

**BUY**

TP: Rs 2,185 | ▲ 35%

**ZYDUS WELLNESS**

Consumer Staples

29 July 2022

### First normal quarter post-Covid; retain BUY

- Q1 revenue grew 17% YoY (9% QoQ) to Rs 6.9bn aided by price hikes and 10.3% volume growth
- Higher RM and A&P costs saw EBITDA margin fall 225bps YoY to 21.3%; gross margin improved QoQ by 340bps on price hikes and a better mix
- Retain BUY and TP of Rs 2,185 led by product innovation, distribution expansion and Heinz India merger synergies

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**Revenue up 17% YoY:** ZYWL's consolidated Q1FY23 revenue grew 17% YoY to Rs 6.9bn led by strong growth in summer season brands, robust distribution and marketing efforts across the brand portfolio, and price hikes. Volumes rose 10% YoY. The company had taken a 7.5% price increase over the last couple of quarters, the benefit of which was visible in Q1.

**EBITDA margin contracts:** Higher input cost inflation, mainly palm oil, milk, aspartame and crude oil exerted pressure on margins. Gross margin contracted 110ps YoY to 54.3% though calibrated price hikes, cost improvement measures and a better product mix sequentially supported QoQ improvement of 340bps. EBITDA margin fell 225bps YoY to 21.3%.

**Sitarganj plant one-offs:** ZYWL incurred one-off expenses of Rs 29mn on the account of cessation of Sitarganj plant operations to maintain a cleaner environment. This plant was under the normal tax regime.

**Strong outlook for international business:** ZYWL's Sugar Free and Complian brands constitutes 93% of its international business. The company launched new extensions to Sugar Free – D'Lite Cookies and D'Lite Chocolate Spread – in international markets during FY22 and entered new geographies such as Hong Kong, Lebanon, Zimbabwe, Muscat, Ethiopia and Australia. Per management, the top 5 markets constitute ~80% of business. 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 this business in the next 4-5 years from ~4% in FY22.

**Revival underway; retain BUY:** ZYWL is trading at 23.3x FY24E EPS. We retain BUY and our TP of Rs 2,185, set at 38x FY24E EPS (in line with its 5Y median) on the back of new launches, increasing distribution strength, a broader presence through existing brands, its ability to cater to white spaces, and a strong gross margin which gives it the leeway to spend more on brand building. We are also positive on ZYWL's debt reduction measures, faster FCF generation and superior execution.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ZYWL IN/Rs 1,618
Market cap	US\$ 1.3bn
Free float	35%
3M ADV	US\$ 1.0mn
52wk high/low	Rs 2,477/Rs 1,430
Promoter/FPI/DII	65%/3%/25%

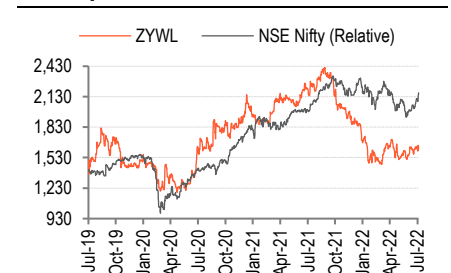
Source: NSE | Price as of 29 Jul 2022

### 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	60.9	70.4
Adj. ROAE (%)	5.9	6.9	7.8
Adj. P/E (x)	33.4	28.2	23.3
EV/EBITDA (x)	32.5	26.1	21.9
Adj. EPS growth (%)	(19.3)	18.0	21.2

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



## Earnings call highlights

### Complan

- The health food drinks (HFD) category declined 4% in the last three months due to new players coming in and lower consumption, compounded by downtrading to lower unit packs (LUP) and lower priced pouches which led to price wars. ZYWL was slow to intervene in the price war in LUPs which resulted in a 20bps QoQ decline in market share for Complan in Q1FY23.
- Per management, it is holding segment market share in key large packs. The company has focused on increasing its presence in sachets and pouches along with activations to drive distribution.
- Management expects recovery in Complan market share in the next couple of quarters through intervention in pack prices and distribution.
- During Q4FY22, ZYWL had launched 450gm pouch packs in West Bengal and received a fair response. The company aims to launch a new chocolate variant which will help the brand compete better going forward. Thereafter, it plans to scale its 450gm packs to a national level to drive market share gains.
- No price hikes were possible in last couple of quarters despite cost inflation, as the leader reduced prices of its product. Hence, management has to react accordingly in order to compete.
- ZYWL had added 100,000 stores since the Complan acquisition.
- Management is consciously making efforts to fill white spaces in the brand over the next few years. Covid slowed the launch of new products in the last two years.
- Currently, the company is increasing focus on marketing Complan Nutrigro, a drink for toddlers (2-6 years) – this category forms 10-11% of the overall HFD market. Management believes that Nutrigro will achieve 6-8% market share in the toddler space over the next few years.
- ZYWL's "Pack Palto, Farak Dekho" campaign highlights the superiority of protein over competition and has witnessed a positive response in persuasion and consideration scores.
- As per Nielsen's MAT Jun'22 report, Complan currently has 4.8% market share vs. 5% in Mar'22.
- Management estimates the HFD category size for the trailing 12 months at Rs 67.5bn.

### Sugar Free

- The brand did not grow during Q1FY23 due to the high base of last year when the two Covid waves drove up diabetic consumption of sugar-free products. However, it witnessed healthy growth in distribution, expanding to 497,000 outlets, as reported by Nielsen (an increase of 26,000 outlets or 5-6% over the year-ago quarter).

- The company's "Sugar Badlo, Health Badlo" campaign supported its Sugarlite brand which registered double-digit growth during the quarter.
- Sugar Free Green grew in high single digits during the quarter.
- ZYWL's Sugar Free brand maintains leadership with market share at 95.5%, as per IQVIA's MAT Jun'22 report.
- The sugar-free category size is pegged at Rs 3.25bn for the trailing 12 months.

### **Glucon-D**

- Glucon-D witnessed double-digit growth in Q1 led by revival in market demand, which was absent during the last two summers due to the pandemic, and further supported by brand campaigns with celebrity Pankaj Tripathi and consumer activations. Per management, the company has recovered to FY19 levels in value terms.
- Typically, the bulk of sales (85-90%) comes during the summer season (January-June) where 1.5 packs on average are purchased per household. Apart from the normal drop-off in demand post June, Covid further impacted the penetration level of Glucon-D. Post-Covid, management has changed its strategy and projected the product as a "partner in health" which can be consumed for any form of fatigue or dehydration and is not 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 penetration.
- ZYWL has launched a 20gm sachet for Glucon-D to drive consumer consumption and a new variant of "Kaccha Mango" in ImmunoVolt.
- Glucon-D has maintained its #1 market share at 60.4% in the glucose powder category, as per Nielsen's MAT Jun'22 report, up 200bps over the same period last year.
- The glucose category is estimated at Rs 9bn for the trailing 12 months.

### **Nycil**

- With the good onset of the summer season, the Nycil brand witnessed a strong comeback and registered double-digit growth in Q1 supported by aggressive television campaigns and on-ground customer activations.
- The company is trying to make Nycil season-neutral and thus advertises the clinical efficacy of the product when outdoors especially amongst kids. Further, the outdoor campaigns and distribution channels have also been strengthened.
- The availability of products improved by 16.5% YoY in Q1 to 1.67mn outlets.
- As per Nielsen's MAT Jun'22 report, Nycil maintained its #1 position with 34.2% market share in the prickly heat powder category and 37.6% volume market share.
- Per management, the company has recovered to FY19 levels in value terms.

### Everyuth

- ZYWL saw strong double-digit growth in Everyuth during the quarter. The brand was supported by TV and digital campaigns for its sub-segments such as face wash, scrubs and peel-offs.
- The company is building on adjacencies such as body lotion and tan removal cream.
- As per Nielsen's MAT Jun'22 report: (a) Everyuth Scrub has maintained its #1 position with 41.8% market share in the facial scrub category, an increase of 510bps YoY (as consumers preferred scrubs over face-wash), (b) Everyuth Peel-off has maintained its #1 position with 76% market share in the peel-off category, and (c) the Everyuth brand is at #5 with 6.6% market share in the overall facial cleansing segment.
- Availability of the brand has increased to 680,000 outlets from 600,000 outlets over the same period last year.

### Nutralite

- The Nutralite brand registered yet another quarter of strong double-digit growth on a YoY basis.
- Nutralite Mayonnaise and chocolate spreads continue to do well.
- The Nutralite DoodhShakti dairy portfolio is also gaining traction as the company expands the presence of its ghee product in institutional channels through the Nutralite DoodhShakti Professional range.

### Other highlights

- E-commerce continued to deliver good growth, contributing 6.5% of sales (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.
- In terms of A&P spend allocation, Glucon and Nycil are advertised mostly in the peak season while brands like Everyuth scrubs, Sugar Free Green and Complian have more consistent advertising. Spends on Nutralite are the least as it has the largest institutional exposure and requires on-the-ground activity.
- The company has goodwill of Rs 39.2bn on the books which will not be amortized as per Ind-AS. Management will think of restructuring it going forward.
- ZYWL will be taxable from FY25 onwards.

**Fig 1 – Consolidated quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>6,968</b>	<b>5,976</b>	<b>16.6</b>	<b>6,398</b>	<b>8.9</b>	<b>20,091</b>	<b>18,667</b>	<b>7.6</b>
COGS	3,186	2,665	19.5	3,144	1.3	9,804	8,449	16.0
% of sales	45.7	44.6	112bps	49.1	(342bps)	48.8	45.3	7.8
Employee cost	451	430	4.9	401	12.5	1,636	1,638	(0.2)
% of sales	6.5	7.2	(72bps)	6.3	21bps	8.1	8.8	(7.2)
A&P spends	962	693	38.9	648	48.3	2,348	2,296	2.2
% of sales	13.8	11.6	221bps	10.1	367bps	11.7	12.3	(5.0)
Other expenses	888	784	13.3	790	12.4	2,857	2,840	0.6
% of sales	12.7	13.1	(38bps)	12.3	40bps	14.2	15.2	(6.6)
<b>EBITDA</b>	<b>1,481</b>	<b>1,404</b>	<b>5.5</b>	<b>1,415</b>	<b>4.7</b>	<b>3,448</b>	<b>3,444</b>	<b>0.1</b>
EBITDA Margin (%)	21.3	23.5	(224bps)	22.1	(86bps)	17.2	18.4	(129bps)
Depreciation and amortization	60	56	8.1	61	(0.7)	236	252	(6.1)
<b>EBIT</b>	<b>1,421</b>	<b>1,348</b>	<b>5.4</b>	<b>1,354</b>	<b>4.9</b>	<b>3,211</b>	<b>3,192</b>	<b>0.6</b>
EBIT Margin (%)	20.4	22.6	(217bps)	21.2	(78bps)	16.0	17.1	(112bps)
Net Interest expenses	41	64	(35.5)	60	(30.8)	255	838	(69.6)
Other non-operating inc (exp), net	20	24	(18.4)	20	(0.5)	104	89	16.3
Exceptional items	29	0	-	0	-	0	1,321	-
<b>Earnings before tax</b>	<b>1,370</b>	<b>1,308</b>	<b>4.7</b>	<b>1,314</b>	<b>4.2</b>	<b>3,060</b>	<b>1,122</b>	<b>172.7</b>
Income taxes	(0)	0	n.m.	(19)	n.m.	(29)	(65)	(56.3)
<b>Reported Net income (loss)</b>	<b>1,370</b>	<b>1,308</b>	<b>4.7</b>	<b>1,333</b>	<b>2.8</b>	<b>3,089</b>	<b>1,187</b>	<b>160.1</b>
Net Margin (%)	19.7	21.9	(222bps)	20.8	(117bps)	15.4	6.4	901bps

Source: Company, BOBCAPS Research

## Valuation methodology

ZYWL is a unique play on India's emerging health & wellness category and enjoys market leadership in various niche segments with limited competition from large FMCG companies. The stock is currently trading at 23.3x FY24E EPS. We retain BUY and our TP of Rs 2,185, set at 38x FY24E EPS (in line with its five-year median) on the back of new launches, increasing distribution strength, a broader presence through existing brands, its ability to cater to white spaces, and a strong gross margin which gives it the leeway to spend more on brand building. We are also positive on ZYWL's debt reduction measures, faster FCF generation and superior execution.

## Key risks

Key downside risks to our estimates are:

- failure to realise expected merger benefits,
- 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
<b>Total revenue</b>	<b>17,668</b>	<b>18,667</b>	<b>20,091</b>	<b>22,045</b>	<b>24,534</b>
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
<b>Reported net profit</b>	<b>1,943</b>	<b>3,867</b>	<b>3,098</b>	<b>3,657</b>	<b>4,442</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>1,943</b>	<b>3,867</b>	<b>3,098</b>	<b>3,657</b>	<b>4,442</b>

### 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
<b>Total liab. and equities</b>	<b>55,897</b>	<b>56,664</b>	<b>56,922</b>	<b>58,788</b>	<b>62,984</b>
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
<b>Total assets</b>	<b>55,897</b>	<b>56,664</b>	<b>56,624</b>	<b>58,788</b>	<b>62,984</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Cash flow from operations</b>	<b>1,606</b>	<b>3,109</b>	<b>1,512</b>	<b>5,927</b>	<b>4,736</b>
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)
<b>Cash flow from investing</b>	<b>843</b>	<b>4,047</b>	<b>1,690</b>	<b>3,895</b>	<b>3,958</b>
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
<b>Cash flow from financing</b>	<b>(819)</b>	<b>1,703</b>	<b>(829)</b>	<b>846</b>	<b>3,100</b>
<b>Chg in cash &amp; cash eq.</b>	<b>1,643</b>	<b>824</b>	<b>2,527</b>	<b>1,698</b>	<b>2,544</b>
<b>Closing cash &amp; cash eq.</b>	<b>824</b>	<b>2,527</b>	<b>1,698</b>	<b>2,544</b>	<b>5,644</b>

### 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	33.7	34.1	32.5	26.1	21.9
Adjusted P/E	50.8	85.4	33.4	28.2	23.3
P/BV	2.7	2.3	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
<b>Adjusted ROAE</b>	<b>5.6</b>	<b>9.6</b>	<b>6.6</b>	<b>7.3</b>	<b>8.2</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
<b>YoY growth (%)</b>					
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
<b>Profitability &amp; Return ratios (%)</b>					
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
<b>Working capital days (days)</b>					
Receivables	24	18	26	18	18
Inventory	135	155	133	150	150
Payables	126	104	79	104	104
<b>Ratios (x)</b>					
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
<b>Adjusted debt/equity</b>	<b>0.4</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>(0.1)</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

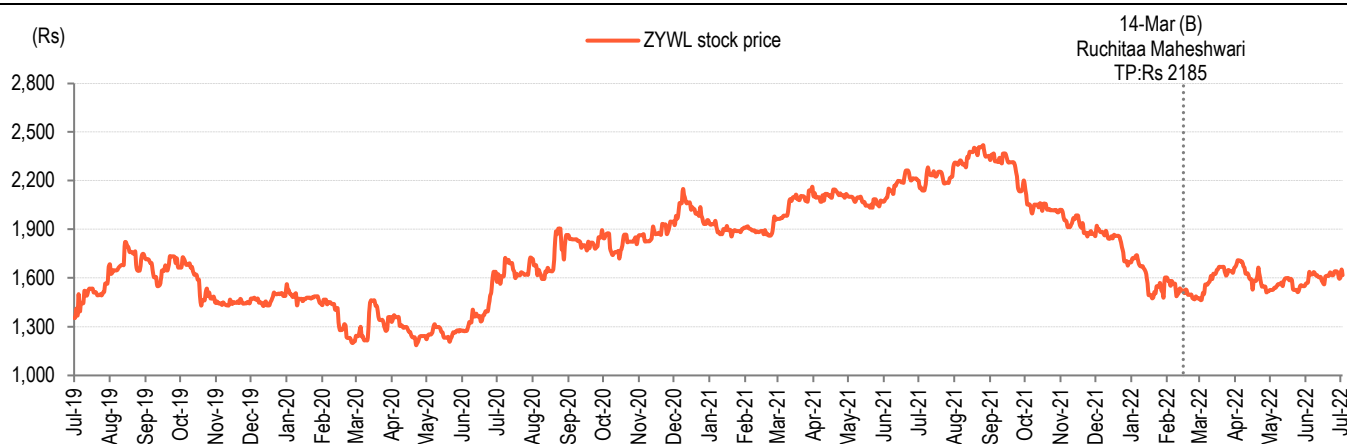
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**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)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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