Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Zydus Wellness Ltd

Good Q1 boosted by summer sales; Market share gains continue

Consumer Goods	Sharekhan code: ZYDUSWELL
Reco/View: Buy ↔	CMP: **Rs. 1,611**
	Price Target: **Rs. 2,250** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

Company details

Market cap:	Rs. 10,251 cr
52-week high/low:	Rs. 2,473 / 1,431
NSE volume: (No of shares)	0.6 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	65.1
FII	2.7
DII	25.1
Others	7.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	2.3	-5.7	-6.5	-25.4
Relative to Sensex	-6.3	-6.6	-7.1	-34.7

Sharekhan Research, Bloomberg

Summary

- Zydus Wellness Limited's (Zydus) reported higher-than-expected Q1FY2023 performance. Revenue/ adjusted PAT grew by 16.6%/6.8% y-o-y. Volume growth stood at 10.3%. Margins down y-o-y due to sustained input cost inflation.
- Zydus gained/maintained market share/leadership position in most product categories. Focus is on sustained market share gains in key brands.
- Summer brands, Glucon D and Nycil, delivered strong double-digit growth after two years of lull. Management is targeting double-digit revenue growth over the next two years, aided by distribution expansion and product innovation.
- We maintain Buy with an unchanged PT of Rs. 2,250. The stock trades at 27.7x/20.0x its FY2023E/ FY2024E earnings, which is at a discount to some large peers.

Zydus Wellness Limited (Zydus) registered 16.6% y-o-y revenue growth in Q1FY2023. Volume growth stood at 10.3%. Two-year revenue CAGR came in at 13.9%. Double digit revenue growth can be attributable to strong double digit growth in two seasonal products Glucon-D and Nycil after two years of Lull. Five of the company's key brands maintained leadership positions in their respective categories as of June 2022. Gross margin and operating profit margin (OPM) declined by 112 bps and 224 bps y-o-y to 54.3% and 21.3%, respectively, impacted by sustained input cost inflation. Operating profit grew by 5.5% y-o-y. This coupled with lower interest expense led to 6.8% y-o-y growth in adjusted PAT to Rs. 140 crore. Exceptional item includes expenses incurred towards cessation of the Sitarganj facility. Reported PAT grew by 4.6% y-o-y to Rs. 137 crore.

Key positives

- 16.6% y-o-y revenue growth was driven by 10.3% volume growth.
- The five-pillar brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth Peel off – maintained leadership positions in their respective categories.
- Glucon-D, Everyuth (grew ahead of category growth), Nycil, and Nutralite brands delivered strong double-digit growth in Q1FY2023.
- Gross margin improved by 352 bps q-o-q.
- E-commerce contribution increased to 6.5% from 5.9% in Q1FY2022.

Key negatives

- Higher raw-material and packing material prices led to 112 bps/224 bps y-o-y contraction in gross margin/OPM.
- Sugarfree and Complan brand registered decline in sales during the quarter.

Management Commentary

- Zydus's summer product portfolio (Nycil and Glucon D) registered strong double-digit growth in Q1FY2023, led by revival in market demand, which was absent during the past two consecutive summers due to the pandemic. Growth was supported by aggressive brand campaigns and consumer activations, which drove demand.
- The company has maintained its leadership position and gained market share in some of the key categories. This along with increased penetration in modern trade/e-commerce channels would help the company to achieve double-digit revenue growth over the next two to three years.
- Management indicated that price hike strategy is different for different brands. In case of Glucon D and Nycil, which are seasonal brands, price hikes need to be taken in the peak season and Zydus has undertaken hikes in the summer season of 2022. The company undertook price hikes across brands in Q4FY2022, except in Complan, where the company did not take price hikes as competitors have actually reduced prices in the past few months.
- Management indicated that key raw materials witnessed a sequential decline in prices (except milk). If raw-material prices continue to cool off and if the product mix is favourable, the company expects margins to be maintained in the near term. The OPM in H2FY2023 will be higher on y-o-y basis.

Revision in estimates – We have broadly maintained our earnings estimates for FY2023 and FY2024 and will keenly monitor the performance in the quarters ahead before making any revision in estimates.

Our Call

View: Retain Buy with an unchanged PT of Rs. 2,250: Zydus is expected to post double-digit revenue growth over the next two years, aided by strong product portfolio, consumer-centric innovations, and higher marketing campaigns. The company maintained its leadership position in key categories in Q1FY2023 and continued to gain market share in its main categories. Further, the company will gain from distribution expansion and initiatives undertaken to improve supply chain in the coming years. The stock is currently trading at 27.7x/22.0x its FY2023E/FY2024E earnings, which is at a discount to some of the large FMCG peers. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 2,250.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	1,867	2,009	2,241	2,597
OPM (%)	18.4	17.2	18.4	19.3
Adjusted PAT	251	309	371	466
% YoY growth	34.9	23.1	20.0	25.6
Adjusted EPS (Rs.)	39.4	48.5	58.3	73.2
P/E (x)	40.9	33.2	27.7	22.0
P/B (x)	2.2	2.1	2.0	1.8
EV/EBITDA (x)	29.3	29.3	24.7	20.1
RoNW (%)	6.2	6.6	7.4	8.6
RoCE (%)	6.5	6.4	7.3	8.6

Source: Company; Sharekhan estimates

Stock Update

Result Update

Revenue growth at 17%; OPM down 224 bps y-o-y

Zydus reported revenue growth of 16.6% y-o-y and 13.9% on a two-year CAGR basis to Rs. 696.8 crore, backed by better penetration and market share gains. Volume growth for the quarter stood at 10.3%, aided by strong growth in summer season brands along with strong distribution and marketing efforts across brands. Five of the company's key brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth Peel off face mask maintained their leadership positions in their respective categories as of June 2022. Higher raw-material and packing material prices led to 112 bps/224 bps y-o-y contraction in gross margin/OPM to 54.3%/21.3%, respectively. Gross margin improved by 352 bps q-o-q, led by price increase, cost-improvement measures undertaken, and better product mix. Operating profit increased by 5.5% y-o-y to Rs. 148.1 crore. In line with increased operating profit, adjusted PAT grew by 6.8% y-o-y to Rs. 139.9 crore. Exceptional item includes expenses incurred towards cessation of the Sitarganj facility. Reported PAT grew by 4.6% y-o-y to Rs. 137 crore.

Leadership position and market share gains continued in Q1

Five of the company's brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth Peel Off facemask maintained their leadership positions in their respective categories as of June 2022. Sugarfree brand continued to maintain its leadership with a market share of 95.5%. Glucon-D has maintained its No. 1 position with a market share of 60.4% in the glucose powder category, an increase of 203 bps y-o-y. Complan had a market share of 4.8% in the health food (MFD) category. Nycil has maintained its No. 1 position with a market share of 34.2% in the prickly heat powder category with a volume market share of 37.6% (from 29.6% in 2018). Everyuth Scrub has maintained its No. 1 position with a market share of 41.8% in the facial scrub category, which is an increase of 511 bps y-o-y and Everyuth Peel off has maintained its number one position with a market share of 76% in the peel off category. Everyuth brand now has a market share of 6.6% in the overall facial cleansing segment.

Double-digit growth in Glucon-D led by product launches

Glucon-D witnessed double-digit growth in Q1FY2023, led by revival in market demand, which was absent during the past two consecutive summers due to the pandemic, and further supported by brand campaigns with celebrity Pankaj Tripathi and consumer activations. Glucon-D Immunovolt, continued to deliver steady business during the quarter. Zydus launched 20 gm sachet for Glucon-D in select markets to drive consumer consumption and a new variant of 'Kaccha Mango' in ImmunoVolt.

Muted performance of Complan

The brand's performance was impacted by continued slowdown in the health foods drink category compounded by downtrading to lower unit packs and lower-price pouches. Zydus focused on increasing play in sachet and pouches along with activations to drive distribution. This should help gradual recovery in the Complan sales in the coming years.

Sweeteners portfolio growth impacted by high base

The sweeteners portfolio did not see growth in Q1FY2023 because of high base of last year due to COVID wave, which led to high diabetic consumption. However, the brand witnessed healthy growth in distribution expanding to 4.97 lakh outlets. With focus on category development, the brand continued to promote Stevia-based Sugarfree Green variant. Management expects Sugarfree Green to be one of the key growth drivers for the brand and plans to build distribution to achieve growth.

Double-digit growth in Everyuth

Everyuth brand witnessed strong double-digit growth during the quarter, supported by TV and digital campaigns for its sub-segments such as face wash, scrubs, and peel-offs. Everyuth's reach has increased to 6.8 lakh outlets from 6 lakh outlets in Q1FY2022. Zydus is the category leader in the facial cleansing category, so the company is focusing on category development. Strong distribution and innovation will aid in further improving market share.

Good Q1 for Nycil

Nycil registered double-digit growth in Q1FY2023, aided by good onset of the summer season, which was further supported by aggressive TV campaigns and on-ground activation to drive demand. Nycil is now available in 1.67 million outlets across the country.

Nutralite focuses on Nutralite DoodhShakti dairy portfolio

The brand once again registered strong double-digit y-o-y growth in Q1FY2023. New launches – Nutralite Mayonnaise and chocolate spreads continued to scale-up well. Nutralite DoodhShakti dairy portfolio is also gaining good traction as Zydus expanded its presence of ghee in institutional channel through Nutralite DoodhShakti Professional range.

Key highlights of the conference call

- **Demand for summer products led to double-digit volume growth:** Zydus registered volume growth of 10.3% y-o-y in Q1FY2023, aided by strong demand for summer products and improved marketing campaigns. Management indicated rural markets delivered good growth during the quarter and that green shoots are visible in the form of better monsoon and higher welfare schemes by the government, which will lead to higher demand in the coming months.
- **Aims to maintain margins in the near term:** The company's key input materials witnessed double-digit increase in prices on a y-o-y basis, impacting gross margin. Gross margin fell by 112 bps y-o-y in Q1FY2023. Price of refined palm oil increased by 25% y-o-y, price of aspartame increased by 55% y-o-y, price of milk was up 20% y-o-y, while diesel prices increased by 5% y-o-y. However, some of the key input prices have witnessed correction in the recent times, which will reduce stress on the margins in the coming quarters. Gross margins improved by 342 bps q-o-q. Thus if raw material prices stabilise in the coming months, the OPM in H2FY2023 will be higher on y-o-y basis. the company has various strategies in place, which will help to mitigate the hit in gross margin. Strategies adopted by the company include calibrated price increases, cost-reduction programmes, control over discretionary spends, long-term supply contracts, and build-up of raw¬-material inventory at an opportune time. Overall the company is focusing on maintaining the OPM in FY2023.
- **Brand-wise strategy for price hikes:** Management indicated that price hike strategy is different for different brands. In case of Glucon D and I, which are seasonal brands, price hikes need to be taken in the peak season and Zydus has undertaken hikes in the summer season of 2022. The company undertook price hikes across brands in Q4FY2022, except in Complan, where the company did not take price hikes as competitors have actually reduced prices in the past few months.
- **Distribution reach to improve:** Management indicated that the company's current reach is at 2.5 million stores with mix of 50:50 in rural and urban. The company will continue to focus on expanding its distribution reach with an aim to enhance distribution to over 3 million stores and 1 million direct coverage over the next three years.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	y-o-y (%)	Q4FY22	q-o-q (%)
Net sales	**693.0**	**588.2**	**17.8**	**635.2**	**9.1**
Other operating income	3.8	9.4	-59.7	4.6	-17.6
Net Revenue	**696.8**	**597.6**	**16.6**	**639.8**	**8.9**
Material cost	318.6	266.5	19.5	314.4	1.3
Employee cost	45.1	43.0	4.9	40.1	12.5
Advertisement and Sales Promotion	96.2	69.3	38.9	64.8	48.3
Other expenditure	88.8	78.4	13.3	79.0	12.4
Total expenditure	**548.6**	**457.2**	**20.0**	**498.3**	**10.1**
Operating profit	**148.1**	**140.4**	**5.5**	**141.5**	**4.7**
Other Income	2.0	2.4	-18.4	2.0	-0.5
Interest Expense	4.1	6.2	-33.7	6.0	-30.8
Depreciation	6.0	5.6	8.1	6.1	-0.7
PBT	**139.9**	**131.0**	**6.8**	**131.4**	**6.5**
Tax	0.0	0.0	-	-1.9	-
Adjusted PAT	**139.9**	**131.0**	**6.8**	**133.3**	**5.0**
Exceptional item	-2.9	-	-	-	-
Reported PAT	**137.0**	**131.0**	**4.6**	**133.3**	**2.8**
Adjusted EPS (Rs.)	22.0	20.6	6.8	20.9	5.0
			bps		**bps**
GPM (%)	54.3	55.4	-112	50.9	342
OPM(%)	21.3	23.5	-224	22.1	-86
NPM (%)	20.1	21.9	-184	20.8	-75
Tax rate (%)	0.0	0.0		-1.4	

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Deflating commodity prices augur well; Good monsoon key for rural demand

High consumer inflation and slowdown in rural demand will keep pressure on sales volume in the near term. However, a normal monsoon, cool-off in commodity prices, and improved consumer sentiments will help volume growth to recover in H2FY2023. Margins of consumer goods companies are expected to be lower y-o-y in Q1FY2023 with raw-material prices remaining high during most of the quarter. However, the scenario has changed in the past 15-20 days with commodity prices cooling from their high, providing some breather for consumer goods companies. Companies are expected to see margin expansion from H2FY2023. Overall, we expect H2FY2023 to be much better compared to H1FY2023, with expected recovery in volume growth and likely margin expansion in Q3/Q4 FY2023. Low penetration levels in key categories (especially in rural India), lower per capita consumption compared to other countries, a large shift to branded products, and emergence of new channels such as e-commerce/D2C provide a number of opportunities for achieving sustainable growth in the medium to long run.

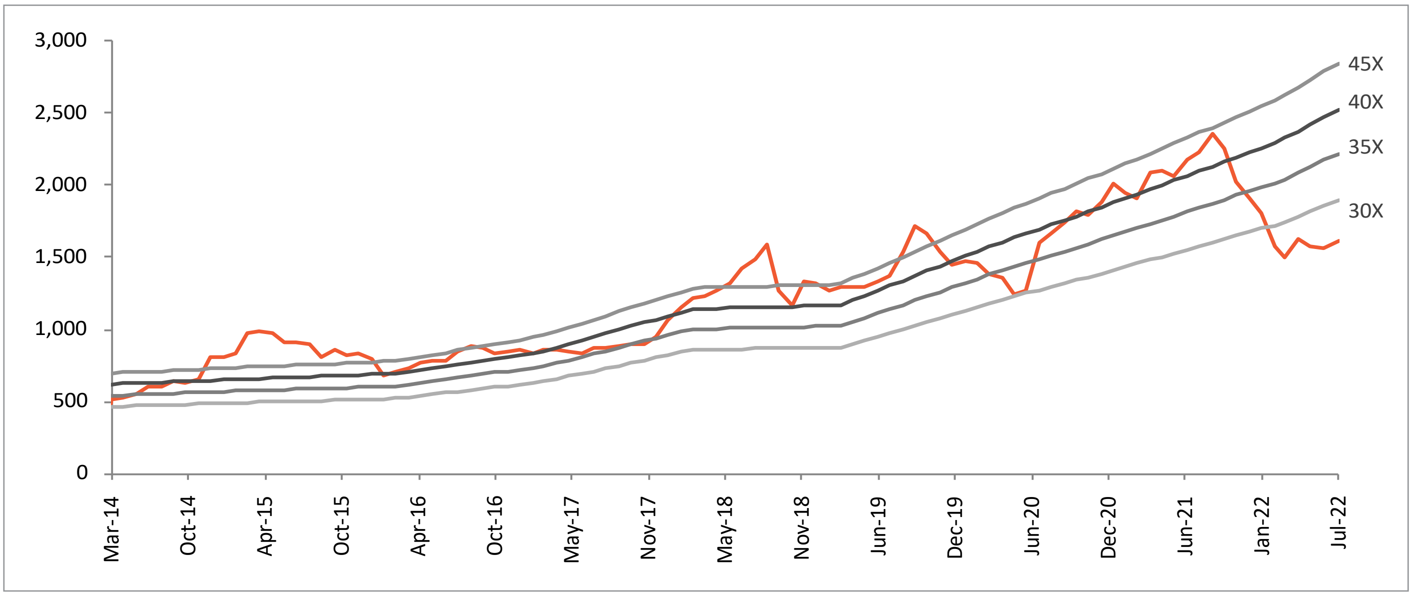
■ Company outlook - Strong growth ahead driven by multiple levers

The company banks on three pillars – accelerating growth of core brands, building international presence, and significantly growing scale – to drive growth in the medium term. Scale-up of the international business and some of the new launches reaching maturity will improve growth prospects in the long run. A better revenue mix and synergistic benefits from integration from Heinz's acquisition will drive profitability ahead. During FY2022-FY2024, we expect the company's revenue and PAT to post CAGRs of 13.7% and 22.8%, respectively. The company is targeting to become debt free over the next two years.

■ Valuation - Retain Buy with an unchanged PT Rs. 2,250

Zydus is expected to post double-digit revenue growth over the next two years, aided by strong product portfolio, consumer-centric innovations, and higher marketing campaigns. The company maintained its leadership position in key categories in Q1FY2023 and continued to gain market share in its main categories. Further, the company will gain from distribution expansion and initiatives undertaken to improve supply chain in the coming years. The stock is currently trading at 27.7x/22.0x its FY2023E/FY2024E earnings, which is at a discount to some of the large FMCG peers. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,250.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Dabur India	56.5	48.7	39.7	45.8	40.3	32.8	26.3	27.8	31.3
Zydus Wellness	33.2	27.7	22.0	29.3	24.7	20.1	6.4	7.3	8.6

Source: Company; Sharekhan Research

About company

Zydus 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 Sugarfree, Everyuth, and Nutralite and innovations offering new benefits to consumers. The company is the market leader in most of its product categories. With the acquisition of Heinz India, a subsidiary of Kraft Heinz in 2019, Zydus's product portfolio widened to include health food drinks and energy drinks. The acquisition of Heinz has also boosted the company's revenue trajectory to Rs. 2,000 crore in FY2022 from Rs. 500 crore in FY2018.

Investment theme

Zydus has a strong brand portfolio that leads its respective categories. Sugarfree brand has a ~96% market share in the artificial sweetener category, while Glucon-D has a ~58% market share. The acquisition of Heinz (completed three years ago) has enhanced the company's product portfolio and distribution reach. Over the past three years, despite losing sales due to COVID-19, the company has consolidated and grown market share across categories, launched multiple innovations, doubled its direct distribution reach, made significant strides in growing business ahead of the category in both online and offline organised trade, reduced cost, and simplified the organisation, leading to synergy benefits. Higher demand for wellness and nutrition-related products and increased in-home consumption in the pandemic situation would augur well for the company in the near term.

Key Risks

- **Macroeconomic slowdown:** Zydus is largely present in niche categories, which are discretionary in nature. Any slowdown in the macro environment would affect growth of these categories.
- **Increased competition:** Zydus 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	CEO
Umesh Parikh	Chief Financial Officer
Dhanraj P Dagar	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Threpsi LLP	11.35
2	ICICI Prudential Asset Management Co.	3.23
3	Life Insurance Corp of India	2.90
4	Nippon Life India Asset Management Company	2.02
5	Aditya Birla Sun Life AMC	1.73
6	Pioneer Investment FD MGMT	1.27
7	Vanguard Group Inc	1.15
8	SBI Funds Management Ltd	0.86
9	Matthews International Capital Management	0.52
10	Sundaram Asset Management Co Ltd	0.37

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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