23 September 2022

Zydus Wellness

Sweet and Healthy; initiating, with a Buy

Rating: **Buy**
Target Price: Rs.2,140
Share Price: Rs.1,603

Uniquely placed in FMCG with all its major brands in Health & Wellness (unlike many of its FMCG peers), Zydus Wellness' leadership in five of its six major brands, Rs50bn revenue target in five years and aiming to return to 20%+ EBITDA margins offer comfort on its growth focus. We initiate coverage on the stock with a Buy recommendation, at a TP of Rs.2,140 (30x Sep'24e EPS of Rs71.3) suggesting 33% potential from the CMP.

An array of strong brands in Health & Wellness. Five of its six major brands are leaders in their categories. They are positioned on Health & Wellness, with vast room for penetration-powered growth. This places Zydus in the enviable position of strengthening its portfolio through distribution expansions, brand extensions and innovations.

Targeting Rs50bn revenue in five years. Zydus Wellness targets Rs50bn (or 2.5x) revenue in five years, translating to a 20% revenue CAGR. To achieve this, it plans to broaden its direct reach to 1m outlets (from 0.6m now) and expand its innovation funnel, looking at small bolt-on acquisitions and driving ~8% revenue contribution internationally. We expect a 13.2% revenue CAGR over the next five years to Rs37.4bn, not factoring in any bolt-on acquisitions.

EBITDA margins to return to over 20% in the next 2-3 years. With input cost pressures abating, cost-efficiency measures and operating leverage should aid in EBITDA margin expansion. The Sitarganj plant closure would save Rs150m annually but entail one-time closure expenses in FY23. We expect margins to return to 20%+, at 20.3% in FY25.

Valuations. We ascribe 30x to Zydus Wellness on Sep'24e (vs. a 10-year average PE of 32x) to arrive at our Rs2,140 target price. At the present price, the stock trades at 28x FY23e EPS of Rs56.7 and 22x FY24e EPS of Rs74. **Key risks:** Failure of product launches, unwarranted or pricey bolt-on acquisitions, price-based competition.

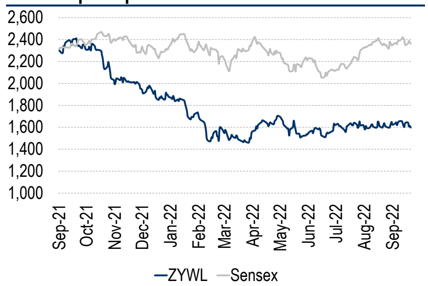
Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	17,668	18,667	20,091	22,926	26,027
Net profit (Rs m)	1,859	2,509	3,089	3,607	4,708
EPS (Rs)	32.2	39.4	48.5	56.7	74.0
P/E (x)	49.7	40.7	33.0	28.3	21.7
EV / EBITDA (x)	35.9	30.5	30.3	25.5	19.5
P / BV (x)	2.7	2.2	2.1	2.0	1.8
RoE (%)	5.4	5.5	6.4	6.9	8.3
RoCE (%)	7.1	6.8	6.6	7.2	8.7
Dividend yield (%)	0.3	0.3	0.3	0.3	0.4
Net debt / equity (x)	0.4	0.1	0.0	-0.0	-0.1

Source: Company, Anand Rathi Research *Note: Price on 22nd Sep.*

Key data	ZYWL IN / ZYDS.BO
52-week high / low	Rs2430 / 1430
Sensex / Nifty	59120 / 17630
3-m average volume	$1.4m
Market cap	Rs102bn / $1272.9m
Shares outstanding	64m

Shareholding pattern (%)	Jun'22	Mar'22	Dec'21
Promoters	65.1	64.8	64.8
- of which, Pledged	-	-	-
Free Float	59.7	59.7	59.7
- Foreign Institutions	2.4	2.6	3.4
- Domestic Institutions	25.1	25.1	24.8
- Public	7.4	7.5	7.0

Relative price performance



Source: Bloomberg

Ajay Thakur
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rsm)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Net revenues	17,668.2	18,666.7	20,091.0	22,926.0	26,026.7
Growth (%)	*110*	*6*	*8*	*14*	*14*
Direct costs	7,787.7	8,448.6	9,803.7	11,236.0	12,349.5
Gross profit	9,880.5	10,218.1	10,287.3	11,690.0	13,677.2
Gross margins %	*55.9*	*54.7*	*51.2*	*51.0*	*52.6*
Other expenses	6,670	6,775	6,862	7,729	8,701
EBITDA	**3,211**	**3,444**	**3,425**	**3,961**	**4,976**
EBITDA margins (%)	18.2	18.4	17.0	17.3	19.1
- Depreciation	264	252	236	263	290
Other income	107	89	127	105	180
Interest expenses	1,399	838	255	196	158
PBT	1,655	2,443	3,060	3,607	4,708
Effective tax rates (%)	(12.4)	(2.7)	(0.9)	-	-
+ Associates / (Minorities)	-	-	-	-	-
Net Income	1,859	2,509	3,089	3,607	4,708
WANS	58	64	64	64	64
FDEPS (Rs / sh)	32.2	39.4	48.5	56.7	74.0

Fig 2 – Balance sheet (Rsm)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	577	636	636	636	636
Net worth	34,607	45,678	48,440	52,015	56,685
Debt	15,192	5,498	3,815	3,315	2,315
Minority interest	-	-	-	-	-
TL / (Asset)	-1,208	-1,265	-1,298	-1,298	-1,298
Lease liabilities	-	-	-	-	-
Capital employed	**48,591**	**49,910**	**50,957**	**54,032**	**57,702**
Net tangible assets	2,047	1,996	2,445	2,932	3,441
Net intangible assets	5,488	5,478	5,455	5,455	5,455
Goodwill	39,200	39,200	39,200	39,200	39,200
CWIP (tang. & intang.)	35	37	119	150	175
Investments (strategic)	-	-	-	-	-
Investments (financial)	1,104	-	270	270	270
Current assets (excl. cash)	5,990	6,161	6,437	7,297	8,007
Cash	824	2,527	1,698	3,922	6,859
Current liabilities	6,098	5,489	4,667	5,193	5,705
Working capital	-108	672	1,770	2,104	2,302
Capital deployed	**48,591**	**49,910**	**50,957**	**54,032**	**57,702**

Fig 3 – Cash-flow statement (Rsm)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	1,213	1,122	3,060	3,607	4,708
+ Non-cash items	-1,626	-2,399	-413	-354	-268
Oper. prof. before WC	2,838	3,521	3,473	3,961	4,976
- Incr. / (decr.) in WC	-230	-656	-1,063	-333	-198
Others incl. taxes	16	-2	41	-	-
Operating cash-flow	2,593	2,867	2,369	3,628	4,778
- Capex (tang. + intang.)	-245	-175	-747	-781	-825
Free cash-flow	2,348	2,693	1,621	2,847	3,953
Acquisitions					
- Div. (incl. buyback & taxes)	694	2	319	32	38
+ Equity raised	-	9,866	-	-	-
+ Debt raised	-502	-11,014	-1,683	-500	-1,000
- Fin investments	-20	-3	-65	-	-
- Misc. (CFI + CFF)	1,347	946	244	91	-22
Net cash-flow	-176	599	-559	2,224	2,937

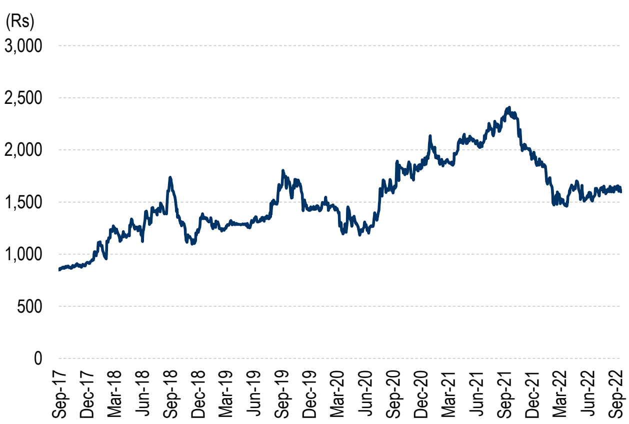
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	49.7	40.7	33.0	28.3	21.7
EV / EBITDA (x)	35.9	30.5	30.3	25.5	19.5
EV / Sales (x)	6.5	5.6	5.2	4.4	3.7
P/B (x)	2.7	2.2	2.1	2.0	1.8
RoE (%)	5.4	5.5	6.4	6.9	8.3
RoCE (%) - after tax	7.1	6.8	6.6	7.2	8.7
RoIC (%) - after tax	7.4	7.2	6.9	7.7	9.7
DPS (Rs / sh)	5.0	5.0	5.0	5.0	6.0
Dividend yield (%)	0.3	0.3	0.3	0.3	0.4
Dividend payout (%) - incl. DDT	15.5	12.7	10.3	8.8	8.1
Net debt / equity (x)	0.4	0.1	0.0	-0.0	-0.1
Receivables (days)	24.4	18.4	25.9	26.9	26.4
Inventory (days)	60.4	71.3	65.7	63.1	59.5
Payables (days)	104.2	85.8	66.2	64.4	62.3
CFO : PAT %	139.4	114.3	76.7	100.6	101.5

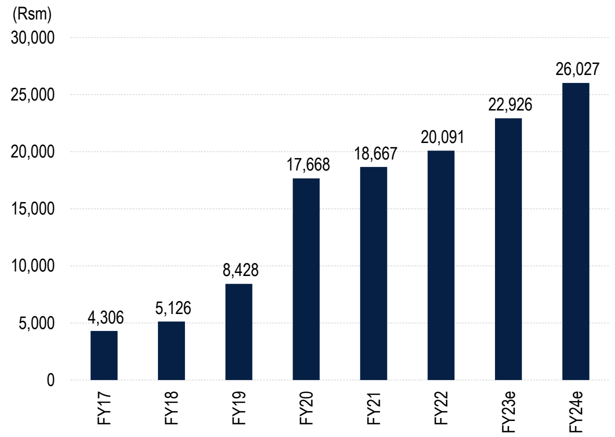
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue



Source: Company, Anand Rathi Research

Strong portfolio of brands

Zydus Wellness has a strong array of products, leading in five of its six major brands. Its brands lead in glucose powder, sugar substitutes, butter substitutes, prickly-heat powder and facial scrubs and peel-offs. In health-food drinks, it is No.5 but has a strong brand legacy which can be rebooted. Its brands are positioned on the health & wellness space with vast room for penetration-led growth. Thus, it is in an enviable position to further strengthen its portfolio through distribution expansion, brand extensions and innovations.

Fig 7 – Well diversified brand portfolio

	Glucon-D	Complan	SugarFree & Sugarlite	Nycil	Nutralite	Everyuth
Category	Glucose energy drink	Health-food drink	Sugar substitute	Prickly-heat powder & cooling talc	Butter substitute	Natural skin-care
Revenue (mix %) FY22	25	21	16	10	8	8
Variants	Three: Tangy Orange, Nimbu Pani, Regular	Four flavours: Classic, Kesar Badam, Kesar Pista, Chocolate	Sugar-free Gold (1988), Sugar-free Natura (2005), Sugar-free Green (2017), Sugarlite (2018)	Five: Classic, Neem & Pudina, Gulabjal, Chandan & Sandalwood, Menthol	Nutralite Margarine (B2B and retail), Nutralite Mayonnaise (2018) in Regular, Cheesy garlic, Tandoori, Achari flavour, Nutralite ChocoSpread (2020)	EverYuth Scrub, EverYuth Peel Off, EverYuth Facewash, EverYuth tan removal, EverYuth body lotion
Category size (Rs bn)	10	72	~4	8	Margarine: 5 Mayonnaise: 8	Facial cleansing: 28 Scrubs: 2.4 Peel-offs: 1
Growth rate %	10-13	6-8	7-9	10	Margarine: 10-12 Mayonnaise: 20	Scrubs: 6-8 Peel-offs: 12-15
Market position	No.1	No. 5	No.1	No.1	No.1 in B2B	No.1 in Scrubs & Peel-offs
Market share %	60	5	96	34	~45 in B2B	Overall 6 Scrubs: 39 Peel-offs: 76

Source: Company, Anand Rathi Research

SugarFree and Sugarlite

Source: Company

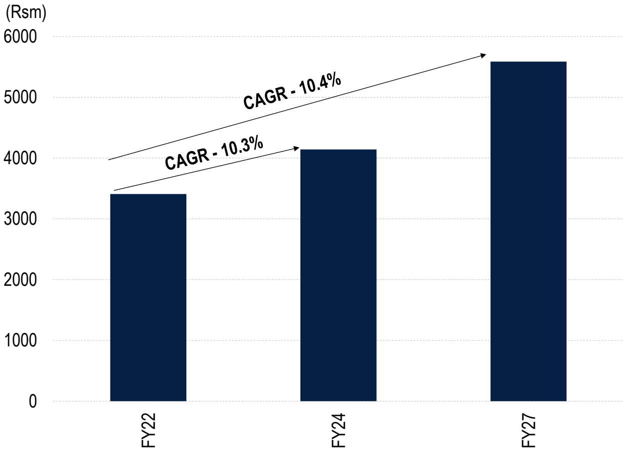
SugarFree and Sugarlite

With a 96% share in artificial sweeteners, SugarFree is a sugar substitute, coming in three sub-categories: SugarFree Gold (50% of SugarFree) in Aspartame, SugarFree Natura (40%) in sucrolose variants and SugarFree Green (~10%) in stevia-based variants. SugarFree caters to ~60m diabetics and India's health-conscious.

The company launched Sugarlite, blended sugar with 50% fewer calories for similar sweetness. It aims to replace sugar and prices Sugarlite at ~4x traditional sugar. Given its sweetness, however, the price would work out to twice that of sugar, says the company. Revenue form Sugarlite is now ~8% that from Sugarfree and doubling almost every year since its launch. Also, the company recently launched Sugarfree D'lite chocolates for the health-conscious and diabetics.

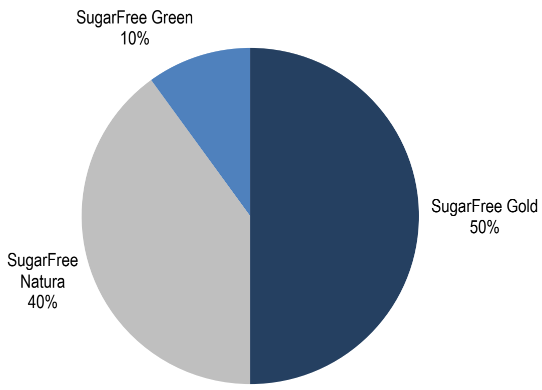
We project 10.3%/10.4% revenue CAGRs for SugarFree in the next 2/5years, led by faster growth (45%/36% CAGRs) in its Sugarlite portfolio.

Fig 8 – SugarFree: 10.3%/10.4% CAGRs in next 2/5 years



Source: Company, Anand Rathi Research

Fig 9 – SugarFree revenue by variants



Source: Company, Anand Rathi Research

Fig 10 – SugarFree pricing compared to competition

Variants / Brands	Manufacturer	Price (Rs)	No. of Tablets	Cost per tablet (Rs)
Aspartame				
SugarFree Gold	Zydus	190	300	0.63
Sweet n' Healthy	Wipro	270	300 + 300 free	0.45
Equal	Higher Health Sciences LLP	190	300	0.63
Sucralose				
SugarFree Natura	Zydus	190	300	0.63
Sweet n' Healthy	Wipro	285	300 + 300 free	0.48
Equal	Higher Health Sciences LLP	190	300	0.63
Stevia				
SugarFree Green	Zydus	215	300	0.7
Equal Stevia	Higher Health Sciences LLP	300	300	1.0
So Sweet Stevia	Herboveda India	360	300	1.2

Source: E-com retailers, Anand Rathi Research

Complan

Source: Company

Complan

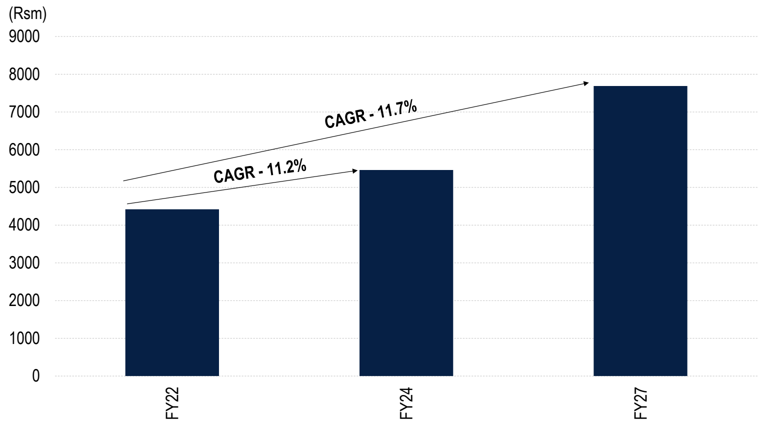
Complan is a 75-year old brand with over five decades in India, launched to address a 'complete planned' food need for children lacking good nutrition. It is available in four flavours: chocolate, kesar badam, creamy classic and pista badam.

It had a ~15% market share and placed second in health-food drinks (HFD) till FY14. A change in the formulation, the market shifting to sub-segmentation, an almost-flat category growth, price disruption by the leader and growth in low-priced units led to its loss of HFD market share to ~5% in recent years. The leader (HUL)'s action have impacted the category: launches of smaller packs and price competition in HFD. Hence, consumers are downgrading to lower-priced units.

Post-merger, Zydus has maintained ~8% market-share in large packs (1kg/ 500 gm) but has been losing share in low-price units (not focused on in the past). Now changing this stance, it has launched LUPs for appropriate intervention in the market. Looking at other sub-segments of HFD and to cater to growing sub-segmentation within HFD, in infant nutrition, the company had launched Complan Nutrigo. Ad campaigns focused on the higher protein content, to boost brand Complan

Thus, management hopes to regain some share in HFD in coming years. We project 11.2%/11.7% revenue CAGRs for Complan in the next 2/5years, aided by market-share gains and faster growth from launches (Nutrigo) and low-priced units.

Fig 11 – Complan, 11.2%/11.7% CAGRs over the next 2/5 years



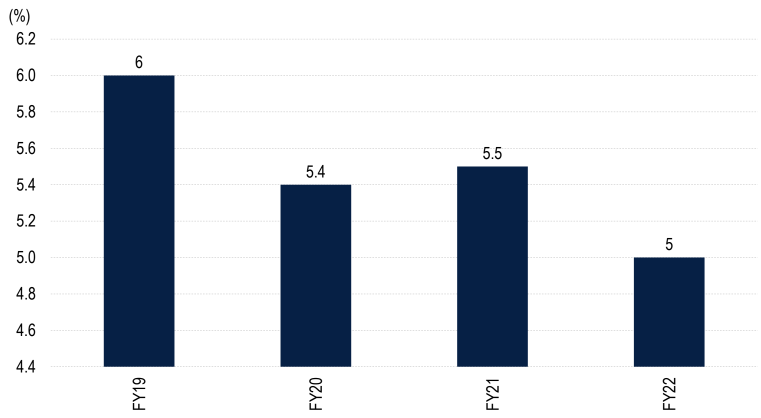
Source: Company, Anand Rathi Research

Fig 12 – Complan fares well in protein content vs. competition

Brands	Company	Price for 500g/400g packs (Rs)	Protein per 100g	Price per 100g (Rs)	Protein (g) per Rs100	Target Group
Complan	Zydus Wellness	305/500g	18g	61.0	29.5	Toddlers, kids
Bournvita	Mondelez	214/500g	7g	42.8	16.4	Toddlers, kids, women
Horlicks	HUL	245/500g	10g	49.0	20.4	Toddlers, kids
Horlicks Plus	HUL	599/400g	34g	149.8	22.7	Adults, mothers, women
Pediasure	Abbott	590/400g	14.1g	147.5	9.6	Toddlers, kids
Ensure	Abbott	680/400g	30g	170.0	17.6	Adults, diabetics
Protinex	Danone	540/400g	34g	135.0	25.2	Adults, mothers, diabetics

Source: E-com Retailers, Anand Rathi Research

Fig 13 – Complan lost market share for lack of LUPs, and sub-segment absence



Source: Company, Anand Rathi Research

Glucon D

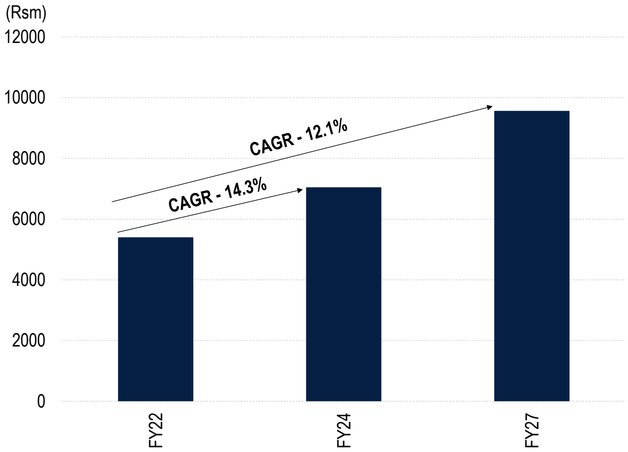
Source: Company

Glucon D

India's No.1 glucose brand of over 85 years, Glucon D is known for providing instant energy, Vitamin C and D. It is available in three flavour: regular, tangy orange and nimbu pani. Almost 75% of its brand revenue comes from its flavoured variants (vs. 25-30% for the competition). Flavoured variants have better margins than regular variants. During Covid-19, to build immunity the company launched Glucon D ImmunoVolt for kids, which continues to do well even now.

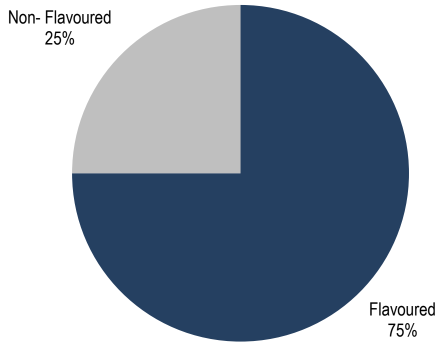
We forecast 14.3%/12.1% revenue CAGRs for Glucon D in the next 2/5 years, aided by market-share gains and summer/heat, driving health-linked higher offtake.

Fig 14 – Glucon-D, 14.3%/12.1% CAGRs over next 2/5 years



Source: Company, Anand Rathi Research

Fig 15 – Glucon-D: 75% of revenue from flavoured variants



Source: Company, Anand Rathi Research

Fig 16 – Glucon D pricing vs competition

Products	Price of regular variants (Rs)	Weight (gm)	Company	Flavours available	Packet size (gm)
Glucon - D	118	450 + 50	Zydus Wellness	Orange, nimbu pani, regular, mango, strawberry	100, 200, 450,1kg
Glucose - D	95	450 + 50	Dabur	Regular, orange, lemon	500, 250
Glucovita	100	500	Wipro	Orange, strawberry, regular	500, 1kg
Apollo Life Gulcose - D	95	500	Apollo Hospital	Orange, lemon	100, 500

Source: E-com Retailers, Anand Rathi Research

Nycil

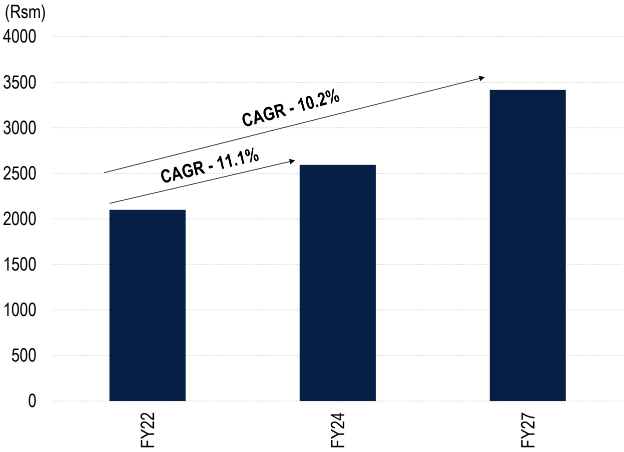
Source: Company

Nycil

Nycil is the No.1 brand in prickly heat & cooling powder, with ~34% market share. While Emami ranks No.1 with its Navratna and DermiCool put together. Nycil is available in five variants and boasts anti-germ & anti-bacteria properties. The company extended the brand into sanitisers and sanitising wipes during Covid times to leverage its anti-germ plank.

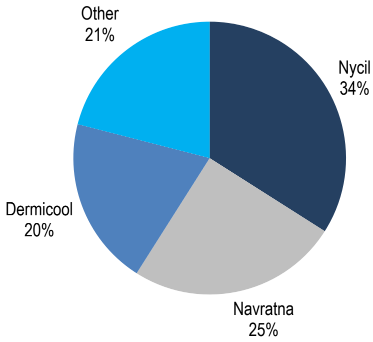
We project 11.1%/10.2% revenue CAGRs for Nycil in the next 2/5years, aided by market-share gains & summer/heat-led health-linked more offtake.

Fig 17 – Nycil, 11.1%/10.2% CAGRs over the next 2/5 years



Source: Company, Anand Rathi Research

Fig 18 – Nycil market share



Source: Company, Anand Rathi Research

Fig 19 – Nycil, competitively priced

Products	MRP (Rs.)	Weight (gm)	Company	Fragrances
Nycil	130	150	Zydus Wellness	Classic , Neem & Pudina, Gulabjal, Chandan & Sandalwood, Menthol
Dermicool	125	150	Emami (earlier Reckit Benckiser)	Mint Fresh, Active Deo, Floral Freeze
Navratna Cool Talc	95	100	Emami	Regular, Lavender, Sandal

Source: E-com Retailers, Anand Rathi Research

EverYuth

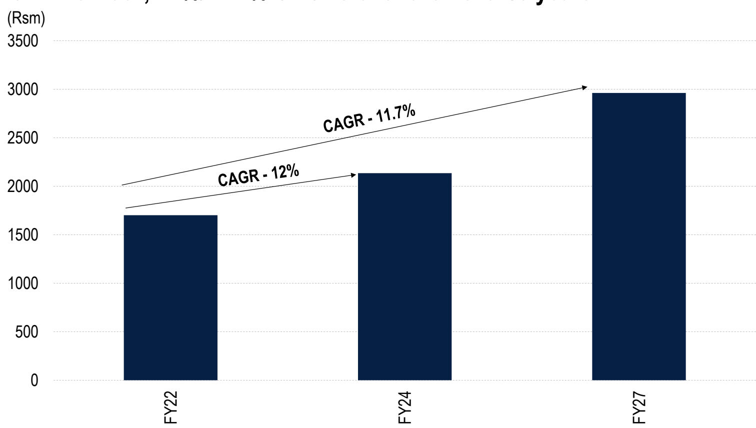
Source: Company

EverYuth

EverYuth was one of the first skincare brands in the country to come out with offerings of niche scrubs and peel-off facemasks. The company is a leader in both sub-segments, with small operations in the ~Rs24bn facewash market. Due to Covid-19, skin care was impacted in the last two years but growth is now reviving with the opening up of markets. Launches under EverYuth brands include a body lotions and tan-removal range, etc.

We forecast 12%/11.7% revenue CAGR for the EverYuth brand over the next 2/5years, aided by launches and brand extensions.

Fig 20 – EverYuth, 12%/11.7% CAGRs over the next 2/5 years



Source: Company, Anand Rathi Research

Fig 21 – EverYuth pricing vs. competition in the facial cleansing category

Segment / Brand	Company	Price (Rs)	Per unit cost (Rs/10 gm)	Market share
Scrubs				
EverYuth Scrub	Zydus Wellness	150/100gm	15	39% share in scrubs
Himalaya	Himalaya	135/100gm	13.5	
Peel-offs				
EverYuth Golden Glow	Zydus Wellness	80 /50 gm	16.0	76% share in peel-offs
EverYuth Orange	Zydus Wellness	130 / 90 gm	14.4	
Himalaya Tan removal Orange	Himalaya	135 / 100 gm	13.5	
Ponds Gold Beauty Peel off	HUL	299 / 80 gm	37.4	
Facial cleansing				
EverYuth Facewash	Zydus Wellness	99/100gm	9.9	~1% share in face-washes
Himalaya Neem facewash	Himalaya	135/100gm	13.5	
Ponds	HUL	175/100gm	17.5	

Source: E-com Retailers, Anand Rathi Research

Nutralite & Dairy portfolio

Source: Company

Nutralite and its dairy portfolio

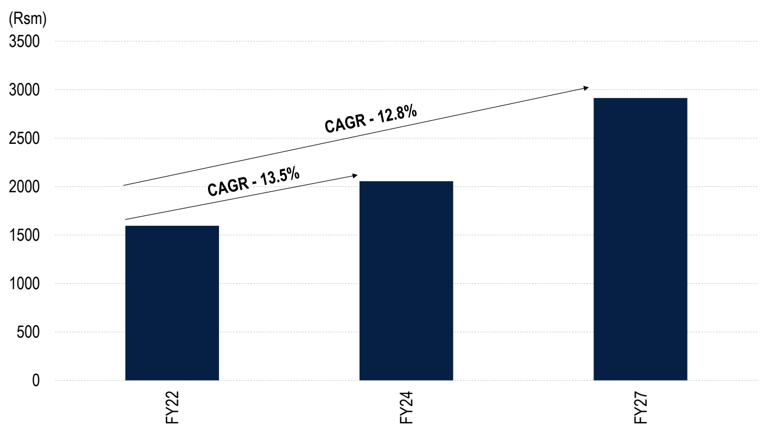
The company's dairy-based health offering, Nutralite, was originally a butter substitute, free of cholesterol and hydrogenated fats. It has now been extended to butter, spreads and ghee.

The table-spread (margarine) market is ~Rs5bn, more than two-thirds from institutions, the rest, retail. The butter substitute includes PUFA (poly-unsaturated fatty acids) and MUFA (mono-unsaturated fatty acids), known cholesterol fighters. The segment is faced with growth issues due to stiff competition between the dominant Nutralite and Amul's Lite and Delicious retail brands. Both these retail at a 10-60% discount to Nutralite, which retails at a strategic 15-30% discount to major butter brands.

In spreads, the chief competitors are Dr. Oetkars, AgroTech Foods and Hershey's, with prices differing based on flavours and variants. In butter, key competitors are Amul, Britannia and Mother Dairy with almost similar pricing. In ghee, key competitors are Amul, Patanjali and Parag Foods.

We are factoring in 13.5%/12.8% revenue CAGRs for the Nutralite brand in the next 2/5 years, driven by launches and brand extensions. Also, dairy products (~9% of revenue) are expected to clock 19.5%/18% CAGRs led by launches (ghee, butter) and the further scaling up of the B2B segment.

Fig 22 – Nutralite, 13.5%/12.8% CAGRs over the next 2/5 years



Source: Company, Anand Rathi Research

Fig 23 – Nutralite & dairy segment pricing, competitive

Segment / Brands	Company	Weight	Price (Rs)	Price/ Unit (Per 100 gm or 100ml)
Margarine				
Amul Lite	Amul	100g	52	52.0
Nutralite	Zydus Wellness	100g	50	50.0
Mayonnaise				
Nutralite	Zydus Wellness	1 Kg	198	19.8
Vebba	Veeba foods	1kg	299	29.9
Funfoods	Dr. Oetkar India	1.2 kg	265	22.1
Choco spread				
Nutralite	Zydus Wellness	275 gm	299	108.7
Nutella	Ferro India	380 gm	350	92.1
Hershey	Hershey's	295 gm	295	100.0
Pillsbury	General Mills	290 gm	290	100.0
Ghee				
Doodhshakti	Zydus Wellness	1L	558	55.8
Amul	Amul	1L	550	55.0
Patanjali	Patanjali	1L	625	62.5
Mother Diary	Mother Dairy	1L	525	52.5

Source: E-com Retailers, Anand Rathi Research

Aiming at relentless growth

Zydus Wellness intends to grow revenue 2.5x in the next five years to Rs50bn. Per management, this will be driven by three major thrust areas: (a) new product developments, (b) distribution expansion in India and abroad, and (c) bolt-on acquisitions.

A) Innovation & Renovation

Zydus Wellness is targeting 5-6% of revenue from new products developed (NPDs launched in the last 2-3 years) vs. 3% now. It has set up an R&D centre in Ahmedabad and plans to increase its R&D efforts to drive innovation-led growth. It is looking at launching differentiated products domestically and for export. Analytics and portfolio-gap assessment in the market will aid the company's R&D and manufacturing initiatives.

The company had as many as 10 launches in FY21, which was a Covid year and four in FY22. Of them, the mayonnaise and SugarFree D'lite chocolate range were well received.

Some of the launches and brand extensions in various segments are enumerated below.

Fig 24 – Recent launches

Product	FY21	FY22
Sugar Free	Sugar Free D'Lite Dark Chocolates 	Sugar Free D'lite Cookies & Chocolate Spread 
Everyuth	Everyuth Alovera Cucumber Gel 	Everyuth Body Lotion 
Nutralite	Nutralite Doodhshakti Ghee & Butter Spread Nutralite Choco Spread 	Nutralite Doodhshakti Professional 
Complan	Complan – Nutrigo 	Complan No Added Sugar (Variant) 
Nycil	Nycli Sanitizer & Wipes, Soothing Body Mist 	
Gulcon- D	Glucon – D ImmunoVolt & Immuno Fizz 	

Source: Company

B) Adding growth 'channels'

The company is focussing on three channels for growth: (a) direct reach, (b) expansion into e-com and modern trade and (c) growing international business

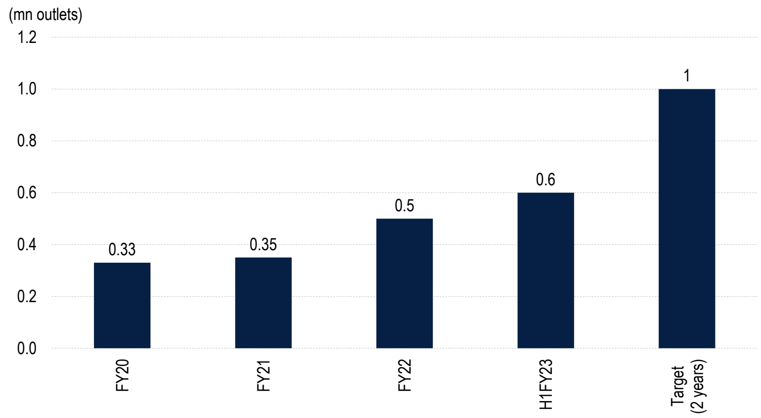
Growing direct reach and GtM strategy

Another area to boost revenue growth is through distribution expansion under the Go-to-Market (GtM) strategy. Currently, the company's direct reach is 0.6m outlets vs. 0.5m in FY22 and 0.35m in FY21. The company is looking to increase its direct reach to 1m outlets in the next 2-3 years. Further, it intends to increase its overall reach (direct + indirect) to 3m outlets vs. 2m currently.

The distribution is equally split between urban and rural markets, but rural revenue is ~30% vs. ~20% pre-acquisition. This could be attributed to urban-centricity of certain products such as SugarFree, Nutralite, etc.

Further, the company has undertaken several cost efficiency and automation initiatives such as (a) launching sales-force automation (SFA) to connect to the distributor management system (DMS), providing real time sales data to assist management to take decisions, (b) implement business analytics and predictive analytics to provide (i) price insights, (ii) customer insights, (iii) sales insights, and (iv) marketing insights and (c) implementing SAP Integrated Business Planning (IBP) for demand forecasting and planning to reduce costs associated with unused inventory at stores.

Fig 25 – Targeting direct distribution through 1m outlets



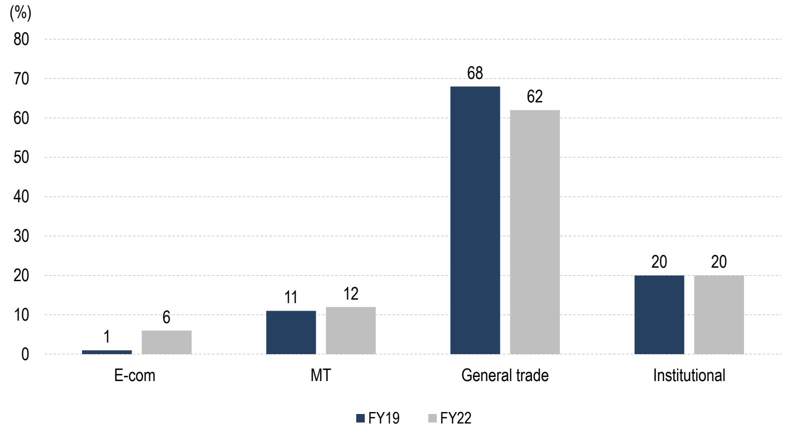
Source: Company, Anand Rathi Research

Rising share of e-commerce and modern trade

E-com and modern trade have grown robustly in recent years, led by the rising footprint of modern trade stores and convenience of online ordering.

The rise in footfalls (in modern trade) and in the channel mix (e-com is Rs1bn+ of revenue from less than 10m four years back) has led to the share of revenue from e-com+modern trade growing from 12% to 18% now. It is likely further rise to 25% over the next few years, as the company is looking to launch many e-com specific products.

Fig 26 – Rising share of e-com and modern trade in channel mix



Source: Company, Anand Rathi Research

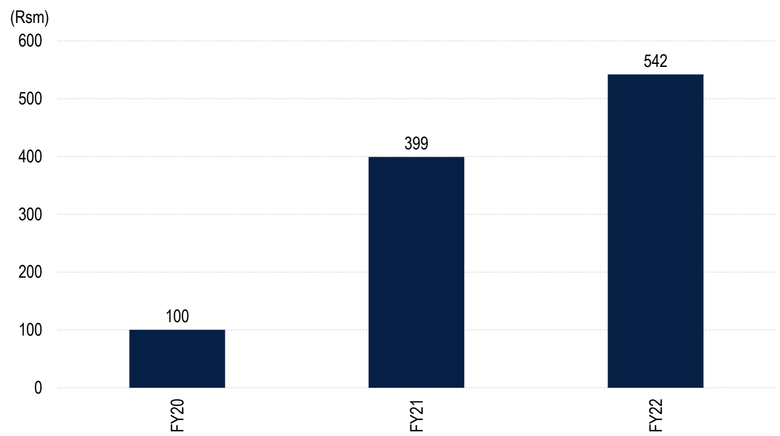
Growing international business

Zydus Wellness has operations in more than 25 international markets. Almost 80-85% of its international revenue arises from Complan and its SugarFree brand; the rest from other brands. Key international markets are the Mid-east, Africa (especially Nigeria), south-east Asia and SAARC nations.

The company's international EBITDA margin is lower than the company average owing to listing fees and additional costs associated with selling & distribution in global markets. Though it could be 4-5% lower, it is expected to converge to the company's average EBITDA margin with higher scale.

The company has increased its portfolio with the launch of Complan products in countries such as the UAE, Bahrain, Qatar, Mauritius Oman, Saudi Arabia and Kuwait, while Nutralite products were launched in Malaysia. The company plans to expand into new regions markets within south-east Asia, New Zealand and the Middle East and expand its portfolio.

Fig 27 – Rise in revenue of DMCC – Dubai-based export unit



Source: Company, Anand Rathi Research

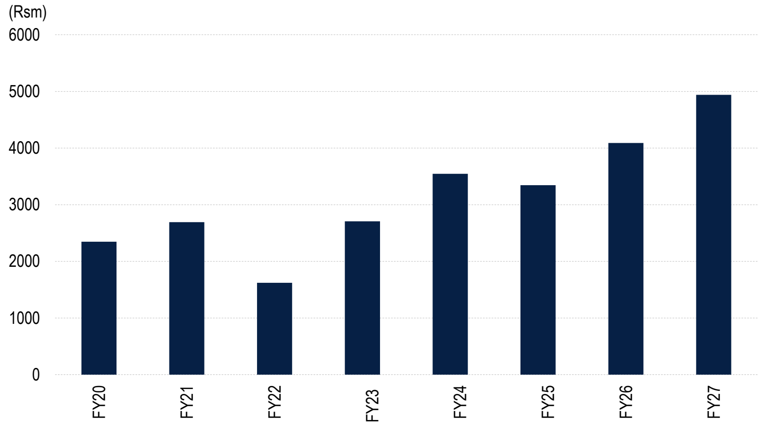
C) Bolt-on acquisitions could drive additional revenue

The Company intends to make acquisitions that complement its products and enter strategic relationships in future as part of its strategy in India and overseas as a means to expand operations, enhance its competitive position and capitalise on potential operational synergies. It has already demonstrated its successful integration of the Heinz acquisition, which has enabled it to accelerate the growth of its portfolio with the help of synergies of the combined entity.

Post debt-repayment, it will seek bolt-on acquisitions that can fill in the product gaps in its health-and-wellness portfolio.

We expect FCF generation of Rs18.6bn over the next five years. Post re-paying debt, we expect ~Rs15bn cash to be available for bolt-on acquisitions, which implies Rs3bn-5bn revenue of the acquisition (based on a 3-5x sales multiple). We haven't factored in any bolt-on acquisition in our numbers currently. But our back-of-the-envelope calculation suggests Rs3bn-7bn revenue potential from bolt on acquisitions, based on timing and valuations.

Fig 28 – Free cash-flow generation of Rs18.6bn likely over the next five years



Source: Company, Anand Rathi Research

Synergies of the Heinz acquisition

Zydus Wellness acquired the Heinz India portfolio from Kraft Heinz in FY19 for ~Rs46 bn. The deal included three major retail brands (Complan, Glucon D and Nycil) and two manufacturing units (Aligarh, UP, and Sitarganj, Uttarakhand), and 800 distributors reaching 0.25m retail outlets directly. Heinz India had Rs11.8bn revenue with a ~10% EBITDA margin in FY18 (~19% adjusted). The deal was funded via debt and equity.

Fig 29 – Zydus Wellness (FY18)

(Rs m)	FY18
Revenue (Rs m)	5,126
EBITDA (%)	24.4%
Gross Block (Rs m)	1,544
Manufacturing (3 Units)	1 Ahmedabad (Gujarat), 2 Mamring (Sikkim)
Distributor	1000+
Retail Outlets (m)	0.82
Key Brands	

Source: Company, Anand Rathi Research

Fig 30 – Heinz India (FY18)

(Rs m)	FY18
Revenue (Rs m)	11,840
EBITDA (%)	10.1% (~19% on adjusted basis)
Gross Block (Rs m)	1,806
Manufacturing (2 Units)	Aligarh (Uttar Pradesh), Sitarganj (Uttarkhand)
Distribution	800+
Retail outlet (mn)	1.5
Key Brands	

Source: Company, Anand Rathi Research

Thus, the combined entity had six major retail brands, five being leaders in their categories. Revenue rose to Rs17.7bn in FY22 and EBITDA to Rs3.4bn. Excl. overlaps, the company had a combined direct reach of 0.33m outlets at acquisition, which has increased to 0.6m now.

Fig 31 – Zydus Wellness (FY- 22)

Rs m)	FY22
Revenue	17,668
EBITDA margin	17%
Gross block	49,188
Manufacturing plants	Ahmedabad (Gujarat), two, Mamring (Sikkim), Aligarh (Uttar Pradesh), Sitarganj (Uttarkhand)
Distributor	800+ (rationalised distributors for better RoI)
Feet-on-the-Street	2000+
Key Brands	

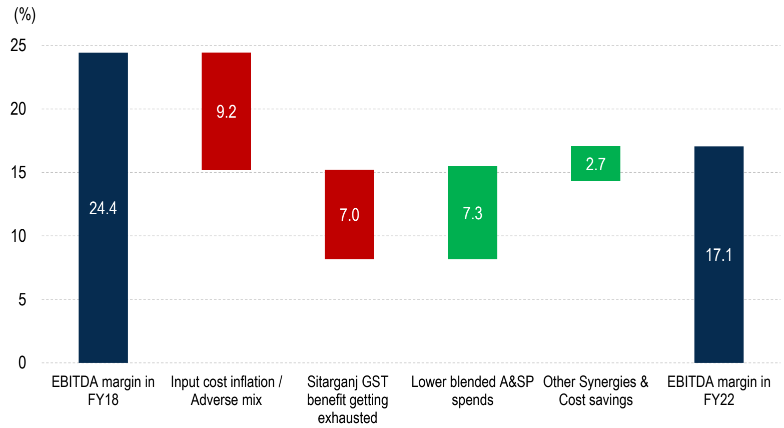
Source: Company, Anand Rathi Research

Zydus Wellness benefited by Rs800m from the synergies of the Heinz acquisition vs. Rs400m initially anticipated. Synergies have been driven by (a) increasing throughput in trade by adding complementary general trade to the existing pharmacy distribution, (b) rationalisation of various positions in the combined entity driving reduction in employees from 1,250 to 1,070 (~15% reduction), (c) implementation of SAP and analytics software to integrate the Heinz acquisition, driving efficiency and demand planning and (d) optimised supply chain by reducing warehouses, consolidating CFAs and reducing distributors (to 800 from the combined entity's 1,600) and rationalising margins from 7.2% earlier to 6% for the combined entity now.

Expect EBITDA margins to return over 20%

Zydus Wellness EBITDA margin fell from 24% in FY18 to 17% in FY22, driven by steep rises in input cost, exhaustion of GST benefit at its Sitarganj unit (impact of Rs280m effective Dec'19) and an adverse mix with the rise of the share of its dairy portfolio.

Fig 32 – EBITDA margin change and its constituents



Source: Company, Anand Rathi Research

However, management is confident of getting back its EBITDA margin to over 20%, led by cost controls, synergies, closure of the Sitarganj unit (saving Rs150m annually), recent price hikes and some falls in input costs. Automation and cost-saving measures (DMS, SFA, etc.) have led to better demand planning and reduced costs. Through-put post introduction of DMS increased to Rs350 an order vs. Rs200 earlier. We project a 19.1% EBITDA margin for FY24 vs. 17% in FY22.

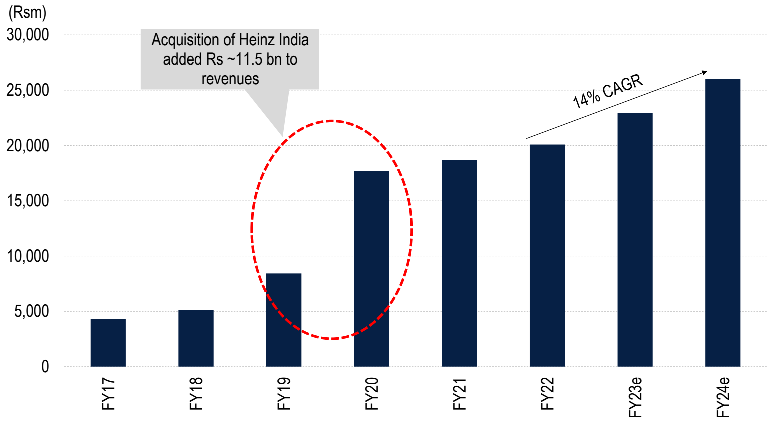
Financials

Expecting a 14% revenue CAGR in the next two years

We expect a steady 12.2% CAGR in the domestic business in the next five years, propelled by launches, distribution expansion and market-share gains. Further, its international business would record a ~40% CAGR, driving its revenue contribution to 7.4% by FY27. Thus, we expect overall revenue of Rs37bn, a 13.3% revenue CAGR, not factoring in potential from bolt-on acquisitions. We project a 14% CAGR in the next two years to Rs25.8bn.

We have not factored in bolt-on acquisitions, which could add Rs3bn-7bn revenue (totalling to Rs4bn-4.4bn), nearer the company's target of Rs5bn in five years. We believe the target is achievable with hot summers (benefits of its summer-centric products) and better-than-anticipated execution, driving strong market-share gains in its range of brands.

Fig 33 – Revenue to register a 14% CAGR over the next two years

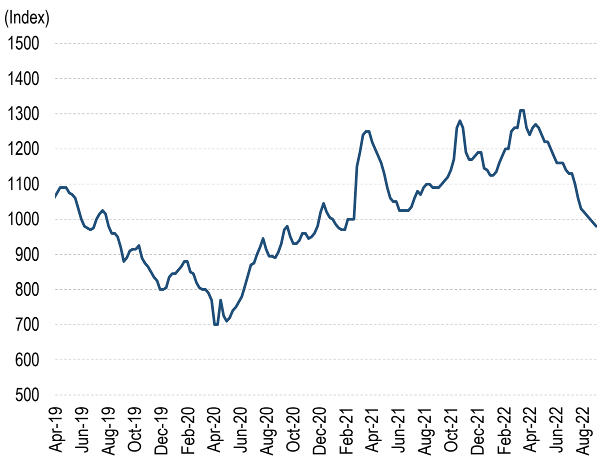


Source: Company, Anand Rathi Research

Expect EBITDA margins to return to over 20%

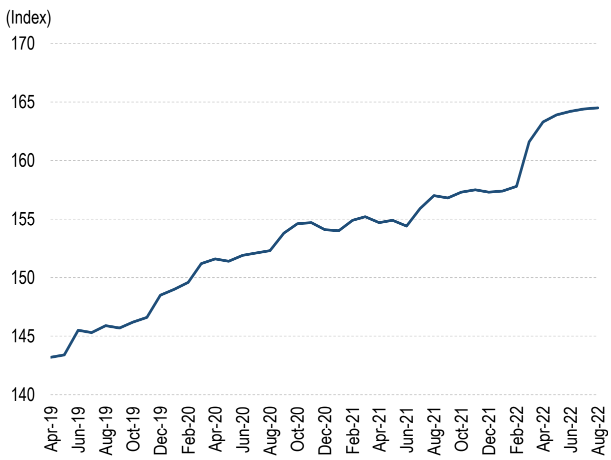
The EBITDA margin, post-acquisition, fell from 24.4% in FY28 to ~17% now due to the steep rise in input costs, exhaustion of GST benefits for its Sitarganj unit (a Rs280m impact effective Dec'19) and an adverse mix from a rise in the share of its dairy range. Prices of some inputs such as milk have risen ~50% from the time of the Heinz India portfolio acquisition. Similarly, prices of other inputs have steeply increased.

Fig 34 – HDPE prices have fallen recently, after a sharp rise



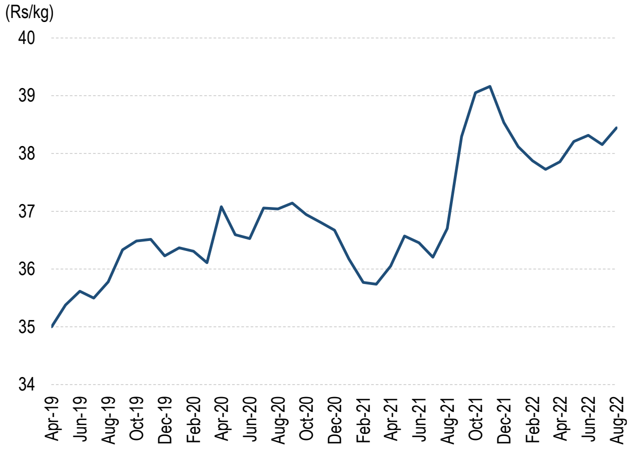
Source: Bloomberg, Anand Rathi Research

Fig 35 – Milk prices have risen ~50% in last three years



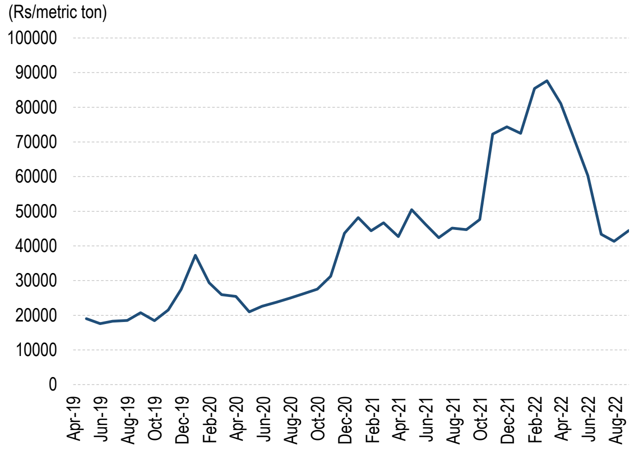
Source: Ministry of Consumer Affairs, Office of Economic Advisor, Anand Rathi Research

Fig 36 – Sugar prices have been steady in the last 3 years



Source: Ministry of Consumer Affairs, Office of Economic Advisor, Anand Rathi Research

Fig 37 – Palm oil price have fallen sharply after a flare-up

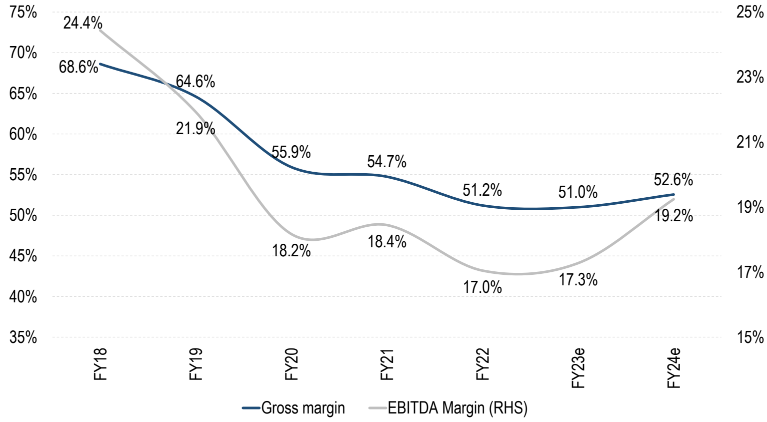


Source: Bloomberg, Anand Rathi Research

The company hiked prices 7.5% in the last few quarters to partially offset high input costs. Further, the recent fall in palm oil prices & packaging costs (20-40% from the peak) could reduce gross margin pressure in coming quarters. Also, cost efficiencies and the closure of the Sitarganj unit (saving Rs150m annually) would aid margin betterment in coming quarters. We expect margins to return to 20%+, at 20.3% in FY25.

Thus, EBITDA would clock a 21%/19% CAGR over the next 2/5 years.

Fig 38 – Gross and EBITDA margins to improve by FY24

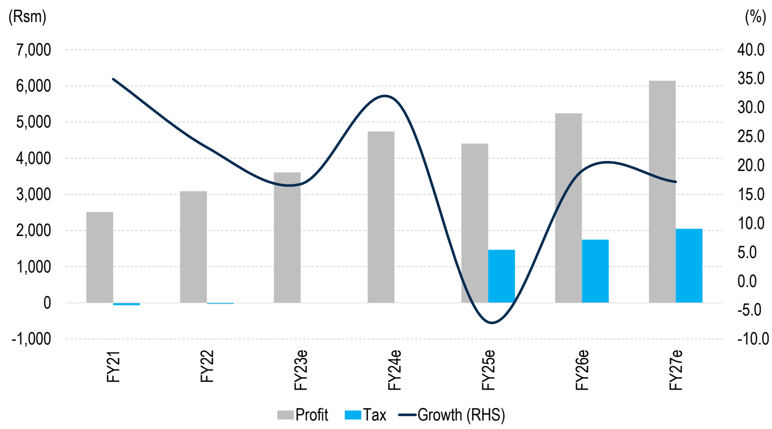


Source: Company, Anand Rathi Research

Profit growth at a strong 23% CAGR in the next two years

We project 23% profit growth in the next two years, aided by margin gains and lower interest costs. For five years, we expect a 15% profit CAGR, on expiration of tax benefits from FY25. The company guided to a ~25% tax rate from FY25. PBT, however, would clock a 22% CAGR in the next five years.

Fig 39 – 21%/15% profit CAGRs expected over the next 2/5 years

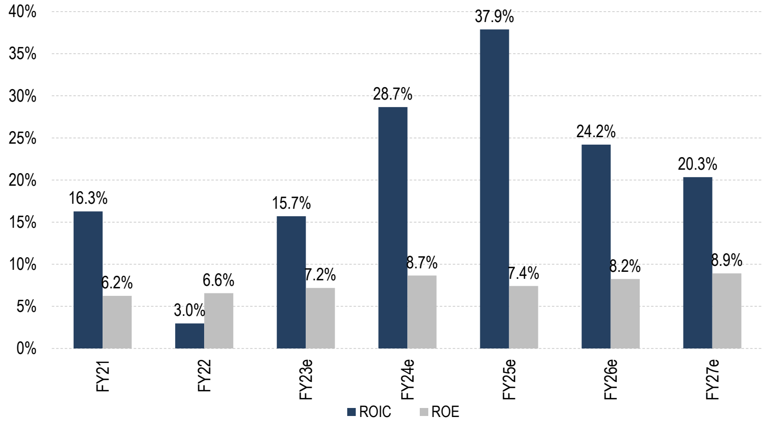


Source: Company, Anand Rathi Research

Return on added investment to average ~25% in five years

Zydus' return ratios declined sharply, from 20-23% pre-acquisition to 6-7% now. Addition of acquisition goodwill and subsequent dilution of equity have been major factors depressing the return ratios. While we expect minor improvements in the return ratios to 8-9% in the next two years, it is unlikely to expand notably until profitability rises considerably. However, a 22%/25% RoIIC average in the next 2/5 years reflects the healthy added returns potential, apparently depressed by the acquisition goodwill.

Fig 40 – RoIIC likely to average ~25%, suggesting healthy added returns



Source: Company, Anand Rathi Research

Valuation

Uniquely placed in FMCG, all Zydus Wellness' brands are positioned in Health & Wellness, unlike many of its peers, which have only a fraction of their portfolio in the space (Dabur has ~40% of its portfolio positioned on the health platform, Emami has ~55% and HUL 35-40%). The headroom for growth in many of these segments is vast. The company's leadership in five of its six major brands offers strong growth assurance.

Management's effort to strengthen the sales force and automate it should aid not just in scaling up revenue but also in focusing on profitability and efficiency. We expect the company's margins to improve and return to 20%+, aided by drops in prices of a few raw materials, savings due to the closed Sitarganj unit (Rs150m annually) and other cost-efficiencies.

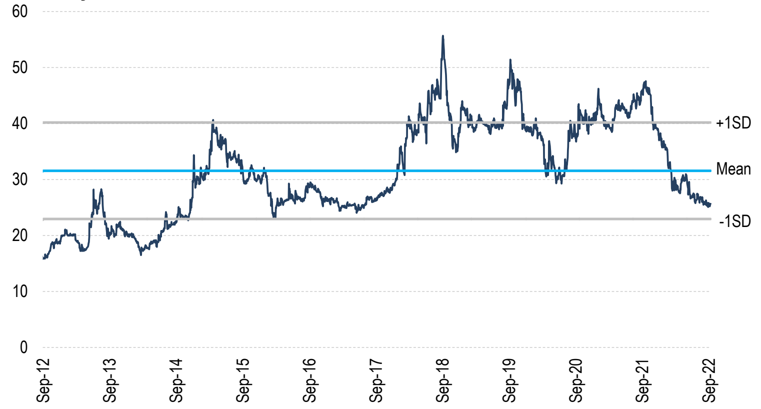
Post-Covid'19, investor interest has shifted from health-focussed consumer plays, driving a sharp fall in Zydus Wellness and de-rating it. The stock trades at a ~20% discount to its 10-year average PE and 25-30% to its mid-cap peers. With management's ambitious growth targets, healthy earnings outlook and attractive valuations, we recommend a Buy at a TP of Rs2,140 (30x Sep'24e EPS of Rs71.3) suggesting 33% potential. At the ruling price, the stock quotes at 28x FY23e EPS of Rs56.7 and 22x FY24e EPS of Rs74.

Fig 41 – Peer Comparison

	CMP	Market	EV	EPS (Rs)			EPS CAGR %	P/E (x)			EV / EBITDA (x)			RoE (%)	D/E (x) (net)
Companies	(Rs)	Cap (Rsm)	(Rsm)	FY22	FY23e	FY24e	(FY22-24e)	FY22	FY23e	FY24e	FY22	FY23e	FY24e	FY22	FY22
HUL	2,693	6,326,862	6,263,902	37.8	41.9	49.0	13.8	71.3	64.3	55.0	48.7	44.7	38.9	18.4	-0.1
ITC	345	4,277,111	4,114,082	12.4	14.2	15.8	12.8	27.9	24.3	21.9	19.9	17.8	16.1	24.8	-0.3
Nestle	18,638	1,797,025	1,789,795	222.5	249.9	300.6	16.2	83.8	74.6	62.0	49.8	40.5	36.0	104.5	-0.3
Dabur	576	1,019,916	1,016,469	9.8	11.2	13.1	15.2	58.5	51.4	44.1	45.1	41.7	36.0	21.7	0.0
Britannia	3,826	921,550	936,451	63.3	70.9	86.4	16.8	60.4	53.9	44.3	42.5	38.1	32.0	49.9	0.6
Marico	549	710,406	703,566	9.5	10.9	12.8	16.0	57.8	50.6	43.0	41.9	36.4	31.2	37.2	-0.2
Godrej Consumer	907	927,223	924,898	17.4	18.7	22.8	14.4	52.0	48.4	39.7	38.6	34.8	29.2	17.0	0.0
Emami	506	223,892	225,129	13.5	17.0	19.8	21.2	37.5	29.7	25.5	21.5	22.5	19.6	43.7	0.1
Colgate	1,595	433,858	427,439	39.7	40.3	44.7	6.2	40.2	39.6	35.7	27.3	26.4	24.1	74.4	-0.4
Zydus Wellness	**1,603**	**102,002**	**101,257**	**48.5**	**56.7**	**74.0**	**23.4**	**33.0**	**28.3**	**21.7**	**30.3**	**25.5**	**19.5**	**6.6**	**0.0**
Jyothy Labs	185	67,989	67,207	4.4	5.5	7.4	29.5	42.0	33.5	25.0	27.1	22.9	17.8	11.3	0.0

*Source: Bloomberg, Anand Rathi Research *Note: Price on 22nd Sep. Barring Zydus Wellness, all other estimates are Bloomberg consensus*

Fig 42 – One-year-forward PE



Source: ACE, Bloomberg, Anand Rathi Research

Risks

- Failure of brand launches
- Unwarranted or overpriced bolt-on acquisition
- Price-based competition in any of its key products
- Stringent regulations in artificial sweeteners or in the nutrition-based healthcare category.

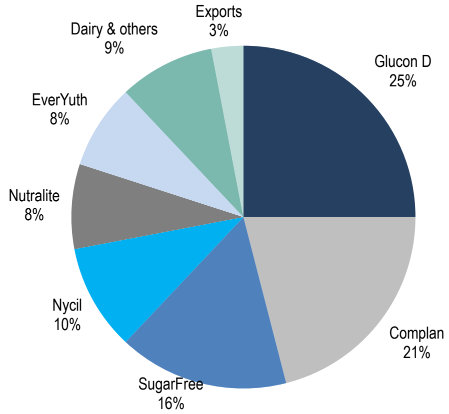
Company & Management

The leading consumer wellness product company, incorporated as Carnation Nutra Analogue Foods in 1988, was acquired in 2006 by the Zydus Group, which brought out the SugarFree and EverYuth brands, establishing Zydus Wellness in 2009.

After the acquisition of Heinz India in FY19, it added three major consumer brands, Glucon-D, Complan and Nycil to its health & wellness brands, SugarFree, EverYuth and Nutralite.

Headquartered in Ahmedabad, it has five manufacturing plants at four places, Aligarh, Sitarganj, Ahmedabad and Sikkim, and co-packing facilities in India, Oman and New Zealand. Its business spans 25 countries across three continents

Fig 43 – Zydus Wellness portfolio break-up (FY22 revenue: Rs20bn)



Source : Company, Anand Rathi research

Fig 44 – Major milestones

Year	Milestones
2021	Re-launched Complan with enhanced proposition & improved taste, and Nutralite Professional Range, Nutralite Doodhshakti Butter and Ghee and Everyuth Body Lotion range
2020	Nine product launches despite the pandemic. Capital restructuring (QIP and preferential issue of Rs10bn) and repurchasing NCDs of Rs15bn
2019	Acquired Heinz India Pvt. Ltd; merged & integrated it with Zydus Wellness Products
2018	Launched Everyuth Tan Removal range, Nutralite Mayonnaise and SugarLite
2017	Launched SugarFree Green with Stevia & production facility in Sikkim – Unit-II
2011	New production facility in Sikkim – Unit-I
2009	SugarFree & Everyuth hived off from Zydus Lifesciences to form Zydus Wellness; listed on the NSE
2006	Acquisition of Carnation Nutra (CNAFL)
2005	Launched SugarFree Natura with Sucralose
1991	Launched Everyuth skin-care range
1988	Launched SugarFree with Aspartame

Source: Company, Anand Rathi Research

Management & Board of Directors

The third generation of the promoter family, chairman and non-executive director **Dr. Sharvil Patel** heads one of the India's largest drug companies, Zydus LifeScience (formerly Cadila Healthcare). After a bachelor's degree in chemical and pharmaceutical sciences from the University of Sunderland, UK, and a doctorate in philosophy from the same university for his research work, he has had more than two decades' experience in the pharmaceutical sector.

Appointed chief operating officer in Mar’15, **Tarun Arora** was elevated to CEO in 2019 and is now a whole-time director. He has a bachelor’s degree in science from the University of Delhi and a post-graduate diploma in business management from IMT, Ghaziabad. He has had more than two decades’ experience in FMCG and was associated with Danone Waters, India; Wipro, Godrej Sara Lee and Bharti Retail in various roles in sales, marketing and leadership.

Fig 45 – Board of Directors & their skillsets

Sr. No.	Name of Directors	Designation	Experience (yrs)	Education	Skills
1	Dr. Sharvil. P. Patel	Non-executive chairman	21	University of Sunderland & Johns Hopkins University School of Medicine	Knowledge and expertise in pharmaceuticals and fast-moving consumer goods, manufacturing, marketing, business and management.
2	Tarun Arora	Chief executive officer & Whole-time director	23	Delhi University, IMT Ghaziabad	Knowledge and expertise in finance, manufacturing, marketing, business and management in FMCG
3	Kulin S. Lalbhai	Independent director	16	MBA - Harvard Business School, Bachelors in electrical engineering	Knowledge and expertise in finance, business and management in FMCG and consumer business.
4	Srivishnu R. Nandyala	Independent director	18	Osmania University	Knowledge and expertise in manufacturing, marketing, business and management.
5	Dharmishtaben N. Raval	Independent director	35	B.Sc. and masters in legislative law	Knowledge and expertise in law
6	Ashish P. Bhargava	Nominee director	20	SP Jain Institute of Management & Research, IIT, Delhi	Knowledge and expertise in finance, marketing, business and management.
7	Ganesh N. Nayak	Non-executive director	41	Bachelor’s & MBA, Newport University	Knowledge and expertise in pharmaceuticals and FMCG, manufacturing, marketing, business and management.
8	Savyasachi S. Sengupta	Independent director	35	India Institute of Management, Ahmedabad	Knowledge and expertise in manufacturing, marketing, business and management.

Source: Company, Anand Rathi Research

Fig 46 – Board Composition

	(No.s)
Board size	8
Non-independent directors	4
Independent directors	4
Gender diversity	
Women %	12.5
Men %	87.5
Average age (years)	54
Average board tenure (years)	7
Average tenure - Independent directors (years)	4
Number of Board meetings	4
Board attendance %	96.8
Number of committee meetings	31
Committee attendance %	92.9
Age Diversity %	
30-39 years	12.5
40-49	25.0
50-59	25.0
60-69	37.5
Board chairperson	Non-executive director
Separate roles of chairperson & MD	Yes
Lead independent director	Under consideration
Board evaluation	Annually
Board re-election	
Independent directors	Fixed term of five years (up to two terms)

Source: Company, Anand Rathi Research

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	**Hold**	**Sell**
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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