BOBCAPS
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BUY

TP: Rs 2,185 | ⮝ 35%

ZYDUS WELLNESS | Consumer Staples | 25 August 2022

Management meet takeaways – Primed for growth

- **Product innovation, distribution expansion and international footprint expected to aid brisk PAT CAGR of 20% over FY22-FY24, in our view**
- **Portfolio of leading wellness brands (Sugar Free, Everyuth, Glucon-D, Nycil, Nutralite) and low market penetration rates offer long growth runway**
- **Retain BUY with TP of Rs 2,185 led by product innovation, distribution expansion and strong brand equity**

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We interacted with ZYWL's CFO Umesh Parikh to gain a perspective on the company's growth prospects and sector outlook. Key takeaways:

Brand can grow in double digits: The average penetration level of ZYWL's portfolio brands stands at ~20% (12-24% across categories), signifying higher growth headroom versus its FMCG peers. Theoretically, an increase in market penetration from modest levels is one of the levers for sustained, long-term category growth – reflected in the near-double-digit uptick in these categories over the years. The company has identified white spaces in the market and has the R&D backbone to launch new variants and extensions. Launches (last 36 months) contribute ~3% of revenue which management expects to rise to ~5% in two years.

Distribution expansion: ZYWL aims to widen direct distribution coverage from 0.6mn to ~1mn by FY25. Growth in modern trade and e-commerce channels are likely to further boost sales.

Sitarganj plant to yield cost savings: The company incurred one-off expenses of Rs 29mn on account of cessation of Sitarganj (Uttarakhand) plant operations in Q1FY23 to maintain a cleaner environment. ZYWL expects to incur some more one-off expenses in Q2 towards employee and transfer-related costs even as savings should far outweigh these costs and remain recurring in nature.

Growth drivers: Per management, growth drivers include operating leverage as the topline grows, potential reduction in distributor margin, locking in of RM prices as they turn favourable, cost savings from Sitarganj plant closure, and other cost controls.

Strong growth visibility; retain BUY: ZYWL is trading at 23x FY24E EPS. We retain BUY with a TP of Rs 2,185 (~31x FY24E EPS) on the back of new launches, increasing distribution strength, a broader presence through existing brands, ability to cater to white spaces, debt reduction measures, robust FCF generation, superior execution and strong gross margins enabling higher brand-building spends.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ZYWL IN/Rs 1,614
Market cap	US$
Free float	35%
3M ADV	US$ 1.2mn
52wk high/low	Rs 2,477/Rs 1,430
Promoter/FPI/DII	65%/3%/25%

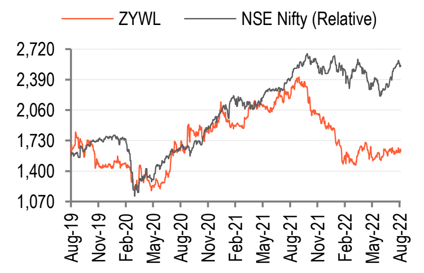
Source: NSE | Price as of 25 Aug 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,091	22,045	24,534
EBITDA (Rs mn)	3,448	4,056	4,711
Adj. net profit (Rs mn)	3,098	3,657	4,442
Adj. EPS (Rs)	48.4	57.4	69.5
Consensus EPS (Rs)	48.4	56.1	69.3
Adj. ROAE (%)	5.9	6.9	7.8
Adj. P/E (x)	33.3	28.1	23.2
EV/EBITDA (x)	32.4	26.0	21.8
Adj. EPS growth (%)	(19.3)	18.0	21.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Management meet takeaways

Growth outlook

- The acquisition of Glucon-D (glucose powder) and Nycil (prickly heat powder) over the past two years has strengthened ZYWL's product portfolio. In addition, the purchase of Sampriti Ghee has enabled the company to enter the professional ghee (clarified butter) segment under the Nutralite brand. Complan is the only brand acquisition that hasn't worked well as the brand isn't a market leader. With various interventions planned by the company, it is expected to regain market share lost since acquisition
- The strategy going forward is to deseasonalise the Glucon-D brand as far as possible by launching into adjacencies. Management is aggressively recruiting the consumer base lost during the pandemic (pre-Covid revenue attained in Q1FY23) and is banking on India's second summer season over September-October to drive sales of the energy drink. It aims to grow the category to Rs 10bn, from Rs 9bn currently, and thereafter in double digits.
- Nycil too is expected to grow through the launch of adjacencies and also at the cost of sensorial talc where sales are declining. The brand is perceived as a family-oriented talc and registers strong growth.
- Overall, management is guiding for strong double-digit topline growth and 100-150bps expansion in operating margin for FY23 and FY24. The goal is to achieve 20% operating margins in 2-2.5 years. The company believes its quest to improve brand awareness (advertising spends at ~14% of revenue) and its target of 4-5 product/variant launches per year will bolster market reach and support double-digit topline growth for the foreseeable future.

Raw material inflation

- Unabated commodity inflation was the key lever for the company to take a price hike of ~7% at the portfolio level.
- ZYWL now believes it can comfortably absorb raw material prices but does not rule out further hikes in the event of surging cost inflation.

Brand highlights

Complan

- Per management, the health food drinks (HFD) category has declined ~4% in Q1FY23 due to lower consumption, compounded by downtrading to lower unit packs (LUP) and lower priced pouches which led to price competition.
- Management expects recovery in Complan market share to 5.7% over the next few quarters through intervention in pack prices and distribution. The company indicated that it is currently maintaining its segment market share in key large packs.

- Sachets form ~15% of the HFD segment. ZYWL has, therefore, begun focusing on expanding its presence in sachets and pouches along with product activations to drive distribution and volume growth.
- During Q4FY22, the company launched a 450gm pouch pack in West Bengal to a fair response. It aims to increase its pouch and sachet play to counter competitive forces.
- ZYWL differentiates its products by communicating their higher protein content compared to competitors and the value proposition from being milk-based vs. malt-based for other brands. Milk is generally perceived as a healthier option than malt.
- The company's *Pack Palto, Farak Dekho* (Turn the Pack, See the Difference) advertising campaign highlights the superiority of its protein content over competition and has witnessed a positive response in persuasion and consideration scores.
- Despite cost inflation, no price hikes were possible during the last couple of quarters as the leader reduced prices of its product, causing management to do the same. Being milk-based (rather than malt-based), the increase in milk prices impacted Complan's margins.
- ZYWL had added 100,000 stores since the Complan acquisition in FY19. The brand is strong in the eastern and southern regions of India and in states such as West Bengal, Bihar, Orissa and Tamil Nadu. It has also been launched in Uttar Pradesh and Bihar across price points.
- Covid-19 slowed the launch of new products during the last two years, but management is actively striving to fill white spaces in the brand.
- ZYWL has relaunched 'Complan Nutrigro', a health supplement targeted at the age group of 2-6 years, with a focus on the original positioning of helping children grow stronger. The product was launched in 2020 but faltered amid the pandemic as medical representatives were unable to meet with doctors and promote sales. Doctors are now open to meetings.
- Marketing of Complan Nutrigro is being ramped up. This category forms 10-11% of the overall HFD market, and management believes Nutrigro will achieve 6-8% market share in the toddler space over the next few years.

Sugar Free

- The artificial sweetener category is facing challenges as the second Covid-19 wave affected the diabetic population in particular and put pressure on related consumption.
- The company's strategy is to transition the segment towards the healthy lifestyle product category to also attract non-diabetics.
- ZYWL's Sugarlite brand continued to grow in high double digits in FY22 with consistent support on the ATL (above the line) and digital front aimed at recruiting new consumers into the "healthier sugar" segment.

- The company took price hikes of 5-6% across the product line in Nov-Dec'21. Currently, it is not planning to take any further price increase provided the prices of key raw materials remain stable.

Glucon-D

- Post-Covid, management has altered its marketing strategy and now projects its glucose energy drink Glucon-D as a "partner in health" that can be consumed for any form of fatigue or dehydration, rather than being just a summer product. The company also ran campaigns in the Hindi heartland of Uttar Pradesh and Bihar, besides enhancing the distribution channel to increase market penetration.
- Its ImmunoVolt variant is delivering steady growth, supported by campaigns and distribution drives, with market share at 28-30%.
- Management expects the energy drinks category to grow from Rs 9bn currently to Rs 10bn, representing a recovery to 2019 levels.
- Per management, the company's revenue in this segment has retraced to FY19 levels.

Nycil

- The company is working to deseasonalise the Nycil prickly heat powder brand to the extent possible and is advertising the clinical efficacy of the product when outdoors. It has also strengthened outdoor campaigns and distribution channels.
- The category has two types of talcs: sensorial talc which is on the decline and functional talc which is growing. Nycil is perceived as a family-oriented talc and registers strong growth.
- Per management, Nycil sales have almost recovered to FY19 levels. Innovations of different product lines are on the anvil to further bolster growth.
- Product availability improved by 16.5% YoY in Q1FY23 to 1.67mn outlets.

Everyuth

- ZYWL is building on adjacencies such as body lotion and aloe vera gel, which were launched in late-2021. It received a good initial response to these products, but sales waned amid the Omicron wave. With resumption of normalcy, the company is aggressively planning its growth strategy around the variants launched in the past two years.
- Everyuth scrubs and peel-offs are growing ahead of the category and continue to lead the market in respective segments.
- Availability of the brand has increased to 680,000 outlets in Q1FY23 from 600,000 outlets over the same period last year.

Nutralite

- The company has created a new identity for its table spreads and margarine in the food service/hotel and restaurant sector (HORECA) segment and has the opportunity to widen offerings in the segment. As much as 75% of Nutralite brand revenue contribution comes from institutions, which management aims to lower to 65-70% in the next couple of years.
- ZYWL's Nutralite DoodhShakti dairy portfolio is gaining traction as the company expands the presence of its ghee product in institutional channels through the Nutralite DoodhShakti Professional range.
- Price hikes have been taken to mitigate the impact of milk and palm oil inflation since raw material prices are market-linked.

International business

- ZYWL's Sugar Free and Complan brands constitute 93% of international business.
- Newer products such as EverYuth, Nycil, Glucon-D and Nutralite are being introduced in the Middle East, Southeast Asia and SAARC countries.
- The company has entered new markets such as Hong Kong, Lebanon, Zimbabwe, Muscat, Ethiopia and Australia in FY22.
- Management has guided for high-double-digit growth in the international business, likely crossing Rs 1bn in revenue in FY23. The target is to have 8-10% of revenue from the business in the next 4-5 years from ~3.5% in FY22.

Other highlights

Distribution

- The e-commerce channel continued to perform well, contributing 6.5% of sales in Q1FY23 vs. 5.9% last year.
- As per Nielsen, ZYWL's products were available at 2.5mn stores in Q1FY23, with an equal split between urban and rural distribution.
- Management aims to widen direct distribution coverage from 0.6mn to ~1mn by FY25.

Rural penetration

- ZYWL's rural go-to-market strategy and SKU differentiation should help increase rural penetration.

A&P spends

- Media spend was rationalised to ~12% of sales in FY21 and FY22 to counter inflation and protect margins. Management intends to raise spends to 13-14% going forward.

- In terms of A&P spend allocation, Glucon and Nycil are advertised mostly during peak season, while brands such as Everyuth Scrubs, Sugar Free Green and Complan have more consistent advertising. Nutralite has the lowest spends as its large institutional exposure requires on-the-ground activity.

Debt

- ZYWL aims to be net debt-free by Q4FY23 and gross debt-free by Jun'23.

Goodwill

- The company has goodwill of Rs 39.2bn on the books which cannot be amortised, as per Indian accounting standards.
- Due to goodwill on its books, ZYWL has optically low return ratios, with ROE at 6.5% in FY22 (+30% ex-goodwill). Management aims to take this figure to 10% in three years.

Valuation methodology

ZYWL is a unique play on India's emerging health & wellness category. The company enjoys market leadership in various niche segments with limited competition from large FMCG companies. We expect a revenue/EBITDA/PAT CAGR of 10.5%/16.9%/19.7% over FY22-FY24 to Rs 24.5bn/Rs 4.7bn/Rs 4.4bn. With an improving revenue trajectory, cost control and minimal increase in capital employed, ROE is projected to improve from 6.5% in FY22 to 8.2% in FY24.

The stock is trading at 23x FY24E EPS. We retain BUY and our TP of Rs 2,185, set at ~31x FY24E EPS, on the back of new launches, increasing distribution reach, a broader presence through existing brands, its ability to cater to white spaces, and a strong gross margin which gives ZYWL the leeway to spend more on brand building. We are also positive on the company's debt reduction measures, robust free cash flow generation and superior execution.

Key risks

Key downside risks to our estimates are:

- failure of new launches,
- aggressive competition from start-ups,
- inability to scale up acquired brands which is typically difficult for FMCG incumbents,
- raw material price increases, and
- economic slowdown/pandemic risk.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	**17,668**	**18,667**	**20,091**	**22,045**	**24,534**
EBITDA	3,211	3,444	3,448	4,056	4,711
Depreciation	(264)	(252)	(236)	(338)	(375)
EBIT	2,947	3,192	3,211	3,718	4,336
Net interest inc./(exp.)	(1,399)	(838)	(255)	(181)	(32)
Other inc./(exp.)	107	89	104	109	119
Exceptional items	44	1,321	0	0	0
EBT	1,717	3,783	3,077	3,665	4,442
Income taxes	205	65	29	0	0
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	**1,943**	**3,867**	**3,098**	**3,657**	**4,442**
Adjustments	0	0	0	0	0
Adjusted net profit	**1,943**	**3,867**	**3,098**	**3,657**	**4,442**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	5,045	4,386	3,643	5,197	5,727
Other current liabilities	429	297	677	353	393
Provisions	259	312	347	367	409
Debt funds	15,558	5,991	3,815	815	15
Other liabilities	0	0	0	0	0
Equity capital	577	636	636	636	636
Reserves & surplus	34,030	45,042	47,804	51,420	55,804
Shareholders' fund	34,607	45,678	48,440	52,056	56,440
Total liab. and equities	**55,897**	**56,664**	**56,922**	**58,788**	**62,984**
Cash and cash eq.	824	2,527	1,698	2,544	5,644
Accounts receivables	1,182	943	1,423	1,102	1,227
Inventories	2,923	3,647	3,616	4,133	4,549
Other current assets	1,396	1,166	919	1,347	1,499
Investments	40,304	39,200	39,470	39,470	39,470
Net fixed assets	2,047	1,996	2,445	2,726	2,902
CWIP	35	37	119	51	57
Intangible assets	5,488	5,478	5,455	5,455	5,455
Deferred tax assets, net	0	0	0	0	0
Other assets	1,697	1,670	478	1,960	2,181
Total assets	**55,897**	**56,664**	**55,624**	**58,788**	**62,984**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	**1,606**	**3,109**	**1,512**	**5,927**	**4,736**
Capital expenditures	(169)	(203)	(767)	(551)	(557)
Change in investments	(643)	1,104	(270)	0	0
Other investing cash flows	49	37	1,215	(1,481)	(221)
Cash flow from investing	**843**	**4,047**	**1,690**	**3,895**	**3,958**
Equities issued/Others	(1,171)	7,233	(305)	(2)	(19)
Debt raised/repaid	(484)	(9,567)	(2,176)	(3,000)	(800)
Interest expenses	0	0	0	0	0
Dividends paid	(28)	(28)	(31)	(38)	(38)
Other financing cash flows	22	18	(8)	(8)	0
Cash flow from financing	**(819)**	**1,703**	**(829)**	**846**	**3,100**
Chg in cash & cash eq.	**1,643**	**824**	**2,527**	**1,698**	**2,544**
Closing cash & cash eq.	**824**	**2,527**	**1,698**	**2,544**	**5,644**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	31.9	18.9	48.4	57.4	69.5
Adjusted EPS	31.9	18.9	48.4	57.4	69.5
Dividend per share	0.4	0.4	0.4	0.5	0.5
Book value per share	600.2	717.9	761.3	818.1	887.0

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	6.1	6.3	5.6	4.8	4.2
EV/EBITDA	33.6	34.1	32.4	26.0	21.8
Adjusted P/E	50.7	85.2	33.3	28.1	23.2
P/BV	2.7	2.2	2.1	2.0	1.8

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	111.9	102.2	100.9	100.0	100.0
Interest burden (PBT/EBIT)	56.2	115.3	92.8	95.8	99.7
EBIT margin (EBIT/Revenue)	17.3	17.6	16.5	17.4	18.2
Asset turnover (Rev./Avg TA)	189.3	188.3	193.1	194.5	173.2
Leverage (Avg TA/Avg Equity)	0.3	0.2	0.2	0.2	0.3
Adjusted ROAE	5.6	9.6	6.6	7.3	8.2

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	109.6	5.7	7.6	9.7	11.3
EBITDA	73.7	7.3	0.1	17.7	16.1
Adjusted EPS	3.9	81.5	(19.3)	18.0	21.2
Profitability & Return ratios (%)					
EBITDA margin	18.2	18.4	17.2	18.4	19.2
EBIT margin	16.7	17.1	16.0	16.9	17.7
Adjusted profit margin	11.0	20.7	15.4	16.6	18.1
Adjusted ROAE	3.7	2.3	5.9	6.9	7.8
ROCE	6.9	6.8	6.4	7.3	8.1
Working capital days (days)					
Receivables	24	18	26	18	18
Inventory	135	155	133	150	150
Payables	126	104	79	104	104
Ratios (x)					
Gross asset turnover	0.4	0.4	0.4	0.4	0.4
Current ratio	1.2	1.7	2.0	1.6	2.0
Net interest coverage ratio	2.2	3.9	13.0	21.2	137.6
Adjusted debt/equity	0.4	0.1	0.0	0.0	(0.1)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

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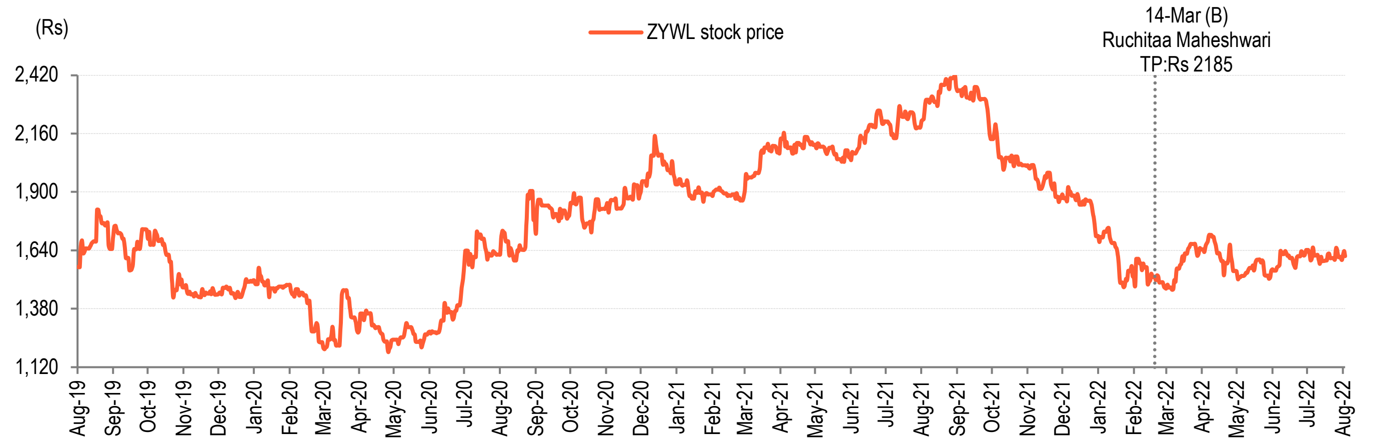
Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): ZYDUS WELLNESS (ZYWL IN)



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