Purpose of this update

Marico usually issues an Information Update once a quarter- on the same day as the declaration of quarterly financial results. We have also issued Updates upon events that have had the potential to influence shareholder value. This update is however being issued in a different context.

We interact with the financial community (investors – current or prospective or past, analysts, and other opinion makers) on a continuous basis. Over time, in the recent past, we have identified a few themes underlying the questions that are usually asked of us. This update seeks to create greater awareness about such “question themes”, The objective is to create the right backdrop to the periodic financial statements that we will issue in the course of this year-FY12. We believe this will facilitate informed judgement on part of the financial community, while analyzing Marico’s financials or projecting the future expected from Marico.

Our objective is also to share information relating to developments in Marico’s business ambiance such as those relating to input costs. We believe this will promote a better appreciation of their impact on Marico.

This update is not a warning, in that, it does not seek to create any apprehensions or defensiveness about Marico’s shareholder value prospects. We do continue to strongly believe in the long term value creation potential of Marico’s businesses.

Mode of Issue of this update

We have issued this Information Update, first to the Stock Exchanges, posted it on Marico’s website and then sent it to the financial community members who are on Marico’s regular mailing list.

Consumer Scenario

India has been through several events in the recent past, the top two being a Civil-Society-led movement against corruption and terrorism-related incidents and security issues. One also senses some stalling of policy-making in the economic reforms area. All these would have an adverse effect on the confidence that businesses or consumers carry. This coupled with the expected lowering of the GDP growth estimates would have some, if not major, effect on consumer demand especially for items of discretionary consumption in our portfolio.

New Products

Marico has had a slew of new offerings to the Consumer in recent times. These include Parachute Advansed Cooling oil, Parachute Advansed Ayurvedic Hair Oil, Saffola Oats and Saffola Arise. We expect to sustain the momentum in our focus categories of Coconut Oil, Hair Care, Health Care and Skin Care across all our geographies. This will call for Advertising & Sales Promotion expenditure (ASP) that may have a marked skew over the next few quarters. This may influence the operating margins in a different manner from quarter to quarter.

Such support for new products across businesses is crucial to the long term sustenance of Marico's growth plans. We believe that this investment will be worthwhile, despite the possibility that as a result margin percentages may vary from quarter to quarter.

Input costs

Copra (dried kernel of coconut) is a major input material for Marico. It constitutes circa 40% of total material cost for the group. It is a peculiar commodity in that the Indian market is fairly insulated from the global market, with restrictions on imports of copra and coconut oil.

The copra market has seen an unprecedented inflation, with prices in YTD FY 12 being higher than those in YTD FY 11, by circa 80%. The current bull-run in copra prices although unusual should give way sometime. However, there have been two developments in the Global Commodities Market in the past 3 years or so. These have queered the pitch and predicting commodity prices is more difficult than ever before.

These developments are:

- A Stronger link between the Vegetable Oil price table and the Fuel Oil price table, because of the increasing use of vegetable oils as non-conventional energy sources.
- An Increase in funds flowing into the commodities as an asset class, some of the funds being speculative, in that the flow is not from actual users.

The resultant increased unpredictability of the copra market creates an imponderable for us. Thus, it is still unclear whether the Copra bull-run denotes a structural upward shift in copra prices. Any structural change is just a possibility at this moment, but if it does materialize, we may not see a major improvement in our margins until we reset the rules of the game. We expect that it will take us a couple of quarters to gauge the trend in the right manner and modify our strategies accordingly.

Margin Expansion / Maintenance or Volume Growths

In the recent past, we have taken several increases in retail prices of several of our products. However, the sustained run-up in input costs has, in some cases, still resulted in some shortfall in the coverage of the cost push. Considering the magnitude of the overall absolute price increases taken, we may leave such shortfall as it is. This would affect our operating margins in the short run.

We have recorded healthy volume growths despite such price hikes. This is a positive sign indicating sustained demand and the underlying strength of our brands.

However, that should not prompt us to keep raising prices. We do realise that it is critical for us to focus on creating a long term consumer franchise, rather than raise prices to target better short term quarterly results.

Also, there are some unconfirmed signs that factors like inflation, especially in food items and higher consumer finance interest rates may have already began affecting overall consumer demand in India.

Against this backdrop, we may not take any further increase in retail prices as it may impact the volume growth numbers.

Environment outside India

The business ambience in the Middle East and North Africa (MENA) region continues to be uncertain. There has been a virtual standstill in business in some countries like Libya, Syria and Yemen. There share of Marico's business in MENA is about 5%. Where we have been able to operate, we have had issues like the authorities in MENA region putting restrictions on companies to take the retail prices up to completely cover for cost push.

Inflation has also been a factor in some countries we operate in.

Kaya & International Business - Accounting

Kaya has been doing well in terms of collections. These have showed a sequential quarter increase for 3 quarters running now. However, as you would be aware, Kaya refined its revenue recognition practice during Q4FY 2011. As a result, there is a new correlation between collections and revenue recognised. This has significantly reduced the comparability of Kaya's quarterly results for FY 12 with those for the corresponding quarters of FY11.

Another change in accounting policies made in FY 11 was the decision to amortize Overseas Brands as per Indian GAAP. This too reduces the comparability of FY12 quarterly numbers with those for FY11.

After an appreciation in the first quarter of this fiscal, the Indian Rupee has been weakening against the USD. Further depreciation of INR cannot be ruled out. There have been fluctuations in some of the other key currencies that Marico deals with. This could lead to a variation in the reported growth of operations in International geographies, as on consolidation of subsidiary accounts there will be a gain / loss while converting global numbers to Indian Rupees.

Likely Shortfall against expectations

On balance, we sense that the numbers expected from us by Financial Community members, especially Stock Market participants, are somewhat excessive.

We must therefore point out that on account of the various factors outlined in this Update, there is a possibility of our Profit after Tax (PAT) for the next couple of quarters falling short of the current expectations of market participants particularly our investors and stock analysts.

Long Term potential intact

Our belief in the long term potential of our businesses continues to be strong. Our belief stands bolstered by the recent record of strong volume growths across categories despite price hikes. This emboldens us to spell out our preference for growing our volume franchise as compared to focusing on profit margins alone. We believe that it is prudent to have a medium to long term perspective of growth rather than taking a quarterly view that could lead to tactical steps.

Also, the adverse impact of some of the factors mentioned in this update above is expected to progressively reduce as we move further into FY 12 and FY 13. It will therefore be advisable to observe the situation for a couple of quarters, before concluding on the shape of things to come.

Expectations from financial community members that track Marico

We expect that the analysts tracking Marico and the Fund Managers investing in Marico will assess Marico's performance for Q2FY 2012 and a couple of quarters thereafter in the context of the various issues outlined in this update.