

De-leveraging on the cards; earnings to get boost...

Zydus Wellness (ZWL) announced a ₹ 1100 crore fund raising with ₹ 350 crore infusion by promoter and ₹ 750 crore by QIB placement of equity/equivalent instruments. We believe the company would utilise funds to repay high cost debt of ₹ 1500 crore that was raised at the time of acquisition of the Heinz business. With equity infusion of ₹ 1100 crore, existing cash of ₹ 200 crore, FY21 earnings, ZWL would be able to repay almost entire debt by March 2021. This would result in saving of ₹ 140 crore interest cost. Assuming equity infusion at current price of ₹ 1650/share (given promoters have infused ₹ 350 crore at ₹ 1643/share), the equity dilution would be ~12%. The mere saving of interest cost would increase our FY22 EPS estimate by 21%.

Leveraging strong footing of doctor advisory, chemist channel

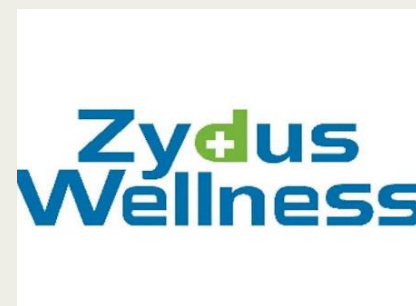
Considering the strong acquired product portfolio, ZWL would be able to leverage its parent's strong footing on doctor's advisory & its stronghold of chemist distribution network. Further high gross margins of ~55% give it more power to spend aggressively on A&P & brand building. These factors coupled with de-leveraging balance sheet are likely to lead to robust growth in revenues, earnings. Further, brands like Glucon D, Complian, Sugarfree, Everyuth, and Nycil are strong in their respective sub categories. These brands have the potential to grow 8-10% on a sustainable basis, which makes the story even more interesting from next five year's perspective.

Synergies to reduce costs; doubling direct distribution reach

Post consolidation of Heinz business, ZWL would be able to cut cost by reducing redundancies at various stages. This would lead to faster decision making and give scale benefits to the company. It would be increasing its direct distribution network to reduce dependency on wholesale network. Further, the company would reduce distributors from 1500 to 800 and implement warehouse optimisation, reducing overall cost of logistics. The acquired brands have been under-penetrated (sales concentrated in East India), which gives opportunity to scale these brands in other regions. We believe all these factors would lead to strong sales growth & margins expansion in FY22. We expect 8.8% CAGR sales growth (despite Covid related disruption) and ~300 bps operating margin expansion in FY20-22E.

Valuation & Outlook

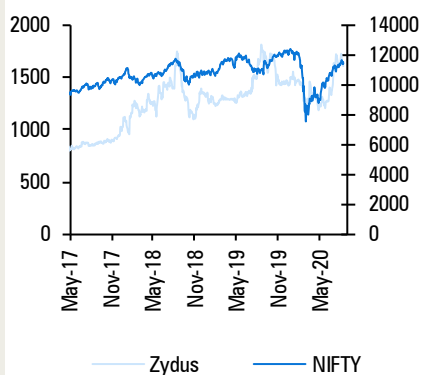
With the reduction of debt, the company would see strong earnings growth in FY20-22E. We expect 51.7% CAGR adjusted earnings growth in FY20-22E (FY20 base was impacted by exceptional expense of ₹ 40 crore related to acquisition & earnings were also negatively impacted by Covid related disruption). Though return ratios would remain in single digits for the next three to four years, we see potential growth opportunities in its brand through increasing penetration & new launches (smaller SKUs & variants). The stock is available at 24.5x FY22E earnings. We value the stock at 35x FY22E EPS and maintain **BUY** rating with a revised target price of ₹ 2300.



Particulars

Particulars (₹ crore)	Amount
Market Capitalization	9,225.6
Total Debt (FY20)	1,519.1
Cash and Investments (FY20)	192.8
EV	10,551.8
52 week H/L (₹)	1860 / 1100
Equity capital	57.7
Face value (₹)	10.0

Price Chart



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Key Financial Summary

₹ Crore	FY17	FY18	FY19	FY20	FY21E	FY22E	CAGR FY20-22E
Net Sales	430.6	512.6	842.8	1,766.8	1,856.2	2,093.0	8.8
EBITDA	99.1	125.3	174.4	321.1	371.2	446.8	18.0
EBITDA Margin %	23.0	24.4	20.7	18.2	20.0	21.3	
Adjusted Net Profit	109.0	133.9	169.1	185.9	279.1	427.6	51.7
Adjusted EPS (₹)	13.9	17.1	29.3	32.2	43.4	66.4	
Adjusted P/E (x)	114.7	93.4	54.5	49.6	36.9	24.1	
RoCE (%)	15.5	15.9	3.2	5.9	7.0	8.3	
RoE (%)	19.6	19.4	5.0	5.4	5.9	8.6	

Debt reduction to boost earnings

We changed our numbers factoring in fund raising of ₹ 1100 crore. We assume the fund raising would be through equity instrument and would be utilised for the ₹ 1500 crore debt repayment. Assuming fund raising would be at the current price (given promoters have infused at ₹ 1643/ share), the equity dilution would be to the tune of ~12%. This would result in interest cost saving to the tune of ₹ 140 crore. This would result in strong earnings CAGR of 51.7% in FY20-22E. We estimate EPS CAGR of 43.6% in FY20-22E.

Exhibit 1: Change in estimates

(₹ Crore)	FY21E			FY18E		FY22E		Comments
	Old	New	% change	Old	New	% change		
Sales	1,809.0	1,856.2	2.6	512.6	2,041.4	2,093.0	2.5	We are marginally changing our revenue estimates factoring in FY20 market share & growth data in annual report
EBITDA	363.7	371.2	2.1	125.3	448.5	446.8	-0.4	
EBITDA Margin (%)	20.1	20.0	-11 bps	24.4	22.0	21.3	-62 bps	
PAT	224.8	279.1	24.1	133.9	317.2	427.6	34.8	Net profit estimates would change by factoring in fund raising with our assumption of debt repayment through QIP
EPS (₹)	39.0	43.4	11.2	34.3	55.0	66.4	20.8	EPS estimates would change factoring in equity dilution and net profit increase through interest expense reduction

Source: Company, ICICI Direct Research

Exhibit 2: Assumptions

	Current				Earlier		Comments
	FY19E	FY20E	FY21E	FY22E	FY21E	FY22E	
Sugarfree (₹ crore)	318.9	344.7	379.1	425.8	386.0	433.6	We change our estimates marginally factoring in FY20 market share data & growth estimates in annual report
Everyuth (₹ crore)	167.9	178.3	164.1	200.9	173.8	212.7	
Glucon D (₹ crore)	102.3	472.0	500.6	556.1	453.6	504.0	
Complan (₹ crore)	99.0	378.0	400.7	445.2	427.7	475.2	
RM / Sales (%)	34.7	42.7	39.2	39.2	39.1	39.1	

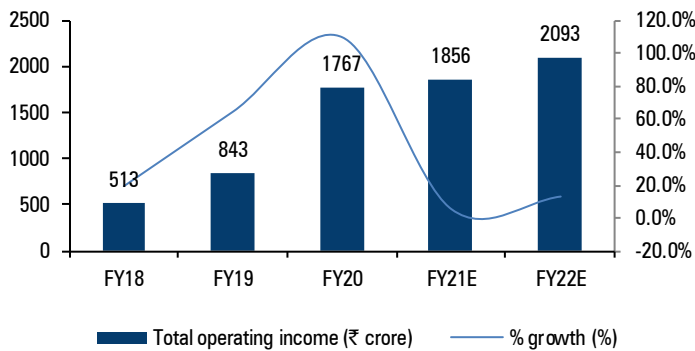
Source: Company, ICICI Direct Research

Annual report analysis

- FY20 was the first year after the consolidation of acquired Heinz business. However, the year was also not normalised given disruption at the end of the year due to Covid related disruption. The loss of sales in March was to the tune of ₹ 100 crore. The impact on sales was much more than other FMCG companies considering Q4 & Q1 account for more than two-third of sales on a normalised basis. Moreover, ZWI also incurred ₹ 40 crore acquisition related expense during the year
- The company has taken four major initiatives to leverage scale benefits post acquisition. (1) It is re-organising its employee structure to reduce redundancies and faster decision making, (2) The company aims to double the direct distribution network and rationalise distributors from 1500 to 800, which would increase its product penetration & simultaneously reduce the cost to serve, (3) It is implementing CFA consolidation through warehousing optimisation, which would reduce the logistic cost, going forward, (4) The company has implemented integration SAP S4 HANA
- The company implemented Project Udaan to integrate two separate sales organisation. With acquisition synergies, the company was able to optimise its cost. It is infrastructure ready to drive direct distribution
- The glucose powder category grew 9.8% while the company has a market share of 59%. We believe the category is ~₹ 800 crore. Malt food drinks (MFD) category witnessed growth of 7.7% with the company holding a market share of 5.4%. We believe the category size is ₹ 7000 crore. The company holds a market share of 94% in artificial sweetener category with sugar-free brand. We believe category size is ~₹ 370 crore
- Within skin care category, ZWL has market share of 77.9% in peel off segment (that is estimated to be ~₹ 80 crore), 32.5% market share in scrub segment (that is estimated to be ~₹ 280 crore). In Prickly heat powder category, Nycil is leader with 34.4% market share. The category is growing at 8.3%. The category is estimated to be ~₹ 850 crore
- Nutralite is largely a HORECA brand, which has been severely impacted by Covid related disruptions. However, the company has launched new variants to drive 'at home' consumption. The brand contributes ~3% to sales, which would not significantly impact overall sales
- The company launched Nycil sanitisers in March-April 2020. ZWL re-launched Sugarfree green with new formulation and new packaging. It also re-launched Sugarlite with better formulation to address the question of taste. ZWL has launched a new campaign to drive growth
- ZWL entered new markets of New-Zealand & Kenya. The company also launched 'Complan' in Middle East countries. It will be managing all its international operations through its new 100% subsidiary 'Zydus Wellness International DMCC'
- The company spends ~13% of its sales as advertisement & promotions. This gives it manoeuvring power to reduce spends at a disruptive times. We believe Covid related disruptions would not impact earnings significantly. On the other hand, trends related to health & wellness would benefit Sugar Free & Complan grow faster
- The company has accelerated its efforts to digitise operations through scaling up e-commerce sales & digital marketing initiatives. The sales of FMCG Industry on e-commerce are expected to reach US\$ 4 billion (which would be 5% of overall sales compared to 2% currently)

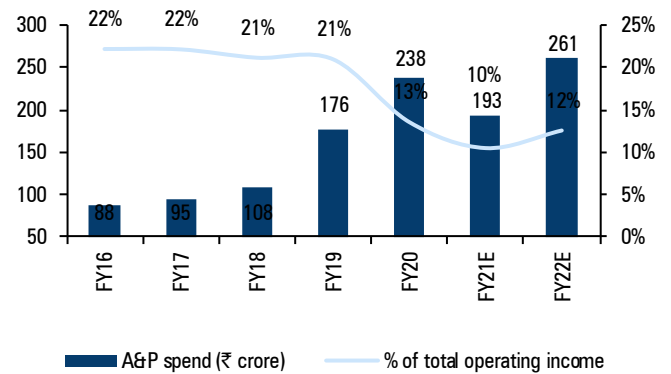
Key Metrics

Exhibit 3: Revenue & revenue growth trend



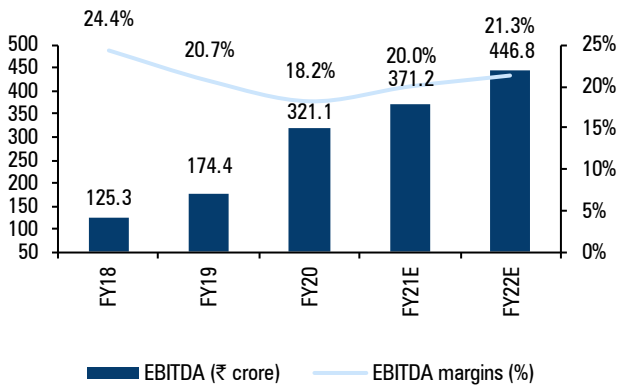
Source: ICICI Direct Research, Company

Exhibit 4: Marketing spend trend



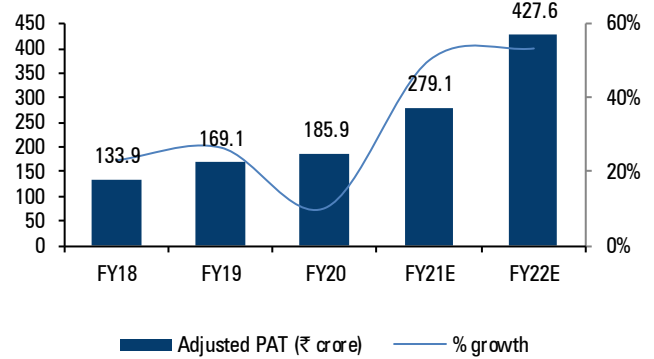
Source: ICICI Direct Research, Company

Exhibit 5: Operating margins trend (%)



Source: Company, ICICI Direct Research

Exhibit 6: Adjusted PAT growth to recover in FY22E



Source: Company, ICICI Direct Research

Exhibit 7: Brand wise revenues (I-direct Estimate)

₹ crore	FY20 Revenues
Sugar Free	344.7
Everyuth	178.3
Complan	378.0
Glucon D	472.0
Nycil	297.5
Nutralite	40.7
Others	58.8

Source: ICICI Direct Research

Exhibit 8: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY19	842.8	64.4	29.3	-14.4	54.5	61.0	5.0	3.2
FY20	1766.8	109.6	32.2	9.9	65.1	33.2	5.4	5.9
FY21E	1856.2	5.1	43.4	34.5	36.9	25.3	5.9	7.0
FY22E	2093.0	12.8	66.4	53.2	24.1	20.6	8.6	8.3

Source: Company, ICICI Direct Research

Financial summary

Exhibit 9: Profit and loss statement				
	₹ crore			
	FY19	FY20	FY21E	FY22E
Total operating income	842.8	1,766.8	1,856.2	2,093.0
Growth (%)	64.4	109.6	5.1	12.8
Raw Material Expenses	298.4	778.8	815.1	921.4
Employee Expenses	85.6	174.7	202.7	226.4
Marketing Expenses	176.1	238.0	193.0	261.2
Administrative Expenses	39.7	0.0	86.9	89.2
Other expenses	68.7	254.3	187.3	148.0
Total Operating Expenditure	668.5	1,445.8	1,485.0	1,646.2
EBITDA	174.4	321.1	371.2	446.8
Growth (%)	39.2	84.1	15.6	20.4
Depreciation	12.5	26.4	26.7	29.4
Interest	30.1	139.9	76.7	1.5
Other Income	38.9	10.7	11.2	11.8
PBT	170.6	165.5	279.1	427.6
Total Tax	-0.6	-20.5	0.0	0.0
PAT before MI	171.2	185.9	279.1	427.6
Minority Interest	2.1	0.0	0.0	0.0
PAT	169.1	185.9	279.1	427.6
Growth (%)	25.4	8.6	50.1	53.2
Adjusted EPS (₹)	40.10	32.24	48.39	74.16

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Profit After Tax	107.6	119.7	279.1	427.6
Add: Depreciation	12.5	26.4	26.7	29.4
(Inc)/dec in Current Assets	-42.7	16.0	9.1	-107.0
Inc/(dec) in CL and Provisions	71.9	97.1	104.7	87.7
CF from operating activities	149.4	259.2	419.5	437.7
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	-64.0	-10.0	-10.0
(Inc)/dec in Fixed Assets	-17.1	-5.1	-50.0	-50.0
Others	-4,144.6	-14.1	-5.0	-5.0
CF from investing activities	-4,161.7	-83.2	-65.0	-65.0
Issue/(Buy back) of Equity	18.6	0.0	1,100.0	0.0
Inc/(dec) in loan funds	1,544.3	-50.2	-1,330.0	-170.0
Dividend paid & dividend tax	-37.6	-69.4	-116.4	-194.0
Interest Paid	-30.1	-140.1	-76.7	-1.5
Others	2,556.4	0.0	0.0	0.0
CF from financing activities	4,051.5	-259.7	-423.0	-365.5
Net Cash flow	39.3	-83.7	-68.5	7.2
Opening Cash	29.6	138.2	82.4	13.8
Cash with Bank	95.4	27.9	0.0	0.0
Closing Cash	164.3	82.4	13.8	21.1

Source: Company, ICICI Direct Research

Exhibit 11: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Liabilities				
Equity Capital	57.7	57.7	64.4	64.4
Reserve and Surplus	3,328.6	3,403.0	4,659.0	4,892.7
Total Shareholders funds	3,386.3	3,460.7	4,723.4	4,957.0
LT Borrowings & Provisions	1500.0	1500.0	170.0	0.0
Deferred Tax Liability	69.3	19.1	19.1	19.1
Others Non-current Liabilities	26.0	27.2	27.2	27.2
Total Liabilities	4,981.5	5,006.9	4,939.6	5,003.3
Assets				
Gross Block	349.1	372.7	412.7	452.7
Less: Acc Depreciation	141.7	168.1	194.8	224.2
Net Block	207.4	204.7	218.0	228.5
Capital WIP	10.3	3.5	13.5	23.5
Goodwill	3,819.7	3,920.0	3,920.0	3,920.0
Non-current Investments	32.9	1.6	1.6	1.6
LT loans & advances	41.0	4.7	14.7	24.7
Deferred Tax Assets	103.0	120.8	120.8	120.8
Other Non-Current Assets	546.2	558.6	563.6	568.6
Current Assets				
Inventory	233.1	292.3	279.7	332.6
Debtors	96.0	118.2	132.2	143.4
Loans and Advances	2.8	0.0	6.1	6.9
Other Current Assets	155.7	172.4	342.9	386.7
Cash	164.3	82.4	13.8	21.1
Investments	46.1	110.4	0.0	0.0
Current Liabilities				
Creditors	398.1	491.1	513.6	579.2
Provisions	2.3	0.0	5.0	5.7
Short term debt & other CL	76.6	91.7	168.8	190.3
Application of Funds	4,981.5	5,006.9	4,939.6	5,003.2

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS	29.3	32.2	43.4	66.4
Cash EPS	31.5	29.2	47.5	71.0
BV	587.3	600.2	734.0	770.3
DPS	5.4	10.0	15.0	25.0
Cash Per Share	28.5	14.3	2.2	3.3
Operating Ratios (%)				
EBITDA Margin	20.7	18.2	20.0	21.3
PBT / Total Operating income	20.2	9.4	15.0	20.4
PAT Margin	20.1	8.0	15.0	20.4
Inventory days	100.9	60.4	55.0	58.0
Debtor days	41.6	24.4	26.0	25.0
Creditor days	172.4	101.5	101.0	101.0
Return Ratios (%)				
RoE	5.0	5.4	5.9	8.6
RoCE	3.2	5.9	7.0	8.3
Valuation Ratios (x)				
P/E	54.5	65.1	36.9	24.1
EV / EBITDA	61.0	33.2	25.3	20.6
EV / Net Sales	12.6	6.0	5.1	4.4
Market Cap / Sales	10.9	5.2	5.0	4.4
Price to Book Value	2.7	2.7	2.2	2.1
Solvency Ratios				
Debt/EBITDA	9.0	4.7	0.5	0.0
Debt / Equity	0.5	0.4	0.0	0.0
Current Ratio	1.0	1.0	1.1	1.1
Quick Ratio	0.5	0.5	0.7	0.7

Source: Company, ICICI Direct Research

Exhibit 13: ICICI Direct coverage universe (FMCG)

Sector / Company	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹)		Rating	(₹ Cr)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY21E	FY20	FY21E	FY22E	FY20	FY21E
Colgate (COLPAL)	1,368	1,540	Hold	39,377	30.0	31.0	34.3	45.6	44.2	39.9	8.8	8.6	7.8	60.7	68.0	76.0	51.2	52.1	58.3
Dabur India (DABIND)	489	565	Buy	87,118	8.2	8.8	10.3	59.7	55.5	47.7	10.0	9.9	8.6	26.1	24.0	24.7	21.9	20.9	21.4
Hindustan Unilever (HINLEV)	2,126	2,410	Hold	519,159	31.2	32.4	40.1	68.2	65.6	53.0	13.6	12.2	0.0	89.5	26.7	33.0	85.7	20.3	25.4
ITC Limited (ITC)	188	250	Buy	245,475	12.5	11.7	13.0	15.1	16.0	14.4	5.3	5.2	4.6	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	141	150	Hold	5,141	4.3	5.3	5.8	32.8	26.6	24.2	3.1	2.9	2.6	24.3	29.7	29.9	21.7	24.2	24.1
Marico (MARLIM)	376	380	Hold	45,286	8.1	8.5	9.6	46.5	44.2	39.3	6.2	6.1	5.5	41.0	42.3	46.2	34.5	35.6	39.5
Nestle (NESIND)	16,300	18,000	Hold	164,869	204.3	230.3	268.9	79.8	70.8	60.6	13.4	12.4	10.9	56.9	59.3	65.9	101.9	114.2	123.6
Tata Consumer Products (TATGLC)	575	525	Buy	41,256	5.0	9.8	11.7	115.2	58.8	49.3	4.3	3.9	3.6	6.9	8.8	9.4	4.6	6.6	7.5
VST Industries (VSTIND)	3,331	4,450	Buy	5,000	196.9	202.1	222.6	16.9	16.5	15.0	4.0	4.2	3.6	52.1	46.3	44.8	38.6	34.2	33.0
Varun Beverage (VARBEV)	746	700	Hold	20,670	16.4	9.7	17.8	45.6	76.6	41.8	2.9	3.4	2.8	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,600	2,300	Buy	9,341	24.6	43.4	66.4	65.1	36.9	24.1	5.3	5.0	4.5	5.9	7.0	8.3	5.4	5.9	8.6

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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