Sharekhan
by BNP PARIBAS

Zydus Wellness

Decent show in tough times

Sector: Consumer Goods
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 1,607**	
Price Target: **Rs. 1,780**	↑

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 9,269 cr
52-week high/low:	Rs. 1859/1070
NSE volume: (No of shares)	0.2 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Sharekhan code:	ZYDUSWELL
Free float: (No of shares)	1.9 cr

Shareholding (%)

Promoters	67.8
FII	2.0
DII	9.9
Others	20.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	26.1	18.2	7.0	7.1
Relative to Sensex	18.4	6.7	14.6	6.8

Sharekhan Research, Bloomberg

Zydus Wellness Limited (ZWL) registered decent numbers amid a tough environment, where supply disruptions caused by lockdown led to a 13.4% and 14.6% decline in revenue and PAT, respectively, (better than our expectation of an over 30% decline in revenue and PAT). Despite discretionary nature of its portfolio, the company registered strong recovery in the performance and posted double-digit revenue growth in June 2020. During the quarter, the company launched several new products such as Complan Nutrigro (for kids between the age group of 2-6), Glucon D Immuno volts in view of higher demand for immuno boosting and in-house consumption categories. Moreover, the company launched the base Complan brand in sachet formats to improve the penetration (especially in rural India) and gain market share in the near future. With Q2 and Q3 being seasonally strong quarter for Sugar Free and Complan (Q4 strong for Nutralite retail business), the management expects revenue growth to improve in the coming quarters. Though gross margins stumbled in Q1FY2021, the management expects gross margins to improve in the coming quarters on account of correction in key input prices. This will also help ZWL post better OPM in the coming quarters. Stable working capital and strong cash generation ability would help ZWL in the current uncertain environment.

Key positives

- Recovery was seen in May and the company posted double-digit growth in June.
- Management confident of achieving good growth under Sugar Free and Complan brands in the coming quarters.
- A slew of new launches done to improve growth prospects in the near to medium term.

Key negatives

- Gross margins decreased by 356 bps affected by an unfavourable mix and higher input prices.

Our Call

View: Maintain Buy with a revised price target of Rs. 1,780: ZWL posted decent performance in Q1FY2021 in the backdrop of supply disruption and discretionary nature of the product portfolio. We have raised our earnings estimates for FY2021 and FY2022 to factor in better-than-expected performance in Q1. New launches, introduction of small packs in Complan and focus on expanding distribution reach provides clear intent of achieving good growth in the near to medium term. The stock is currently trading at 42.4x its FY2022E earnings. We maintain our Buy recommendation on the stock with revised price target of Rs. 1,780.

Key Risks

Any slowdown in the sales of key discretionary categories or disruption caused by frequent lockdowns would act as a key risk to earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY18	FY19	FY20*	FY21E*	FY22E*
Revenue	503	843	1,767	1,696	1,934
OPM (%)	24.9	21.9	18.2	18.5	19.3
Adjusted PAT	137	182	186	154	218
% YoY growth	22.7	33.1	2.3	-16.9	41.4
Adjusted EPS (Rs.)	23.7	31.5	32.2	30.3	37.9
P/E (x)	46.0	51.0	49.8	60.0	42.4
P/B (x)	9.1	2.7	2.7	2.6	2.5
EV/EBIDTA (x)	48.7	49.8	28.4	29.0	24.3
RoNW (%)	21.9	8.9	5.4	4.4	6.0
RoCE (%)	22.9	7.4	6.1	5.8	6.9

Source: Company; Sharekhan estimates;
**includes the acquired portfolio of Heinz India Private Limited*

Revenue declined by 13.4% y-o-y; unfavourable mix affected margins: Q1FY2021 is seasonally a strong quarter for products such as Glucon-D and Nycil. Revenue declined by 13.4% y-o-y to Rs. 537.4 crore as against Rs. 620.3 crore in Q1FY2020, better than our expectation of Rs. 425.1 crore. Sales in April were affected by supply disruptions due to the lockdown, but May witnessed recovery and June registered double-digit growth. All key brands including Everyuth scrub, Everyuth Peel-off, Glucon-D, and Nycil maintained their leadership positions. Gross margins declined by 356 bps to 55.7% due to an unfavourable revenue mix. Despite a significant decline in gross margins, lower advertisement spends limited the drop in OPM to 121 bps which stood at 22.8% (better than our expectation of 19.8%). Operating profit was down by 17.7% y-o-y to Rs. 122.4 crore. Profit before tax declined by 22% to Rs. 83.2 crore and lower incidence of tax resulted in adjusted PAT declining by 14.6% y-o-y to Rs. 89.2 crore in Q1FY2021 as against Rs. 104.4 crore in Q1FY2020. An exceptional loss of Rs. 24 crore in the base quarter led to a 10.9% growth in reported PAT.

Key conference call highlights:

- April was impacted by COVID-19 with disruptions in supply, resulting in negligible sales. A recovery was witnessed in May and June registered strong double-digit growth. All logistical challenges were solved and distributors. All manufacturing facilities are operating at a reasonable capacity utilisation. Demand is gradually recovering as of July and we expect Q2 and Q3 to be better for brands such as Sugar Free and Complan.
- Sugar Free registered strong growth backed by higher in-home consumption and digital campaigns and Sugar Lite gained good traction. Recovery in Nycil sales was driven by good demand for hand sanitisers and social media promotions. Glucon-D was impacted due to supply disruptions and early monsoon whereas Everyuth portfolio declined significantly due to its discretionary nature. Nutralite had a subdued quarter as institutional sales (75% of Nutralite's revenues) declined significantly due to closure of restaurants. The retail business witnessed some recovery in June. April was muted for Complan, but the brand witnessed recovery in May and June.
- Nycil launched its first-ever brand extension in the space of hand sanitisers in March 2020 which is gaining good traction. The company forayed into the toddler health food drinks (HFD) segment by launching Complan Nutrigro for 2-6 year old kids, which is being promoted through the medical/doctor marketing route. The company also launched Nutralite choco spread in two flavours through the e-commerce platform. Several other products such as Glucon-D Immuno volts and 75 gram sachet format of Complan are in the pipeline are expected to be launched in the next quarter. ZWL is targeting ~5% NPD contribution by FY2022-end.
- Gross margins were lower in Q1FY2021 due to use of raw material inventory bought at higher prices and an unfavourable product mix. However, with raw material prices, especially skimmed milk prices (SMP) softening, the benefit of the same is expected to flow in from Q2FY2021. This, along with prudent advertising will help OPM to expand in the near term.
- Nycil commands ~35% market share of the Rs. 750 crore functional talc category whereas Glucon-D commands ~59% of the Rs. 850 crore glucose powder category. Both brands are category leaders and are expected to grow in double-digits in the near to medium term, driven by innovation, distribution expansion and investment behind brands.
- Within Complan, new launches such as Complan Nutrigo and the 75 gram sachet format will help ZWL to fill in the gaps where the company has minimal presence and help penetrate, especially the rural markets, which will in turn aid in gaining market share. The company intends to establish Complan Nutrigo as a standalone variant for 2-6 year old kids adding to overall equity of Complan as a superior nutrition provider. With right strategies including relevant consumer engagements and specific innovation, the company expects a 50-100 bps gain in the category's market share in the near to medium term.
- The company believes that there is an opportunity to provide consumers with products which are more relevant in current times such as Nycil hand sanitisers. The company is also finding newer ways of managing the business and has been working on changes in the business operating model, including the possibilities of using digital technology and increasing its focus on the strongly growing e-commerce channel.

Results (Consolidated) Rs cr

Particulars	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
Net Revenue	537.4	620.3	-13.4	487.9	10.1
Total expenditure	415.0	471.5	-12.0	383.3	8.3
Operating profit	122.4	148.7	-17.7	104.6	17.0
Other Income	1.8	3.0	-39.9	1.3	40.0
Interest Expense	34.6	34.9	-0.7	34.7	-0.3
Depreciation	6.4	10.4	-38.0	6.9	-6.7
PBT	83.2	106.5	-22.0	64.3	29.3
Tax	-6.1	2.1	-386.7	-7.6	-20.7
Adjusted PAT	89.2	104.4	-14.6	71.9	24.0
Exceptional item	0.0	-24.0	-	-2.8	-
Reported PAT	89.2	80.4	10.9	69.1	29.1
Reported EPS (Rs.)	22.8	20.6	10.9	17.7	29.1
			bps		bps
GPM (%)	55.7	59.2	-356	53.9	177
OPM(%)	22.8	24.0	-121	21.4	133

Source: Company; Sharekhan Research

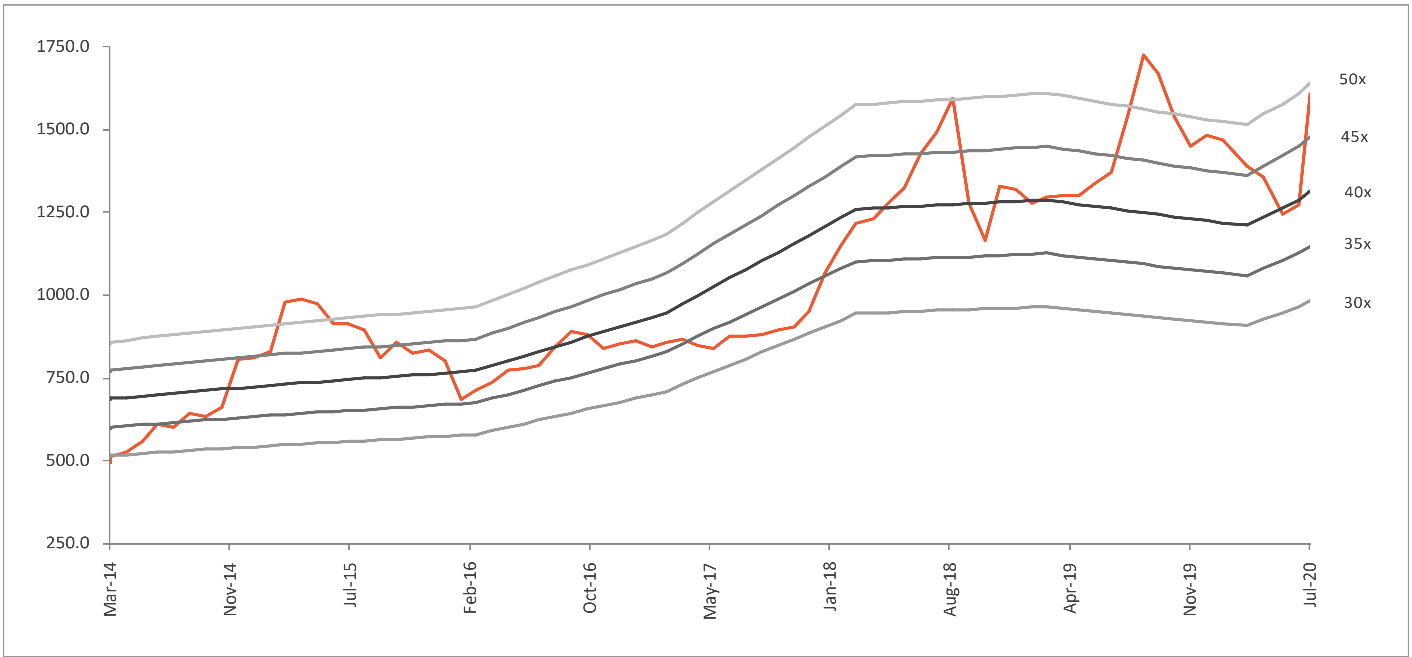
Outlook

Recovery likely in the coming quarters: ZWL's Q1FY2021 performance was affected by supply disruption. With a strong recovery in June (double-digit revenue growth clocked) and the momentum expected to sustain in the coming quarters, we expect ZWL to post better performance in the remaining of the fiscal. Q2 and Q3 are seasonally strong quarters for Sugar Free and Complan (Q4 strong for Nutralite retail business). Though gross margins stumbled in Q1FY2021, the management expects the gross margins to improve in the coming quarters on account of correction in key input prices. This will help ZWL post better OPM in the coming quarters. Stable working capital and strong cash generation ability would help ZWL in the current uncertain environment.

Valuation

Maintain Buy with a revised price target of Rs. 1,780: ZWL posted decent performance in Q1FY2021 in the backdrop of supply disruption and discretionary nature of the product portfolio. We have raised our earnings estimates for FY2021 and FY2022 to factor in better-than-expected performance in Q1. New launches, introduction of small packs in Complan and focus on expanding distribution reach provides clear intent of achieving good growth in the near to medium term. The stock is currently trading at 42.4x its FY2022E earnings. We maintain our Buy recommendation on the stock with revised price target of Rs. 1,780.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Dabur India	59.5	55.2	43.9	49.8	44.8	35.3	27.0	26.5	29.5
Zydus Wellness	49.8	60.0	42.4	28.3	29.0	24.3	6.1	5.8	6.9

Source: Company, Sharekhan estimates

About company

ZWL is the listed entity of 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, a subsidiary of Kraft Heinz. With this, ZWL's product portfolio widened to include health food drinks and energy drinks. The acquisition of Heinz has also boosted ZWL's revenue trajectory to ~Rs. 1,700 crore from Rs. 600 crore earlier.

Investment theme

ZWL has a strong brand portfolio that leads their respective categories. The Sugarfree brand has a ~94% market share in the artificial sweeteners category, while Glucon-D has an ~59% market share. The acquisition of Heinz has enhanced the company's product portfolio and distribution reach. However, the same was 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 2-3 years, in the backdrop of a stable consumption environment. Higher demand for wellness and nutrition related products and increase in in-home consumption in the pandemic situation would augur well for ZWL in the near term.

Key Risks

- **Macroeconomic slowdown:** ZWL is largely present in niche categories, which are discretionary in nature. Any slowdown in the macro environment would 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	Threpsi LLP	12.5
2	Life Insurance Corp of India	4.3
3	Matthews International Capital Man	2.5
4	Reliance Capital Trustee Co Ltd	1.7
5	Prazim Trading & Inv Co	1.4
6	PPFAS Asset Management	1.3
7	L&T Mutual Fund Trustee Ltd	0.4
8	Dimensional Fund Advisors LP	0.2
9	Aditya Birla Sun Life Asset Management	0.2
10	IndiaFirst Life Insurance Co Ltd	0.1

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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