

Sector: Consumer Goods
Result Update

	Change
Reco: Hold	↔
CMP: Rs. 1,486	
Price Target: Rs. 1,610	↓

↑ Upgrade ↔ No change ↓ Downgrade

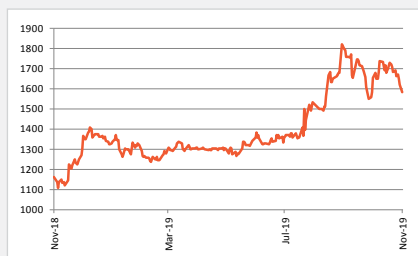
Company details

Market cap:	Rs. 8,575 cr
52-week high/low:	Rs. 1859/1085
NSE volume: (No of shares)	15,351 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Sharekhan code:	ZYDUSWELL
Free float: (No of shares)	1.9 cr

Shareholding (%)

Promoters	67.6
FII	4.9
DII	19.3
Others	8.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.4	3.6	22.7	36.2
Relative to Sensex	-8.8	-3.7	12.9	17.3

Sharekhan Research, Bloomberg

Zydus Wellness

Seasonality affected Q2 performance

Zydus Wellness Limited's (ZWL) Q2FY2020 performance is strictly not comparable y-o-y due to consolidation of the Heinz portfolio from Q1FY2020. After consolidation of the Heinz portfolio, revenue growth was lacklustre, at 3.6%, on a like-to-like basis due to lower sales of by-products such as ghee and milk trading. Excluding by-products, revenue grew by ~9%, aided by the steady performance of some key brands. Gross margins and OPM declined y-o-y due to an unfavorable revenue mix (lesser contribution from high-margin products such as Glucon-D and Nycil). The company maintained its leadership position in most key categories. It is focusing on enhancing the market share of milk-food-drink (MFD) brand Complian through higher media spends, consumer promotions and reaching out to doctors to make them understand Complian's benefits. Moreover, it is planning to expand its direct distribution reach by two times from the current level of 2-3 lakh outlets by FY2021. It is working on cost synergies through the merger and expects a saving of Rs. 40 crore in 2-3 years.

Key positives

- Sugarfree, Everyuth Scrub/Peel Off, Nycil and Glucon D maintained their leadership positioning on y-o-y basis.
- Working capital days stood at negative 22 days despite the on-going integration of acquired portfolio with the base portfolio.

Key negatives

- Gross margins and OPM declined q-o-q due to change in the revenue mix affected by seasonality in the business.

Our Call

View: Maintain Hold with a revised price target of Rs. 1,610: We have reduced our earnings estimates for FY2020 and FY2021 to factor in seasonality in the business. The management has maintained its thrust on improving the growth prospects of each key brand under its portfolio. Further, it is trying to reduce the seasonality by adding new variants of existing brands in the coming years. The company expects growth prospects of key brands to improve in 2-3 years. Further, it expects margin expansion through operating efficiencies and cost synergies. However due to lack of clarity on the seasonality of the Heinz portfolio over the next two quarters, we would not like to change our stance on the stock. We maintain our Hold recommendation on the stock with a revised target price of Rs. 1,610. We will keenly monitor the performance over the next two quarters. The stock is currently trading at 31.4x its FY2021E earnings.

Key Risks

Any slowdown in category growth of some of the key brands would act as a key risk to our earnings estimates.

Valuations (Consolidated)

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E*	FY21E*
Revenue	463	503	843	1,758	2,021
OPM (%)	21.4	24.9	20.7	20.0	21.2
Adjusted PAT	111	137	171	199	273
% YoY growth	5.7	22.7	25.4	16.2	37.2
Adjusted EPS (Rs.)	28.5	34.9	29.7	34.5	47.4
P/E (x)	52.2	42.6	50.1	43.1	31.4
P/B (x)	10.4	8.4	2.5	2.4	2.3
EV/EBIDTA (x)	58.1	45.0	48.9	24.1	19.8
RoNW (%)	21.5	21.9	8.4	5.7	7.5
RoCE (%)	23.0	22.9	7.1	6.8	7.9

Source: Company; Sharekhan estimates * Estimates are including the Heinz consolidation

Q2FY2020 numbers not comparable with Q2FY2019 due to Heinz acquisition

Revenue stood at Rs. 326 crore with comparable growth of 3.6%; OPM came in at 6.3%: Q2FY2020 revenue stood at Rs. 326 crore as against Rs. 138.2 crore in Q2FY2019 and Rs. 607.4 crore in Q1FY2020. Revenue is not comparable sequentially as well as y-o-y because of the seasonal nature of the some brands, which makes the business skewed towards Q1 and Q4. Comparable revenue growth was muted at 3.6%, affected by lower sales of by-products including ghee and trading of milk. However, excluding by-products, comparable revenue growth stood at 9%. All key brands including Sugar Free, Everyuth scrub, Everyuth Peel-off, Nycil and Glucon-D maintained their leadership positions. Gross margin and OPM stood at 56.7% and 6.3%; lower both sequentially as well as y-o-y, largely affected by a change in product mix and higher milk prices. Operating profit came in at Rs. 20.4 crore. ZWL reported a net loss of Rs. 12 crore in Q2FY2020 as against a net profit of Rs. 41.4 crore in Q2FY2019 and Rs. 80.4 crore in Q1FY2020.

Key brands maintained leadership positions: In terms of brands, Sugar Free grew by 7.8% and maintained its leadership position with a market share of 94.6%, backed by digital media campaigns and television commercials. Everyuth Scrub and Peel-off Mask grew faster than the category, clocking a 12.5% and 16.4% rise in sales, respectively, led by good growth in e-commerce channels and were category leaders with a market share of 32.6% and 82.1%, respectively. Nycil is gaining good momentum after the re-launch in the last quarter with a new formulation and its market share improved by 200 bps to 34.2%. Glucon-D stayed the leader with a 59.3% market share and the category grew by 15.3%. Nutralite was driven by consumer offers and sampling. The MFD category growth stood at 9% backed by consumer offers and Complian's market share stood at 5.7

Key conference call highlights:

- Q2FY2020 was affected by seasonality in some brands. Business is skewed towards Q1 and Q4 as compared to Q2 and Q3, which are seasonally weak quarters, in the ratio of 60:40, which was almost 70:30 earlier.
- Operating profit was hit by higher investment on brands through advertisements, consultant expenses to the tune of Rs. 7.2 crore and higher raw material prices, especially inflation in milk prices.
- One-offs stood at Rs. 7.2 crore for Q2FY2020 and expenses of Rs. 33 crore for H1FY2020, which are largely done and not expected to recur.
- ZWL is expecting cost synergy benefits of around Rs. 40 crore in 2-3 years due to the Heinz merger, in the form of supply chain infrastructure and distribution enhancement.
- Direct distribution reach stood at around 2.3 lakh outlets as on date, which the company expects to double by the end of FY2021.
- Nutralite had a muted quarter affected by an aggressive local player in a specific region. However, the company expects sales of the brand to pick-up and grow in mid-single-digits in the near term.
- Complian sales were affected by higher milk prices, as the company did not undertake any price hikes to mitigate the effect. The brand has a greater salience in Q2 and Q3 and thus, ad spends for Complian increase during this period.
- However, the company has been consistently investing on the brand and expects to drive the growth and gain market share through consumer promotions, advocacy through doctors and digital campaigns. ZWL launched Complian Kesar Badam in a jar format during the quarter.

Result (Consolidated)

Particular	Rs cr				
	Q2FY20	Q2FY19	Y-o-Y %	Q1FY20	Q-o-Q %
Net Revenue	326.0	138.2	-	607.4	-46.3
Total expenditure	305.6	99.7	-	498.2	-38.7
Operating profit	20.4	38.5	-47.0	109.1	-81.3
Other Income	4.0	10.2	-61.3	3.0	30.4
Interest Expense	35.1	0.5	-	34.9	0.7
Depreciation	3.8	2.1	82.8	10.4	-63.1
PBT	-14.6	46.2	-	66.9	-
Tax	-2.6	4.0	-	-1.9	-
PAT before M.I.	-12.0	42.2	-	68.8	-
Minority Interest	0.0	0.8	-	0.0	-
PAT after M.I.	-12.0	41.4	-	68.8	-
Exceptional item	0.0	0.0	-	11.6	-
Reported PAT	-12.0	41.4	-	80.4	-
Reported EPS (Rs.)	-3.1	10.6	-	20.6	-
			bps		bps
GPM (%)	56.7	68.9	-	58.4	-167
OPM (%)	6.3	27.9	-	18.0	-

Source: Company; Sharekhan Research

*Q2FY2019 numbers do not include the acquired Heinz portfolio and are thus, not comparable

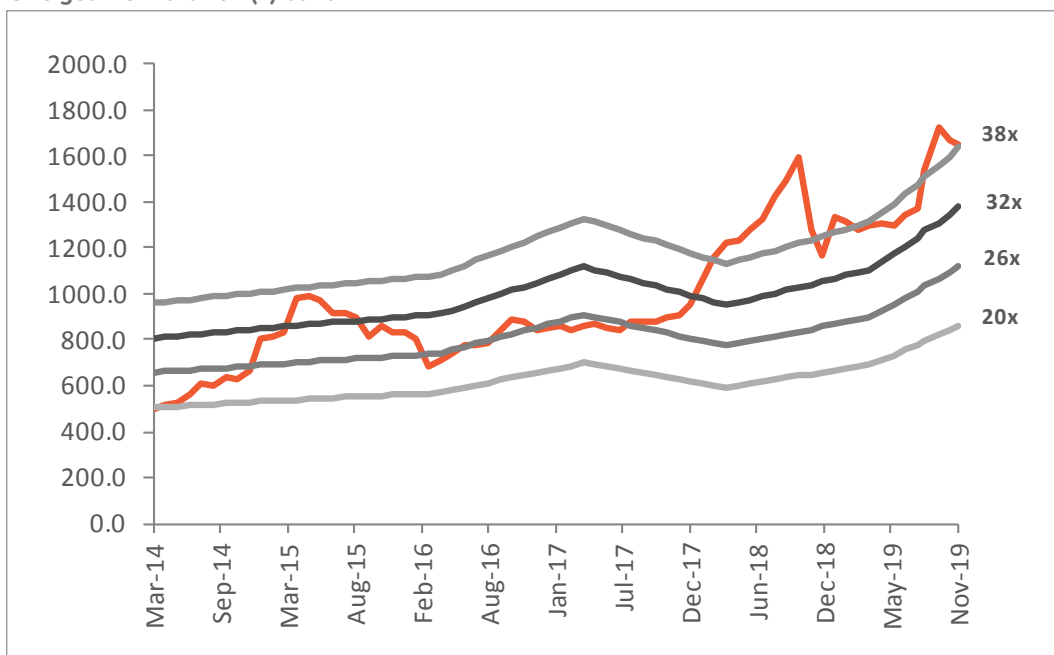
Outlook

Revenues in H1FY2020 stood at Rs. 933.4 crore, while OPM stood at 13.9%. Q3FY2020 revenue is expected to be in line with Q2FY2020, while Q4FY2020 revenue will be higher due to higher pre-season sales for Glucon D and Nycil. The management expects gross margins to stand at 60% for FY2020 and with ad-spends expected to remain at 14-15% of sales, OPM would be at around 20%. Effective tax rate for next two years is expected to be nil. The company expects cost saving of Rs. 40 crore over the next 2-3 years due to cost synergy benefits.

Valuation

We have reduced our earnings estimates for FY2020 and FY2021 to factor in seasonality in the business. The management has maintained its thrust on improving the growth prospects of each key brand under its portfolio. Further, it is trying to reduce the seasonality by adding new variants of existing brands in the coming years. The company expects growth prospects of key brands to improve in 2-3 years. Further, it expects margin expansion through operating efficiencies and cost synergies. However due to lack of clarity on the seasonality of the Heinz portfolio over the next two quarters, we would not like to change our stance on the stock. We maintain our Hold recommendation on the stock with a revised target price of Rs. 1,610. We will keenly monitor the performance over the next two quarters. The stock is currently trading at 31.4x its FY2021E earnings.

One year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE(%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Hindustan Unilever	72.9	59.4	50.0	51.6	42.8	37.0	113.2	108.7	95.9
Zydus Wellness	50.1	43.1	31.4	48.9	24.1	19.8	7.1	6.8	7.9

Source: Company, Sharekhan estimates

About company

ZWL is the listed entity of the Zydus Group and one of the leading companies in the fast-growing Indian consumer wellness market. The company's growth over the years has been led by pioneering brands such as Sugar Free, EverYuth and Nutralite and innovations offering new benefits to consumers. The company is the market leader in most of its product categories. The company has recently acquired Heinz India, subsidiary of Kraft Heinz. With this, ZWL's product portfolio widened to include health food drinks and energy drinks. The Heinz acquisition has also boosted ZWL's revenue trajectory to ~Rs. 2,000 crore from Rs. 600 crore earlier.

Investment theme

ZWL has portfolio of strong brands that lead their categories. The Sugarfree brand has a 94% market share in the artificial sweeteners category, while Everyuth Peel-off mask has an 84% market share. The acquisition of Heinz enhanced the company's product portfolio and distribution reach. However, the same is earnings dilutive in the initial years as the acquisition was funded through a mix of debt and equity. The acquisition will start adding to the bottom-line in another 3-4 years, in the backdrop of a stable consumption environment.

Key Risks

- ◆ **Macroeconomic slowdown:** ZWL is largely present in niche categories, which are discretionary in nature. Any slowdown in the macro environment will affect growth of these categories.
- ◆ **Slow growth in acquired brands:** Slow growth in acquired brands (Heinz's portfolio) will prolong the time for the acquisition to become earnings positive.
- ◆ **Increase in competition:** ZWL is facing stiff competition in skin care products such as face wash and scrubs from multinationals, which has affected the revenue growth of these categories.

Additional Data

Key management personnel

Sharvil P Patel	Chairman
Tarun Arora	Whole Time Director and CEO
Umesh Parikh	Chief Financial Officer
Dhanraj P Dagar	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Cadila Healthcare Ltd	63.6
2	Threpsi LLP	12.5
3	Zydus Family Trust	4.1
4	Matthews International Capital Management	3.3
5	Life Insurance Corp Of India	2.2
6	Reliance Capital Trustee Co Ltd	1.7
7	Prazim Trading & Inv Company	1.4
8	PPFAS Asset Management	0.7
9	Dimensional Fund Advisors LP	0.4
10	Aditya Birla Sun Life Asset Management	0.2

Source: Bloomberg

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