



# Marico Kaya Enterprises

STOCK INFO.  
BSE Sensex:8,102

BLOOMBERG  
MAKA:IN

S&P CNX:26,909

REUTERS CODE  
MRCK.NS

7 January 2015

Buy

Initiating Coverage

INR967

(INR CRORES)

Y/E MARCH	FY15E	FY16E	FY17E
Revenue	338	401	472
EBITDA	32	44	59
EBITDA Margin	9.4%	11.0%	12.4%
NP (Adj.)	30	41	50
EPS (Adj.)	23.2	31.5	38.9
EPS Growth	334%	36%	24%
BV/share	176	196	212
RoCE (%)	13	16	20
Op. RoCE (%)	53	76	122
P/E (x)	42.1	31.0	25.1
P/BV (x)	5.5	5.0	4.6

## KEY FINANCIALS

Shares Outstanding (cr)	1.29
Market Cap. (Rs cr)	1257
Market Cap. (US\$ m)	210
Past 3 yrs Sales Growth (%)	22%
Past 3 yrs NP Growth (%)	Loss to Profit

## STOCK DATA

52-W High/Low Range (INR)	1098/214
Major Shareholders (as of September 2014)	
Promoter	60.6
Non Promoter Corp Holding	11.3
Public & Others	28.2
Average Daily Turnover(6 months)	
Volume	88291
Value (Rs cr)	4.80
1/6/12 Month Rel. Performance (%)	0/280/NA
1/6/12 Month Abs. Performance (%)	-5/284/NA

**Maximum Buy Price :INR1020**

**We recommend a BUY on Marico Kaya with a target of INR 1250 - valuing the company at 32x FY17E EPS**

**Creating multiple moats:** Since Kaya's launch in 2002, the company has been creating multiple moats around its skin cure business. (i) The 'Kaya' brand is today synonymous to skin cure treatments and is the only national chain exclusively offering cosmetic dermatology services in India. (ii) Kaya has developed its proprietary advanced technologies over the last 12 years which are being carried out under the supervision of 166 dermatologist doctors across India and Middle East. (iii) Kaya underwent a decade long gestation period (turned profitable in FY14) owing to the capital intensive nature of business which would act as a deterrent for new entrants. (iv) One of the pre-requisites for success in this business involves a high capacity utilization rate. Being a pioneer in this business, Kaya enjoys a first mover advantage wherein it has occupied prime locations in tier 1 cities targeting the affluent class. This would prevent new entrants to set up shops in areas where Kaya is already present as that could mean low capacity utilization resulting in prolonged payback.

**Cost efficiencies & operating leverage resulting in significant margin expansion:** In the last two years, the company's EBITDA margin expanded by 22% points to 5% in FY14. The margin expansion is attributed to i) a reduction of dermatologist doctors from 250 few years ago to 166, ii) 10% cut in rental & clinic overheads, iii) 2% reduction in backend costs, and iv) reduction in media spends from 11% of sales a few years back to 8%. The business has high operating leverage which provides continued scope for margin expansion. Almost 70% of the company's expenses are fixed in nature (salaries, rent, overheads) meaning incremental capacity utilization adds more than proportionately to the EBITDA. The overall capacity utilization currently stands at 35%, while a few of the high performing clinics have a utilization of 55%. Kaya is targeting SSSG of 10-12%, revenue CAGR of 20% and EBITDA margins of 12% by FY17E.

**Valuations & View:** Over the last decade, Kaya has had a long learning curve and has staged an impressive turnaround over the last eighteen months. With the company now having de-merged from Marico, we believe the company will not experiment too much with its business model and maintain its core focus on skin cure services. The stock is currently trading at a P/E of 25x FY17E EPS which is a 22% discount to other consumer stocks. We thus value the company at INR 1250 at a P/E of 32x FY17E in line with the consumer basket.

## Analyzing the industry structure

### Bargaining power of buyers - LOW

- Buyers' options restricted to hospitals, individual doctors, regional clinics and Kaya, the only national brand in dermatology. Buyers prefer niche brands as they co-relate this treatment to beauty enhancement rather than a disease. The organized sector being limited as of now provides limited options to customers.
- Buyers typically belong to the high income group who give prime importance to brand & quality of service rather than price.

### Bargaining Power of Suppliers - LOW

- Raw Material forms barely 20% of revenues and primarily is generic in nature. Further Kaya has been trying to increase the share of high end services where the gross margins are even higher.
- Dermatologists are permitted to operate their own clinics along with their employment at Kaya which maximizes their earnings and is a win-win situation for Kaya as well as the Doctor.

### Industry Rivalry - LOW

- Intensity of rivalry in the organized segment is low as Kaya's core focus is on cosmetic dermatology services as against multiple offerings by the only other pan India company - VLCC (dermatology forms 5-7% of VLCC's sales).
- Kaya is the only niche brand providing dermatology services on a pan India basis. There are 20 odd regional players with 2-5 outlets and many individual doctors, however their appeal is limited to the periphery of their locality and do not pose a threat to Kaya's industry positioning.

### Threat of New Entrants - LOW

- Access to/development of complex technology/knowhow & high cost advanced machines/equipment is a major barrier.
- High fixed cost model (rent, employees, doctors, overheads) resulting in longer gestation period shall prevent new entrants.

### Threat of Substitutes - LOW

- Technology Obsolescence.
- Pharma/FMCG companies may come out with innovative products at cheaper prices in the long run.

**Negative working capital business; cash rich company:** Kaya clinics operate on negative working capital of 50 days as clients are required to make advance payments for packages and services to be offered over the near term. Advances from customers stood at INR66cr (20% of sales) as on Sep 2014. Kaya divested its Singaporean subsidiary Derma Rx in Jan 2014 for INR1.7b which made the company cash surplus. Kaya thus has net cash of INR1.85b which is sufficient to meet its capex needs for the next 4-5 years. The company is looking to add 10-15 clinics and 15-20 skin bars in India; and 2-4 clinics in the Middle East every year. The cost of setting up a clinic is INR 0.8-1.0cr half of which goes towards machinery and technology. Thus the company would incur a capex of INR30cr per annum.

**Possesses key attributes of becoming a wealth creator:** We believe Kaya's business model possesses many attributes of becoming a wealth creator. (i) Kaya is the pioneer and the market leader (only organized pure play) in the skin cure service industry which is in a nascent stage of evolution. (ii) Kaya has a highly scalable business. With more people graduating to the affluent category as well as growing consciousness among working women provides a huge opportunity. (iii) The business has high operating leverage which provides continued scope for margin expansion. As there are no precedents to Kaya in this business, it is difficult to arrive at sustainable margin levels once the industry matures, however one thing that is certain is that margin expansion shall continue till there is an increase in capacity utilization. (iv) The company is backed by strong leadership/management with Mr. Harsh Mariwalla at helm. With his track record of building Marico from scratch we believe Kaya is treading the path of building a sustainable and profitable business model.

## Marico Kaya Enterprises Financials &amp; Valuation

INCOME STATEMENT (INRCR)					
Y/E MARCH	FY13	FY14	FY15E	FY16E	FY17E
<b>Revenues</b>	<b>259</b>	<b>291</b>	<b>338</b>	<b>401</b>	<b>472</b>
Growth	21%	12%	16%	18%	18%
COGS	58	54	61	73	86
<b>Gross Profit</b>	<b>200</b>	<b>237</b>	<b>277</b>	<b>328</b>	<b>386</b>
GP Margin	77.4%	81.4%	81.8%	81.8%	81.8%
Employee Cost	101	116	129	153	179
Other Expenses	114	107	116	131	148
<b>EBITDA</b>	<b>-14</b>	<b>13</b>	<b>32</b>	<b>44</b>	<b>59</b>
EBITDA Margin	-5.6%	4.6%	9.4%	11.0%	12.4%
Depreciation	22	9	12	15	18
Other Income	0	4	10	11	13
<b>PBIT</b>	<b>-36</b>	<b>8</b>	<b>30</b>	<b>41</b>	<b>54</b>
E/O. Inc/(Loss)	(10)	41	0	0	0
Interest Cost	2	0	0	0	0
<b>PBT</b>	<b>-48</b>	<b>48</b>	<b>30</b>	<b>41</b>	<b>54</b>
Tax	0	6	0	0	4
Rate	0%	11%	0%	0%	7%
<b>Adjusted PAT</b>	<b>-38</b>	<b>7</b>	<b>30</b>	<b>41</b>	<b>50</b>
Growth	-17%	-118%	334%	36%	24%

RATIOS					
Y/E MARCH	FY13	FY14	FY15E	FY16E	FY17E
<b>Adjusted EPS (INR)</b>	<b>-30</b>	<b>5</b>	<b>23</b>	<b>31</b>	<b>39</b>
Book Value	24	264	176	196	212
Div Per Share	0	0	0	10	20
Dividend Payout	0%	0%	0%	37%	60%
Net Debt / Equity	2.0	-0.5	-0.8	-0.8	-0.8
P/E	NA	182.6	42.1	31.0	25.1
P/BV	40.9	3.7	5.5	5.0	4.6
EV/EBITDA	NA	93.4	39.5	28.6	21.4
EV/Sales	4.9	4.3	3.7	3.1	2.7
Dividend Yield	0%	0%	0%	1.0%	2.1%
ROCE	-25%	2%	13%	16%	20%
Operating ROCE	-39%	5%	53%	76%	122%
<b>Op ROCE on G.Block</b>	<b>-17%</b>	<b>3%</b>	<b>19%</b>	<b>24%</b>	<b>31%</b>
EBITDA Margin	-5.6%	4.6%	9.4%	11.0%	12.4%
PAT Margin	-14.8%	2.4%	8.8%	10.1%	10.6%
Debtor days	1	0	0	0	0
Inventory days	136	155	156	153	154
Creditor days	112	122	126	126	126
Customer Advances	83	83	83	80	80
<b>W.Cap cycle</b>	<b>-58</b>	<b>-50</b>	<b>-52</b>	<b>-52</b>	<b>-52</b>

BALANCE SHEET (INRCR)					
Y/E MARCH	FY13	FY14	FY15E	FY16E	FY17E
Share Capital	13	13	13	13	13
Reserves	18	327	214	240	260
<b>Networth</b>	<b>31</b>	<b>340</b>	<b>227</b>	<b>253</b>	<b>273</b>
Loans	113	0	0	0	0
<b>SOURCES OF FUNDS</b>	<b>144</b>	<b>340</b>	<b>227</b>	<b>253</b>	<b>273</b>
Gross Fixed Assets	150	105	140	177	216
Less: Depreciation	118	86	98	113	131
<b>Net Fixed Assets</b>	<b>32</b>	<b>18</b>	<b>42</b>	<b>65</b>	<b>86</b>
Capital WIP	0	1	0	0	0
Goodwill	0	198	55	55	55
<b>Investments</b>	<b>104</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Cash	52	185	171	199	229
Curr. Assets (ex cash)	57	73	78	84	92
Creditors and Prov.	102	134	119	151	189
<b>Net Curr. Assets (ex cash)</b>	<b>-45</b>	<b>-62</b>	<b>-41</b>	<b>-66</b>	<b>-97</b>
Less Net Def. Tax Liab	0	0	0	0	0
<b>APPLICATION OF FUNDS</b>	<b>144</b>	<b>340</b>	<b>227</b>	<b>253</b>	<b>273</b>

CASH FLOW (INRCR)					
Y/E MARCH	FY13	FY14	FY15E	FY16E	FY17E
EBITDA	-14	13	32	44	59
Adjustments	8	24	0	0	0
(Inc)/Dec in W.Cap	12	(8)	(7)	25	31
Pre Tax OCF	6	29	25	69	90
Tax Paid	0	-6	0	0	-4
<b>CF from Operations</b>	<b>6</b>	<b>24</b>	<b>25</b>	<b>69</b>	<b>86</b>
(Inc)/Dec in FA	(13)	(13)	(35)	(37)	(39)
Invst/Loan: Subsidiary	(81)	161	0	0	0
Other Investments	62	28	(14)	0	0
Interest Received	0	4	10	11	13
<b>CF from Investing act.</b>	<b>(31)</b>	<b>181</b>	<b>(39)</b>	<b>(26)</b>	<b>(26)</b>
Capital fm rights issue	132	0	0	0	0
Inc/(Dec) in Debt	(67)	(71)	0	0	0
Interest Paid	(2)	(0)	0	0	0
Divd Paid (incl Tax)	0	0	0	(15)	(30)
<b>CF from Financing act.</b>	<b>63</b>	<b>(71)</b>	<b>0</b>	<b>(15)</b>	<b>(30)</b>
<b>Inc/(Dec) in Cash</b>	<b>37</b>	<b>133</b>	<b>(14)</b>	<b>28</b>	<b>30</b>
Add: Opening Balance	15	52	185	171	199
<b>Closing Balance</b>	<b>52</b>	<b>185</b>	<b>171</b>	<b>199</b>	<b>229</b>

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