BUY
TP: Rs 2,185 | ⮝ 33%

ZYDUS WELLNESS | Consumer Staples | 10 November 2022

High commodity prices play spoilsport

- **Q2 revenue grew 12% YoY (-38% QoQ) to Rs 4.3bn aided by 5% volume growth**
- **Gross/EBITDA margins fell 490bps/420bps YoY to 43%/3.8% due to higher input and other costs**
- **Retain BUY on product innovation, distribution expansion and improving product category penetration; TP unchanged at Rs 2,185**

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Revenue up 12% YoY: ZYWL's consolidated Q2FY23 revenue grew 12% YoY to Rs 4.3bn led by 5% volume growth and marketing efforts across the portfolio. The company witnessed downtrading by rural consumers (25% of the topline), which led to sequentially lower volume growth.

EBITDA margin contracts: Higher input cost inflation, mainly in milk (+25% YoY), aspartame (+65% YoY) and dextrose monohydrate (+65% YoY), along with weakening of the rupee and higher crude prices exerted pressure on margins. Gross margin contracted 490ps YoY to 43.3% and EBITDA margin fell 420bps to 3.8%. To mitigate cost inflation, the company plans to take calibrated price hikes in the coming months (+2% hike taken now), the full benefit of which is expected in Q4.

Key growth triggers: (a) Per management, raw material inflation is likely to soften in H2FY23, which will not only aid gross margin expansion but will also provide flexibility for aggressive brand investments. We believe this will bolster volume growth. (b) Management is looking at filling white spaces and has been offering brand extensions and new launches, which we expect will aid revenue growth.

(c) The average penetration of ZYWL's portfolio brands stands at ~20% (12-24% across categories), signifying higher growth headroom vs. its FMCG peers. In our view, an increase in market penetration from modest levels is one of the levers for sustained long-term category growth. To improve penetration, ZYWL aims to widen direct distribution coverage from 0.6mn to ~1mn by FY25. Growth in modern trade, chemist channel sales and e-commerce channels is likely to further boost sales.

Revival underway; retain BUY: ZYWL is trading at 23.6x FY24E EPS. We retain BUY and our TP of Rs 2,185, set at 38x FY24E EPS (in line with the stock's 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 the company the leeway to spend more on brand building. We are also positive on ZYWL's debt reduction measures, quick free cash flow generation and superior execution.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ZYWL IN/Rs 1,642
Market cap	US$ 1.3bn
Free float	35%
3M ADV	US$ 1.2mn
52wk high/low	Rs 2,090/Rs 1,430
Promoter/FPI/DII	65%/3%/25%

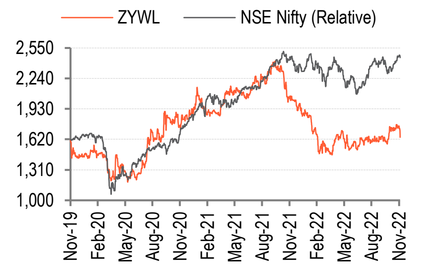
Source: NSE | Price as of 10 Nov 2022

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)	33.9	28.6	23.6
EV/EBITDA (x)	33.0	26.4	22.2
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 has declined in value terms over the last three quarters (down 3% over Jan-Sep'22) due to new players coming in and lower consumption, compounded by downtrading to lower unit packs (LUP) and cheaper pouches which led to price wars.
- Per management, LUPs or sachets which earlier constituted 14-15% of the HFD segment have risen to 26-27%. Sachets which were previously a mainstay in rural markets are now gaining popularity among the mass urban population as well. The company estimates that price of the 500gm pack have declined by 15-16% YoY across the industry in CY22, lowering the average realisation in the category.
- ZYWL remains focused on increasing its presence in sachets and pouches, along with product activations to drive distribution.
- The company is consciously making efforts to fill white spaces in the brand over the next few years.
- During Q2, it launched two new variants, Royal Chocolate and Kesar Badam, as well as a new Creamy Classic pouch in West Bengal.
- Complan's competitors are aggressive marketers which helps them gain market share. ZYWL recently accelerated marketing spends and the effects should be visible in coming quarters.
- The company's *Pack Palto, Farak Dekho* (Turn the Pack, See the Difference) campaign highlights the superiority of its protein content over competition and has witnessed a positive response in persuasion and consideration scores.
- As per Nielsen's MAT Sep'22 report, Complan has 4.6% market share vs. 5.4% in Sep'21 (4.8% in Jun'22). Management expects market share to recover in the next couple of quarters through intervention in pack prices and distribution.

Sugar Free

- ZYWL's Sugar Free brand did not grow during Q2FY23 due to the high base of last year, but remained in high single digits on a three-year CAGR basis.
- Focused actions drove growth of Sugar Free Green, with direct distribution of this product doubling QoQ during the quarter.
- Sugar Free Green and Sugar Lite together contribute 40% of the company's topline.
- ZYWL's Sugar Free brand maintains leadership with market share at 95% (96.2% in Sep'21), as per IQVIA's MAT Sep'22 report.

Glucon-D

- Glucon-D revenues witnessed double-digit growth in Q2FY23 as ZYWL leveraged the second-summer opportunity across key markets through television campaigns.
- Post-Covid, management altered its strategy to project the product as a “partner in health” that can be consumed for any form of fatigue or dehydration and 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 raise penetration.
- Glucon-D has maintained its #1 market share at 60% in the glucose powder category, as per Nielsen’s MAT Sep’22 report, up ~160bps over the same period last year.

Nycil

- With a prolonged monsoon season, the Nycil brand witnessed strong double-digit sales growth supported by television campaigns.
- As per Nielsen’s MAT Sep’22 report, Nycil maintained its #1 position with 35% market share in the prickly heat powder category vs. 34.5% in Sep’21 and 34.2% in Jun’22.

Everyuth

- ZYWL saw strong double-digit growth in Everyuth during the quarter. The brand was supported by television and digital campaigns for its sub-segments such as face wash, scrubs and peel-offs.The company is building on adjacencies including body lotion and tan removal cream.
- As per Nielsen’s MAT Sep’22 report: (a) Everyuth Scrub has maintained its #1 position with 41.8% market share in the facial scrub category, an increase of 270bps YoY (as consumers preferred scrubs over face-wash), (b) Everyuth Peel-off has maintained its #1 position with 75.7% market share in the peel-off category vs. 77.3% in Sep’21, and (c) the Everyuth brand is at #5 with 6.5% market share in the overall facial cleansing segment.

Nutralite

- The Nutralite brand registered yet another quarter of strong double-digit revenue growth on a YoY basis.
- ZYWL’s DoodhShakti dairy portfolio, which includes butter, spreads and ghee, delivered a strong performance backed by an increased distribution drive, festival-specific digital activations and celebrity-endorsed online recipe videos.
- Nutralite mayonnaise and chocolate spreads continue to do well.

Sustained healthy outlook for international business

- ZYWL's Sugar Free and Complan brands constitute 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. 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.

Fig 1 – Consolidated quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Net Sales	**4,295**	**3,837**	**11.9**	**6,968**	**(38.4)**	**11,262**	**9,812**	**14.8**
COGS	2,435	1,987	22.6	3,186	(23.6)	5,621	4,652	20.8
% of sales	56.7	51.8	491bps	45.7	1097bps	49.9	47.4	5.3
Employee cost	436	423	3.1	451	(3.2)	887	853	4.0
% of sales	10.2	11.0	(87bps)	6.5	369bps	7.9	8.7	(9.4)
A&P spends	517	475	8.8	962	(46.3)	1,479	1,167	26.7
% of sales	12.0	12.4	(34bps)	13.8	(177bps)	13.1	11.9	10.4
Other expenses	744	646	15.1	888	(16.2)	1,632	1,430	14.1
% of sales	17.3	16.8	47bps	12.7	458bps	14.5	14.6	(0.6)
EBITDA	**163**	**305**	**(46.8)**	**1,481**	**(89.0)**	**1,644**	**1,710**	**(3.8)**
EBITDA Margin (%)	3.8	8.0	(417bps)	21.3	(1747bps)	14.6	17.4	(283bps)
Depreciation and amortization	64	61	5.2	60	6.5	125	117	6.6
EBIT	**98**	**244**	**(59.8)**	**1,421**	**(93.1)**	**1,519**	**1,593**	**(4.6)**
EBIT Margin (%)	2.3	6.4	(408bps)	20.4	(1,810bps)	13.5	16.2	(274bps)
Net Interest expenses	29	67	(56.1)	41	(29.0)	71	131	(46.0)
Other non-operating inc (exp), net	14	34	(59.8)	20	(30.8)	33	58	(42.6)
Exceptional items	0	0	-	0	-	0	0	-
Earnings before tax	**82**	**211**	**(60.9)**	**1,399**	**(94.1)**	**1,481**	**1,519**	**(2.5)**
Income taxes	(2)	(4)	(37.8)	(0)	666.7	(3)	(4)	(29.7)
Reported Net income (loss)	**85**	**215**	**(60.5)**	**1,399**	**(93.9)**	**1,484**	**1,523**	**(2.5)**
Net Margin (%)	2.0	5.6	(362bps)	20.1	(1,811bps)	13.2	15.5	(234bps)

Source: Company, BOBCAPS Research

Valuation methodology

ZYWL is a unique play on India's emerging health & wellness category that enjoys market leadership in various niche segments with limited competition from large FMCG companies. The stock is currently trading at 23.6x 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 the company leeway to spend more on brand building. We are also positive on ZYWL's debt reduction measures, quick 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 (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	6.2	6.4	5.7	4.9	4.3
EV/EBITDA	34.2	34.6	33.0	26.4	22.2
Adjusted P/E	51.6	86.7	33.9	28.6	23.6
P/BV	2.7	2.3	2.2	2.0	1.9

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

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BUY – Expected return >+15%

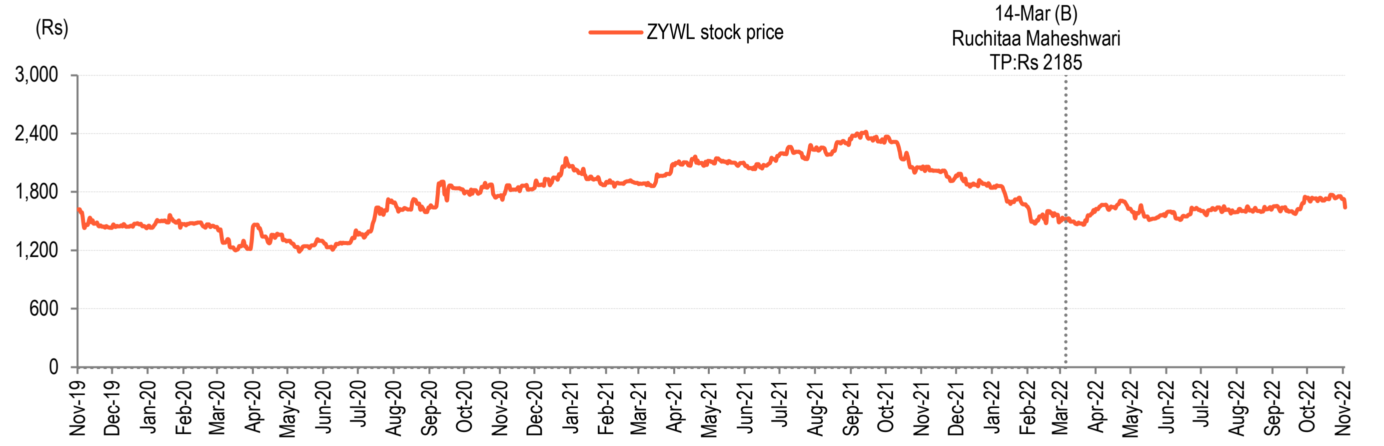
HOLD – Expected return from -6% to +15%

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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