Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Zydus Wellness Ltd

Seasonal vagaries hit Q1; bounceback on cards

Consumer Goods	Sharekhan code: ZYDUSWELL

Reco/View: Buy	↔	CMP: **Rs. 1,433**	Price Target: **Rs. 1,654**	↓

↑ 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		↔	

ESG Disclosure Score

NEW

ESG RISK RATING 38.44

Updated Jul 08, 2023

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

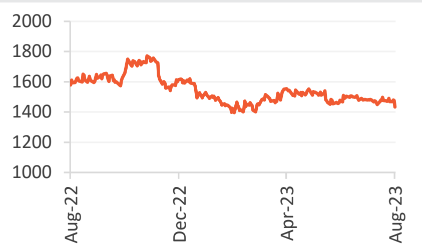
Company details

Market cap:	Rs. 9,117 cr
52-week high/low:	Rs. 1,791 / 1,364
NSE volume: (No of shares)	0.4 lakh
BSE code:	531335
NSE code:	ZYDUSWELL
Free float: (No of shares)	2.1 cr

Shareholding (%)

Promoters	67.1
FII	3.6
DII	22.1
Others	7.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.3	-6.5	1.6	-9.3
Relative to Sensex	-2.9	-13.3	-7.2	-21.1

Sharekhan Research, Bloomberg

Summary

- Zydus wellness Limited's (ZWL's) Q1FY2024 performance was affected unseasonal rains (impacting sales of summer products) and sweeteners registered a lower offtake resulting in flat revenues and a sharp fall in margins.
- Revenue (ex-Glucon D) grew in double digits (with volumes rising 4.5%); management is confident of growth recovering in quarters ahead with leadership positioning in most of the categories.
- ZWL eyes OPM of 17-18% over the next two years driven by improved mix and better operating leverage. Aim is to reach OPM of 20% over the next 4-5 years.
- Stock has underperformed in the past one year and trades at 25x/20x its FY2024E/FY2025E earnings. We maintain a Buy recommendation on the stock with a revised PT of Rs. 1,654.

Zydus Wellness Limited's (ZWL's) Q1FY2024 performance was weak due to multiple factors 1) unseasonal rains, hitting sales of summer products and 2) moderation in the offtake of Sugarfree. Revenues stood flat at Rs. 702 crore with revenues of food & nutrition segment declining by 1.6% y-o-y, while the personal care segment (including Nycil and Everyuth) saw 11.8% y-o-y growth. Gross margins decreased by 170 bps y-o-y to 52.6% affected by unfavourable mix. OPM excluding one-time cost of Rs. 14.2 crore decreased by 264 bps y-o-y to 18.6%. Operating profit decreased by 11.8% y-o-y to Rs. 130.7 crore and the adjusted PAT decreased by 16% y-o-y to Rs. 118.1 crore.

Key positives

- Excluding Glucon D, revenue growth stood in double digits, with a 4.5% volume growth.
- Personal care segment registered double-digit growth.
- Key brands such as Sugar Free, Everyuth Scrub, Everyuth Peel Off, Nutralite, Glucon D, and Nycil continued to maintain a strong lead in their respective categories.
- Gross margins of non-dairy products continued to improve.

Key negatives

- OPM fell 264 bps y-o-y to 18.6% due to higher other expenses and lower sales volume.

Management Commentary

- No significant impact of WHO's new guidelines against the use of non-sugar sweeteners to control the use of weight or reduce weight on product offtake. Category growth was in mid-single digits in Q1, lower than double digit growth in the earlier years. The company is focusing on right communication and right consumer to improve the growth ahead.
- Lower summer product sales affected sales volume and leading to a 6.2% volume decline in Q1FY2024. Excluding Glucon D, volume growth stood at 4.5% in Q1. Management expects volume growth to improve in the coming quarters. Overall revenue growth is expected to be in high single digit to low double digits in FY2024.
- Gross margins were hit by an unfavourable mix in Q1. The decline in the input prices and better mix should help gross margins to improve from Q2. If required, the company might opt for a price hike in milk-based products. Overall, it is targeting the OPM of 17-18% by FY2025 and expects OPM to consistently improve in the coming years.
- Complan's household growth stood at 12% y-o-y while the overall category growth stood at 2%. Focus on adding new customers under the brand to gain consistent improvement in the market share ahead.
- Tax rate is expected to remain nil in FY2024 and FY2025. It will normalise from FY2026.

Revision in earnings estimates - We have reduced our earnings estimates for FY2024 and FY2025 by 7% and 4% respectively to factor in below par performance in Q1FY2024, as it is one of the strongest quarters for ZWL with large sales coming from Nycil and Glucon D.

Our Call

View - Maintain Buy with revised PT of Rs. 1,654: Seasonal vagaries hit ZWL's Q1 numbers. However, ZWL is confident of good recovery in the performance in the quarters ahead as raw material prices fall. With strategies in place, ZWL is expected to post double-digit revenue growth in all the key brands in 3-4 years, aided by consumer-centric innovations, distribution expansion, and higher marketing campaigns. The stock has underperformed the broader market and is trading at 25x/20x its FY2024E/FY2025E earnings. In view of the future growth prospects and attractive valuation, ZWL can be considered a good pick in the mid-to-small cap space. We maintain our Buy recommendation with a revised price target (PT) of Rs. 1,654.

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	FY22	FY23	FY24E	FY25E
Revenue	2,009	2,255	2,450	2,789
OPM (%)	17.2	15.0	16.0	17.3
Adjusted PAT	309	320	360	458
% YoY growth	23.1	3.7	12.3	27.2
Adjusted EPS (Rs.)	48.5	50.4	56.6	71.9
P/E (x)	29.5	28.5	25.3	19.9
P/B (x)	1.9	1.8	1.7	1.6
EV/EBITDA (x)	26.0	26.5	22.7	18.1
RoNW (%)	6.6	6.4	6.8	8.1
RoCE (%)	6.4	6.0	6.8	8.1

Source: Company; Sharekhan estimates

Many headwinds for Q1

Reported revenues stood flat at Rs.702.6crore, lower than our expectation of Rs. 789 crore. Food & Nutrition segment sales declined by ~2% in Q1 while personal care products registered a growth of 11.8%. Gross margins fell 170 bps, which we believe is on back of unfavourable mix. This along with higher advertisement and sales promotion activities led to a 467 bps decline in the OPM to 16.6% lower than our expectation of 21.9%. One-time expenditure of Rs. 14.2 crore, because of payment towards one time settlement with workers, legal charges and provision for inventory write off for Sitarganj plant. OPM excluding one-time cost of Rs14.2crore decreased by 264 bps y-o-y to 18.6%. Operating profit decreased by 11.8% y-o-y to Rs.130.7crore. Adjusted PAT decreased by 13% y-o-y to Rs.122crore, much lower than our expectation of Rs. 165 crore.

Key brands retained their leadership position and continued to gain market share

Five brands – Glucon-D, Sugarfree, Nycil, Everyuth Scrub, and Everyuth Peel Off facemask maintained its leadership position in their respective categories as of June 2023. Glucon-D has with a market share 59.9% maintained its No.1 position. Sugar Free continues to maintain its leadership with a market share of 96.2%. The company continued to build its SugarFree Green franchise with aggressive media campaigns and also focusing on campaigns for adopting healthier lifestyles. Nycil has maintained its dominant position by further increasing its market share by 117 basis points over the same period last year, which now stood at 35.5 percent in the Prickly heat powder category. Complan has steadily gained volume market share during the quarter to 4.5%. Everyuth Scrub has increased by 42 basis point at MAT level over same period last year to 42.4% strengthening its leadership position in the facial scrubs category. Everyuth Peel Off has maintained its number one position with a market share of 78.7% in the Peel off an increase of 19 bps. Overall, the Everyuth brand is amongst the top 5 brands in the country with a market share of 6.2% in the facial cleansing segment.

Brand-wise performance

- **Everyuth maintained good growth momentum:** Everyuth brand maintained its good growth momentum driven by a differentiated product portfolio in facial skin cleansing segment. Face scrub category grew by 6.5% while peel-off registered low single digit growth. Management expects peel-off being an occasional skin cleansing category should do well during festive and wedding season.
- **Sweeteners portfolio:** The portfolio witnessed a mid-single-digit growth in Q4. Negative publicity on some platforms has affected category growth. The company focuses to shift more towards Sucralose and Stevia-based brands. Also, it is focusing on targeting right communication and right consumer to improve the growth in the coming years. Launched new communication 'Katrina's Fitness wali Chai', motivating consumers towards embracing healthier lifestyle.
- **Nutralite:** Nutralite posted robust growth across portfolio in Q1FY2024. This is on back of strong growth in the base product and newly launched dairy portfolio (including Ghee). The brand renovation with a wider portfolio segment around dairy and non-dairy, supported by focused B2B and B2C teams continued to deliver strong growth for quarter.
- **Complan:** Quarterly volume offtakes grew faster than the category for the brand and the brands volume market share has progressively improved. Market share stood at 4.5% in the Health Food Drink (HFD) category.
- **Glucon-D:** Unseasonal rains during summer season impacted the brand sales for the quarter.
- **Nycil:** Nycil gained traction during the quarter with the arrival of the summer season. The new packaging highlights 'coolness factor' and brand campaigns highlight 'Ghamoriyonki Chutti'. It re-launched Body Mist. The prickly heat powder category grew by 13% in FY2023.

Results (Consolidated) **Rs cr**

Particulars	Q1FY24	Q1FY23	y-o-y (%)	Q4FY23	q-o-q (%)
Net Revenue	**702.1**	**696.8**	**0.8**	**713.0**	**-1.5**
Material cost	333.0	318.6	4.5	350.6	-5.0
Employee cost	47.3	45.1	4.9	43.5	8.8
Advertisement and Sales Promotion	104.4	96.2	8.6	66.7	56.6
Other expenditure	86.7	88.8	-2.3	107.6	-19.4
Total expenditure	**571.4**	**548.6**	**4.1**	**568.4**	**0.5**
Operating profit	**130.7**	**148.1**	**-11.8**	**144.6**	**-9.6**
Other Income	2.4	2.0	23.1	0.7	233.3
Interest Expense	5.1	4.1	23.2	5.2	-1.2
Depreciation	6.2	6.0	2.6	6.7	-7.0
PBT	**121.8**	**139.9**	**-12.9**	**133.5**	**-8.7**
Tax	0.0	0.0	-	-17.1	-
Adjusted PAT	**121.8**	**139.9**	**-13.0**	**150.6**	**-19.1**
Exceptional item	-14.2	-2.9	-	5.3	-
Reported PAT	**107.6**	**137.0**	**-21.5**	**155.9**	**-31.0**
Reported EPS (Rs.)	16.9	21.5	-21.5	22.8	-26.0
			bps		**bps**
GPM (%)	52.6	54.3	-170	50.8	175
OPM (%)	18.6	21.3	-264	20.3	-166
NPM (%)	17.3	20.1	-273	21.1	-378
Tax rate (%)	0.0	0.0		-12.8	

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Rural recovery on cards; margin improvement to sustain

Rural demand bottomed out with sales returning to the positive growth path in Q4FY2023. With price inflation stabilising and a decline in key input prices, managements of most companies are confident of witnessing a gradual pick-up in rural demand in the quarters ahead. Moreover, expectation of a well spread-out monsoon and the government offering some incentives prior to the budget might provide some boost to rural sentiments in the coming quarters. In FY2024, revenue growth is expected to be volume-led growth with companies focusing on passing on the benefits of the decline in input cost to customers in the coming quarters. The drop in input prices will drive gross margins in the coming quarters. Despite higher media spends, OPM is expected to remain high on a y-o-y basis in the near term.

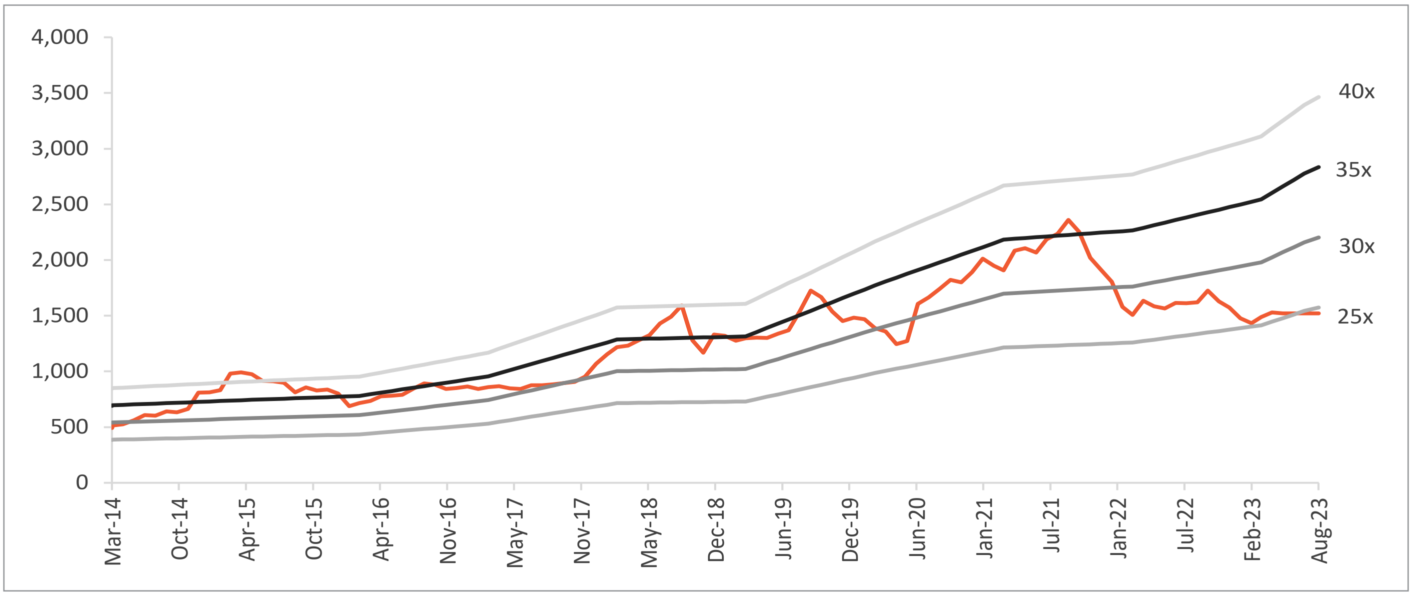
■ Company outlook - Strong growth ahead driven by multiple levers

ZWL 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 gain market share consistently. A better revenue mix and synergistic benefits from integration of Heinz's acquisition will drive profitability ahead. The company is targeting to become debt-free in two years.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,654

Seasonal vagaries hit ZWL's Q1 numbers. However, ZWL is confident of good recovery in the performance in the quarters ahead as raw material prices fall. With strategies in place, ZWL is expected to post double-digit revenue growth in all the key brands in 3-4 years, aided by consumer-centric innovations, distribution expansion, and higher marketing campaigns. The stock has underperformed the broader market and is trading at 25x/20x its FY2024E/FY2025E earnings. In view of the future growth prospects and attractive valuation, ZWL can be considered a good pick in the mid-to-small cap space. We maintain our Buy recommendation with a revised price target (PT) of Rs. 1,654.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Dabur India	57.8	42.9	35.2	45.6	34.9	28.5	22.1	27.0	30.0
Zydus Wellness	28.5	25.3	19.9	26.5	22.7	18.1	6.0	6.8	8.1

Source: Company, Sharekhan estimates

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 13% and 16%, respectively, during FY2022-FY2025E.

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.
- 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 Pankaj Patel	Chairman
Tarun Gian Arora	Chief Executive Officer
Umesh Parikh	Chief Financial Officer
Nandish P. Joshi	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Threpsi LLP	11.35
2	Nippon Life India Asset Management Company	4.79
3	ICICI Prudential Asset Management Co.	2.80
4	Government Pension Fund - Global	1.59
5	Norges Bank	1.58
6	Life Insurance Corp of India	1.22
7	Vanguard Group Inc	1.05
8	Aditya Birla Sun Life AMC	0.65
9	Tatta AMC	0.50
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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