Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Zydus Wellness Limited

Equity issuance to reduce debt; three pillars strategy to drive growth

Consumer Goods	Sharekhan code: ZYDUSWELL	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,835**	
Price Target: **2,300**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 10,581 cr
52-week high/low:	Rs. 1,950/1,070
NSE volume: (No of shares)	0.2 lakh
BSE code:	531335
NSE 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	13.6	44.1	44.7	7.2
Relative to Sensex	15.2	35.5	11.2	9.0

Sharekhan Research, Bloomberg

Summary

- We re-iterate a Buy rating on Zydus Wellness (ZWL) with a revised price target of Rs. 2,300. Negative working capital, focus on strengthening balance sheet and strong earnings visibility makes ZWL a best pick in mid-cap FMCG space.
- The company is raising ~Rs. 1,100 crore through QIP/preferential allotment to promoter, which will be utilised to reduce debt. Reduction in debt would lead to cost savings of Rs. 90-100 crore, which would result in strong EPS accretion in FY2022-23.
- It has identified three pillars of growth from a medium to long-term perspective: driving synergistic benefits from Heinz deal, new launches and expanding international footprint.
- The three pillars strategy could help company to achieve earnings CAGR of 27% over FY2020-23 (with OPM expanding by 180 bps).

Zydus Wellness Limited (ZWL) is one of emerging consumer goods companies with strong positioning in niche categories such as artificial sweeteners, glucose powder, scrubs and margarine. Our interaction with the company's management suggests that it has identified a 'three pillars' growth strategy to achieve sustainable revenue growth in the near to medium term. Further, ZWL is also focusing on strengthening its balance sheet by raising funds of ~Rs. 1,100 crore through a QIP/preferential allotment to promoters. The entire fund will be utilised to reduce debt, which currently stands at Rs. 1,500 crore (taken for Heinz acquisition). Average cost of debt currently stands at 9% (semi-annually). Thus, the reduction in debt will lead to interest cost savings of Rs. 90-100 crore in FY2022/23. This would result in EPS accretion in strong double digits (despite equity dilution). Under the leadership of Tarun Arora (CEO & Whole Time Director), the company has framed three pillars strategy to drive sustainable growth in the near to medium term - 1) driving synergistic benefits from Heinz acquisition; 2) sustained new product launches; and 3) expanding reach in the international markets. The domestic business will be supported by expanded distribution reach of over 1,700 distributors and well-established supply chain with high-quality production facilities. The company has launched 4-5 new products in the immunity boosting and hygiene space, which are gaining good traction. Further, operations are back to 90% of pre-COVID levels with most categories (except for face wash/scrubs) re-gaining momentum. However, Q2 is seasonally a weak quarter for ZWL due to lesser sales of Glucon D and hence, it will not provide a clear picture of recovery. With an improved revenue mix and efficiencies, operating margins (OPM) are expected to improve to 20% by FY2023.

Our Call

Retain Buy with revised PT of Rs. 2,300: With the 'three pillars' strategy and reduction in debt on books, ZWL is well-versed to achieve a 27% earnings CAGR over FY2020-23 (with OPM expanding by 180 bps to 20%+ in the same period). The company has strong presence in niche categories, which are largely health & hygiene centric, gaining good acceptance amid the current pandemic. The company is focusing on expanding in the rural markets with the help of scaled-up distribution led by the Heinz acquisition and expanding footprint internationally. This will be supported by a lean balance sheet with negative working capital. Thus, we believe ZWL is one of the best picks in the mid-cap space and retain our Buy recommendation on the stock with a revised price target of Rs. 2,300.

Key risk

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	843	1,767	1,696	1,934	2,243
OPM (%)	21.9	18.2	18.5	19.3	20.0
Adjusted PAT	182	186	199	303	377
% YoY growth	33.1	2.3	7.3	51.9	24.3
Adjusted EPS (Rs.)	28.3	28.9	31.1	47.2	58.6
P/E (x)	58.2	56.9	59.1	38.9	31.3
P/B (x)	3.1	3.1	2.5	2.4	2.2
EV/EBIDTA (x)	56.9	32.4	36.6	30.5	24.5
RoNW (%)	8.9	5.4	4.9	6.3	7.3
RoCE (%)	7.4	6.1	5.7	6.6	7.6

Source: Company; Sharekhan estimates

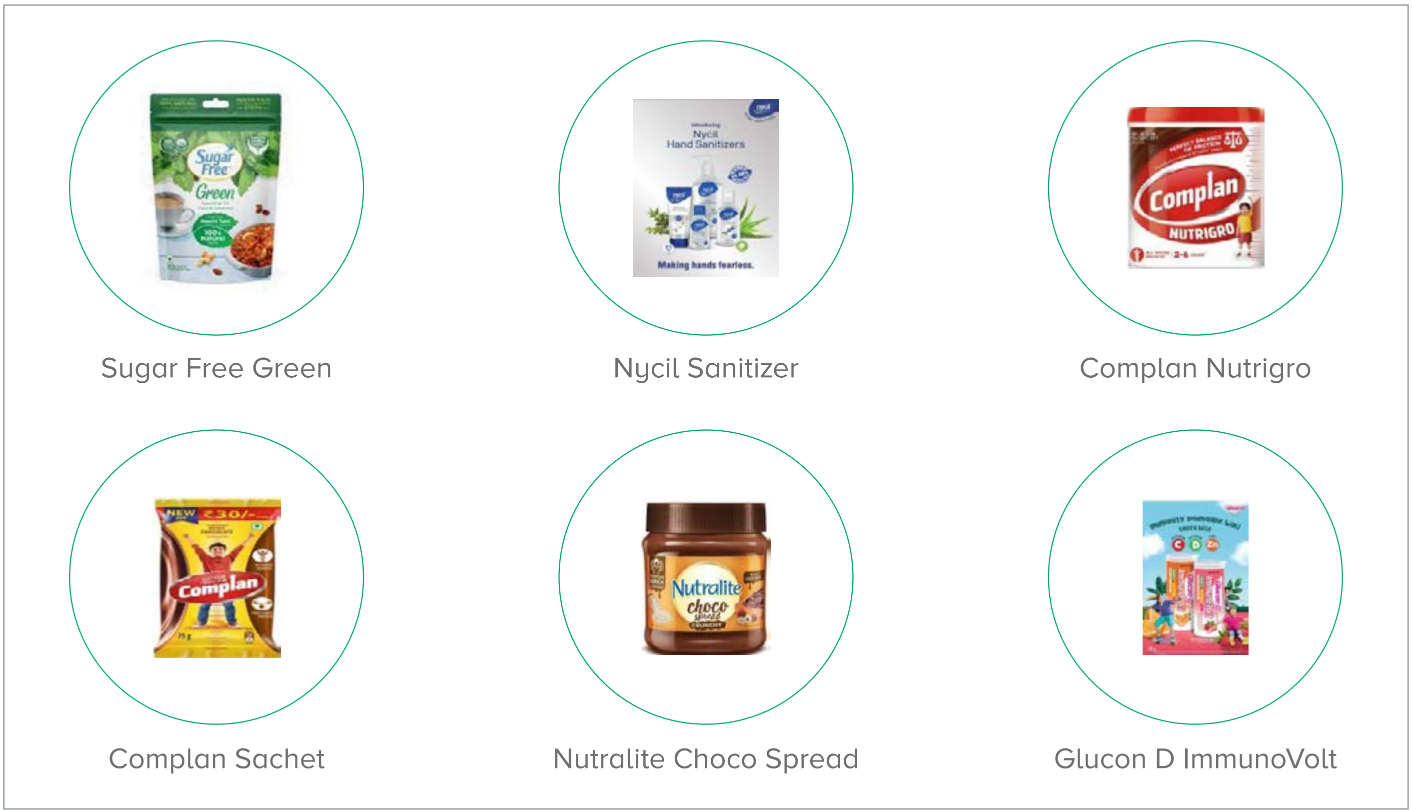
** Estimates are considering the impact of debt reduction and equity dilution post the recent equity issuance through QIP*

Key highlights of our interaction with the management

ZWL has framed 'three pillars' growth strategy to drive sustainable revenue and earnings growth in near term:

Pillar 1 - New launches: In the current pandemic environment, demand for Health & Wellness (H&W) products are gaining strong traction due to rising awareness and consumer becoming more cautious and health centric. ZWL products including Sugarfree (substitute to sugar), Nutralite (healthier substitute to butter), Glucon D (energy drink) and Complan (Health Food Drink) have strong recognition in H&W space (also sold through the chemist channel). Further, ZWL has launched products such Nycil sanitiser, Complan Nutrigro (toddler health food drink), Glucon D ImmunoVolt (energy bites that boost immunity) and Sugarfree Green (for consumers seeking better weight management) to expand its H&W portfolio. It has also introduced Complan sachets to penetrate in Northern and Western India markets, which are relatively weaker markets for the health food drinks segment.

Innovation in times of COVID



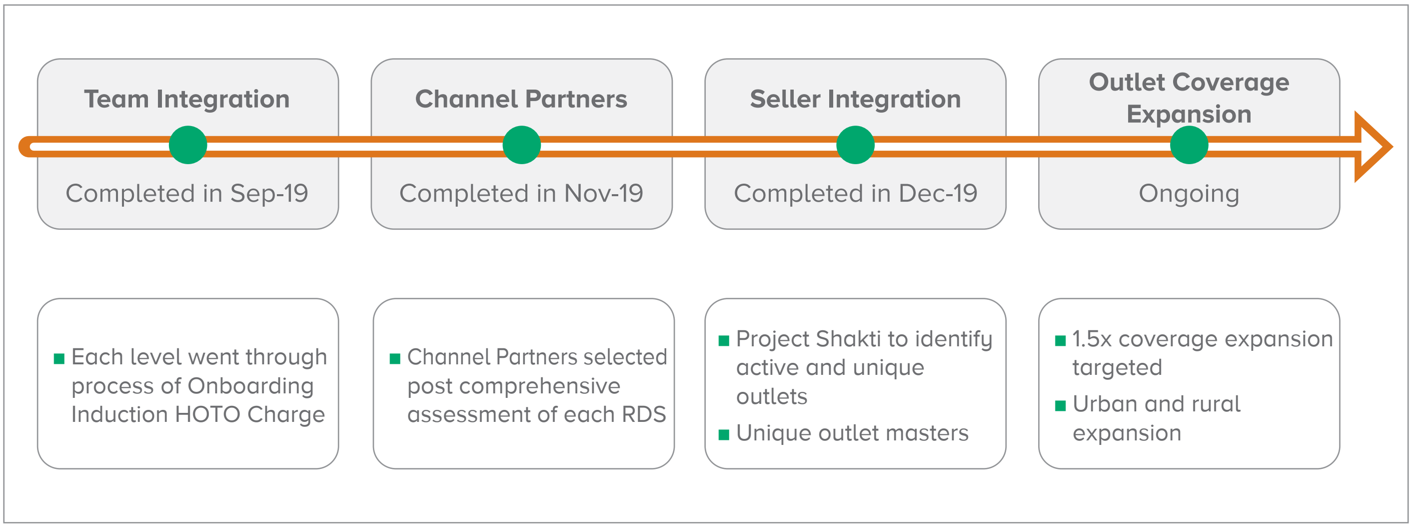
Source: Company, Sharekhan Research

Pillar 2 - Expanding global footprint: ZWL is continuously focusing on expanding its global footprint with the incorporation of Zydus DMCC, a wholly-owned subsidiary in Dubai, UAE in FY2020. Through this subsidiary, the company is planning to expand the reach of its product portfolio in existing 23 countries and reach newer markets (Focusing on SAARC, Middle East and South East Asia). ZWL expects the revenue contribution from international business to stand at about 10% in the medium to long term.

Pillar 3 - Leveraging on Heinz acquisition to significantly scale up growth: The Heinz acquisition enabled the company to become one of the leading consumer wellness companies in India with a No. 1 positioning in 4 of 5 categories of presence. Addition of large general trade channel to an existing pharmacy channel complemented the company's existing distribution reach. Further, ZWL is focusing on deriving benefits through supply chain synergies in the form of delivery cost savings through the value chain. Reducing logistic cost through warehouse and C&F optimisation, (optimised from 9 branches to 6 branches and reduced from 1800+

ambient distributors to 800+ distributors) while expanding the footprints are some of the key areas ZWL focused during the Heinz integration. We expect synergistic benefits to result in sustainable revenue growth and margin expansion in the near to medium term.

Market strategy



Source: Company, Sharekhan Research

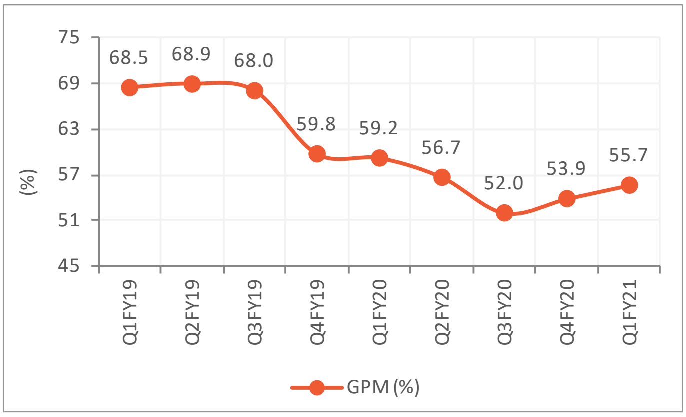
Enhanced distribution reach and well-established supply chain will support growth strategies: ZWL has structured distribution networks to facilitate sales to address different consumer demands. The company has over 1,700+ distributors and ~2,000 feet-on-street, which directly sell products to retail outlets and retail chains in India. Further, it has 25 warehouses/20 cold chain warehouses and 23 Carry and Forward agents to support its distribution network. Deriving synergies through the Heinz distribution network, the company is focusing on expanding reach in the rural market. Well established supply chain will help in reducing logistic cost through warehousing optimisation and freight lane consolidation.

Taken adequate steps to recover quickly in the current pandemic environment: The company resumed operations gradually after getting necessary approvals from government authorities during the lockdown. It quickly migrated to a daily operations protocol with all necessary safety measures. It opened a few CFAs by the end of March, thereby enabling supply of essential products and the rest in April. The company introduced Project Garuda, engaging with third-party logistics vendors to revive last mile connectivity. It set-up telesales channel for 6,000 top retailers in 35 cities and also leveraged on e-Commerce channels across platforms. Overall, the company has recovered to 90% of pre-COVID levels in August-September. Most categories are regaining momentum (except for face wash/scrubs). However, Q2 is seasonally a weak quarter for ZWL due to lesser sales of Glucon D and hence, it will not provide a clear picture of recovery.

Raising ~Rs. 1,100 crore through equity issuance to reduce debt on books: ZWL is planning to raise funds of ~Rs. 1,100 crore through preferential allotment of Rs. 350 crore to promoter and qualified institutional placement (QIP) issuance of Rs. 750 crore. The company would be issuing and allotting 21.3 lakh equity shares at a price of Rs. 1,643.1 per share aggregating to Rs. 350 crore to the Zydus family trust. Further, it will be doing QIP placement of 44.4 lakh shares at a price of Rs. 1,690 per share aggregating to Rs. 750 crore. Post issuance, equity dilution stands at 10% and the equity share capital will enhance to 6.42 crore shares from current 5.77 crore shares. The funds raised will be utilised to reduce equivalent debt on books (currently stands at Rs. 1,500 crore). The average cost of debt is 9%. The reduction in debt will lead to interest cost savings of Rs. 90-100 crore in FY2022 and FY2023, which would lead to significant EPS accretion (despite equity dilution).

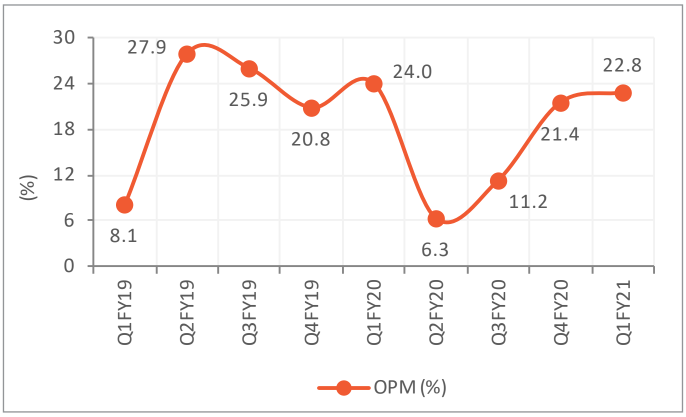
Financials in charts

Gross margins impacted by unfavourable mix in Q1FY2021



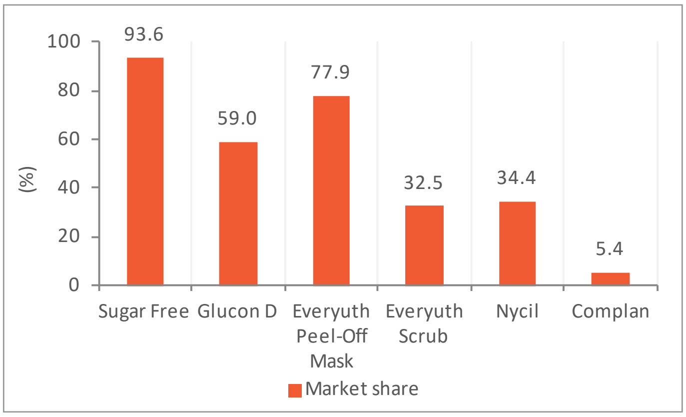
Source: Company, Sharekhan Research

OPM came in at 22.8% in Q1FY2021



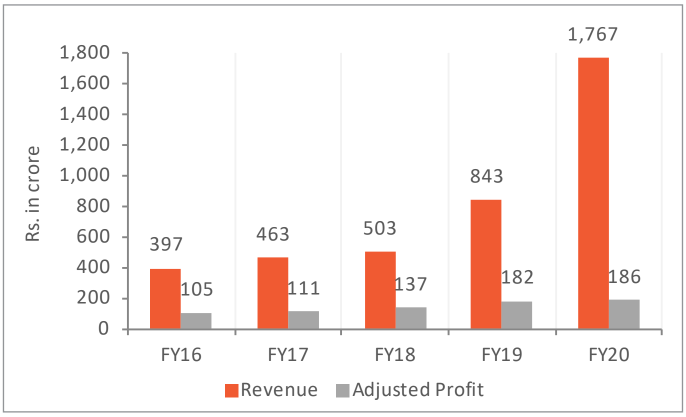
Source: Company, Sharekhan Research

Market share of key categories maintained



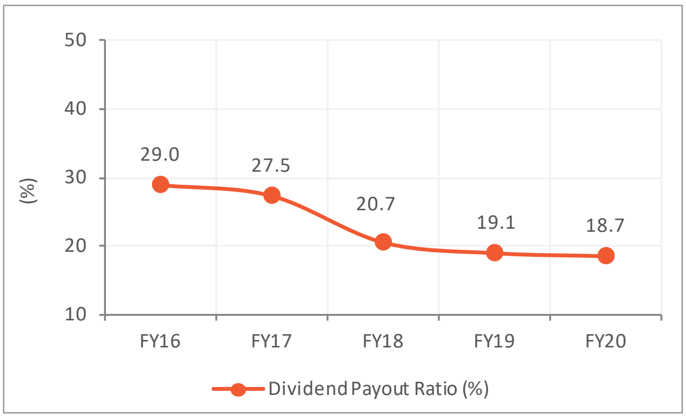
Source: Company, Sharekhan Research

FY2020 included consolidation of Heinz portfolio



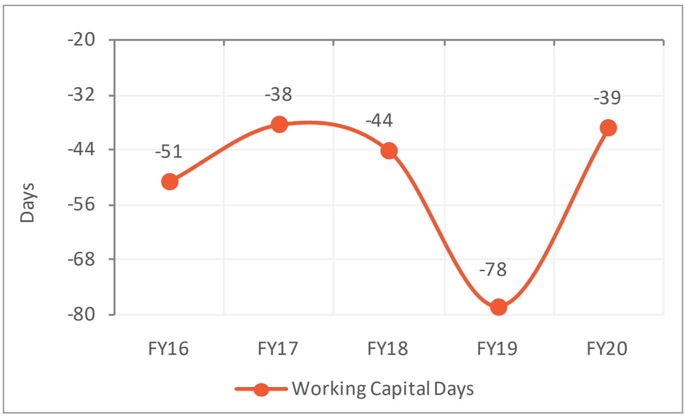
Source: Company, Sharekhan Research

Dividend payout ratio maintained



Source: Company, Sharekhan Research

Working capital cycle remained stable



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Supply chain back to normal; heath & wellness products gaining good traction

Consumer goods companies clocked a strong revival in June with production and supply recovering to 90% of pre-COVID levels. With a strong pick in rural demand, general trade normalising and higher sales through online channels, we expect business performance to normalise from Q2FY2021. In the current pandemic environment, health, hygiene and immunity boosting products are gaining good traction. We expect this trend to continue in the near to medium term. Most of the consumer goods companies would be launching new products in these categories in the near to medium term.

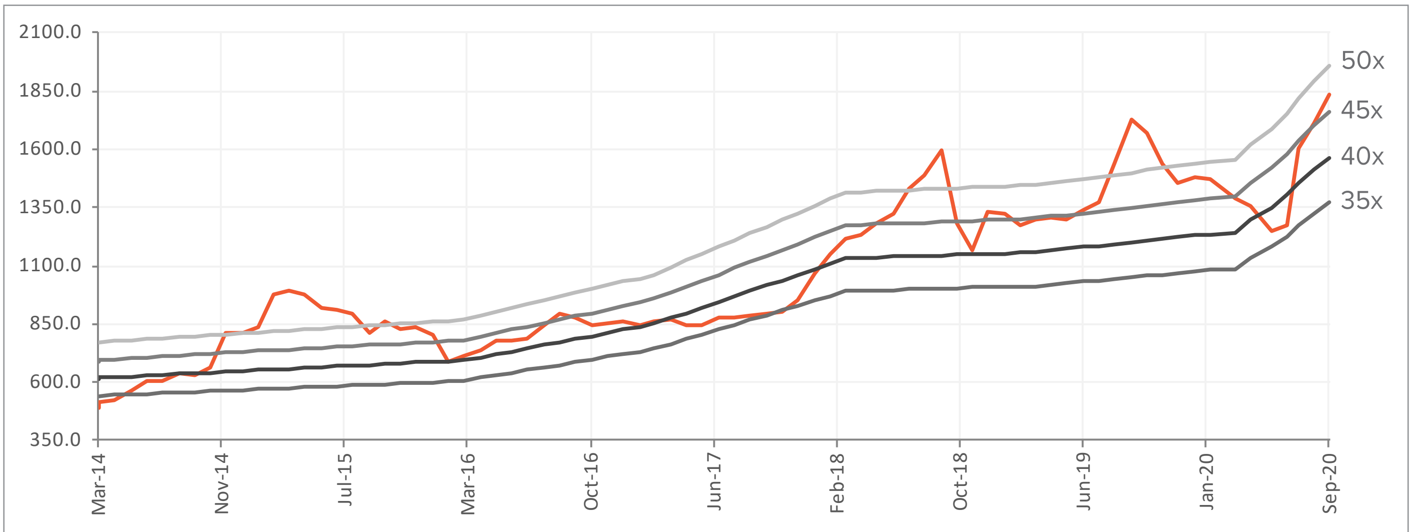
Company Outlook – Q2 is seasonally weak quarter; long-term growth prospects intact

Like other consumer goods companies, ZWL's Q1 performance was affected by supply disruptions caused by the COVID-led lockdown. However, the company started its operations after gaining regulatory approvals and operations have gradually improved to 90% of pre-COVID levels with supply chain and distribution back on track. However, Q2 is a seasonally weak quarter for ZWL due to lower sales of energy drink during the monsoons and hence, any sequential recovery would not fully capture in Q2FY2021 results. Having said that, ZWL's near to medium-term growth prospects are intact with the three pillars growth strategy. Also, an improvement in revenue mix, synergistic benefits of Heinz acquisition and efficiencies would help OPM to improve to ~20% by FY2023.

Valuation – Retain Buy with revised TP of Rs. 2,300

With the 'three pillars' strategy and reduction in debt on books, ZWL is well-versed to achieve a 27% earnings CAGR over FY2020-23 (with OPM expanding by 180 bps to 20%+ in the same period). The company has strong presence in niche categories, which are largely health & hygiene centric, gaining good acceptance amid the current pandemic. The company is focusing on expanding in the rural markets with the help of scaled-up distribution led by the Heinz acquisition and expanding footprint internationally. This will be supported by a lean balance sheet with negative working capital. Thus, we believe ZWL is one of the best picks in the mid-cap space and retain our Buy recommendation on the stock with a revised price target of Rs. 2,300.

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	57.6	53.4	42.5	48.1	43.3	34.1	27.0	26.5	29.5
Zydus Wellness	56.9	59.1	38.9	32.4	36.6	30.5	6.1	5.7	6.6

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

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

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

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.