Sharekhan by BNP PARIBAS

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Zydus Wellness Ltd

Mixed Q2; Market share gains continue

Consumer Goods	Sharekhan code: ZYDUSWELL

Reco/View: Buy	↔	CMP: Rs. 1,643	Price Target: Rs. 1,975	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

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		↔	

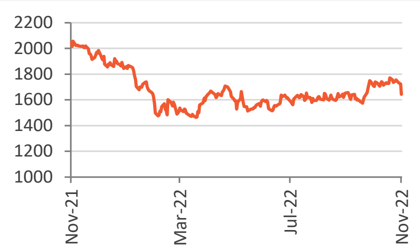
Company details

Market cap:	Rs. 10,452 cr
52-week high/low:	Rs. 2,091 / 1,431
NSE volume: (No of shares)	0.5 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	65.4
FII	3.6
DII	23.8
Others	7.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.6	2.3	7.5	-19.8
Relative to Sensex	-9.7	0.4	-7.0	-20.3

Sharekhan Research, Bloomberg

Summary

- Zydus Wellness Limited (Zydus) delivered mixed performance in Q2FY2023 with 12% y-o-y revenue growth, while PAT declined by 61% y-o-y. Key brands including Glucon-D, Everyuth, Nycil, and Nutralite recorded double-digit growth.
- Gross margin/OPM are down 491/417 bps y-o-y due to sustained input cost inflation, unfavourable product mix, weakening currency, and higher other expenses.
- Zydus gained/maintained market share/leadership position in most product categories. The company's focus is on sustained market share gains in key brands aided by distribution expansion and product innovation.
- The stock has corrected by 20% in the past year and is trading at 35.8x/25.6x its FY2023E/FY2024E earnings. We maintain our Buy recommendation on the stock with a revised PT of Rs. 1,975.

Zydus Wellness Limited (Zydus) registered 11.9% y-o-y revenue growth in Q2FY2023 to Rs. 429.5 crore. Volume growth stood at ~5%. Three-year revenue CAGR came in at 10%. Double-digit revenue growth can be attributed to strong double-digit growth in Glucon-D, Everyuth, Nycil, and Nutralite. Five of the company's key brands retained their leadership positions in their respective categories as of September 2022. Gross margin and operating profit margin (OPM) declined by 491 bps and 417 bps y-o-y to 43.3% and 3.8%, respectively, impacted by multiple headwinds. Operating profit decreased by 46.8% y-o-y to Rs. 16.3 crore. In line with the decline in operating profit coupled with lower other income, adjusted PAT declined by 60.5% y-o-y to Rs. 8.5 crore. In H1FY2023, revenue grew by 14.8% y-o-y to Rs. 1,126.2 crore. OPM contracted by 283 bps y-o-y to 14.6%, while PAT declined by 2.7% y-o-y, impacted by high input cost inflation.

Key positives

- The company's five-pillar brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth Peel off – maintained their leadership positions in their respective categories.
- Glucon-D, Everyuth, Nycil, and Nutralite brands delivered strong double-digit growth in Q2FY2023.
- Market share of Complan is increasing in modern trade and e-commerce channels.
- Direct distribution of Sugarfree Green doubled in Q2FY2023 sequentially.

Key negatives

- Gross margin/OPM contracted by 491 bps/417 bps y-o-y impacted by higher input cost inflation, unfavourable product mix, weakening currency, and increased other expenses.

Management Commentary

- Volume growth was impacted as rural consumers are downtrading to minimise the impact of inflation in their household budgets. However, management stated that green shoots are visible in the form of better monsoon season and higher welfare schemes by the government, which will lead to higher demand in the coming months.
- 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 the company has undertaken calibrated price hikes to mitigate the impact of price inflation and is continuously monitoring the environment. The company expects margins to be maintained in the near term if raw-material prices cool off and if the product mix is favourable. OPM in H2FY2023 is expected to be higher compared to H1FY2023.

Revision in estimates – We have lowered our estimates for FY2023 and FY2024 due to lower lower-than-earlier-expected margins due to higher inflation. Management expects the input cost inflation to soften, but prices are expected to remain high on a y-o-y basis. We have introduced FY2025 estimates through this note.

Our Call

View: Maintain Buy with a revised PT of Rs. 1,975: Zydus delivered steady revenue growth in Q2FY2023, while bottomline was impacted by the sharp decline in margins due to multiple headwinds. The company maintained its leadership position and continued to gain market share in its key categories in Q2FY2023. With strategies in place, 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 stock has underperformed the broader market and has corrected by 20% in the past year. The stock is trading at 35.8x/25.6x its FY2023E/FY2024E earnings. In view of the future growth prospects and attractive valuation, we maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,975.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenue	1,867	2,009	2,309	2,676	3,045
OPM (%)	18.4	17.2	14.4	16.5	17.0
Adjusted PAT	251	309	292	408	490
% YoY growth	34.9	23.1	-5.6	39.9	20.1
Adjusted EPS (Rs.)	39.4	48.5	45.8	64.1	77.0
P/E (x)	41.7	33.8	35.8	25.6	21.3
P/B (x)	2.3	2.2	2.1	1.9	1.8
EV/EBITDA (x)	29.8	29.9	31.4	23.5	19.7
RoNW (%)	6.2	6.6	5.9	7.7	8.6
RoCE (%)	6.5	6.4	5.9	7.7	8.7

Source: Company; Sharekhan estimates

Steady revenue growth; Bottomline impacted by the sharp margin decline

Zydus reported revenue growth of 11.9% y-o-y to Rs. 429.5 crore, backed by ~5% volume growth (three-year CAGR at 10%). Five of the company's key brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth facial cleansing gained strong market share compared with Q2FY2020. Higher inflation in milk price, unfavourable product mix, and weakening currency led to 491-bps y-o-y contraction in gross margin to 43.3%. OPM declined by 417 bps y-o-y to 3.8%, impacted by higher other expenses. Other expenses were high due to increased coal and husk rates and the statutory wage rate hike in North-Eastern states. Despite double-digit revenue growth, operating profit decreased by 46.8% y-o-y to Rs. 16.3 crore due to the steep decline in margins. In line with decline in operating profit coupled with lower other income, adjusted PAT declined by 60.5% y-o-y to Rs. 8.5 crore. In H1FY2023, revenue grew by 14.8% y-o-y to Rs. 1,126.2 crore. OPM contracted by 283 bps y-o-y to 14.6%, while PAT declined by 2.7% y-o-y, impacted by high input cost inflation.

Key brands retained leadership position and continued to gain market share

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 September 2022. Sugarfree brand continued to maintain its leadership with a market share of 95.6% in the sugar substitute category. Market share of Sugarfree increased by 140 bps against Q2FY2020. Glucon-D maintained its No. 1 position with a market share of 60% in the glucose powder category, an increase of 157 bps y-o-y and 110 bps over Q2FY2020. Complan had a market share of 4.6% in the health food (MFD) category. Nycil has maintained its No. 1 position with a market share of 35% in the prickly heat powder category, an increase of 47 bps y-o-y and 170 bps over Q1FY2020. 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 269 bps y-o-y and 800 bps over Q2FY2020. Everyuth Peel off has maintained its No. 1 position with a market share of 75.7% in the peel-off category. Everyuth brand now has a market share of 6.5% in the overall facial cleansing segment with a fifth market rank.

Double-digit growth in Glucon-D

Glucon-D witnessed double-digit growth in Q2FY2023. The company leveraged the second summer opportunity across its key markets through TV campaigns.

Muted performance of Complan

Health Food Drink category continued to witness slowdown and a similar trend was witnessed by Complan. The company launched sachets and pouches in key markets to drive demand. Zydus witnessed increasing market share of Complan in modern trade and e-commerce channels against Q1FY2023. Management has indicated that green shoots are visible for improving market share of Complan.

Sweeteners portfolio growth impacted by high base

The sweeteners portfolio delivered muted growth in Q2FY2023 because of high base of Q2FY2022 due to COVID-19 wave, which led to high diabetic consumption. On a three-year CAGR basis, the portfolio registered high single-digit growth. Focused actions drove growth of Sugafree Green. Direct distribution of Sugarfree Green has doubled in Q2FY2023 compared to Q1FY2023. 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 registered another strong quarter with double-digit growth supported by campaigns across face wash, scrubs, and peel-off. Everyuth Scrub's volume market share grew from 34.8% in 2018 to 42.3% in Q2FY2023. 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 improvement of market share.

Strong Q2 for Nycil

Nycil registered strong double-digit sales growth in Q2FY2023 on account of prolonged monsoon season. The brand is strengthening its leadership position with volume market share improving from 29.6% in 2018 to 38.1% in Q2FY2023.

Double-digit growth in Nutralite

Nutralite continued to build momentum in the overall business and delivered strong double-digit growth. DoodhShakti dairy portfolio, which includes butter, spreads and ghee, delivered strong performance backed by increased distribution drive, festival-specific digital activations, and online recipe videos endorsed by celebrity Shilpa Shetty.

Key highlights of the conference call

- **Demand expected to improve going ahead:** Zydus registered volume growth of ~5% y-o-y in Q2FY2023, which was supported by continued marketing efforts across brands. Management indicated that rural consumers are downtrading to minimise the impact of inflation in their household budgets and pickup in rural demand has been slower than urban areas. However, management stated that green shoots are visible in the form of better monsoon season and higher welfare schemes by the government, which will lead to higher demand in the coming months.
- **Gross margins expected to improve sequentially:** Higher inflation in milk price, unfavourable product mix, and weakening currency led to a 491-bps y-o-y contraction in gross margin to 43.3%. Price of refined milk increased by 25% y-o-y, price of aspartame increased by 65% y-o-y, while price of Dextrose Monohydrate was up 17% y-o-y. However, some of the key input prices have witnessed correction in recent times, which will reduce stress on margins in the coming quarters. 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.
- **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 the aim to enhance distribution to over 3 million stores and 1 million direct coverage over the next three years.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Net Revenue	**429.5**	**383.7**	**11.9**	**696.8**	**-38.4**
Material cost	243.5	198.7	22.6	318.6	-23.6
Employee cost	43.6	42.3	3.1	45.1	-3.2
Advertisement and Sales Promotion	51.7	47.5	8.8	96.2	-46.3
Other expenditure	74.4	64.6	15.1	88.8	-16.2
Total expenditure	**413.2**	**353.1**	**17.0**	**548.6**	**-24.7**
Operating profit	**16.3**	**30.5**	**-46.8**	**148.1**	**-89.0**
Other Income	1.4	3.4	-59.8	2.0	-30.8
Interest Expense	2.9	6.7	-56.1	4.1	-29.0
Depreciation	6.4	6.1	5.2	6.0	6.5
PBT	**8.2**	**21.1**	**-60.9**	**139.9**	**-94.1**
Tax	-0.2	-0.4	-37.8	0.0	666.7
Adjusted PAT	**8.5**	**21.5**	**-60.5**	**139.9**	**-93.9**
Exceptional item	0.0	0.0	-	-2.9	-100.0
Reported PAT	**8.5**	**21.5**	**-60.5**	**137.0**	**-93.8**
Reported EPS (Rs.)	1.3	3.4	-60.5	21.5	-93.8
			bps		**bps**
GPM (%)	43.3	48.2	-491	54.3	-
OPM(%)	3.8	8.0	-417	21.3	-
NPM (%)	2.0	5.6	-362	20.1	-
Tax rate (%)	-2.8	-1.8		0.0	

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - H2FY2023 to be relatively better compared to H1

Consumer goods companies would start seeing the benefit of correction in key input prices from Q3FY2023. The recent sharp correction in some key input prices helped companies to pass on benefits to the customer in the form of price cuts in highly penetrated categories (such as soaps). This along with good monsoon in most parts of the country (except for some parts in the North and East) will aid good recovery in sales volumes in the coming quarters. A decline in commodity prices has also helped inflationary pressures to ease out, thus boosting consumer sentiments. Hence, some tailwinds are building up for the sector to improve its growth in the coming quarters. Overall, we expect H2FY2023 will be much better compared to H1FY2023 with expected recovery in sales volumes. OPM is also expected to improve from Q3FY2023. Low penetration in key categories (especially in rural India), lower per capita consumption compared with other countries, a large shift to branded products, and emergence of new channels such as e-commerce/D2C provide several opportunities for achieving sustainable growth in the medium to long run.

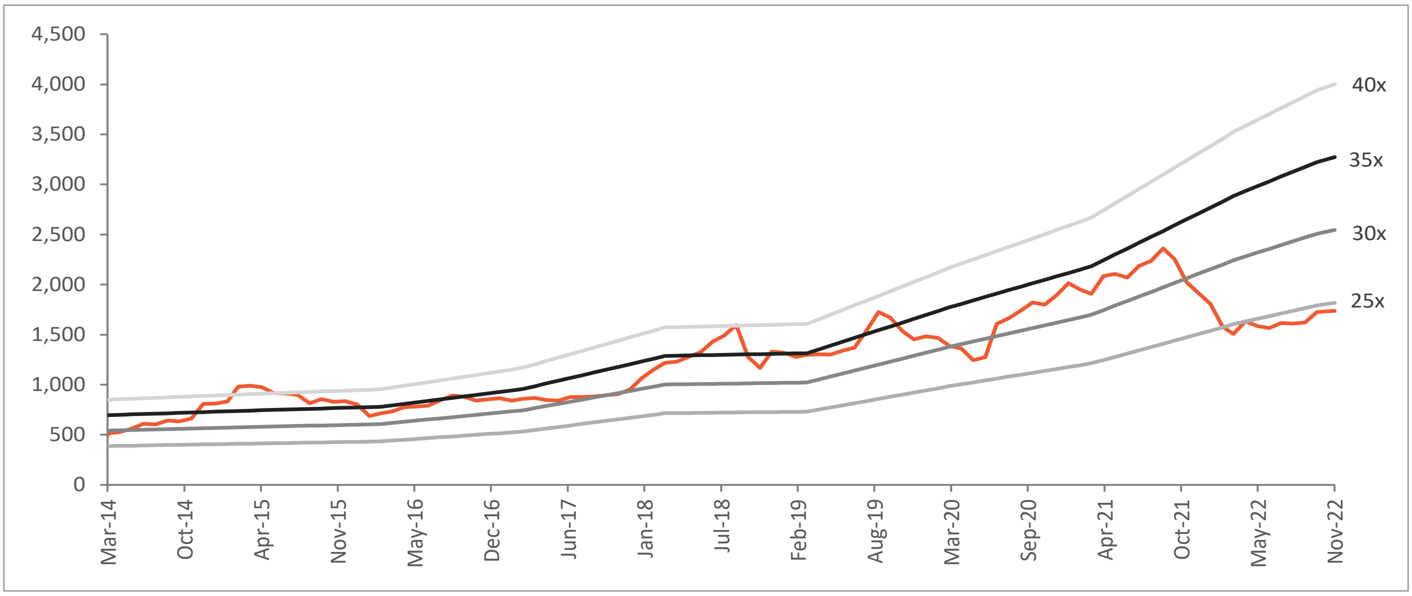
■ Company outlook - Strong growth ahead driven by multiple levers

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. Key brands of the company continue to maintain their strong leadership position and continue to gain market share consistently. A better revenue mix and synergistic benefits from integration from Heinz's acquisition will drive profitability ahead. The company is targeting to become debt free over the next two years.

■ Valuation - Maintain Buy with a revised PT Rs. 1,975

Zydus delivered steady revenue growth in Q2FY2023, while bottomline was impacted by the sharp decline in margins due to multiple headwinds. The company maintained its leadership position and continued to gain market share in its key categories in Q2FY2023. With strategies in place, 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 stock has underperformed the broader market and has corrected by 20% in the past year. The stock is trading at 35.8x/25.6x its FY2023E/FY2024E earnings. In view of the future growth prospects and attractive valuation, we maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,975.

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	53.6	48.3	38.0	43.4	40.1	31.7	26.3	26.8	31.4
Zydus Wellness	33.8	35.8	25.6	29.9	31.4	23.5	6.4	5.9	7.7

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 its 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. We expect the company's revenue and PAT to report a CAGR of 15% and 17%, respectively, during FY2022-FY2025E.

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	Nippon Life India Asset Management Company	3.65
3	ICICI Prudential Asset Management Co.	3.60
4	Life Insurance Corp of India	2.10
5	Government Pension Fund - Global	1.11
6	Vanguard Group Inc.	1.06
7	Sundaram Asset Management Co. Ltd.	0.86
8	Aditya Birla Sun Life AMC	0.84
9	Matthews International Capital Management	0.37
10	SBI Funds Management	0.30

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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