"Marico Limited 2QFY15 Post Results Analyst Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Marico Limited 2QFY15 Post-Results Analyst Conference Call hosted by Ambit Capital. As a reminder all participants' line will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Rakshit Ranjan. Thank you and over to you, Mr. Ranjan.

Rakshit Ranjan: Thank you. And good evening everybody and welcome to Marico's conference call. We have with us the senior management of Marico comprising Mr. Saugata Gupta – Managing Director and CEO; and Mr. Vivek Karve – Chief Financial Officer. I would now like to hand over the call to Mr. Saugata who will take you through the highlights of Marico's performance during the quarter. Over to you sir.

Saugata Gupta: Good evening and thank you very much for attending the conference call. I will just spend a couple of minutes to give you a broad feel of the quarter and also talk to you about the medium-term aspiration of the organisation. I think we have had decent growth this quarter. It has been an all-round growth and we have been bucking the trend for now three consecutive quarters. The other interesting thing is that in spite of high inflation we have managed to drive this growth. 80% of our portfolio gained market share and after a long time all our international markets have clocked steady growth while achieving a structural leap in our margins and therefore the 14-15% margin is here to stay because we would also like to invest behind growth in our international markets. We will continue to choose growth over short-term margins and we believe that we will be able to pick up these margins as we expect copra deflation to set in mid fourth quarter of this fiscal and going forward into next year. On the ground, we do not see any significant improvement of consumption although there are some green shoots and positive sentiments. We expect some gradual improvement as we move in H2 and definitely next year if the GDP grows in 2-3 consecutive quarters by 5.5%. But you must realise that FMCG is not that volatile a sector. So therefore the growth will be gradual but definitely I think the worst is over and there are some green shoots especially in urban consumptions.

I also want to give you some flavour on the fact that the FMCG growth and the HPC growth in reality is higher than what is being reported. And we are concerned about the retail numbers, the degree of under reporting specially in our value-added hair oil portfolio is very high and it perhaps gives convenient excuses for under-performance to certain other players. Distributor stocking has actually reduced in the last 12 months. So therefore either we have actually gained much more share or the market growth is high. Our internal dipstick indicates that the latter is true and the market growth is higher than what it has been reported by Neilsen and we have taken it up with them because it is important that the markets get a right picture of what the truth is.

To give you some more flavour on our four-year medium-term strategy, which I shared with you in the last conference call, our belief is driving capability ahead of growth. If you keep on doing the right thing you will get the outcome rather than chase outcomes. You have to manage and balance contradiction, short term versus long term, speed with excellence and as you move up, governance with the kind of entrepreneurship the company is all about. Therefore we have taken up five transformation areas which are: driving innovation, go to market, IT transformation, cost management and talent value proposition. Our focus will be more on organic growth especially in the international markets. We believe that we should be in a position to deliver the same kind of growth that we have posted in our past CAGR track record in international markets (which has been mostly inorganic) through organic. Earlier the management was much more focused on chasing, negotiating and integrating acquisition. Now our entire belief is that the bandwidth and capabilities can be focused towards innovation-driven organic growth.

The One Marico harmonisation is going well. We will see far more cross pollination and talent mobility. What you have seen is perhaps much more cost rationalisation till now. However, while we talk about four year numbers, it is important to get some flavour some of the green shoots which we like to track. In India it is about continuing to grow at 7-8% while driving momentum in the new businesses. So things like Paras business growing at 15% plus, our foods doing INR 100 crores next year and our body lotion doing INR 70-80 crores next year. We spoke about Project ONE which is now going to clock INR 3 crores per month of incremental revenue and we expect by the end of next year an annualised incremental revenue of INR 100 crores. So these are some of the green shoots which will drive the growth. In international business, the biggest focus is to drive 8-10% volume growth organically. This is something which we have not achieved so far and we have to achieve now and also INR 100 crores business from the new markets which is North Africa, Indo China and rest of South Asia next year. Driving profitable growth in the Middle East and establishing some new legs in all the markets will also be a focus. In Bangladesh we have already started our journey of having the second leg and reducing our dependence on Parachute Coconut oil but in the other markets also we have a single portfolio of market leadership situation. We need to now start putting the second legs in place.

I would also like to give you a flavour of our CSR activities. I think more than doing the quarterly volume growth, this gives us much more pleasure and we are continuing to do a good work in the Marico Innovation Foundation. We just did a campaign on protect your heart and we actually did 1.35 lakh free checkups for all our consumers. The Nihar Shanti education initiative has educated 1.14 lakh children. These are brands with a purpose which drive value to the consumer and also make their lives better. We are going to extend our CSR activities to the community around our factories and we are very enthused by the clean India campaign. And also we are planning an impactful way to drive our CSR activities in Bangladesh. We have also shared with you the sustainability report last quarter. And lastly, before I end, I want to talk about two awards. The best Boards ward which we have got by ET Corporate Dossier and

Haygroup and Top Companies for Leader by ET, Ernst, and Hewitt. We had a distinguished peer set; it reflects our high standards of governance, vision of our founder promoter in building best-in-class boards and our investment behind leadership development. Our next aim is to strive to establish Marico as one of the most exciting FMCG companies to work in, in our core markets. And therefore going forward there will be significant focus on culture, talent and innovation to drive this repeatable model of growth. So I am happy to take questions.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin with the question and answer session. First question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: My first question is on the new products introduced in the last few years; body lotion and oats has done extremely well. On hair colour you have commented that repeat purchase is good, but my question is our price points are much higher than the number one player in crème at least at that price point. And now Rs.20 price point has also come. So do you see a requirement of price cut in this?

Saugata Gupta: I think this is the most attractive sector in the hair colour space which is bound to grow. Obviously the market dynamics have changed since we had launched in terms of the number of players. Having said that we are extremely bullish about this category, Based on what has happened in the competitive set, we need to review ourmarketing mix for growth. Having said that I think at the end of the day when you have conviction about a category, the endeavour is to ensure that we constantly review based on the changing market situation and provide best value for your consumer. So I think there are things to be done and we have to perhaps give a new stimulus and ensure that we have a more competitive mix. Having said that, this category is going to grow. For other players it could be either upgrading or down-grading their existing customers but for us it is a new category.

Abneesh Roy: Sir this was launched around 9-10 months back when do you started giving data for hair colour and body lotion you have not given the growth rate so if you could give us what was the growth rate?

Saugata Gupta: I think the growth rate has been 30% plus in this quarter but I think it is better to give you a better growth rate during the season.

Abneesh Roy: Sir in oats what is happening, you have grown at 31% and the other listed entity says that they have cemented number two position with big lead over the number three. I understand it could be in different markets, but what is our strategy on the south India market, when do we plan to become strong number one there also?

Saugata Gupta: See we participate in the all-India market and I do not think we want to measure our size state by state. Number two, our focus is on the value-added part of the segment because in foods the value-added players make much more margin than when you participate in the commodity end.

We are number two player in value share at 17% and in the value-added oats segment we are 63% of the market where four players take part. Now in the south, where the commodity part of the market is far more prevalent, there could be somebody who is number two but that is not the market we are interested in. Margins in the value added portfolio are nearly 10-15 times the commodity portfolio. You do not make money in the commodity part of the market.

Abneesh Roy: So this 31% growth is on your overall oats portfolio or value added portfolio?

Saugata Gupta: It is overall oats portfolio.

Abneesh Roy: Right. And how much will the INR 15 pack be? Are you disclosing that number of your oats portfolio?

Saugata Gupta: No, we do not want to get into sales mix numbers details.

Abneesh Roy: And sir one last question. If you see industry trends, other players are coming out with premium hair oil, what is our take on that? Why are we not trying that much more aggressively the seven hair oil, eight hair oil and then the MNCs at Rs.200? Why we are not targeting that much more seriously or we feel it will be a small portion so not worth?

Saugata Gupta: I think our strategy was to have a broader participation to ensure that we fulfill all potential consumer needs and premiumise the category. The fact that a lot of people are getting into that category proves that in spite of the so called skeptics about the category who believe that this practice is dying, the prevalence of hair oiling continues to thrive in this country and it has exhibited growth equal to or more than a lot of personal care categories in this country. I think premiumisation is a space which is going to be interesting and which, as a market leader in both volume and value, we should exploit.

Abneesh Roy: Okay. Sir that is all from my side. Thank you.

Moderator: Thank you very much. Next question is from the line of Percy Panthaki from IIFL. Please go ahead.

Percy Panthaki: My first question is on the value added hair oils pricing. I see from your investor update your volume growth is 13%, value growth 33%. Which means that there is approximately a 20% kind of a price increase in this segment. Now from what I understand this would be the highest price increase by any player within the value added hair oils segment and would more than offset for any inflation in crude, LLP, etc. So my estimate again and correct me if am wrong is that there would have been a decent margin expansion in the VAHO category based on these price increases. So just wanted to understand your thought process, is this just something tactical you are doing that copra inflation is too much to manage in that category itself and some tactical sort of cross subsidisation is happening or is this more of a secular or a long-term trend where you feel that certain products within your VAHO category are sub-optimal in terms of margins and that is why the VAHO margins will not go up sort of in the next 2-3 years?

Saugata Gupta: Okay. Let me give you some flavour on it. One is that the 20% growth can be a mixture of mix and inflation; it need not be just inflation and as I said that the premiumisation is something we want to drive. Within a certain brand also, as we get loyal consumers, there is upgradation that happens and you get higher realisation. Secondly, the value added coconut oil part of our portfolio has experienced inflation and we have passed it out. I think it is important that we start driving both premiumisation in the category and also ensure that we get a certain margin in the category. So that is the reason this has happened. So some part of it has come from the need to offset input cost pressures and some of it has been mix. So there has not been general price increases but our endeavour will be to ensure that we start to premiumise the category and that's one of the reasons why we are focusing on value share.

Percy Panthaki: Right. Also wanted to ask, see copra is down almost around 20% versus the peak about two months back. So what is your thought process there in terms of passing on some of this decline to the consumers because the unorganised trade will pass it off immediately; they will not wait for any time period to elapse and if I recall correctly last cycle about two years or two and a half years back, we had suffered a little bit in terms of volumes because the price cuts were a little delayed from our side, correct me if I am wrong on that. So just wanted to know your thought process on near term, next 3-6 months, what do you think about pricing in terms of the coconut oil segment?

Saugata Gupta: Copra prices from the peak have only fallen 6-7%, I do not know where you got this 20% number.

Percy Panthaki: From Bloomberg Saugata if you look at...

Saugata Gupta: Our data suggest it is 6-7%, you might have seen one point so you have to see it from a monthly perspective. May be you have just seen average; you must have seen the intentional prices.

Percy Panthaki: No, this is copra at Cochin and of course it is not a monthly average. I am just taking today's price versus the peak that peak might have been there only for a few days.

Saugata Gupta: As I said on a monthly average peak versus today's price it is down than the last three months by 5-6%.

Percy Panthaki: Okay.

Saugata Gupta: I think if you take a point to point decline of 20% it does not necessarily get translated in the market. So you should take a kind of a monthly average from the peak month to current, and in that cse the drop is 5-6%. We believe the season starts sometime in February so right now is the off season and now the north east monsoon is prevalent in most of the copra growing area. So the first sign of the drop is going to happen in February-March. And you are absolutely right, last time we were perhaps little late in taking certain price drops and price calls. As we have said, our philosophy is to ensure - subject to a margin band - we will maximise both volume growth and market share gain. Having perhaps not handled it right in last few times, we should have learned our lesson and we should be able to do a better job this time.

Percy Panthaki: Right. And what gives you confidence that February you will see this decline, I understand it is a new season, etc., and that is why you are talking about February but what are the driving dynamics of the price of copra and therefore what is the logical train of thought which leads you to the conclusion that it will come down?

Saugata Gupta: Commodity is very difficult to predict. So therefore whatever current trend suggests, and it is based on cyclical data, is that post the inflation cycle, usually which is an 18 month cycle, the drop starts coming in the onset of the season and then if it has to accelerate it happens more towards quarter two. That is what empirical data suggest; having said that obviously commodity forecasting is the toughest business and therefore it is very difficult to predict that. However, this is what the data suggest.

Percy Panthaki: Okay. Because if I understand currently the reason for the spike was that there was a slightly poorer crop last time around. So if that is the reason is there any indication that the crop now is going to be better?

Saugata Gupta: Could be very difficult to say but the current trend indicates that it will.

Percy Panthaki: And last question if I might, what is your more holistic view on the youth business. I am not looking at it just from the acquisition that you have made in terms of deos, hair gels, Livon conditioners, etc. But when I talk about youth brands I would include any sort of geographic spread you would do of these brands, or some other brands you would launch organically or acquire or sort of go into any new category. So just wanted a very high level view of what you think that the youth business can be for Marico over a 3-5 year period.

Saugata Gupta: Most of the emerging markets of Asia and Africa where we operate one of the things that is common to most of these markets is the average age of the demographical skew towards youth. We have a high percentage of young people, most of these markets are going to witness a significant GDP growth over the next 5-10 years which means that the next generation will be have far more disposal income and therefore will have far more proclivity towards consumption of personal goods and grooming will be a big part. And our effort is to participate in these markets. Most of these categories have a low penetration. We now have platforms and technological knowhow in both hairstyling and serums. Deodorants is the part which is more competitive and lower margin but say 67-70% of the Paras business is hairstyling and serums which have much higher margin than deos.

At the same time we are market leaders and therefore we will invest behind market growth. And we must realise that in the last say 12-15 months because of economic slowdown and these categories being urban discretionary have faced a bit of a slowdown. I think there is no reason why we would not want to participate and accelerate this group. And we have witnessed this in other markets such as Vietnam, Egypt and we are now doing it in some other smaller markets. And therefore we believe that this is one area where we have a right to win and these are categories with high margin, high velocity of innovation. It offers tremendous opportunity for cross pollination of platforms although we have different power brands in each of the regions that is HairCode in Middle East and North Africa, Set Wet in Indian subcontinent, and X-men in South Asia and Indo-China. So, with different power brands but the same product platforms, given the population demographics and the penetration, these are high tailwind categories for us to invest.

Moderator: Thank you very much. Next question is from the line of Ruchi Jain from Morning Star. Please go ahead.

Ruchi Jain: Just a follow-up on the pricing that you have taken on the value added hair oil. The 20% price increase you mentioned is partly due to mix and inflation. So you are basically saying that beyond inflation you passed on prices, you have increased prices much beyond inflation is that correct?

Saugata Gupta: Not really. What I said is that within a brand there could be upgradation. If large packs start growing more than the small packs one can see a higher increase in value. Also, within the four brands of hair oils, the higher margin brand is growing at a faster rate. So I would not get into details but all I can tell you is that it is a mixture of mix and inflation and inflation has happened because in the case of the value added coconut oil there has been significant inflation in input cost because it has coconut oil in it.

Ruchi Jain: Sure. I just wanted to understand if you increase prices beyond inflation because that shows pricing power.

Saugata Gupta: Yes some of it is beyond inflation.

Ruchi Jain: Okay, on the same product. And on Saffola in your detailed update you have reported that you have increased 3% prices across portfolio. Does that mean all products within the Saffola franchise like edible oil cost, muesli everything put together 3% increase?

Saugata Gupta: This is only for oil.

Ruchi Jain: Okay for oils you have increased prices by 3%?

Saugata Gupta: That is right.

Ruchi Jain: And that is below inflation or that is again for that particular.

Saugata Gupta: Not really, because I think now there will be secular decline in the prices of edible oil.

Ruchi Jain: Okay, got it. And on the body lotions I just wanted to check you have been at a 6% market share for a couple of quarters now and the growth rate you are mentioning is 30%. Do you see this sort of going up any time soon in terms of market share?

Saugata Gupta: It should be. As we are a new player, there is a lag in the pickup factor but I believe we will be growing at the category market growth rate. But I think it is too early to comment because there is a skew towards the main season in quarter three and quarter four because of winter. We should wait for actually the next two quarters to see how the body lotion performs.

Ruchi Jain: And what would you say the category would have grown at in H1?

Saugata Gupta: As per Neilson it is 5-6%. We have grown at around 30% plus during the quarter.

Ruchi Jain: Category growth is only 5-6%?

Saugata Gupta: Just one second. I think it is in the single digit that is all I can tell you now, but we will just get back to you offline.

Ruchi Jain: Sure. So I will wait for that answer on the call.

Moderator: Thank you. Next question is from the line of Prakash Kapadia from iAlpha Enterprises. Please go ahead.

Prakash Kapadia: Sir if you could give us some sense on Saffola. We have achieved 10% volume growth almost for three quarters, what is driving this now, is it de-focus by the number two player, is it increase CSD contribution, is it increased modern trade sales?

Saugata Gupta: I think what has happened in Saffola is that the growth is not coming from general trade. We have been prototyping in at least one or two markets the potential in middle India and we are getting good results. We believe there is a lot of potential because we have not really, in the last couple of years, given any distribution thrust to this brand. As far as Saffola growth is concerned, we have been delivering consistent communication and inputs to the brand. Saffola Total, as per clinical trials and the latest medical trends, is one of the best blended oils. Also, what has happened is that with the growth of oats and the flavoured oats, the total A&P inputs that are going behind these prducts is obviously having a positive rub off on the master brand.

Prakash Kapadia: Okay. And sir on deodorants over the last two, two and a half years we have lost market share so what is hitting us, because one of the rationales will be the increased distribution reach. This should do well obviously you mentioned about the comments on some bit of slowdown and category being discretionary. So is it pricing at our end, is it advertising, is it unorganised guys what is affecting deodorant growth?

Saugata Gupta: I think it is an extremely competitive category and what has happened is that some of the players have been more innovative than us. Having said that, I think we have taken one shift in our strategy. We have three categories which are deodorant, serums and styling gels. In the two categories which contribute up to 70% of the Paras portfolio, which also earns higher margin, we are market leaders. So strategically we want to invest in these categories to grow while trying to maintain market share in deodorants. And in deodorants we have to innovate to grow and that is something which in terms of both share of voice and spends and innovation we have fallen behind and that is the reason we have been able to gain market share and get our act right.

Having said that, our focus going forward in terms of spends and in terms of inputs will be much more in the styling gel, serums and the Livon hair gain business where our right to win is far higher. So instead of investing behind deos if you put the same investment and input behind these two portfolios, I think the growth rate will be fast and we have started the journey from the last one or two months in this quarter itself.

Saugata Gupta: I just wanted to come back to the one question on the body lotion category, the YTD value growth of the category is around 11%. And volume growth is 2%.

Moderator: Thank you. The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

Arnab Mitra: My first question is on the project ONE expansion in the top six metros, the 60% kind of addition seems very high for the fact that these cities would be well covered, is it that you are entering new kinds of outlets like chemist of food kind of outlets or where there actually gaps in terms of smaller shops there which you covering now and secondly the INR 100 crores kind of exit number that you said, do you think this is purely incremental or some bit of this would be anywhere going through wholesale earlier?

Saugata Gupta: I think you are absolutely right. About the 60% increase in direct reach in the top six metros - see what used to happen is that our traditional portfolio which is coconut oil, edible oil and hair oil was being sold in certain set of outlets which were mainly grocery and wholesale. As we started entering new categories mainly the food business, the body lotion, and we started premiumising hair oil and also acquired the Paras business we realised that there was a gap in especially three segments which are chemist, cosmetic and food. In these three segments we did not have a critical mass to do direct distribution. There was some indirect distribution that was happening through wholesale. Now that we are a critical mass of brands, we started driving distribution in these. The grocery channel in our core categories may be contributing 80-90% but in these new set of outlets, the value-added portion may be your majority. So, we now have a critical mass or circuital portfolio. To give you an analogy, four years ago we did not have good rural distribution in the North because we did not have to carrier brand which Nihar Shanti Amla gave. Once you have a carrier brand you can always piggy back your core on to that. So that is exactly what has happened. Now the number which we are clocking which is INR 3 crores might not be fully incremental but a significant portion of it will be incremental because wholesale actually throughputs more leadership brands. And wholesale does not drive range and I think what happens is when you do direct distribution you also get to do reselling.

Arnab Mitra: Right. My other question is on Saffola as you said there has been price increases even this quarter and actually if I look at your input cost also it is kind of fallen edible oils have also fallen so what is the rationale of taking up prices when input is probably stable or slightly down? Is it because you see lower competitive intensity now as compared to a year, year and a half back is that driving you, giving you some leeway to take more price hike in this segment?

Saugata Gupta: I think this 3% is more adjustment of prices between the various blends. I do not think we plan to take any price increases in Saffola over the next two quarters.

Arnab Mitra: But even if I look at this quarter's numbers there is a reasonable Y-o-Y price component, is that also a lot of mix or there is actually…?

Saugata Gupta: If you see the 9% price component, it is versus last year where most of the price increases were taken in the second half of last year.

Arnab Mitra: Right. But you are not facing any pressure to lower prices given that edible oil prices have come off and in some segments.

Saugata Gupta: I think it is too early but our endeavour will be to maximise volume growth and market share subject to emerging brand. We promise that we will be much more proactive in taking those price cuts. I think we struggled a bit last time, especially on Parachute, and we now have far more refined pricing models in place. Our belief is that in an emerging market it is far easier to get back margins, especially on falling raw material prices, than to get back losts consumer market share or franchise.

Arnab Mitra: Lastly on the VAHO premiumisation that you spoke about. How do you actually look to drive this because you have different products which are very differently positioned you have Amla, you have light hair oils, you have some coconut perfume. So the consumer sense I presume would be different in terms of who uses what. So do you actually drive people across different brands here or you basically would need premium formats within the same brand where you drive people up, because you seem to have very different positioning in the mix.

Saugata Gupta: See I think the market is graduating from an ingredient focus to consumer needs. And our strategy is to have much broader participation by fulfilling need gaps with wider portfolio and then premiumise. And what hair oil delivers, which no other category delivers, is nourishment;

nourishment cannot be delivered by a wash product and what consumers are looking for is a fine balance between nourishment and sensorials and also a specific problem solving like it could be hair fall. So I think that is the route towards premiumisation and if you look at some of the new trends like Moroccan Oil and all Argan oil, in fact there is a merging of beauty and nourishment which only hair oils can provide.

Arnab Mitra: Right. And just one last question. Is the MENA recovery fully played out or you still have margins which are much lower than what you used to do and that could play out going ahead?

Saugata Gupta: I think it is going to be a gradual recovery and it will take a couple of quarters. But if you were to look at overall international business, the 14-15% operating margin is here to stay. Then going forward anymore margins will be ploughed back towards higher growth. And as I said, what is important for the international business over the next 2-3 years is to replicate the past five year growth rate, if not more through the organic route. That will be a far better sustainable growth and will also significantly improve the RoCE of the business.

Moderator: Thank you very much. Next question is from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: Just few questions from my end. Firstly sir I just wanted to understand if you look at the standalone gross margins at similar levels to Q1. I just wanted to understand from your end with you having put in most of the price increases with edible oil prices expected to come off and copra inflation not to increase from here. It is fair to assume that this is the lowest level of gross margin that we could look at going forward or will it improve from here, is that a fair assumption?

Saugata Gupta: In consumption terms that would be more from quarter 4 and quarter 1 of next year because we are already in November.

Harit Kapoor: Okay. No, but I just wanted to understand from a sequential basis do you expect that this 40.3% on standalone gross margin could be the bottom?

Saugata Gupta: I think directionally yes, but as I said, you have to look at the impact in consumption terms that will happen in quarter 4.

Harit Kapoor: Okay. If I can put it in another way, is the complete copra inflation in terms of even our inventories, etc., in the Q2 number now?

Saugata Gupta: I would say Q2 and Q3 rather just in Q2. Any improvement in raw material pricing will only happen more towards January-February.

Harit Kapoor: Okay, understood. Second thing was in the international margins, we have done close to 16%-odd. I just wanted to understand obviously Bangladesh is at a much higher number right now, which are the geographies which are probably significantly lower than this average and what is our thought process behind that in order to improve the EBITDA margins there?

Saugata Gupta: In some of the geographies we are still in the invest-to-grow mode but in the core markets, which are Bangladesh, Egypt and Vietnam, the operating margins are good. Gulf is still coming out of the losses and issues which we had faced in 2012 and the margins there are improving. And also you must realise that we are now investing in certain markets like Myanmar, Cambodia, and North Africa. We will also be using South Africa as a bridgehead for growing into Sub-Saharan Africa. So, the way to look at international margins is that even in established markets like Bangladesh we will now invest behind making it a full-fledged personal care business. In Bangladesh, we have just launched male grooming portfolio - which is deos and gels, body lotion and colours. In colour we are already number one in Bangladesh. In value-added hair oils we are getting very good growth. So there is no reason why we can't become the full-fledged personal care player in Bangladesh given our distribution strength.

We do not treat Bangladesh as a cash cow but we expect the other markets to move up and as other markets move up in margins we will find new markets for growth. But our first endeavour and focus will be organic play. So if we can grow 15% in constant currency terms organically over the next 2-3 years we have done a good job and any acquisitions or inorganic will be a top up.

Harit Kapoor: Understood. Just lastly you said that in your opening remarks that the last three or four years of growth a part of it was inorganic-led the focus as against you said will be more organic from here on over the four year strategy. Just want to understand this really means that the cash that you throw up in the business may not be required to that extent as it was required earlier. Can we imply that this could result in higher payout ratios going forward as well?

Saugata Gupta: Yes. I think we have already indicated that if we do have surplus cash the dividend payout will improve. Having said that, we are not ruling out any inorganic opportunity. Should an opportunity arise, we will definitely look into it. But in India we have enough on the plate and enough headroom for growth and we will focus on doing fewer things, bigger things, and better.

Moderator: Thank you very much. Next question is from the line of Amnish Agarwal from Prabhudas Lilladher. Please go ahead.

Amnish Agarwal: Sir my question is regarding our Vietnam business where last year we had reported very sharp increase in gross margin as well as EBITDA margins and profitability. So while now there is a slowdown in sales growth there are around 4%-odd so how has been the performance in the margins and overall profitability in that business?

Saugata Gupta: See in terms of operating margins there has been no dip. However there is implication on tax rates and therefore the PAT percentage has done down. While there was a little bit of consumption slowdown in Vietnam where all FMCG companies reported a flat growth, assuming Nielsen numbers are correct. There is a bit of a struggle for all the companies in Vietnam due to consumption slowdown. In our case, however, there is an additional factor of some stock correction in our system. While we have been transplanting and cross-pollinating our GTM practices occur across our markets, one of the things is keeping certain distributor stock and supply chain efficiency.

Also, the other good thing is the macro economic recovery is expected in the second half of the year and going forward by January-March quarter the Vietnam growth will start panning out. As far as market share is concerned we have not lost market share and our leadership position in shampoo. So I would like to see this as a temporary phenomenon. Having said that, the consumption story and lot of markets in South East Asia go through these cycles that after one or two years of high growth there is one or two year of tepid growth and again it picks up. But overall on a long term basis, it is a very exciting market. Again the same thing about penetration being lower in most of the categories and the per capita is expected to increase, the GDP growth is expected to go to 5-6%. The economy is opening up and I think it is an exciting market. Also, as a bridgehead for most of our endeavours in Indo-China mainly Myanmar and Cambodia, it has a significant place as we are also manufacturing in Vietnam for these other geographies.

Amnish Agarwal: Sir my question is also involving the margins because last year we had seen very sharp increase in margins in that market. So will we be able to hold on to the margins or was it more like a one-time sharp increase in margins and profitability over there?

Saugata Gupta: I think we peaked last year. There may not be a further upside but we have to also invest beyond creating the second lag. I think that is important in all our markets. The important thing in all our emerging markets is to define the sustainable margin to maximise growth. And we have been searching in each of our markets, what is the sweet spot where you can maximise market share, volume growth while maintain a threshold level of margins.

Amnish Agarwal: Okay. So you believe that you will be able to hold on to the kind of numbers we had last year?

Saugata Gupta: What number are you talking about?

Amnish Agarwal: Sir in FY14 our profitability in Vietnam had increased from a PAT level from 20 crores.

Saugata Gupta: Not a PAT level as I told you. The effective tax rate has increased in Vietnam but in operating margin terms we will be able to hold it as we do not see expansion there.

Amnish Agarwal: Okay so if active tax rate will go up to what percentage now because last year it was hardly some 12%-odd?

Vivek Karve: The tax rate is likely to go from 7.5% to 15%.

Amnish Agarwal: Okay. But otherwise all other parameters will be intact?

Saugata Gupta: Yes but the topline has to recover which has been flattish in the first couple of quarters. We expect quarter three also to be similar and we expect growth to pick up from January-March quarter.

Moderator: Thank you very much. Next question is from the line of Abdul Karim from Narnolia Securities. Please go ahead.

Abdul Karim: Sir could you throw some light on the performance of the food business during this quarter and how do you see margin in business, what is your plan and strategy in terms of the muesli business?

Saugata Gupta: Muesli is a very marginal business and we are only distributing it in modern trade. May be it has long-term potential but so far our focus is driving the savory oats and the sweet oats business. As I said that within that, we want to ensure that we stay in the value added part of the business by offering superior taste to the consumer rather than participating in the commoditised part of the business which is plain oats. The business is tracking quite well. We should be hitting, as I said in our note, INR 70-80 crores this year and it is well-poised to cross the INR 100 crores mark next year.

Abdul Karim: Okay. Sir there is a slight reduction in advertisement spend during the quarter two, so any particular indication that for the next couple of the quarters for next year ad spend would be at similar level or would be increased?

Saugata Gupta: Annualised ad spends will hover around 11-13% or rather 12%. If you look at the absolute ad spend, it has increased by 24% this quarter versus last quarter. So we have not pulled the plug on advertising. It is just that the growth in the topline has given us the air cover for increasing the advertising area.

Abdul Karim: Sir any guidance for tax rate going forward.

Vivek Karve: For the current year the tax rate is likely to be in the range of 28-29%. And this is likely to be in the same range for the coming year also.

Moderator: Thank you very much. Next question is from the line of Ajay Thakur from Axis Capital. Please go ahead.

Ajay Thakur: Saugata you had referred to focus shifting towards innovation from inorganic kind of growth. So what is giving us confidence of increasing our innovation focus now? Is it more of a pipeline, is it stronger pipeline of the product and to the same question, does it also mean that we would be having higher A&P spends going ahead?

Saugata Gupta: I think what gives us confidence is that there has been lot of learnings. If you really look at our track rate for the last three, four years, it hadn't been good. I think with some of the new initiatives like body lotion and foods that innovation track record has improved. In fact, one of the unsung heroes is Ayurvedic hair fall oil which we only sell in the south and we will sell INR 50 crores of that next year. We do not talk about it but that is one more of the innovation. I think where we have improved over the last couple of years is having a much sharper choice making framework and focusing on few things. Internally, once you focus on few things and use no escape buttons, the resilient of making it right increases. And we have also looked at and sharply improved internal capability. Whether it is R&D capability or marketing capability, we are investing behind them but not everything can be invented internally. We want to explore connect and develop capabilities in driving some of the innovations.

I must also tell you when you do fewer things, when you believe in them, when you have the conviction and the management bandwidth is focused on doing fewer things in a bigger and better way, automatically the success rate increases. One of the other thing we have changed in our internal culture and performance management system is that we now encourage much more experimentation, risk taking. This is a journey because at the end of the day if you are risk averse, the innovation strike rate goes down because people are not willing to experiment. Innovation is not about just new products; innovation is a way our life which can be into processes and value management. So we are looking at innovation much more holistically in the organisation.

Ajay Thakur: Okay and same question actually. That also means there would be higher A&P spends going ahead?

Saugata Gupta: It depends on the category. That is why I said it could be within 11-13% band. Now the question is, if you are doing brand extension, for example Saffola oils and Saffola food, the way to look at it is as combined A&P on the brand or for example Set Wet deos versus Set Wet gel. There is always a kind of a rub off effect on the mother brand. If you had created a new brand and invested behind any advertising I would tend to agree with you, when it means leveraging the existing brand it might not be so.

Ajay Thakur: Okay. And my second question was if you look at, you have been distributing Bio Oil so how is the income and distribution income for the same actually being accounted. And where would it be reflected in our P&L?

Saugata Gupta: It is a very small initiative. The reason for distributing Bio Oil for us was to gives us a critical mass in some of the chemist channel and in one of the new channel called e-commerce. We believe it is a good product and it is a lot of learning for us on how to sell our problem solution brands at very high pricing. So the entire distribution which we have taken for Bio Oil in India is not for bulking up in sales but it is more for internal learning and it is a win-win for the manufacturers of Bio Oil and us.

Moderator: Thank you very much. Next question is from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: Two questions first again on A&P, can you just conceptually explain sir in number of other categories or for different companies we see when the inflation is fairly high the industry typically cut backs on A&P and the A&P increases when the deflation prevails. In case of Marico on a Y-o-Y basis there has been a 24% increase. Is it mainly led by new innovations and the base business would it has seen some moderation and the delta is mainly because of new innovation that you would have done?

Saugata Gupta: One of the learnings is to not cut behind investments and building brand equity in both inflationary and deflationary environment. And also, what we have done in the last two years in our value management exercises is to concentrate on ensuring effective spends. So some of the A&P increase is also because we have cut down on unnecessary spends on ineffective consumer promos and driven it to ATL. So I think both in the case of inflation and deflation, if philosophically our choice is to drive market share and also volume growth it is imperative that we do not cut down on A&P. But having said that, I think during deflation if we make higher margins the amount of A&P available to fund newer products will be higher. In the case of inflation, if we pass on the inflation and get higher sales turnover, maintaining a same percentage of A&P, we will still get headroom to drive the actual A&P spends. So that is how it works for us.

Vivek Maheshwari: Okay. And second on the other expenses there is a 12% decline in fixed expenses in this quarter which is why the overall other expenses increased by only 7%. The press release says something like 'certain one-time project base consulting charges for capacity building', can you just explain in simple terms what exactly is this?

Saugata Gupta: Yes. So I think these are onetime consulting charges. We were having three value management projects for which we were working with external consultants to identify value management and cost savings in our business and we were also working with another consultant for the international business foot print. We do have a great internal talent pool to leverage once we use these consultants. We hope we do not have to use them again because we want to build internal capability for that.

Vivek Maheshwari: Okay. And is there anything in the next two quarters which will help Y-o-Y comparables or second quarter was about it?

Saugata Gupta: I think you can keep the same trend I think that way.

Moderator: Thank you. Next question is from the line of Sagarika Mukherjee from SBI Cap Securities. Please go ahead.

Sagarika Mukherjee: Sir I just wanted to know the increase in the goodwill in September balance sheet versus the March balance sheet, it is INR 416 crores versus INR 254 crores. Just wanted to understand the reason behind this.

Vivek Karve: In the information update, we have stated about the buyout of the minority stake by our subsidiary in Vietnam. The goodwill arises out of this buyout.

Sagarika Mukherjee: Okay. So the incremental 16% or 15% stake that is right?

Vivek Karve: Yes, that is right. Your understanding is correct.

Moderator: Thank you very much. Next question is from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.

Kaustubh Pawaskar: Sir my question is on your operating margins. Sir at consolidated level what kind of operating margins you would be comfortable with going ahead? In the scenario where we are seeing that raw material prices have corrected substantially and some of the raw material prices you would be utilising for promotional activities or giving price offs or discount kind of a thing. So what kind of margins you would be comfortable at the consolidated level?

Saugata Gupta: I think subject to quarterly fluctuations an annual operating margin of 14-15% is the comfortable margin.

Kaustubh Pawaskar: 14-15%?

Saugata Gupta: Yes that is what we have indicated in our previous quarter.

Kaustubh Pawaskar: But that remains provided that you would be seeing some kind of correction in the raw material prices?

Saugata Gupta: There could be quarterly fluctuations but our entire bias will be towards maximizing growth potential subject to a margin staying on an annualize basis in the 14 to 15% band.

Moderator: Thank you very much. Next question is from the line of Sandip Patodia from Fund Smith. Please go ahead.

Sandip Patodia: I just wanted to ask you, beyond your base business I guess the Marico story is based on transformation of your portfolio and that is dependent on you being able to deliver big bang innovations. And as you rightly stated that your track record in the past has been mixed so I just wanted to understand what gives you the confidence that your strike rate would be much better and you will be able to deliver innovations to transform your portfolio?

Saugata Gupta: Let me tell you two things. One is - our core business is not a cash cow where we will have flat growth. The only exception may be the Parachute Coconut Oil business in Bangladesh. But even our value-added hair oil business is growing in double digits in volumes, quarter after quarter which translates into share gain. As far as the new business is concerned we are not talking of introducing new categories or new products. We already have on the table the youth business, skin care and foods. In the international markets, innovation will mean cross-pollination of some of the categories. For example in Bangladesh innovation is actually introducing some of the categories which are there in some of the other international markets. Innovation of new business also means entering into new countries, for example Sri Lanka, Nepal, Myanmar, North Africa, and Cambodia. We should be able to sell INR 100 crores next year in these new geographies. So it is the combination of that. We are not saying that we are going to enter three more new categories. The current portfolio has enough legs to deliver a certain growth rate. And I think we have to build on the base. The way we look at it is - focus on few things, make it big because ultimately the management bandwidth is independent of the size of the price and therefore we will focus and galvanize the entire organization to grow what we have on the table. And obviously there is enough innovation potential even in the so called boring category of hair oil. So, I think we need not get into other new things because it is always nice to venture into new thing. But there is enough opportunity on the table to drive this growth organically.

Sandip Patodia: Okay, thank you. And second question. I remember reading that you have a revenue growth target of around 19% which I worked backwards from doubling your revenues by 2018. That is why it baffles me because you cannot control your copra prices, you are having a revenue growth target slightly absurd in my view. So, I wonder why that is first and secondly aren't you have any operating profit growth targets, free cash flow targets or return capital employed targets instead?

Saugata Gupta: People are entitled to have an opinion whether it is absurd or not. I think it is an aspiration. Every organisation has an aspiration and this aspiration is based on sound ground fundamentals. IYes, we cannot control commodity prices as they are cyclical so one year you might grow by 25-30% but next year you can grow by 10-12%. But as long as you deliver 8-10% volume growth over the long term, and it is something which is possible. We intend to improve our RoCE, However we do not want to take an RoCE target because that might encourage a certain behaviour and we might compromise on growth. You must realise that we are operating in emerging markets and there is a cost of time capital and early entry into some of these markets. So we do have internal target for bottomline and we have already indicated that as of now in the immediate term 14-15% EBITDA margin is something which we want to maintain.

Sandip Patodia: Understood. And I guess does that mean that the EBITDA growth or EBIT growth per se is also along the same line as your revenue growth targets or you think that would grow slightly slower than that?

Saugata Gupta: Aspiration and rallying point is not about excel sheet. It is about galvanizing an organization and having a strategic blueprint to achieve that. Now if I achieve 16 or 17% instead of 18% I do not think we will be very unhappy. It is about aspiring for something which is a stretch but not out of reach and I think that is what a good aspiration is all about.

Moderator: Thank you very much. Ladies and gentlemen that was the last question. I now hand the conference over to Mr. Rakshit Ranjan for closing comments. Over to you.

Rakshit Ranjan: Thanks a lot. On behalf of Ambit Capital I thank the senior management of Marico as well as the participants on the call. I would like to now hand the call back to Mr. Saugata for any closing comments please over to you, sir.

Saugata Gupta: We are reasonably satisfied with this growth but as we move ahead in the next couple of quarters what is important is to see whether the Indian consumption story is back especially in urban. We believe it will happen and for us what is important is to ensure that we do not lose sight of the few big bets which we are chasing and also not lose sight of driving volume growth and market share. And as I said that we expect some kind of input cost correction in our chief raw material which is copra and this time we need to get the pricing right and ensure that we continue to invest behind growth. The organisation is focused on the five transformation areas and continues to drive a repeatable model of growth. And what is important in all this is a huge focus on innovation, talent, and culture which my top team and I will focus on as we go into the growth journey. What is also important to understand is to look at numbers over multiple quarters and annual period. There would be quarterly fluctuation, whether there is inflation or deflation, but as long as we keep on chasing that 8% organic volume growth, we believe that the margin expansion and market share gain will happen. So thank you for your listening and good night.

Moderator: Thank you. Ladies and gentlemen on behalf of Ambit Capital that concludes this conference call. Thank you for joining us and you may now disconnect your lines.