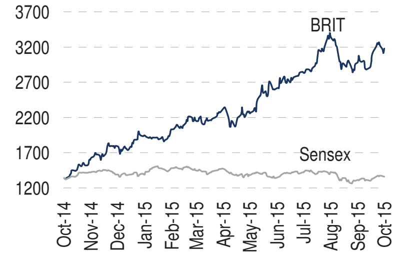
Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	69,127	78,584	90,050	104,228	120,233
Net profit (₹ m)	3,860	5,415	7,782	9,797	11,537
EPS (₹)	32.2	45.1	64.6	81.3	95.7
Growth (%)	53.3	40.3	43.1	25.9	17.8
PE (x)	100.3	71.5	50.0	39.7	33.7
PBV (x)	48.5	31.1	22.3	16.4	12.5
RoE (%)	56.9	53.0	52.1	47.7	42.2
RoCE (%)	58.0	67.8	71.6	67.9	60.5
Dividend yield (%)	0.4	0.5	0.6	0.8	0.9
Net gearing (x)	-0.2	-0.5	-0.6	-0.7	-0.7

Source: Company, Anand Rathi Research

Key data	BRIT IN / BRIT.BO
52-week high / low	₹3,435 / ₹1,300
Sensex / Nifty	27215 / 8238
3-m average volume	$12m
Market cap	₹387bn / $6bn
Shares outstanding	120m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	50.7	50.8	50.8
- of which, Pledged	-	-	-
Free Float	49.3	49.3	49.3
- Foreign Institutions	20.0	19.1	19.5
- Domestic Institutions	9.0	9.2	9.3
- Public	20.3	21.0	20.5

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	69,127	78,584	90,050	104,228	120,233
Revenue growth (%)	11.8	13.7	14.6	15.7	15.4
- Op. expenses	62,855	69,945	78,233	89,458	102,929
EBIDTA	**6,272**	**8,639**	**11,817**	**14,770**	**17,304**
EBITDA margin (%)	9.1	11.0	13.1	14.2	14.4
- Interest expenses	83	39	21	21	16
- Depreciation	832	1,445	1,253	1,343	1,421
+ Other income	239	869	900	1,000	1,100
- Tax	1,736	2,611	3,662	4,610	5,429
Effective tax rate (%)	31.0	32.5	32.0	32.0	32.0
+ Associates/(Minorities)	-1	2	-	-	-
Adjusted PAT	3,860	5,415	7,782	9,797	11,537
+ Extraordinary items	94	1,472	-	-	-
Reported PAT	3,954	6,886	7,782	9,797	11,537
Adj. FDEPS (₹/share)	32.2	45.1	64.6	81.3	95.7
Adj. FDEPS growth (%)	53.3	40.3	43.1	25.9	17.8

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	240	240	241	241	241
Reserves & surplus	7,741	12,211	17,173	23,445	30,753
Net worth	7,981	12,451	17,414	23,686	30,994
Total debt	1,727	1,707	770	813	861
Minority interest	24	24	24	24	24
Def. tax liab. (net)	89	-234	-120	-121	-122
Capital employed	**9,821**	**13,949**	**18,088**	**24,402**	**31,757**
Net fixed assets	9,547	8,924	9,688	10,345	10,924
Intangible assets	-	-	-	-	-
Investments	1,979	5,179	5,179	5,179	5,179
- of which, Liquid	1,939	5,169	5,169	5,169	5,169
Working capital	-2,795	-2,418	-2,627	-2,712	-2,783
Cash	1,091	2,263	5,848	11,589	18,436
Capital deployed	**9,821**	**13,949**	**18,088**	**24,402**	**31,757**
WC days	-15	-11	-11	-9	-8
Book value (₹/sh)	66.5	103.8	144.5	196.6	257.2

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	3,860	5,415	7,782	9,797	11,537
+ Non-cash items	832	1,445	1,253	1,343	1,421
Cash profit	4,692	6,860	9,034	11,139	12,959
- Incr./(decr.) in WC	-1,615	377	-208	-86	-71
Operating cash-flow	6,307	6,483	9,243	11,225	13,030
- Capex	1,538	822	2,016	2,000	2,000
Free-cash-flow	4,769	5,660	7,226	9,225	11,030
- Dividend	1,686	2,309	2,820	3,525	4,230
+ Equity raised	136	-107	1	-	-
+ Debt raised	-2,355	-343	-824	42	47
- Investments	897	3,201	-	-	-
- Misc. items	94	1,472	-	-	-
Net cash-flow	61	1,173	3,584	5,742	6,847
+ Op. cash & bank bal.	1,029	1,091	2,263	5,847	11,589
Cl. cash & bank bal.	1,091	2,263	5,847	11,589	18,436

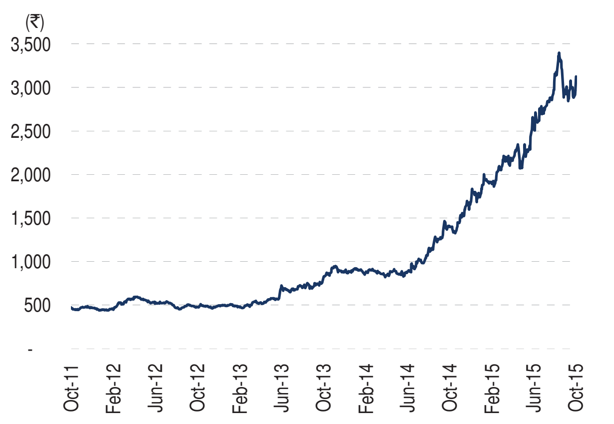
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @₹3,227

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	100.3	71.5	50.0	39.7	33.7
Cash P/E (x)	82.5	56.4	43.0	34.9	30.0
EV/EBITDA (x)	61.5	44.1	31.9	25.1	21.1
EV/sales (x)	5.6	4.9	4.2	3.6	3.0
P/B (x)	48.5	31.1	22.3	16.4	12.5
RoE (%)	56.9	53.0	52.1	47.7	42.2
RoCE (%)	58.0	67.8	71.6	67.9	60.5
Dividend yield (%)	0.4	0.5	0.6	0.8	0.9
Dividend payout (%)	43.7	42.6	36.2	36.0	36.7
Net debt/equity (x)	-0.2	-0.5	-0.6	-0.7	-0.7
Debtor (days)	6	6	6	6	6
Inventory (days)	22	19	18	17	17
Payables (days)	59	64	62	60	58
Fixed asset T/O (x)	7.2	8.8	9.3	10.1	11.0
Oth Income/PBT (%)	4.3	10.8	7.9	6.9	6.5

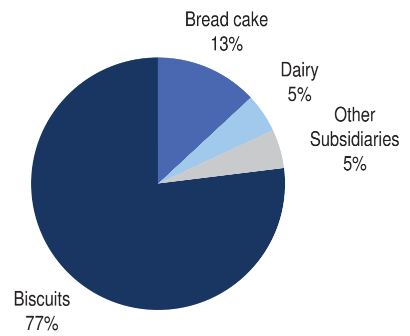
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue break-up (FY15)



Source: Company

Complete foods co. in the making

Sets sights on larger dairy and snacking segments

Britannia had diversified into the broader foods portfolio, selling cakes, rusks and breads. It had entered the dairy segment but largely focused on cheeses, curds and flavoured milk. The above measures had led to the share of non-biscuits revenue rising from 13% in FY07 to 23% in FY15. The company plans to further diversify into the foods category and is planning to enter the larger ₹750bn regulated dairy and ₹300bn snacks segments.

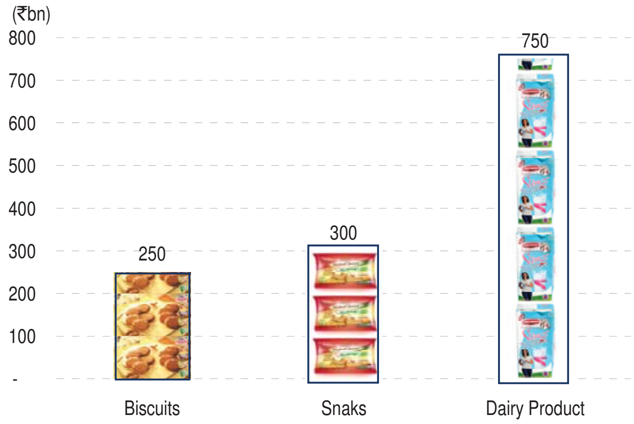
The company could invest up to ₹3bn-3.5bn in the dairy business, with a completely-integrated model. Management had earlier tried to enter the snacks segment with the launch of Healthy Start (RTE breakfast) and 50-50 Snackuits Multigrain thins. In our opinion, health-based snacks such as Snackuits could find more takers in future.

Fig 7 – Looking to evolve into a complete foods company

Source: Company

Britannia plans to enter the regulated dairy market, estimated at ₹750bn, and the macro-snacking market of ₹300bn

Fig 8 – Opportunity size of newer markets spells faster revenue momentum

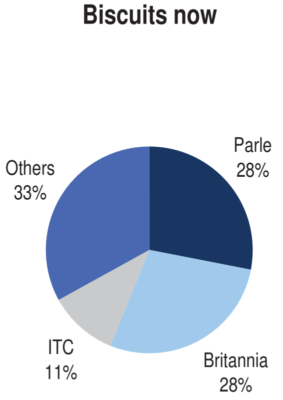


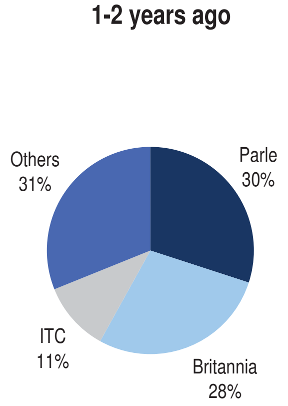
Source: Company

But not at the expense of its core biscuits

While Britannia attempts to establish itself as a complete foods company, it hasn't lost its sight of its core, biscuits. It has grown ahead of the market in the last few quarters and thereby narrowed the leadership gap with Parle. In fact, last quarter it had a higher market share than Parle. This could largely be attributed to Parle's value-based biscuits portfolio (bringing in 90% of its revenue), which has had slower growth than the mid and premium biscuits (80% of Britannia's biscuits range).

Fig 9 – Britannia inching toward market leadership in recent quarters





Source: Hindustan Times, Industry

Affordable premium driving better mix

Smaller SKUs of premium brands at popular price points driving consumer uptrading

Rising disposable incomes, increasing health awareness and greater reach and affordability have been driving a consumer shift towards premium biscuits. Britannia, with over 80% of its biscuit range straddling the mid and premium segments, has been a key beneficiary of consumer up-trading. It has a three-pronged strategy, which has hugely helped it benefit from the general trend. (a) It has launched several premium and health-positioned brands (Nutri Choice, Pure Magic, Good Day Chunkies. (b) It has introduced smaller SKUs of premium biscuits at the popular price points of ₹5, ₹10 and ₹20 to promote trials and consumers up-trading. (c) It has increased brand investments from ~6.5% over FY05-09 to more than 8% over FY10-15.

In Q1 FY16, the change in mix brought one-third of the gross-margin gain of 500bps

Britannia has introduced several variants (Marie with Honey and Vita Marie Gold, Cream in Krunchy, Elaichi and Banana flavours); 50-50 is being extended to Maska Chaska and later to Snackuits. Similarly, Treat and Good Day have seen extensions into premium products, priced 2-3x more than the original, commanding better margins than the base biscuits.

Investment in the brands and new product development (primarily aimed at premiumisation of its portfolio) has made Britannia's brands stronger and helped drive the better mix and greater profitability.

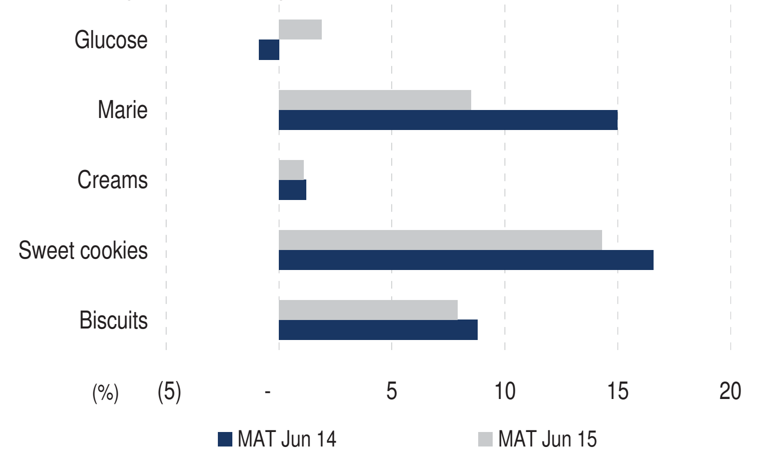
Fig 10 – Premiumisation ladder for Britannia

Source: Company, Anand Rathi Research

Declining share of glucose

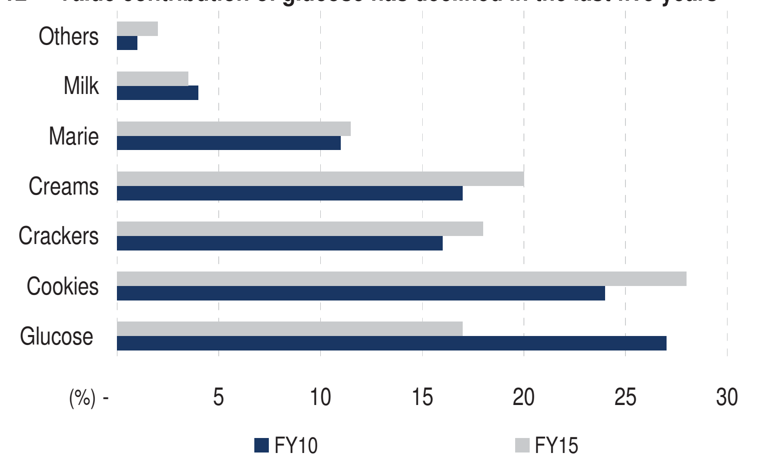
Shifting consumer preferences and faster growth in the non-glucose segment have led to a decline in the glucose-biscuit sub-segment. The latter, which contributed almost 40% of Britannia's sales in FY07 fell to <20% in FY15. While the decline in the lower-margin glucose segment has aided margins, management is looking to differentiate and premiumise its glucose offerings in order to improve market share. Thus, Britannia, with just one-fifth the market share of the leader, Parle, in the glucose segment, plans to nearly double its share—from ~8% to over 15%. The variant will command a 5-15% premium to the leader's biscuit brand.

Fig 11 – Faster growth in non-glucose aids Britannia's mix



Source: Nielsen, Hindustan Times ** MAT – Moving average for 12 months*

Fig 12 – Value contribution of glucose has declined in the last five years



Source: Media reports, Industry

Distribution steps to retain momentum

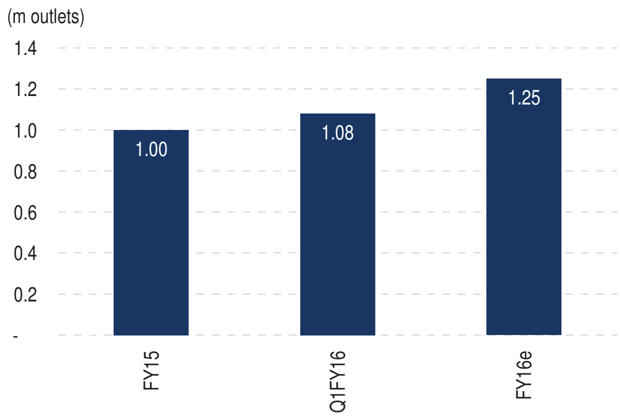
Driving higher per-capita consumption

Two-thirds of Britannia's Q1 revenue growth of 13% was fuelled by wider distribution; one-third came from innovations. The company plans to broaden its reach through (a) a 25% p.a. expansion in direct reach, (b) spread its rural reach through a hub-and-spoke model and (c) raise its share in the Hindi belt.

Two-thirds of Q1 revenue growth of 13% was fuelled by wider distribution; one-third came from innovations

- Go-to-market strategy: Britannia's reach is two-thirds that of its nearest competitor. While it doubled its direct reach last year to 1m outlets, it plans to increase that by 25% each year. It added 80,000 direct outlets in Q1.
- Sales splitting: Last year it embarked upon splitting its market area between two sales people for better coverage and assortments. This was rolled out in 588 towns until FY15. The company added another 73 towns in Q1.
- Britannia's rural market share is two-thirds that of its urban share, which it plans to increase.
- It plans to drive sales efficacy through hand-held devices. In the last year it has doubled the number of its sales force that use handheld devices.
- In the Hindi belt (Rajasthan, MP, UP) and Gujarat it has just one-fifth the share of the market leader.

Fig 13 – To add 25% to direct reach every year



Source: Company, Anand Rathi Research

Rural growth rate 3x that of urban growth

While the rural market has been slowing down, the expanded distribution channels into the hinterland have aided Britannia's rural growth, driving three times urban growth. Management says that the slowdown in the rural market has led to consumption being cut down or to downtrading. However, it indicated that small-ticket items such as FMCG products have seen some cutting down in consumption but not in quality, while down-trading has mostly been reported in durables of higher prices.

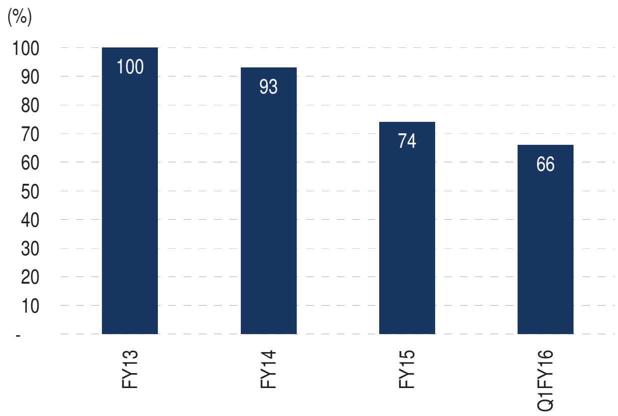
Margins to scale up

Cost-saving measures

In the last three years, trade loads and returns have come down 30-35%. Last year, this, along with other similar cost-saving measures, saved ₹600m-650m

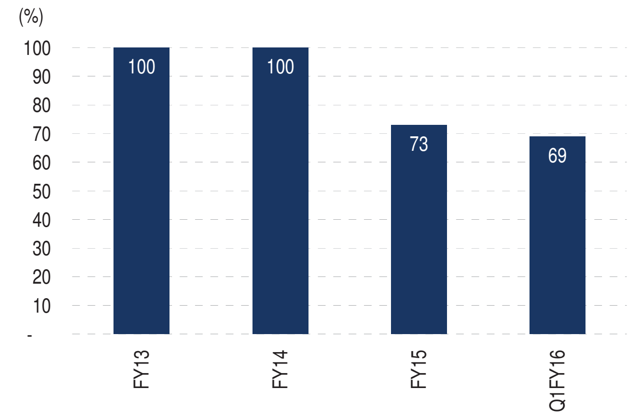
Management has relentlessly focused on savings in key cost areas—trade loads (discounts given to distributors) and trade returns (poor items returned by distributors). In fact, the trade load has been lowered 35% in the last three years, while trade returns have come down 30%. This, along with other similar cost-saving measures, aided the ₹600m-650m savings last year. Management indicated that only 20% of its plants are energy efficient; it plans to raise that in coming quarters. Also, it is trying to reduce market distance from its manufacturing locations through IT initiatives (use of tools such as Optimiser) and manufacturing units near markets. These help in cost savings.

Fig 14 – ~35% reduction in trade loads



Source: Company, Anand Rathi Research

Fig 15 – ~30% reduction in trade returns

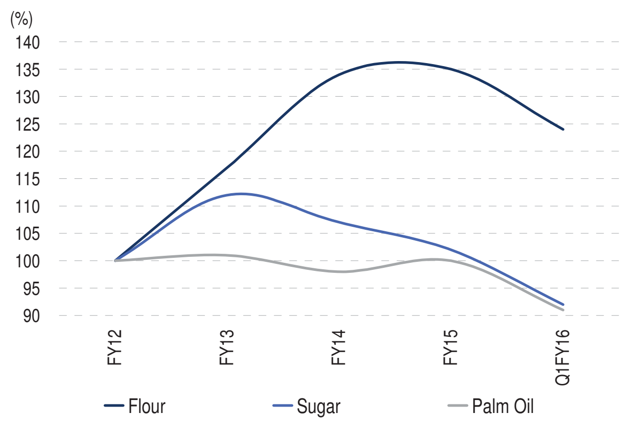


Source: Company, Anand Rathi Research

Benign input cost, better mix, cost savings to drive an EBITDA-margin gain of 340bps

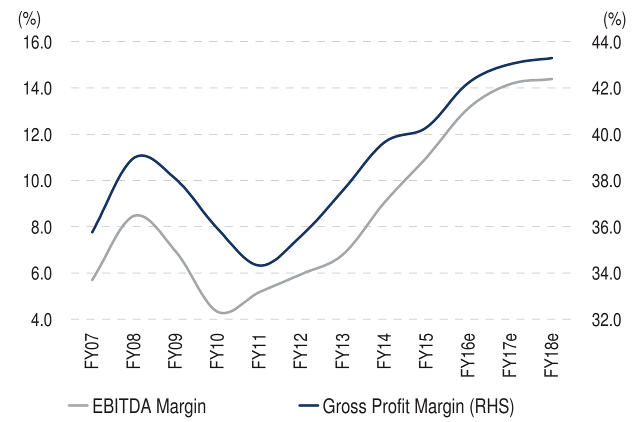
Key inputs (flour, sugar, refined palm oil, ~60% of raw material cost) have slipped sharply in recent months. This, along with the benefit of consistent premiumisation (contributing one-third of the overall margin benefit), has aided the expansion in the gross margin of more than 500bps. With both of the above benefits likely to continue, we forecast an EBITDA margin expansion of 340bps.

Fig 16 – Key input prices have moderated ~10% yoy



Source: Company, Anand Rathi Research

Fig 17 – Margin gain due to premiumisation, lower input cost

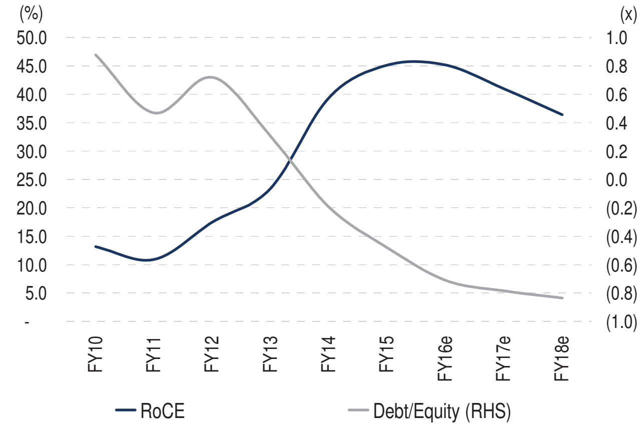


Source: Company, Anand Rathi Research

Return ratios improve; asset sale could act as trigger

The improving margin—from FY11's ~5% to FY15's 11%—and greater working capital (net-working-capital-to-sales improved from -0.5% in FY11 to -5% in FY15) have led to better return ratios. The RoCE has improved from 11% in FY11 to 45% in FY15. Net-debt-to-equity has improved from 0.5x in FY11 to -0.5x in FY15. The possible sale of six acres of prime land in Bangalore, estimated to fetch ₹4.5bn, could further improve the cash position.

Fig 18 – EBITDA margin gain led by premiumisation and lower input cost



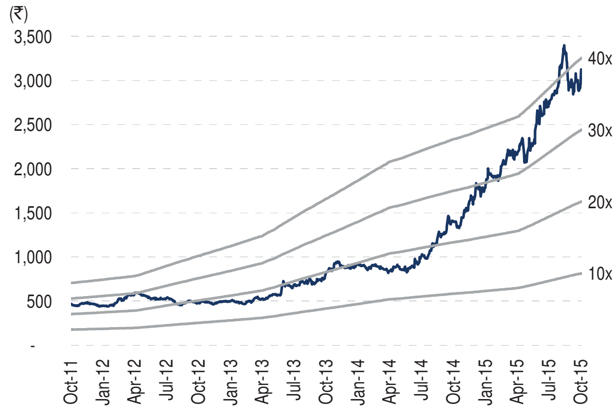
Source: Company, Anand Rathi Research

Valuations

Outlook bright, but fully priced; Hold

Britannia's consistent performance and strong earnings assurance have driven a re-rating (trading at ~40x FY17e). We believe the premium valuation will persist and maintain a Hold rating on the stock, with a price target of ₹3,400 (based on 38x Sep'17e). At the ruling market price of ₹3,227, the stock trades at 50x FY16e EPS of ₹64.6 and 40x FY17e EPS of ₹81.3.

Fig 19 – PE band



Source: Anand Rathi Research

Risks

- **Sharp rise in raw material prices:** A sharp rise in raw material costs (more than 60% of sales) could eat into margins. The sharp depreciation in the rupee and the rise in crude-oil prices have led to higher crude-linked packaging costs (~10% of input cost).
- **Rise in competitive intensity:** The entry of Modelez International's Oreo biscuits in the premium cream sub-segment and new cookie variants launched by ITC (Sunfeast Delishus Gourmet) and Parle (Goldstar) could intensify competition, resulting in higher A&P spending, which could eat into Britannia's pricing power.

19 October 2015

Marico

Set for two-fold growth in four years; upgrading, to a Buy

Rating: **Buy**
Target Price: ₹500
Share Price: ₹400

Marico has set itself a stiff 2x revenue target by FY18 (having posted 17% revenue CAGR over FY11-15). This would be driven by high single-digit volume growth in its domestic business, premiumisation in its core hair-oil range, and launches in its food and youth portfolios. Margin tailwinds assure earnings growth more than revenue momentum. Hence, we upgrade it from a Hold to a Buy.

Volume recovery on the cards. Over FY13-15 domestic volume growth has been a subdued 6% (a 12% CAGR over FY09-13). This was affected by the rising price difference between Parachute and loose oil (and Saffola and alternative oils) and by the broader slowdown. However, early signs of an urban market upturn and measures for Parachute and Saffola are expected to improve volume momentum in coming quarters.

Distribution tonic to revive Saffola volume. To address volume volatility in Saffola and to better manage price differences (vs. alternatives), Marico plans to introduce smaller SKUs, introduce difference pricing, broaden distribution reach and improve Saffola's brand positioning.

Copra price drop to aid margins. Copra (~35% of raw-material cost) has slid 30% yoy. This, along with lower packaging and paraffin costs, augurs well for margins. We expect the margin tailwind to flow through into FY17 as well, and drive a gross margin expansion of 200bps over FY15-17.

Valuation. We are cautiously optimistic of Marico's medium-term revenue and earnings performance. Yet short-term volume growth could be a touch soft because of Saffola and the macro-economic slowdown. Favourable margin tailwinds and the recent lower Marico stock price provide a good entry opportunity. Hence, we upgrade our recommendation from a Hold to a Buy. **Risks:** Sharp jump in copra prices, and a rise in competition in hair oils and premium edible oils.

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	46,865	57,330	65,276	75,504	88,909
Net profit (₹ m)	4,759	5,736	7,034	8,486	10,108
EPS (₹)	7.4	8.9	10.9	13.2	15.7
Growth (%)	30.4	20.5	22.6	20.6	19.1
PE (x)	54.2	45.0	36.7	30.4	25.5
PBV (x)	19.0	14.1	11.2	9.0	7.3
RoE (%)	28.5	36.0	34.1	32.8	31.6
RoCE (%)	28.8	38.6	41.7	41.7	40.9
Dividend yield (%)	0.9	0.6	0.8	0.9	1.1
Net gearing (x)	0.2	0.1	-0.1	-0.3	-0.4

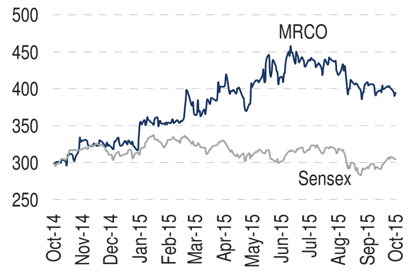
Source: Company, Anand Rathi Research

Key data	MRCO IN / MARCO.BO
52-week high / low	₹467 / ₹294
Sensex / Nifty	27215 / 8238
3-m average volume	$3.2m
Market cap	₹258bn / $4bn
Shares outstanding	645m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	59.7	59.7	59.7
- of which, Pledged	-	-	-
Free Float	40.3	40.3	40.3
- Foreign Institutions	25.0	26.3	25.9
- Domestic Institutions	8.6	6.2	6.5
- Public	6.8	7.9	7.9

Estimates revision (%)	FY16e	FY17e
Sales	-	-
EBITDA	-	-
EPS	-0.4%	0.2%

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	46,865	57,330	65,276	75,504	88,909
Revenue growth (%)	2.0	22.5	13.7	15.7	17.8
- Oper. expenses	39,366	48,631	54,669	62,894	74,017
EBIDTA	**7,500**	**8,699**	**10,607**	**12,609**	**14,892**
EBITDA margin (%)	16.0	15.2	16.3	16.7	16.8
- Interest expenses	345	230	182	138	125
- Depreciation	769	843	912	999	1,091
+ Other income	464	592	750	900	1,050
- Tax	1,905	2,368	3,079	3,712	4,418
Effective tax rate (%)	28.6	29.2	30.4	30.4	30.4
Reported PAT	-187	-114	-150	-175	-200
+/- Extraordinary items	4,759	5,736	7,034	8,486	10,108
+/- Minority interest	95	-	-	-	-
Adjusted PAT	4,853	5,736	7,034	8,486	10,108
Adj. FDEPS (₹/sh)	7.4	8.9	10.9	13.2	15.7
Adj. FDEPS growth (%)	30.4	20.5	22.6	20.6	19.1

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	645	645	645	645	645
Reserves & surplus	12,961	17,603	22,373	28,029	34,741
Net worth	13,606	18,248	23,018	28,674	35,386
Total debt	6,831	4,366	3,783	3,406	3,567
Minority interest	358	137	287	462	662
Def. tax liab. (net)	96	79	139	199	259
Capital employed	**20,892**	**22,829**	**27,227**	**32,740**	**39,874**
Net fixed assets	8,920	10,790	11,347	11,548	11,707
Intangible assets	-	-	-	-	-
Investments	3,105	2,838	2,838	2,838	2,838
- of which, Liquid	419	416	416	416	416
Working capital	4,802	7,152	6,341	7,358	8,801
Cash	4,064	2,049	6,700	10,996	16,528
Capital deployed	**20,892**	**22,829**	**27,227**	**32,740**	**39,874**
WC days	37	46	35	36	36
Book value (₹/sh)	21.1	28.3	35.7	44.5	54.9

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	4,759	5,736	7,034	8,486	10,108
+ Non-cash items	769	843	912	999	1,091
Cash profit	5,527	6,579	7,947	9,485	11,199
- Incr./(decr.) in WC	-1,892	2,350	-810	1,017	1,443
Operating cash-flow	7,419	4,229	8,757	8,468	9,757
- Capex	-8,491	2,713	1,470	1,200	1,250
Free-cash-flow	15,910	1,516	7,287	7,268	8,507
- Dividend	2,673	1,745	2,264	2,830	3,396
+ Equity raised	-8,383	430	150	175	200
+ Debt raised	-1,964	-2,483	-522	-317	221
- Investments	1,589	-267	-	-	-
- Misc. items	95	-	-	-	-
Net cash-flow	1,397	-2,015	4,651	4,296	5,532
+ Op. cash & bank bal.	2,668	4,064	2,049	6,700	10,996
Cl. cash & bank bal.	4,064	2,049	6,700	10,996	16,528

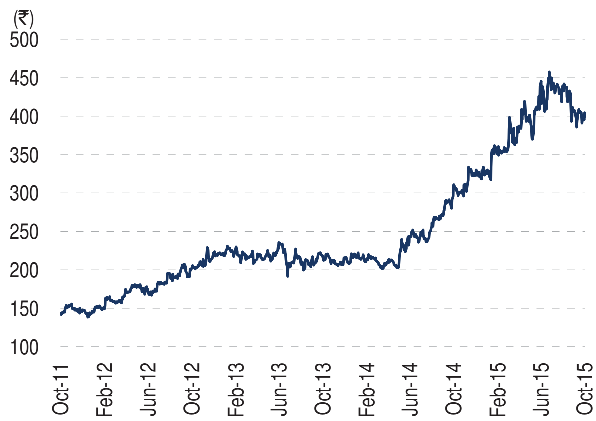
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹400

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	54.2	45.0	36.7	30.4	25.5
Cash P/E (x)	46.7	39.2	32.5	27.2	23.0
EV/EBITDA (x)	34.7	29.9	24.0	19.8	16.4
EV/sales (x)	5.6	4.5	3.9	3.3	2.8
P/B (x)	19.0	14.1	11.2	9.0	7.3
RoE (%)	28.5	36.0	34.1	32.8	31.6
RoCE (%)	28.8	38.6	41.7	41.7	40.9
Dividend yield (%)	0.9	0.6	0.8	0.9	1.1
Dividend payout (%)	56.2	30.4	32.2	33.3	33.6
Net debt/equity (x)	0.2	0.1	-0.1	-0.3	-0.4
Debtor (days)	17	11	11	11	11
Inventory (days)	62	63	63	63	62
Payables (days)	68	54	75	74	74
Fixed asset T/O (x)	5.3	5.3	5.8	6.5	7.6
Oth Income/PBT (%)	6.5	6.2	7.3	7.3	7.1

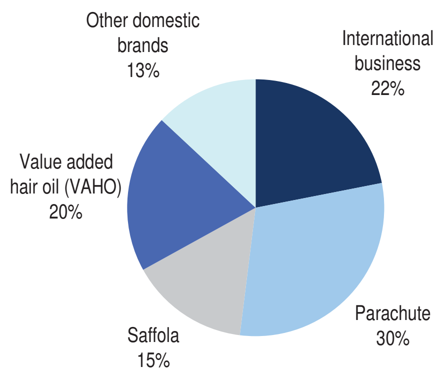
Source: Company, Anand Rathi Research

Fig 5 – Share price chart



Source: Anand Rathi Research

Fig 6 – Revenue break-up (FY15)



Source: Anand Rathi Research

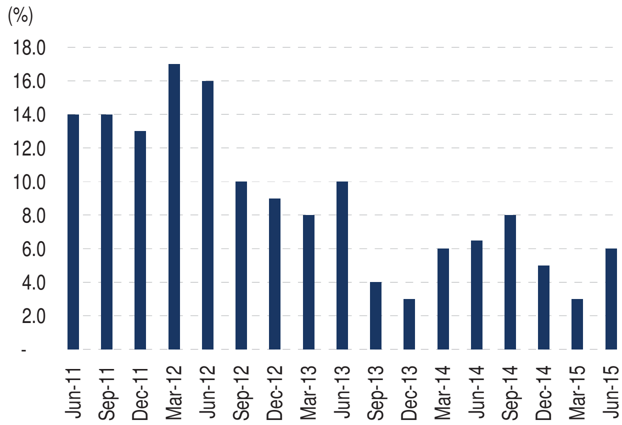
Volume growth to recover

Company aims at 8-10% volume growth

In Q1 FY16 Marico reported just 6% yoy domestic volume growth, similar to that in FY14 and FY15. This was lower than the 13% organic domestic volume growth in the preceding two years. The volume slowdown could be attributed to the broader market slowdown, rising price differences in Parachute and Saffola with competing oils, and fewer new launches in the interim.

Expected recovery in the urban market (67% of revenue) in H2 FY16, distribution initiatives, new launches and a judicious price/mix and promotions are expected to drive volume recovery. Thus, management believes it has sorted out most of these issues and expects steady 8-10% volume growth in the domestic business.

Fig 7 – Domestic volume momentum slows in recent quarters



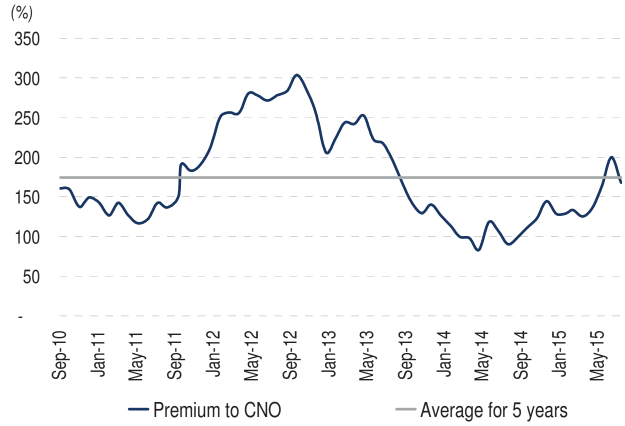
Source: Company, Anand Rathi Research

Steady price premium to loose coconut oil should aid in 8% CAGR in volumes over FY15-18

Parachute (~30% of consolidated revenue) – price premium to loose oils in comfort zone

The price difference of Marico to loose coconut oil stood near its five-year average and lower than the high price premium of FY13 when copra prices slipped sharply. We believe that Parachute has a direct co-relation with copra prices and gains volume growth and market share when coconut prices rise steadily. Thus, the current environment of price premiums just above the five-year average augurs well for volume growth of Parachute rigid packs and should aid in volume growth. Thus, we are building in ~8% volume CAGR over FY15-18 for Parachute rigid packs.

Fig 8 – Parachute price premium to loose coconut oil



Source: Company, Anand Rathi Research

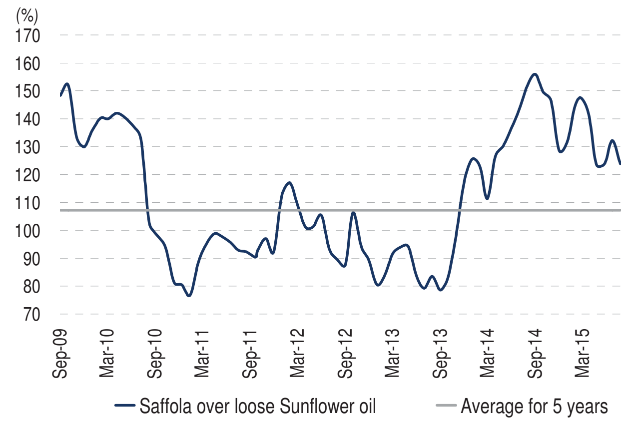
Saffola - fresh initiatives to aid recovery

Urban demand recovery in H2, distribution expansion and product offerings straddling price ranges would drive volume recovery in Saffola

Saffola (accounting for ~15% of consolidated revenue) has been battling the category slowdown, exacerbated by the high price premium in recent months to competing oils such as sunflower oil. A part of the slowdown has been attributed to a deceleration in the pace of consumer upgrades, with urban consumers feeling the pinch of inflation (Saffola is predominantly an urban brand). To address this issue, the company plans to take the brand into Middle India and try a different pricing. Also, lower price SKUs are being tested for wider consumer acceptance and off-take.

We are cautiously optimistic of a recovery in Saffola volumes fuelled by an upturn in urban demand in H2, distribution expansion and product offerings straddling price ranges. We are projecting 8% volume growth for FY16 and 10% for FY17.

Fig 9 – Saffola price premium to Sunflower oil



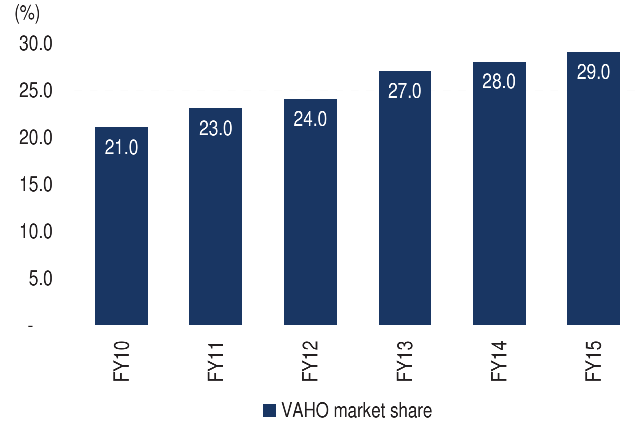
Source: Company, Anand Rathi Research

Premiumisation to drive the VAHO segment

Premiumisation to aid in value market share, growing ahead of volume share in the hair oil sub-segments

Value-added hair oils (VAHO, accounting for ~20% of consolidated revenue) have seen a 17% CAGR in volumes in the past four years, helped by market-share gains. While most of the gains have come from the value brand Shanti Amla, the company plans to premiumise its portfolio to drive faster revenue momentum with a low-teen volume momentum. Thus, VAHO's market share (by value) at 23% (vs. 29% volume share) is likely to improve. We are optimistic about a sustained ~14% volume growth in the next two years.

Fig 10 – Increasing volume market share in VAHO



Source: Company, Anand Rathi Research

Fresh initiatives to aid volume recovery

Distribution initiatives such as increased sales in rural markets to 35-37% (from 33% currently) and wider direct coverage in urban markets through Project One would aid in volume momentum

The company plans to widen its rural distribution and increase the share of rural sales in the next few years to 35-37%, from 33% now. Further, it also plans to increase its direct coverage of the top six metros through Project ONE, along with product innovations and extensions into adjacent categories to spur volume growth in the medium term.

Project ONE will achieve an additional ₹600m-650m sales in FY16. Further, the company is targeting the chemist channel to improve distribution of products such as Saffola Oats and Livon Hair Gain tonic.

Also, Marico plans a slew of launches in the foods, wellness and youth sub-segments to drive fewer but larger innovations. Several of these prototypes are already being tested in the market.

Thus, we expect domestic volume growth to revive from H2 FY16 and clock 9% in FY16 and 10% in FY17.

Fig 11 – Segment-wise revenue growth trend

Rev. mix (%) *	Brands / segments	FY12	FY13	FY14	FY15	FY16e	FY17e	FY18e
27	Parachute (rigid pack) volume	11	10	4	6	8	8	8
14	Saffola edible oils (volume)	11	7	9	6	4	8	10
19	Value-added hair oils (volume)	24	24	11	10	14	14	15
5	Youth brands (value)	na	na	16	na	(5)	20	20
	Domestic business (volume)	14	11	6	6	6	9	10
78	Domestic business (value)	26	13	8	28	12	15	16
22	Intl. business (value, post-forex)	30	8	16	10	4	11	14
100	Marico group (revenue growth)	28	15	10	24	10	14	16

Source: Company, Anand Rathi Research

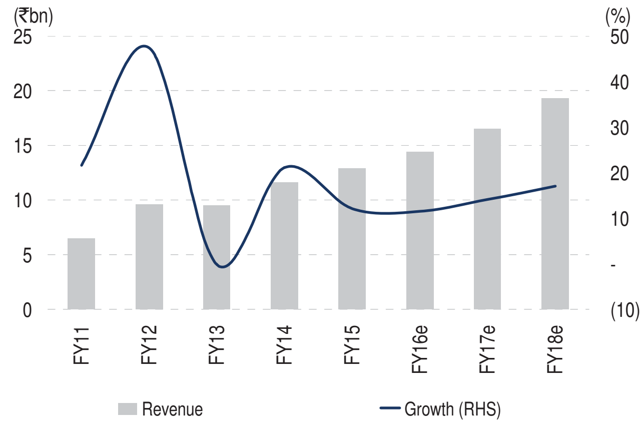
Inter'nl: Bangladesh to be soft; other markets better

The international business (22% of revenue) is expected to post steady double-digit organic revenue growth driven by growth recovery in MENA, and the Vietnam market. Bangladesh (45% of international revenue) could be subdued due to the sluggish economic environment. Marico is diversifying into other categories in Bangladesh such as value-added hair oils, hair dyes, and the premium edible oil sub-segment.

However, most these categories are in a nascent stage and, hence, we expect growth to pick up with market development of these categories. We expect 14% revenue CAGR over the next three years for Marico's international business, impacted by currency volatility and a slow increase in the Bangladesh business.

Expect steady, 14%, revenue growth in Marico's international business aided by growth in the Middle Eastern and south-east Asian markets

Fig 12 – International business to register a 14% CAGR over FY15-18



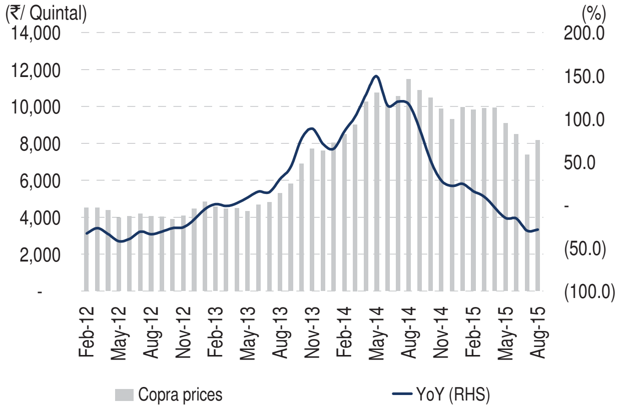
Source: Company, Anand Rathi Research

Fall in RM cost to aid margins

Fall in copra prices to aid margins

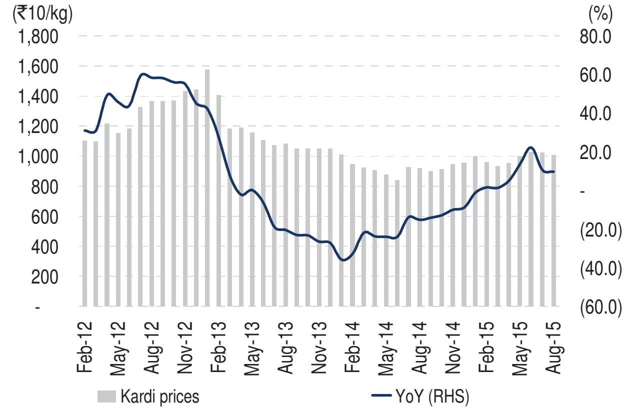
Marico's domestic gross margin expanded by more than 400bps in Q1 FY16, aided by the benign commodity environment with copra prices coming down 10% yoy, and packaging cost (16% of raw material cost) and paraffin 6% and ~30% yoy, respectively. We expect the benefit of the softer copra and other input prices to persist through the next few quarters. Thus, we are projecting a gross-margin expansion of 200bps over FY15-17. This should also aid in the EBITDA margin expansion of 140bps, with part of the gross-margin benefit being re-invested in the business.

Fig 13 – Copra prices have come down recently



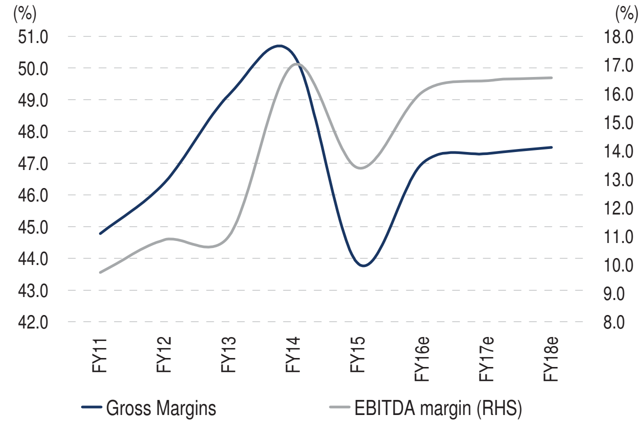
Source: Company, Anand Rathi Research

Fig 14 – Kardi price up 10% yoy in recent months



Source: Company, Anand Rathi Research

Fig 15 – Margins to expand



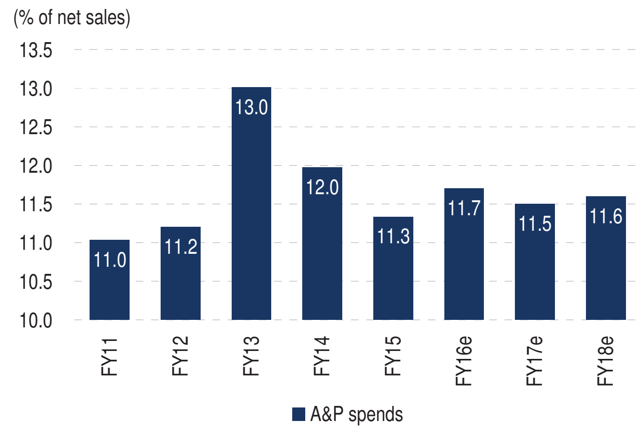
Source: Company, Anand Rathi Research. Note – Inclusive of Kaya prior to vertical business split in FY13

A&P spends to rise

Rise in competition and new product launches to drive slight increase in A&P spends (as percent of net sales)

The fall in commodity prices and keener competition would drive higher A&P spends. In fact, Dabur has re-launched Anmol Pure Coconut hair oil and Anmol Coconut hair oil with Jasmine. This would spur increased competition in the coconut-oil segment. Also, several launches such as Livon Moroccan Silk serum, and Saffola Oats would drive higher brand spending.

Fig 16 – A&P spends to rise



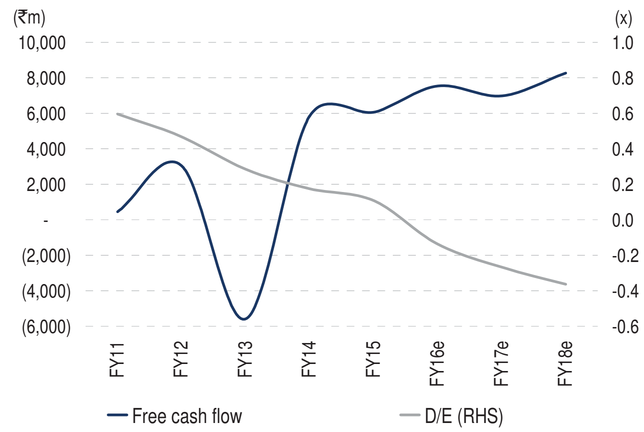
Source: Company, Anand Rathi Research

Higher dividend payout in the offing

Because of the rising cash balances, dividend payouts could rise from ~30% now

At end-Q1 FY16 Marico had net cash of ~₹4bn. With average cash of ~₹7bn in the next two years, we expect the surplus cash balance to rise. Management has indicated that the company would pay out higher dividends rather than build cash surpluses in the absence of any major M&A plans (high valuations and portfolio fit being detrimental). Thus, the present dividend payout (of ~30%) could rise in future.

Fig 17 – Dividend payout could rise due to higher free-cash-flow



Source: Anand Rathi Research

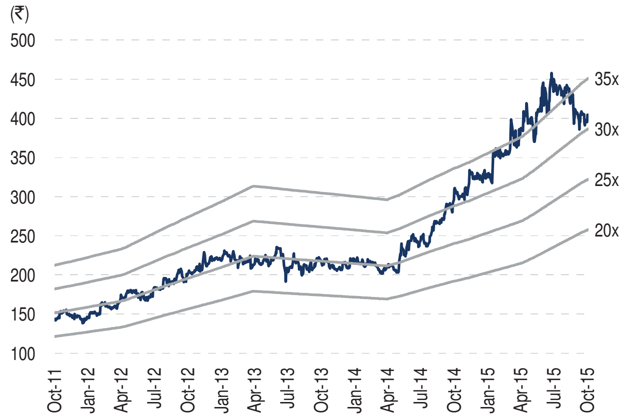
Valuation

Steady medium-term outlook

While we are cautiously optimistic about Marico's medium-term revenue and earnings performance, short-term volume growth could be a touch soft due to Saffola and the macro-economic slowdown. However, the management thrust on volume-led growth, premiumisation of its portfolio and new launches are expected to drive handsome revenue momentum.

Further, the recent 10% dip in the last three months has brought down valuations to a more reasonable level, providing a good entry opportunity. Hence, we upgrade Marico to a Buy with a target price of ₹500 (25% potential). At the current market price of ₹400, the stock trades at 37x FY16e EPS of ₹10.9 and 30x FY17e EPS of ₹13.2.

Fig 18 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- Sharp jump in copra prices (35-40% of raw material cost)
- Keener competition in hair oils and the premium edible oil segment.

ANANDRATHI

India I Equities

Consumer
Company Update

Change in Estimates ☑ Target ☑ Reco ☑

19 October 2015

Emami

Growing franchise; upgrading, to a Buy

Rating: **Buy**
Target Price: ₹1,450
Share Price: ₹1,073

Emami's growing tribe of products, which includes a recent foray into male grooming to the acquired niche *ayurved* hair oil provides it with a strong medium-term growth platform. Market-share gains in core brands, persistent industry-leading gross margins and consistent earnings performance render Emami a compelling portfolio stock. Hence, we upgrade our recommendation from a Hold to a Buy.

Power brands at a 16% CAGR over FY15-17. The top-four brands (Navratna, Boroplus, Zandu, Fair & Handsome; accounting for 70% of revenue) dominate their categories. These brands recorded a 17% CAGR over FY10-15, aided by market-share gains, further strengthening the core portfolio. Further, despite the demand slowdown, variants (Zandu Ultra Balm, Boroplus Facewash) are likely to assist continuing revenue momentum.

New brands/ acquisitions to add growth glitz. Emami is test-marketing its health-care products, which could be rolled out nationally next year. This, along with the possible extension of the "HE" brand into the larger male grooming, would provide the added growth impetus. Management expects ~5% growth in its new products. The acquisition of Kesh King, with a ₹3bn turnover, would provide the further fillip to growth.

Better sales mix, driven by Kesh King, to boost margins. Kesh King's ~45% EBITDA margin, along with lower paraffin and packaging cost, would aid the gross margin. However, the mentha oil price rise and higher A&P spends could partly offset this. For FY16 we are building in an EBITDA margin expansion of 300bps yoy, to 27%.

Valuation. Consistent share gains in the power brands, one of the highest margins and a proven record of successful launches keep us believers in the story. The stock trades at 38x FY16e EPS of ₹28.2 and 31x FY17e EPS of ₹34.9. **Risks:** Sharp rise in the price of menthol and failure to scale up its launches.

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	18,208	22,172	30,228	36,559	42,928
Net profit (₹ m)	4,098	4,902	6,406	7,930	9,327
EPS (₹)	18.1	21.6	28.2	34.9	41.1
Growth (%)	-13.5	19.6	30.7	23.8	17.6
PE (x)	59.4	49.7	38.0	30.7	26.1
PBV (x)	26.1	19.8	16.7	13.1	10.3
RoE (%)	47.9	45.3	47.6	47.7	44.2
RoCE (%)	48.8	52.1	46.3	42.6	44.8
Dividend yield (%)	0.7	0.7	0.7	0.8	1.0
Net gearing (x)	-0.2	-0.2	0.5	0.2	-0.0

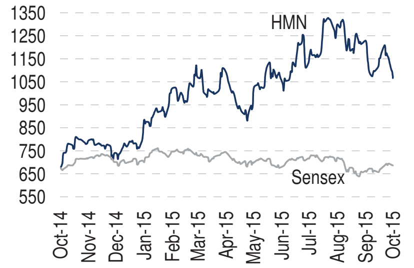
Source: Company, Anand Rathi Research

Key data	HMN IN / EMAM.BO
52-week high/low	₹1,368 / ₹645
Sensex/Nifty	27215 / 8238
3-m average volume	$4.1m
Market cap	₹244bn / $3.8bn
Shares outstanding	227m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	72.7	72.7	72.7
- of which, Pledged	18.9	16.0	14.2
Free Float	27.3	27.3	27.3
- Foreign Institutions	16.3	16.7	16.5
- Domestic Institutions	1.3	1.3	1.5
- Public	9.6	9.3	9.3

Estimates revision (%)	FY16e	FY17e
Sales	0.5	0.5
EBITDA	-0.1	-0.7
EPS	1.7	0.4

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	18,208	22,172	30,228	36,559	42,928
Revenue growth (%)	6.7	21.8	36.7	20.9	17.4
- Oper. expenses	13,752	16,772	21,973	26,357	31,008
EBIDTA	**4,456**	**5,401**	**8,254**	**10,202**	**11,920**
EBITDA margin (%)	24.5	24.4	27.3	27.9	27.8
- Interest expenses	54	51	707	665	475
- Depreciation	352	343	502	562	622
+ Other income	594	964	641	710	779
- Tax	547	1,070	1,280	1,755	2,274
Effective tax rate (%)	11.8	17.9	16.7	18.1	19.6
Reported PAT	-0	-2	-	-	-
+/- Extraordinary items	4,098	4,902	6,406	7,930	9,327
+/- Minority interest	-74	-46	-2,100	-1,500	-1,500
Adjusted PAT	4,025	4,856	4,306	6,430	7,827
Adj. FDEPS (₹/sh)	18.1	21.6	28.2	34.9	41.1
Adj. FDEPS growth (%)	-13.5	19.6	30.7	23.8	17.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	227	227	227	227	227
Reserves & surplus	9,094	12,079	14,394	18,434	23,340
Net worth	9,321	12,306	14,621	18,661	23,567
Total debt	666	602	8,484	6,585	4,687
Minority interest	0	46	46	46	46
Def. tax liab. (net)	48	120	50	110	180
Capital employed	**10,035**	**13,075**	**23,200**	**25,401**	**28,479**
Net fixed assets	-733	4,776	6,486	6,924	7,302
Intangible assets	4,811	41	15,041	15,041	15,041
Investments	2,958	5,013	-	-	-
- of which, Liquid	-	-	-	-	-
Working capital	300	-296	784	908	945
Cash	2,700	3,541	889	2,528	5,192
Capital deployed	**10,035**	**13,075**	**23,200**	**25,401**	**28,479**
WC days	6	-5	9	9	8
Book value (₹/sh)	41.1	54.2	64.4	82.2	103.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	4,098	4,902	6,406	7,930	9,327
+ Non-cash items	352	343	502	562	622
Cash profit	4,450	5,245	6,908	8,492	9,949
- Incr./(decr.) in WC	-32	-595	1,080	124	37
Operating cash-flow	4,482	5,840	5,829	8,368	9,913
- Capex	-13	1,082	17,212	1,000	1,000
Free-cash-flow	4,495	4,758	-11,384	7,368	8,913
- Dividend	1,859	1,882	1,992	2,390	2,921
+ Equity raised	-620	56	-	-	-
+ Debt raised	-733	9	7,811	-1,839	-1,828
- Investments	1,327	2,054	-5,013	-	-
- Misc. items	-74	-46	-2,100	-1,500	-1,500
Net cash-flow	-117	841	-2,652	1,639	2,664
+ Op. cash & bank bal.	2,817	2,700	3,541	889	2,528
Cl. cash & bank bal.	2,700	3,541	889	2,528	5,192

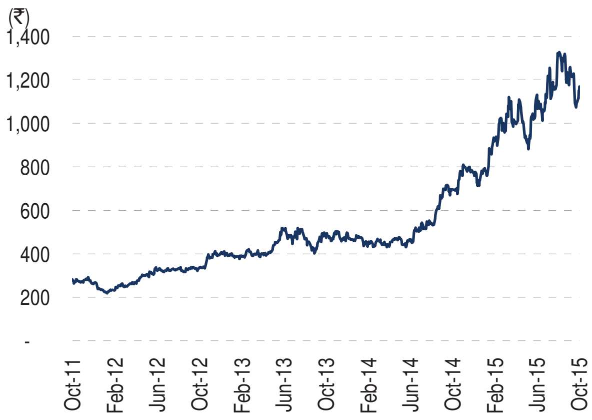
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @₹1,073

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	59.4	49.7	38.0	30.7	26.1
Cash P/E (x)	54.7	46.4	35.3	28.7	24.5
EV/EBITDA (x)	54.2	44.5	30.4	24.3	20.4
EV/sales (x)	13.3	10.9	8.3	6.8	5.7
P/B (x)	26.1	19.8	16.7	13.1	10.3
RoE (%)	47.9	45.3	47.6	47.7	44.2
RoCE (%)	48.8	52.1	46.3	42.6	44.8
Dividend yield (%)	0.7	0.7	0.7	0.8	1.0
Dividend payout (%)	45.4	38.4	31.1	30.1	31.3
Net debt/equity (x)	-0.2	-0.2	0.5	0.2	-0.0
Debtor (days)	16	17	17	16	16
Inventory (days)	28	21	21	22	22
Payables (days)	60	61	50	50	51
Fixed asset T/O (x)	4.5	4.6	1.4	1.7	1.9
Oth Income/PBT (%)	12.7	16.1	7.2	6.2	5.6

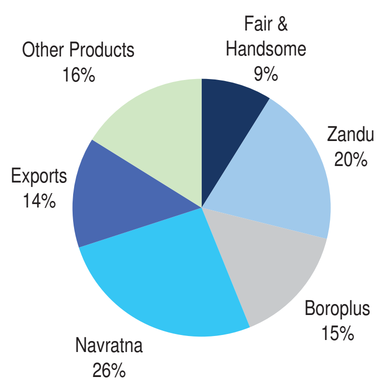
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue break-up (FY15)



Source: Company

Power brands to retain growth tempo

Power brands to see a 16% CAGR over FY15-18

Emami's power brands (Boroplus Antiseptic Cream, Navratna Oil, Zandu Balm, Fair and Handsome) are market leaders in their categories. These enjoy strong brand equity, having registered a 17% CAGR over FY10-15, ahead of the market growth rate. In fact, three of the four have gained market share in the past five years. Fair and Handsome has maintained its ~60% market share in the face of stiff competition and new entrants (HUL's Fair & Lovely Men, Nivea Men, Garnier Men, etc.) Also, they enjoy strong pricing power, reflected by consistent 5-6% price increases in the Navratna hair oil brands over the past five years.

We expect the power brands to register a 16% CAGR in revenue over FY15-18, assisted by brand extensions into newer sub-segments. Also, being the market leader, the company plans to invest in its core brands to expand the category.

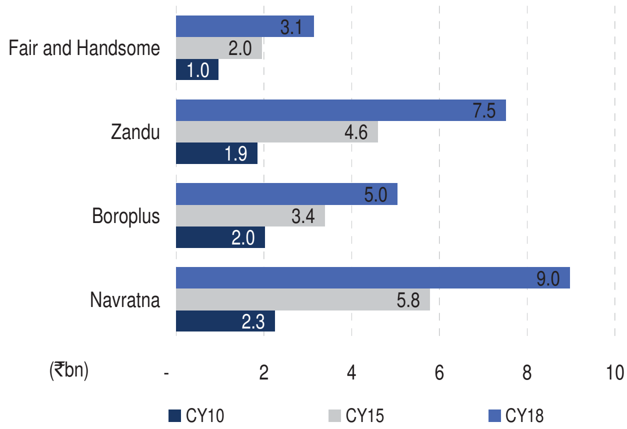
Power brands have posted a 17% revenue CAGR over FY10-15. We expect a 16% CAGR over FY15-18, fuelled by brand extensions, such as the Boroplus anti-pollution face-wash launch

Fig 7 – Strong brand positioning of power brands

Brands	Segment	Competitors	Market size (₹ bn)	Market share (%) FY10	Market share (%) FY15	Penetration (%)
Navratna	Cooling oil	Himgangee	7.5	49	65	17
Boroplus Antiseptic cream	Antiseptic cream	GD Pharma	4.4	74	76	26
Fair & Handsome	Men's fairness cream	HUL, Nivea, Garnier	3.8	60	59	70
Zandu & Mentho Plus balm	Balm	Amrutanjan	7.4	61	61	32
Prickly Heat powder	Cool talc	Paras Pharma	4.4	13	27	43

Source: Company

Fig 8 – Brand-wise revenue growth



Source: Company, Anand Rathi Research Note: Zandu includes Zandu OTC range and Navratna includes Navratna talc

Launches, international business to add impetus

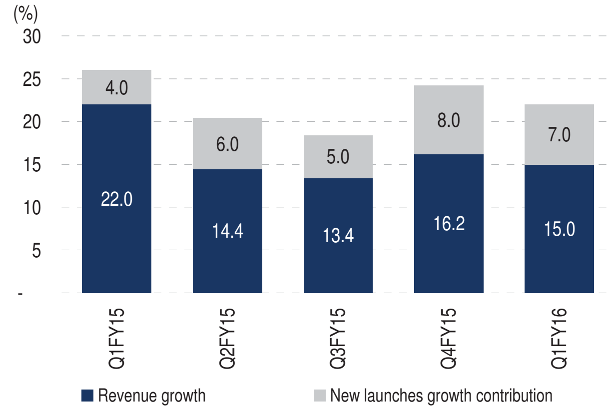
New product launches to drive growth

Over the last two years, to broaden its product range Emami has launched a slew of products/ variants. These included "HE" deodorants, Zandu Balm Ultra Power and Zandu Balm Junior, 7-Oils-in-One, Fair and Handsome face wash, to name a few. Further, it acquired She Comfort Sanitary Napkins to make a foray into the fast-growing female-hygiene market.

New product launches added an average 6% to revenue growth over the last five quarters. Given the strong product pipeline, management expects to add at least 5% from its new products

These brands have added to the growth impetus in revenue, bringing 5-8% to revenue in the last five quarters. Given a healthy pipeline of new products/ variants, we expect this growth rate to continue.

Fig 9 – In the last five quarters, new products added ~6% to revenue growth

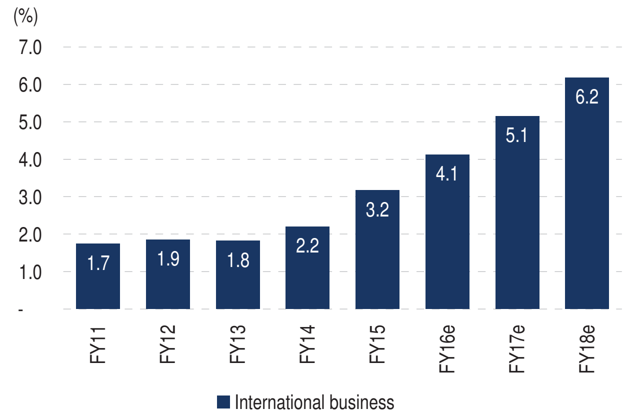


Source: Company, Anand Rathi Research

International business could see a 25% CAGR

Emami's exports to the CIS and the Middle East constitute 14% of its revenue. However, the business has suffered due to counterfeits and low-end exports in the past. Management has tried to sort out the issue with new managerial personnel for international clusters and by setting up manufacturing in Bangladesh. Thus, it expects its international business to rebound and grow 20-25% in the next few years. We are projecting a 25% revenue CAGR in the international business over FY15-18.

Fig 10 – International business contribution to rise



Source: Company, Anand Rathi Research

Kesh King acquisition to aid mix

Emami enters niche category with high margin profile

Emami has recently entered another niche category by acquiring the hair- and scalp-care business of 'Kesh King' and allied brands, for ₹16.5bn.

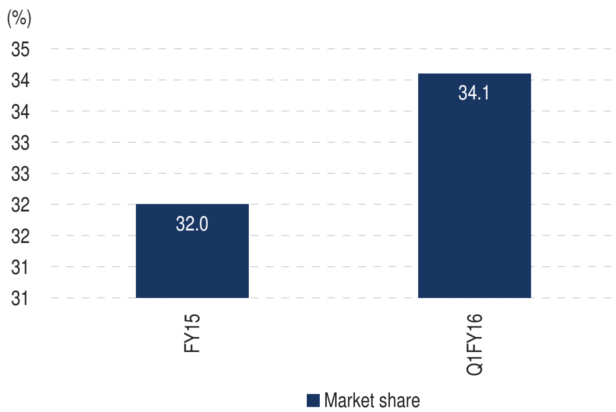
Kesh King is the market leader in *ayurved* hair- and scalp-care (a ~₹9bn market) with a ~34% market share (Apr-Jun'15). It clocked ₹3bn revenue in FY15, implying a 61% revenue CAGR in the last three years. Its portfolio includes *ayurved* medicinal oil, herbal shampoos and conditioners and *ayurved* capsules. The company has ~0.54m retail outlets in the country, predominantly in the North and West regions.

Kesh King, with a ~45% EBITDA margin, will drive the improved product mix

Fig 11 – Kesh King products include hair oils, shampoos and tablets

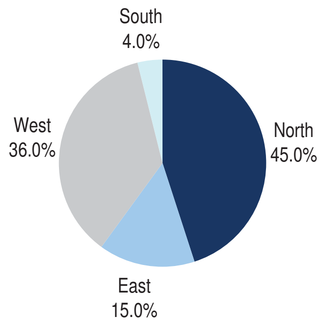
Source: Company

Fig 12 – Improving market share



Source: Company

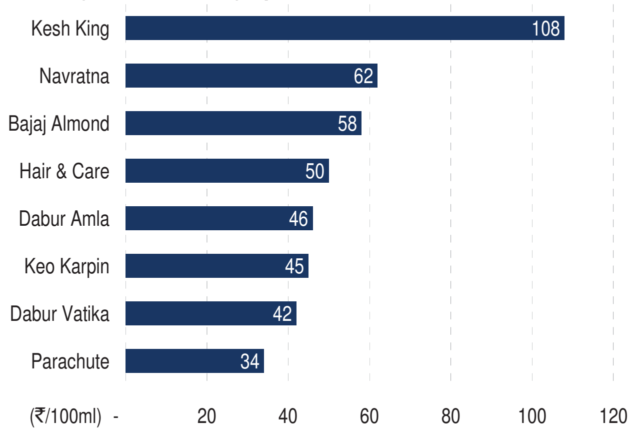
Fig 13 – Region-wise sales break-up



Source: Company

Kesh King products come at a considerable premium to those of other companies (a 70-100% mark-up to the premium light hair oils). Thus, they generate ~45% EBITDA margins, higher than those of Emami. Synergies such as sourcing and scale benefits, efficiency in selling and distribution, and lower overheads could accrue to Emami. The company plans to fund the acquisition through a mix of debt and internal accruals. Given the substantial interest cost to fund the acquisition, we expect the acquisition to be earnings-accretive from FY17.

Fig 14 – Kesh King retails at a high premium to other hair oils



Source: Industry, Anand Rathi Research

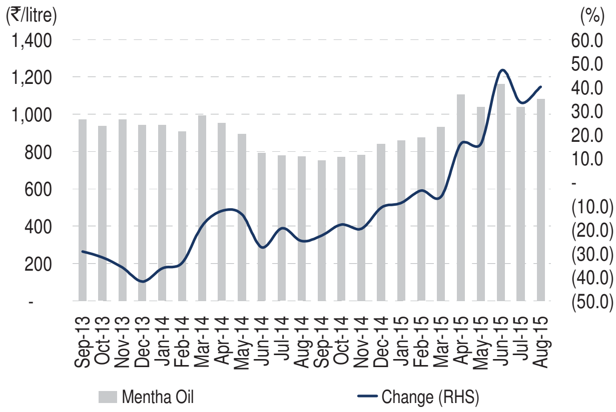
Better product mix to aid margins

The price of mentha oil (constituting 15-20% of RM cost) has risen 30% yoy in the past few months. However, benign packaging cost and the better mix, driven by the Kesh King acquisition, would drive gross-margin gains

Input cost a mixed bag; KK to drive gross-margin gain

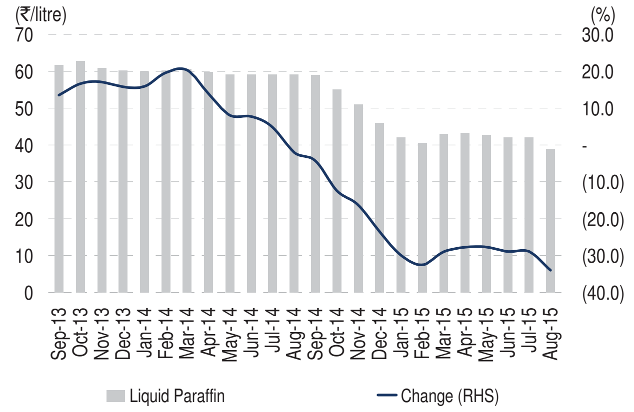
The price of menthol has gone up in the last few months (30% yoy). But packaging prices (40% of raw material cost) and paraffin (10%) have slipped 25-35% yoy. Besides, the company held some menthol inventory; hence, Q1 was unaffected. We believe that the higher menthol prices could be offset by the lower crude-oil prices. Further, Kesh King, with a ~45% EBITDA margin, is expected to drive a better mix. Consequently, we expect the gross margin over FY15-18 to improve 220bps yoy to 67% (one of the highest in the sector).

Fig 15 – Mentha oil (15-20% of raw material cost)



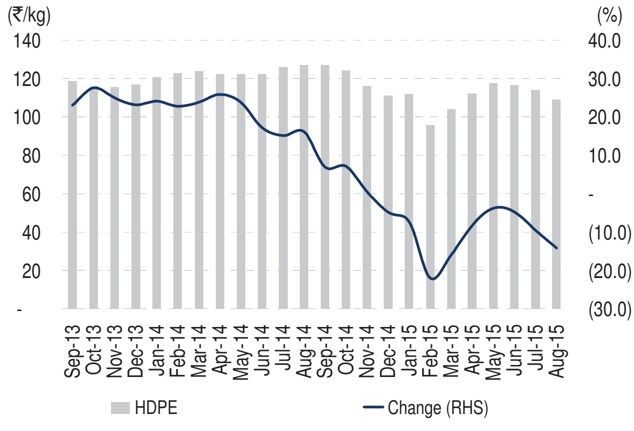
Source: Bloomberg, Anand Rathi Research

Fig 16 – Light liquid paraffin (10% of raw material cost)



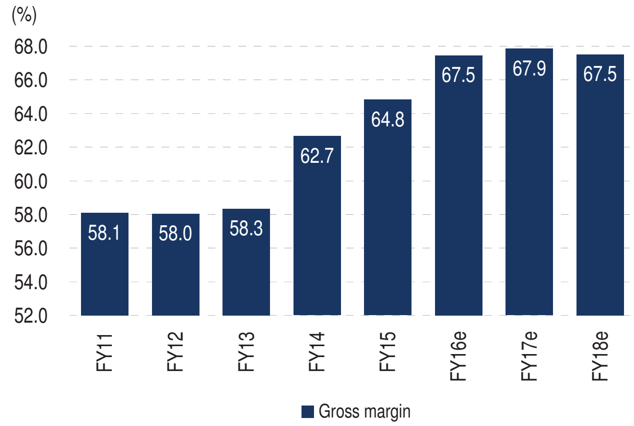
Source: Marico, Anand Rathi Research

Fig 17– Packaging (40% of raw material cost)



Source: Marico, Anand Rathi Research

Fig 18 – Gross margin expansion

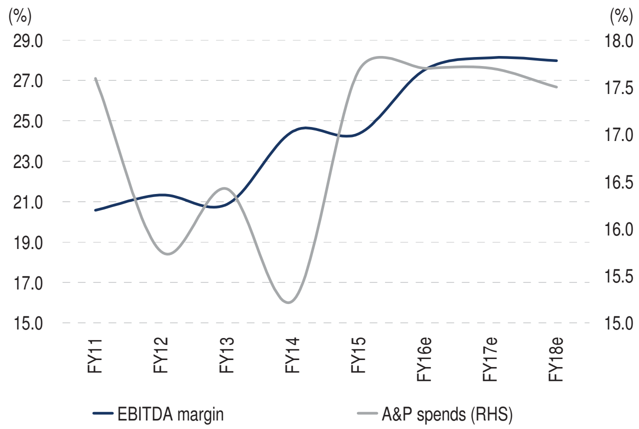


Source: Company, Anand Rathi Research

Brand spends to rise, but not at the expense of profit

Given the slew of launches by the company and investment to support existing brands, we expect Emami's A&P spends to be elevated. Management is guiding to over 18% A&P spend (as percent of net sales). However, the better revenue mix (due to the Kesh King acquisition) should aid in the EBITDA margin expansion. Thus, we expect earnings to register a 24% CAGR over FY15-18, assisted by a 25% revenue CAGR and a margin gain of 350bps.

Fig 19 – EBITDA margin and A&P spends

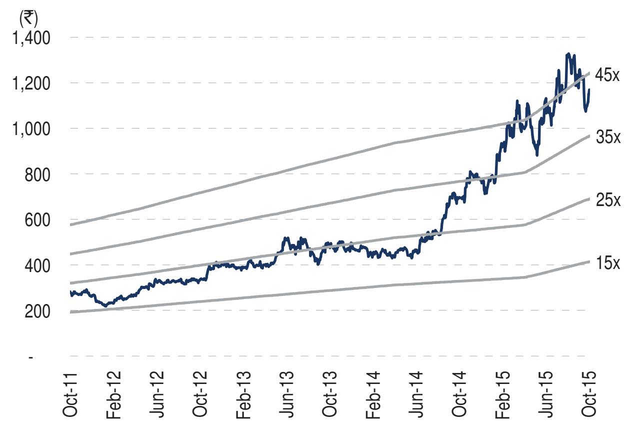


Source: Company, Anand Rathi Research

Valuation

Consistent share gains in power brands, one of the highest margins in the sector, and a track record of successful launches keep us believers in the story. The stock has come down ~20% from its recent peak in the last few months, affording an attractive entry opportunity. Hence, we are upgrading our recommendation from a Hold to a Buy, with a target price of ₹1,450 (based on 38x Sep'17). At the ruling market price of ₹1,073, the stock trades at 38x FY16e EPS of ₹28.2 and 31x FY17e EPS of ₹34.9.

Fig 20 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- Further sharp increases in the price of menthol and failure to scale up its product launches.

19 October 2015

Jyothy Laboratories

'Option' premium; Hold

Rating: **Hold**
Target Price: ₹340
Share Price: ₹311

Jyothy Labs has transformed itself from a single-brand entrepreneurial firm into multi-brand, professionally-managed FMCG company. The new management's focus on a better sales mix, volume-led growth and efficiency in the supply chain has turned around the loss-suffering Henkel acquisition and improved margins. Triggers such as a possible Henkel stake buy and the sale of land assets could lead to a re-rating of the stock. Hence, we maintain our Hold recommendation.

Gunning for double-digit volume growth. Jyothy Labs reported a subdued Q1 FY16, just 8% revenue growth and 6% volume growth. Growth had been affected by Ujala growing just 1%. Management is confident, however, of double-digit volume growth driven by product launches (the Ujala Crisp and Shine rollout in Tamil Nadu), brand extension (Maxo to be introduced in a paper format) and brand campaigns (Pril and Exo being re-launched in new packaging).

Benign input prices to aid margins. The fall in prices of crude oil aided the gross margin in Q1 (up ~400bps yoy). This was further helped by the better sales mix with the higher-margin Henko matic, Margo and Maxo Liquid vapouriser growing faster. We expect the above two factors to persist, and project an EBITDA margin gain over FY15-18 of ~450bps.

Asset sale could improve profit. The company plans to sell its prime Chennai and Karaikal properties. The two-acre Chennai plot could bring ₹500m, the sale of its Karaikal unit could fetch another ₹500m. The funds could be used to pay off debt.

Valuation. We are optimistic on Jyothy Labs for these possible triggers: monetisation of its land assets, and Henkel exercising its option to buy a 26% stake. This could lead to a stock re-rating. We retain our Hold call with a target price of ₹340 (30x Sep'17e). **Risks:** A sharp rural slowdown due to the poor monsoon and keener competition are deterrents.

Key financials (YE Mar)	FY14	FY15	FY16e	FY17e	FY18e
Sales (₹ m)	13,239	15,053	17,042	19,799	22,954
Net profit (₹ m)	818	792	1,486	1,858	2,320
EPS (₹)	4.5	4.4	8.1	10.1	12.6
Growth (%)	18.1	-3.2	85.8	23.8	24.9
PE (x)	68.8	71.0	38.2	30.9	24.7
PBV (x)	7.7	7.2	6.7	6.0	5.4
RoE (%)	11.9	10.5	18.2	20.6	23.0
RoCE (%)	10.1	9.9	15.1	19.4	23.9
Dividend yield (%)	1.0	1.3	1.4	1.6	1.8
Net gearing (x)	0.8	0.7	0.6	0.5	0.4

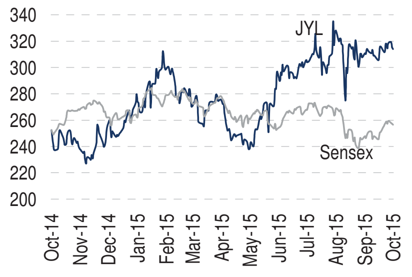
Source: Company, Anand Rathi Research

Key data	JYL IN / JYOL.BO
52-week high / low	₹342 / ₹225
Sensex / Nifty	27215 / 8238
3-m average volume	$0.8m
Market cap	₹56bn / $871m
Shares outstanding	181m

Shareholding pattern (%)	Jun '15	Mar '15	Dec'14
Promoters	66.8	66.8	66.8
- of which, Pledged	25.0	25.0	25.0
Free Float	33.2	33.2	33.2
- Foreign Institutions	10.6	16.3	15.5
- Domestic Institutions	13.5	7.6	8.0
- Public	9.1	9.3	9.8

Estimates revision (%)	FY16e	FY17e
Sales	-	-
EBITDA	-4.4%	-4.0%
EPS	-	-

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	13,239	15,053	17,042	19,799	22,954
Revenue growth (%)	19.7	14.4	13.2	16.2	15.9
- Op. expenses	11,700	13,518	14,797	16,948	19,567
EBIDTA	**1,539**	**1,535**	**2,245**	**2,852**	**3,387**
EBITDA margin (%)	11.6	10.2	13.2	14.4	14.8
- Interest expenses	553	578	449	467	385
- Depreciation	243	325	331	358	383
+ Other income	79	195	252	319	388
- Tax	6	35	240	493	692
Effective tax rate (%)	0.8	4.3	13.9	21.0	23.0
+ Associates/(Minorities)	2	1	10	5	5
Adjusted PAT	818	792	1,486	1,858	2,320
+ Extraordinary items	-4	419	440	440	-
Reported PAT	814	1,211	1,926	2,298	2,320
Adj. FDEPS (₹/share)	4.5	4.4	8.1	10.1	12.6
Adj. FDEPS growth (%)	18.1	-3.2	85.8	23.8	24.9

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
Share capital	181	181	183	185	185
Reserves & surplus	7,163	7,616	8,359	9,344	10,476
Net worth	7,344	7,797	8,542	9,529	10,661
Total debt	6,914	6,243	6,365	5,980	5,066
Minority interest	16	14	4	-1	-6
Def. tax liab. (net)	12	5	-378	-1,081	-1,773
Capital employed	**14,285**	**14,059**	**14,534**	**14,427**	**13,948**
Net fixed assets	3,075	2,999	2,881	2,823	2,740
Intangible assets	7,908	7,903	7,903	7,903	7,903
Investments	610	1,935	1,935	1,935	1,935
- of which, Liquid	-	-	0	0	0
Working capital	1,993	455	805	905	969
Cash	698	767	1,009	860	4.1
Capital deployed	**14,285**	**14,059**	**14,534**	**14,427**	**13,948**
WC days	55	11	17	17	15
Book value (₹/sh)	40.6	43.1	46.7	51.6	57.8

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
PAT	818	792	1,486	1,858	2,320
+ Non-cash items	243	325	331	358	383
Cash profit	1,061	1,118	1,818	2,216	2,703
- Incr./(decr.) in WC	345	-1,538	350	100	63
Operating cash-flow	716	2,656	1,468	2,116	2,640
- Capex	529	245	213	300	300
Free-cash-flow	187	2,411	1,255	1,816	2,340
- Dividend	635	871	962	1,080	1,188
+ Equity raised	746	112	-228	-236	-5
+ Debt raised	536	-677	-261	-1,089	-1,606
- Investments	595	1,326	-	-	-
- Misc. items	-4	419	440	440	-
Net cash-flow	236	68	243	-149	-459
+ Op. cash & bank bal.	463	699	767	1,010	860
Cl. cash & bank bal.	699	767	1,010	860	401

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹311

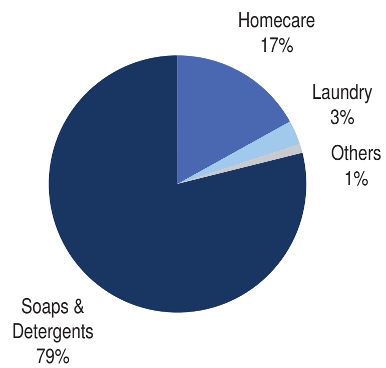
Year-end: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	68.8	71.0	38.2	30.9	24.7
Cash P/E (x)	53.0	50.4	31.3	25.9	21.2
EV/EBITDA (x)	40.6	40.2	27.5	21.5	17.8
EV/sales (x)	4.7	4.1	3.6	3.1	2.6
P/B (x)	7.7	7.2	6.7	6.0	5.4
RoE (%)	11.9	10.5	18.2	20.6	23.0
RoCE (%)	10.1	9.9	15.1	19.4	23.9
Dividend yield (%)	1.0	1.3	1.4	1.6	1.8
Dividend payout (%)	66.7	59.8	42.7	40.2	43.8
Net debt/equity (x)	0.8	0.7	0.6	0.5	0.4
Debtor (days)	18	14	15	15	15
Inventory (days)	48	45	45	43	43
Payables (days)	62	99	92	91	92
Fixed asset T/O (x)	1.2	1.4	1.6	1.9	2.2
Oth Income/PBT (%)	9.1	12.0	8.7	8.5	8.3

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Anand Rathi Research

Fig 6 – Revenue break up (FY15)



Source: Anand Rathi Research

Innovations, initiatives to drive growth

Aiming at double-digit volume growth

The company reported subdued, 8%, revenue growth in Q1 FY16, led by 6% volume growth. Revenue growth was affected by weak, 2%, growth in the flagship Ujala brand. Nevertheless, four of its brands grew in double digits and management exuded confidence in regaining double-digit volume growth from Q2, primarily driven by the new launches.

In May'15 the company launched Ujala Crisp and Shine in Tamil Nadu, and saw a good response. In coming quarters it plans to roll them out in more states. Also, it is working to launch Maxo in a paper format. Further, it is taking several steps such as the re-launch of EXO and PRILL bars to drive growth in the segment.

Most of these new launches are aimed at up-trading consumers, and are likely to boost margins. Also, the company has increased its brand spend (A&P-to-net-sales increased from 7.6% in FY12 to 12% in FY15) to support innovations and strengthen its brand range.

Fig 7– Category-wise brand performance

Brands	Segment	Market size (₹ bn)	Category growth rate (%) in Q1FY16	Market share (%)	Brand growth in Q1FY16	Key Initiatives & comments
Ujala	Fabric whitener	5.5	Stagnant	76	2	New extension 'Ujala Crisp and Shine' to be launched in TN
Maxo	Mosquito repellent	Coils - 10, Liquid vaporisers - 15	5 9	18 8	5	Maxo to be launched under 'Maxo Genius' branding in Liquid vapouriser and Card formats
Exo & Pril	Dish wash	Bars - 18, Liquids - 4.5	6 7	10 17	17	Exo bar re-launched in August 15 with superior new bar formulations. Pril Bar re-launched on a different sensorial platform in Sep'15
Henko	Detergents	180	NA	7*	42	New Henko LINTelligent campaign launched last year. Henko Stain Champion re-staged with new packaging
Margo	Soaps	130	NA	1	48	Margo face wash launched in Oct'14

** Henko's share in matic detergent segment. Henko had grown 42% in matic segment and 13% in regular variant*
Source: Company, Anand Rathi Research

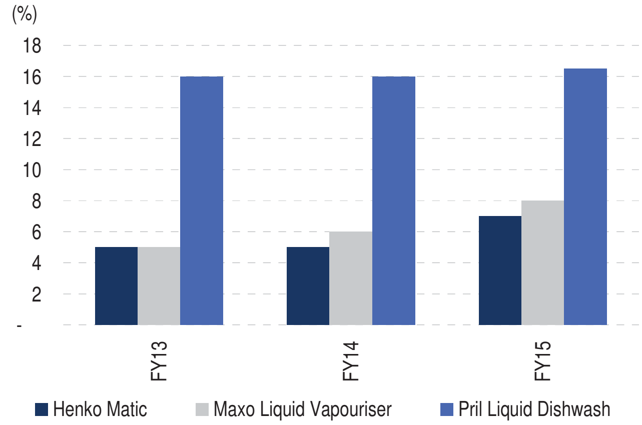
Fig 8– New launches, category-wise

Source: Company, Anand Rathi Research

Gaining market share in key growth segments

Despite the recent general slowdown, Jyothy Labs continues to gain market share in its key categories, extending its market leadership in its flagship Ujala Whitener (with a 76% market share), in Maxo, Exo and Henko Matic. The market-share gain in Henko Matic is one of the company's great achievements as it comes in an intensely competitive and premium segment. Management expects the gain to continue, driven by the new measures and greater spending on brands.

Fig 9– Share gains in key growth segments



Source: Company, Anand Rathi Research

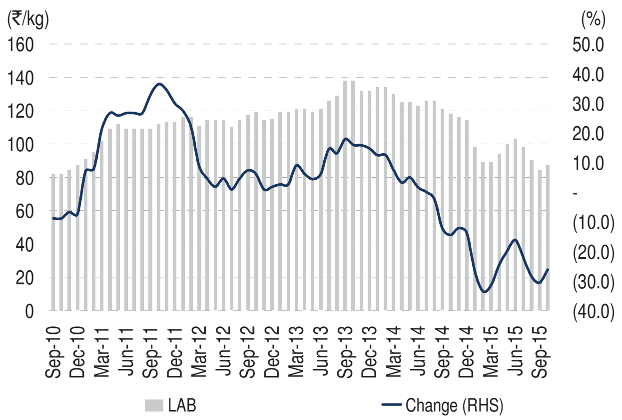
Margin on an upswing

Input cost tailwinds to drive gross-margin gains

Jyothy Labs' revenue is closely linked to the price of crude oil. Of its revenue ~80% arises from soaps & detergents. It has immensely benefitted from the sharp fall in price of crude. Its Q1 gross margin expanded sharply (by 410bps), partly aided by a better mix (a 25% contribution). Thus, despite higher brand spends (A&P spend increased 130bps yoy), the EBITDA margin expanded 30bps yoy.

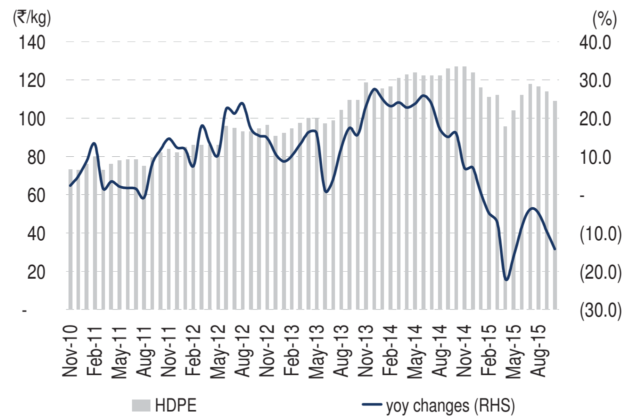
We expect the EBITDA margin to rise by 420bps yoy, fuelled by a better gross margin over FY15-17 (of 210bps) and by the front-ended ESOP expenses.

Fig 10 – LAB price has slid...



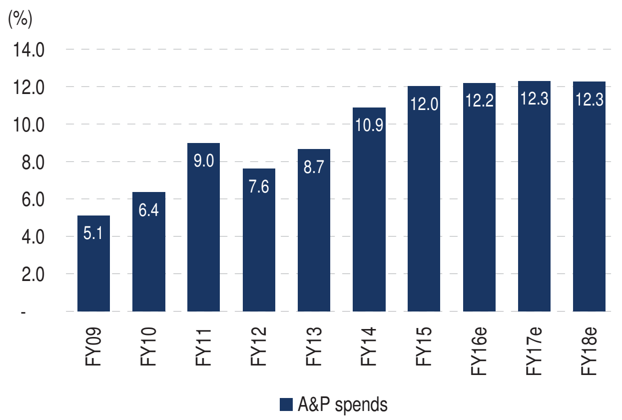
Source: Reliance, Anand Rathi Research

Fig 11 – ... packaging cost, too



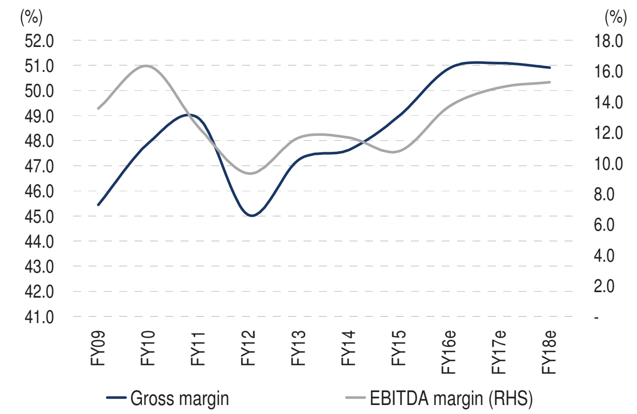
Source: Marico, Anand Rathi Research

Fig 12 – A&P spends to be high



Source: Company, Anand Rathi Research

Fig 13 – Gross margin and EBITDA margin



Source: Company, Anand Rathi Research

Re-rating triggers in place

Henkel stake purchase could re-rate Jyothy

Henkel has a call option to purchase a 26% stake in Jyothy. It will be triggered on 1st Apr'16. The price of the option (if exercised) is not fixed and depends on prevailing prices and/or mutually acceptable terms. The probability of Henkel buying the stake is high as the erstwhile Henkel business has turned around and has been streamlined for Henkel to extend its global brands into India.

The buying of the stake by Henkel could immensely benefit Jyothy Labs as the latter would be able to tap into the former's R&D expertise and could make Jyothy a hub for a few additional areas, in our view. According to the present arrangement, Henkel has two permanent invitees on Jyothy's board.

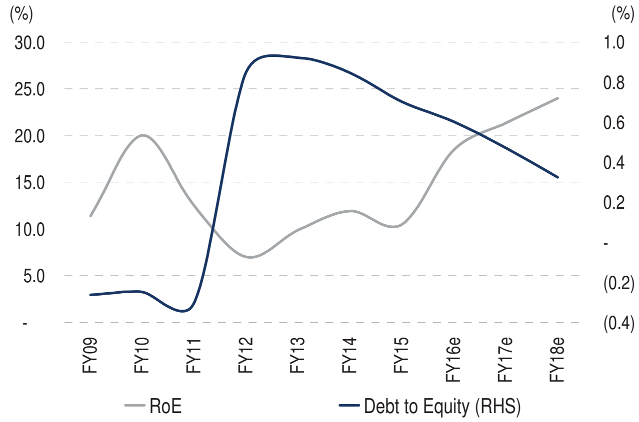
Fig 14 – United Spirits was sharply re-rated after Diageo purchased a stake

Source: Bloomberg, Anand Rathi Research

Asset sale to reduce debt

The company is looking to monetise its land parcels worth about ₹1bn. In fact, its near two-acre plot at the prime Ambattur location could alone fetch it ₹400m-500m. This could be used to pay off debt, now at ~₹4bn. We expect the debt-equity ratio to improve to 0.5x by FY17, excluding any payouts from a possible asset sale.

Fig 15– Better return ratio and debt-to-equity



Source: Company, Anand Rathi Research

Valuations

Re-rating triggers in place

We are cautiously optimistic on Jyothy Labs given its steady and improving market share in key segments, margin tailwinds and strong earnings assurance (a 45% CAGR over FY15-18). Further triggers such as the monetisation of its land assets and Henkel exercising its option to buy a 26% stake could lead to a stock re-rating. Hence, we retain our Hold recommendation with a target price of ₹340 (30x Sep'17e). At the ruling market price of ₹311, the stock trades at 38x FY16e EPS of ₹8.1 and 31x FY17e EPS of ₹10.1.

Fig 16 – PE band

Source: Bloomberg, Anand Rathi Research

Risks

- A sharp rural slowdown due to the poor monsoon and a sharp rise in competition.

Appendix

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