Sharekhan by BNP PARIBAS

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Stock Update

Zydus Wellness Limited

Strong Q3; Repayment of NCDs boosted PAT growth

Consumer Goods	Sharekhan code: ZYDUSWELL	Result Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,949**	
Price Target: **Rs. 2,300**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

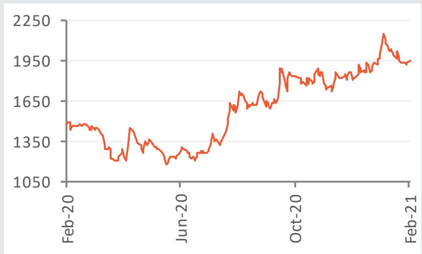
Company details

Market cap:	Rs. 12,402 cr
52-week high/low:	Rs. 2,218/1,070
NSE volume: (No of shares)	0.5 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	64.8
FII	2.0
DII	26.2
Others	7.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.5	4.2	21.7	31.8
Relative to Sensex	-7.0	-18.5	-7.6	9.4

Sharekhan Research, Bloomberg

Summary

- Zydus Wellness Limited (ZWL) posted strong performance in Q3FY2021 with revenue and operating profit growing by ~15% and ~33%, respectively (OPM expanding by 176 bps); lower interest cost led to PAT standing at Rs. 29 crore versus Rs. 9 crore in Q2FY2020.
- Excluding Nutralite, all brands reported strong double-digit revenue growth in Q3. Nutralite business recovered to 90% of pre-COVID level and will reach 100% in Q4.
- Improving penetration of Complan, higher traction for Sugarfree and Glucon D along with new products performing well and improved growth of Everyuth brand coupled with distribution enhancement will be key revenue drivers in the near term.
- With improving growth prospects in key brands and deleveraged balance sheet, ZWL is well poised to achieve earnings CAGR of 28% over FY2020-FY2023. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,300.

Zydus Wellness Limited's (ZWL) revenue grew by 15% y-o-y to Rs. 381.6 crore in Q3FY2021, better than our expectation of Rs. 355.1 crore. Growth was better than 5% growth achieved in Q2. Except for Nutralite, all other brands registered double-digit revenue growth during the quarter. Benign milk prices and better revenue mix aided gross margins to improve by 262 bps to 54.6%. Despite higher ad spends, OPM improved by 176 bps to 13.0%. This along with lower interest cost due to repayment of non-convertible debentures (NCDs) resulted in adjusted PAT standing at Rs. 29.1 crore as against Rs. 9 crore in Q2FY2020. Everyuth, Nycil, and Glucon D maintained their leadership position with market share of 34.8%, 35.7%, and 58.3% in their respective categories. Further, Sugarfree, which is the market leader in artificial sweetener category, registered yet another quarter of double-digit revenue growth. Complan distribution expanded to more than 5 lakh outlets from around 3.5 lakh outlets helping the brand to grow in double digits. The company's focus is to expand the brand reach to 6.5 lakh outlets in the coming years. The company launched Rs. 5 per 18gm sachets to attract new recruits in the southern and eastern parts of India, while Rs. 30 per 75gm pack is getting good traction in the northern and western parts of the country. New product launches such as Glucon D immuno volts and Nutralite choco spread are gaining strong traction in the domestic market. Thus, improving penetration of Complan, higher traction for Sugarfree and Glucon D along with new products performing well and improved growth of Everyuth brand coupled with distribution enhancement will be key revenue drivers in the near term. Further, the international business, which currently contributes around 3% to revenue, is growing at 300% y-o-y. Except for palm oil, other input prices have remained relatively benign. Synergistic benefits from the integration of Heinz acquisition and better revenue mix would help gross margins remain stable in the coming quarters. ZWL's management targets OPM of close to 20% by FY2023.

Key positives

- Sugarfree registered yet another quarter of double-digit growth, backed by innovative campaigns and strong traction on the e-commerce platform.
- Complan base brand also grew in double digits; market share slightly improved to 5.5%.
- Direct distribution reach will go up to 5 lakh outlets by March 2021 from 3.5 lakh outlets

Key negatives

- GST budgetary support to Sitarganj facility ceased in January 2020, resulting in lower revenue growth (FY2020 benefit was Rs. 32 crore) at net level to 13%.
- Nutralite sales are yet to reach pre-COVID levels (currently 90%).

Our Call

View: Retained Buy with an unchanged PT of Rs. 2,300: We have broadly maintained our earnings estimates for FY2021/FY2022/FY2023. With improving growth prospects in key brands and deleveraged balance sheet, ZWL is well poised to achieve an earnings CAGR of 28% over FY2020-FY2023 (with OPM inching close to 20% by FY2023). Health and immunity-boosting products will continue to get good traction and penetration levels will improve in the post pandemic era. The stock is currently trading at 40.7x/31.9x its FY2022/FY2023E EPS, which is at a discount to some of the large consumer goods stocks. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,300.

Key risk

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	843	1,767	1,802	2,054	2,383
OPM (%)	21.9	18.2	18.6	18.3	19.3
Adjusted PAT	182	186	220	308	392
% YoY growth	33.1	2.3	18.3	39.8	27.5
Adjusted EPS (Rs.)	28.3	28.9	34.2	47.9	61.1
P/E (x)	61.9	60.4	56.9	40.7	31.9
P/B (x)	3.3	3.2	2.6	2.5	2.3
EV/EBIDTA (x)	60.5	34.5	36.5	32.3	25.8
RoNW (%)	8.9	5.4	5.4	6.3	7.6
RoCE (%)	7.4	6.1	6.1	6.7	7.8

Source: Company; Sharekhan estimates

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

Revenue grew by 14.7% y-o-y; OPM expanded by 176 bps: Q3FY2021 net revenue grew by 14.7% y-o-y to Rs. 381.6 crore as against Rs. 332.7 crore in Q3FY2020. Except Nutralite, all other brands registered double-digit growth during the quarter. Other operating income was low due to withdrawal of GST budgetary support for the Sitarganj plant from January 2020. Most key brands, including Glucon-D, Sugar Free, EverYuth Scrub, Peel Off Face Mask and Nycil, maintained their leadership positions. Gross margin declined by 262 bps y-o-y to 54.6%, led by benign raw-material cost. Despite higher ad-spends, lower other expenses and improvement in gross margin led OPM to grow by 176 bps y-o-y to 13%. Operating profit grew by 32.7% y-o-y to Rs. 49.5 crore. Interest cost stood at Rs. 9.9 crore versus Rs. 35.3 crore in Q3FY2020, led by the company's strategy to buy back debentures. Strong operating performance and reduction in interest cost led to adjusted PAT standing at Rs. 29 crore as against Rs. 9 crore in Q3FY2020. There was a pre-tax exceptional item of Rs. 34.2 crore pertaining to debenture redemption premium. Thus, the company reported PAT of Rs. 1.7 crore.

Key brands maintained leadership position; New launches performing well: Sugarfree category witnessed strong double-digit growth. Innovative campaigns such as Sugar Free Chef activation on Diwali and 21-Day No Sugar Challenge were launched on digital media. Sugar Free also launched Sugar Free D'lite dark chocolates in domestic markets through the ecommerce platform through digital campaign and marketing initiatives across Ecommerce portals. EverYuth Scrub is the leading brand with a market share of 34.8%. The quarter marked the launch of Aloe Vera Gel in this category. In the prickly heat powder category, Nycil leads with a market share of 35.7%, which is an increase of 213 bps over the same period last year. Glucon-D has maintained its number one position with a market share of 58.3%. Glucon-C Immuno Fizz was launched in December 2020 to tap the market of 'Immunity Booster' product in the effervescent format. Earlier launch of Gluco Immuno volt is gaining traction and is witnessing good response in the market. In the malted food drink category, Complan has a market share of 5.5%. The company's promotional campaign on Complan has focussed on the product's nutritional superiority through multiple media. The company has launched Rs. 5 package in southern and eastern regions. Demand for Nutralite has been steadily increasing and there has been sequential improvement across the portfolio, including institutional business. Mayo portfolio, especially retail business, delivered good performance because of increased demand for the category. Nutralite Choco Spread continued to deliver steady business on E-Commerce and modern trade channels.

Key Conference call takeaways

- Sugarfree maintained its leadership position in the artificial sugar category and registered double-digit growth driven by consistent investment in digital media and increased footprint on the e-commerce channel during the quarter.
- Complan is now available in more than 5.5 lakh outlets. Focus is on expanding the reach to its historic reach of 6.5 lakh outlets. ZWL launched small package of Rs. 5 per 18gm pack to penetrate in the southern and eastern parts of India. The launch got good response in Tamil Nadu with recovery in traction after almost one and a half year. Earlier the company had launched Rs. 30 per 75gm pack in the northern/ western parts of India, which is also getting good traction. Complan base brand is growing in double digits and ZWL's market share in the health food drink category has marginally improved to 5.5%.
- Till date, the company has launched nine new products. Among the new launches, Gluco immune volts and Nutralite Choco spread have received strong acceptance and brands are expected to be one of key drivers in the long run. The company made four new launches in Q3 Everyuth Aloe Cucumber Gel, Nycil Sanitizing Wipes, SugarFree D'Lite Chocolates, and Glucon C Immuno Fizz. The company has recently launch Nutralite Doodhshakti Ghee and Butter to expand its Nutralite portfolio.

- The e-commerce channel, which contributes ~4.5% to overall revenue, grew by 240% y-o-y in Q3FY2021. On the other hand, the international business contributes 3% to the total revenue and grew by almost 300% in Q3.
- ZWL has indirect reach to 2 million outlets and targets to have direct reach to 5 lakh outlets by March 2021 (from earlier 3.5 lakh outlets) under project Vistaar. The company plans to expand its distribution reach in the coming years.
- Gross margin in Q3 was led by 1) working out in trade terms with trade partners by reducing lower trade margins but improving RoI of traders; 2) synergistic benefits in packaging materials; and 3) improving the buying capabilities to purchase key inputs. Except from palm oil, prices of key inputs such as milk and other commodities are relative benign. The company might increase prices of key brands to pass on the significant increase in palm oil prices. This along with better revenue mix will help gross margins to better off in the coming years.
- Overall, the company has maintained its target of achieving OPM of 20% by FY2023.

Results (Consolidated) **Rs cr**

Particular	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net Revenue	381.6	332.7	14.7	342.0	11.6
Total expenditure	332.1	295.4	12.4	314.9	5.5
Operating profit	49.5	37.3	32.7	27.1	82.6
Other Income	2.5	2.4	3.7	2.8	-10.3
Interest Expense	9.9	35.3	-72.0	30.8	-68.0
Depreciation	6.3	5.3	17.2	6.5	-3.5
PBT	35.9	-0.8	-	-7.4	-
Tax	6.8	-9.7	-	19.6	-65.1
Adjusted PAT	29.1	8.9	-	-27.0	-
Minority Interest	0.0	0.0	-	0.0	-
PAT after M.I.	29.1	8.9	-	-27.0	-
Exceptional item	-27.3	-4.6	-	-78.4	-
Reported PAT	1.7	4.2	-	-105.3	-
Reported EPS (Rs.)	0.4	0.7	-40.5	-16.6	-
			bps		**bps**
GPM (%)	54.6	52.0	262	53.7	96
OPM (%)	13.0	11.2	176	7.9	505

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Health and wellness products to gain good traction

Domestic FMCG market's growth recovered to 5% in Q3FY2021 from 1% in Q2FY2021. Strong pick-up in rural demand, normalisation of general trade channels, and higher e-commerce sales helped sales of most consumer goods companies to recover to pre-COVID levels across most product categories. Sales of immunity-boosting products such as Chyawanprash, Ashwagandha and Giloy grew 2x-5x, while honey sales grew by 40%-50% in the past six months. Growth rate of these categories might moderate, but improving penetration will drive growth. The increase in key input prices would be mitigated by judicious pricing and cost-saving initiatives in the coming quarters.

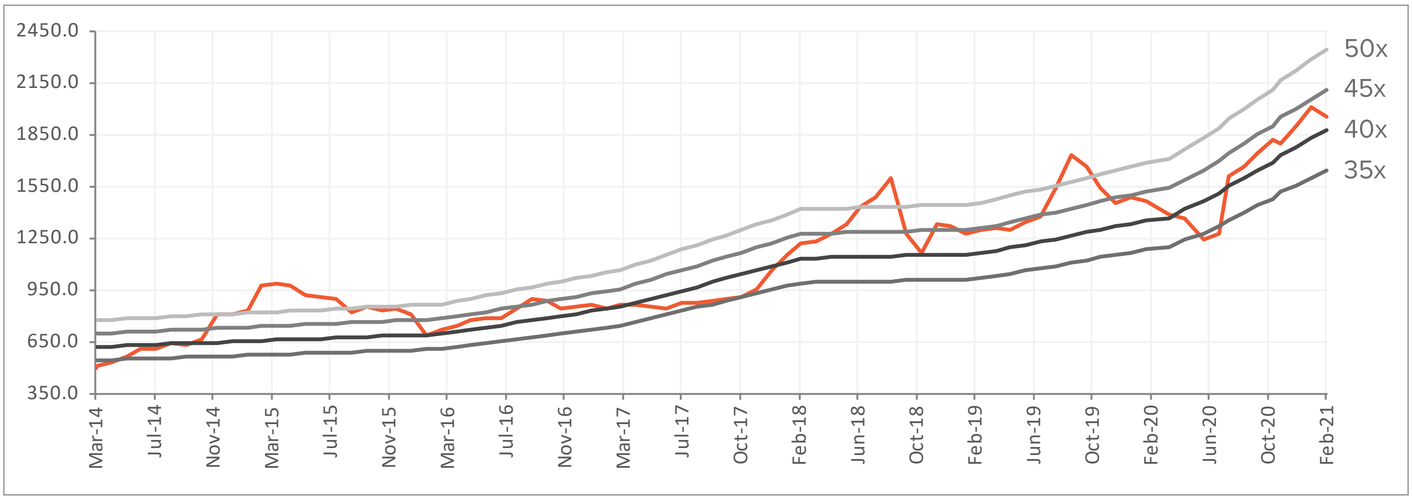
■ Company Outlook – Q3 showed strong growth; Long-term growth prospects intact

Strong recovery in the demand environment aided ZWL to post strong performance in Q3 with double-digit revenue growth. Q4 will be another strong quarter, as summer-centric products such as Glucon D and Nycil heat powder expected to get strong traction. Improving penetration of Complan, higher traction for Sugarfree and Glucon D with new products performing well and improved growth of Everyuth brand coupled with distribution enhancement will be key revenue drivers in the near term. Except for palm oil, other input prices have remained relatively benign. Synergistic benefits from the integration of Heinz acquisition and better revenue mix would help gross margins to remain stable in the coming quarters. ZWL's management targets OPM of close to 20% by FY2023.

■ Valuation – Retain Buy with an unchanged PT of Rs. 2,300

We have broadly maintained our earnings estimates for FY2021/FY2022/FY2023. With improving growth prospects in key brands and deleveraged balance sheet, ZWL is well poised to achieve an earnings CAGR of 28% over FY2020-FY2023 (with OPM inching close to 20% by FY2023). Health and immunity-boosting products will continue to get good traction and penetration levels will improve in the post pandemic era. The stock is currently trading at 40.7x/31.9x its FY2022/FY2023E EPS, which is at a discount to some of the large consumer goods stocks. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,300.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Dabur India	54.2	45.0	38.8	43.9	36.2	30.9	27.4	29.3	28.9
Zydus Wellness	56.9	40.7	31.9	36.5	32.3	25.8	6.1	6.7	7.8

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 has 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 its respective categories. Sugarfree brand has a ~94% market share in the artificial sweetener category, while Glucon-D has a ~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 increased 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.
- **Increased competition:** ZWL is facing stiff competition in skin care products such as face wash and scrubs from multinationals, which has affected 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

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

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