India I Equities

FMCG

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

14 May 2024

Zydus Wellness

Healthy Q4 performance paints a better long-term outlook; Buy

Rating: **Buy**
Target Price (12-mth): Rs.2,150
Share Price: Rs.1,721

With its Q4 revenue up 10% y/y (vs. the Street's 5% y/y estimate) and a 45bp expansion in its EBITDA margin to 20.7% (20%), Zydus Wellness posted a healthy quarterly performance. Its personal care range (EverYuth, Nycil) posted a good 23% y/y growth, helped by the upswing in consumption demand while Food & Nutrition posted 6% y/y growth, hurt by price cuts in Nutralite. Management was optimistic of double-digit revenue growth in FY25, led by innovation, distribution and its international foray and expected margin to revert to 17-18% over the next two years, aided by operating leverage and softer input prices. We tweak our FY25e/F26e EPS slightly to factor in the Q4 performance and a lower FY25 tax rate. We retain our long-term view of a double-digit revenue CAGR and margins returning to 18-20% over 2-4 years. We retain our Buy with a higher 12-mth TP of Rs2,150, 33x FY26e EPS (earlier Rs1,910).

Volumes grew 5.5% in Q4 driving 10% revenue growth y/y. Product/brand market-shares were largely steady with Complan's share loss at just 15bps for MAT Mar'24. Management indicated penetration-led growth for Complan, Nycil and Glucon D, which should aid in a longer-term volume upturn. Thus, consistent innovation, brand spends, distribution (targeting 2.9m to 3.5m reach in three years) and its international foray (targeting 8-10% revenue) should lead to an 11.5% revenue CAGR over FY24-26.

EBITDA margin expands only 45bps y/y despite the gross margin rising 380bps y/y, as a 270bp rise in ad-spend and a 70bp increase in staff costs offset the gross margin gains. Management, though, was optimistic of the EBITDA margin returning to 17-18% helped by higher prices, softer input costs, and operating leverage. We build in a 17.9% EBITDA margin for FY26 (up 470bps from FY24) as the company would benefits from the reversion to the mean (in margins).

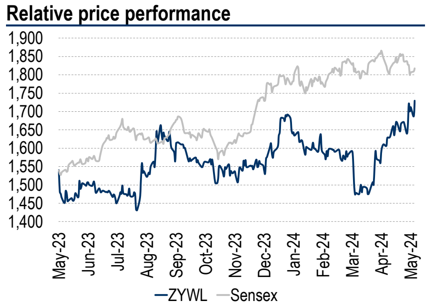
Valuations. The stock quotes at 27x/26x FY25e/FY26e EPS of Rs64.3/Rs65. **Key risks:** Failure of product launches, unwarranted or pricey bolt-on acquisitions, price-based competition.

Key data	ZYWL IN / ZYDS.BO
52-week high / low	Rs1750 / 1425
Sensex / Nifty	73105 / 22218
3-m average volume	$0.8m
Market cap	Rs110bn / $1317.6m
Shares outstanding	64m

Shareholding pattern (%)	Mar'24	Dec'23	Sep'23
Promoters	69.6	69.2	68.5
- of which, Pledged	-	-	-
Free Float	30.4	30.8	31.4
- Foreign Institutions	3.3	3.3	3.4
- Domestic Institutions	19.4	19.7	20.2
- Public	7.7	7.9	7.8

Estimates revision (%)	FY25e	FY26e
Sales	0.7	1.2
EBITDA	-3.4	-2.1
PAT	-3.2	2.1

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY22	FY23	FY24	FY25e	FY26e
Sales (Rs m)	20,091	22,549	23,280	26,025	29,012
Net profit (Rs m)	3,089	3,205	2,811	4,093	4,138
EPS (Rs)	48.5	50.4	44.2	64.3	65.0
P/E (x)	35.5	34.2	39.0	26.8	26.5
EV / EBITDA (x)	32.5	33.0	35.3	24.9	19.7
P / BV (x)	2.3	2.1	2.0	1.9	1.8
RoE (%)	6.4	6.3	5.2	7.1	6.7
RoCE (%)	6.6	6.5	5.7	7.5	7.0
Dividend yield (%)	0.3	0.3	0.3	0.3	0.4
Net debt / equity (x)	0.0	0.0	0.0	-0.1	-0.1

Source: Company, Anand Rathi Research

Ajay Thakur
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Net revenues	20,091	22,549	23,280	26,025	29,012
Growth (%)	7.6	12.2	3.2	11.8	11.5
Direct costs	9,804	11,460	11,383	12,334	13,586
Gross profit	10,287	11,089	11,897	13,691	15,426
Gross margins %	51.2	49.2	51.1	52.6	53.2
Other expenses	6,862	7,717	8,815	9,454	10,236
EBITDA	**3,425**	**3,373**	**3,082**	**4,236**	**5,190**
EBITDA margins (%)	17.0	15.0	13.2	16.3	17.9
- Depreciation	236	250	238	256	272
Other income	127	49	139	210	320
Interest expenses	255	161	240	97	65
PBT	3,060	3,010	2,743	4,093	5,172
Effective tax rates (%)	(0.9)	(6.5)	(2.5)	-	20.0
+ Associates / (Minorities)	-	-	-	-	-
Net income	3,089	3,205	2,811	4,093	4,138
WANS	64	64	64	64	64
FDEPS (Rs)	48.5	50.4	44.2	64.3	65.0

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Share capital	636	636	636	636	636
Net worth	48,440	51,227	54,004	58,059	62,149
Debt	3,815	2,925	1,925	1,300	875
Minority interest	-	-	-	-	-
TL / (Assets)	-1,298	-1,493	-1,561	-1,561	-1,561
Lease liabilities	-	-	-	-	-
Capital employed	**50,957**	**52,659**	**54,368**	**57,798**	**61,463**
Net tangible assets	2,445	2,669	3,231	3,875	4,602
Net intangible assets	5,455	5,455	5,455	5,455	5,455
Goodwill	39,200	39,200	39,200	39,200	39,200
CWIP (tang. & intang.)	119	130	175	200	225
Investments (strategic)	-	-	-	-	-
Investments (financial)	270	700	700	700	700
Current assets (excl. cash)	6,437	9,185	8,178	8,812	9,585
Cash	1,698	382	1,897	4,476	7,187
Current liabilities	4,667	5,061	4,468	4,919	5,491
Working capital	1,770	4,124	3,710	3,893	4,094
Capital deployed	**50,957**	**52,659**	**54,368**	**57,798**	**61,463**

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
PBT	3,060	2,909	2,743	4,093	5,172
+ Non-cash items	-413	-421	-339	-143	-18
Oper. prof. before WC	3,473	3,329	3,082	4,236	5,190
- Incr. / (decr.) in WC	-1,063	-2,399	414	-183	-201
Others incl. taxes	41	13	-68	-	1,034
Operating cash-flow	2,369	917	3,564	4,054	3,954
- Capex (tang. + intang.)	-747	-443	-845	-925	-1,025
Free cash-flow	1,621	474	2,718	3,129	2,929
Acquisitions					
- Div. (incl. buyback & taxes)	319	319	32	38	48
+ Equity raised	-	-	-	-	-
+ Debt raised	-1,683	-890	-1,000	-625	-425
- Fin investments	-65	413	-	-	-
- Misc. (CFI + CFF)	244	168	171	-113	-255
Net cash-flow	-559	-1,316	1,516	2,579	2,711

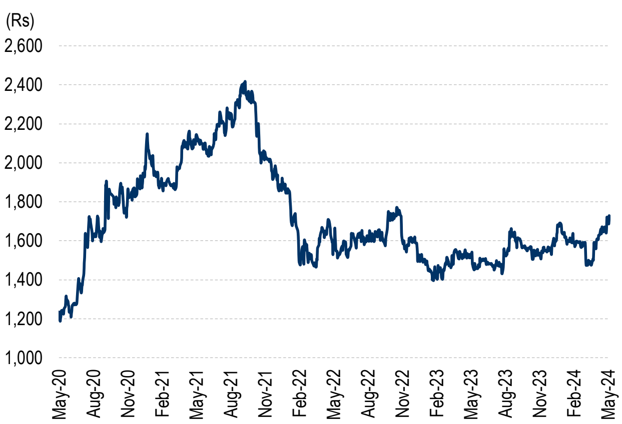
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
P/E (x)	35.5	34.2	39.0	26.8	26.5
EV / EBITDA (x)	32.5	33.0	35.3	24.9	19.7
EV / Sales (x)	5.5	4.9	4.7	4.1	3.5
P/B (x)	2.3	2.1	2.0	1.9	1.8
RoE (%)	6.4	6.3	5.2	7.1	6.7
RoCE (%) - after tax	6.6	6.5	5.7	7.5	7.0
RoIC (%) - after tax	6.9	6.7	5.9	8.0	7.9
DPS (Rs / sh)	5.0	5.0	5.0	6.0	7.5
Dividend yield (%)	0.3	0.3	0.3	0.3	0.4
Dividend payout (%) - incl. DDT	10.3	9.9	11.3	9.3	11.5
Net debt / equity (x)	0.0	0.0	0.0	-0.1	-0.1
Receivables (days)	25.9	33.6	31.4	30.1	29.3
Inventory (days)	65.7	74.0	70.4	67.0	64.9
Payables (days)	66.2	50.7	52.5	52.2	52.8
CFO : PAT %	76.7	28.6	126.8	99.0	95.6

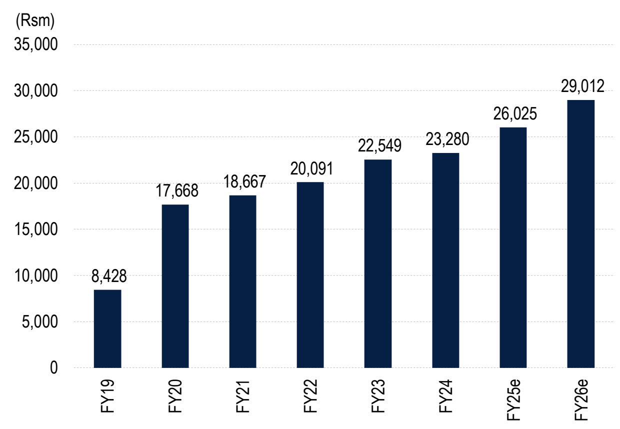
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue-growth trend



Source: Company

Result highlights

Fig 7 – Quarterly results

(Rs m)	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24
Net sales	**5,976**	**3,837**	**3,881**	**6,398**	**6,964**	**4,295**	**4,156**	**7,130**	**7,021**	**4,399**	**4,032**	**7,826**
Y/Y (%)	*11.2*	*12.2*	*1.7*	*5.6*	*16.5*	*11.9*	*7.1*	*11.4*	*0.8*	*2.4*	*-3.0*	*9.8*
Gross profit	3,310	1,850	1,874	3,254	3,778	1,860	1,823	3,623	3,691	1,987	1,940	4,276
Gross margins (%)	*55.4*	*48.2*	*48.3*	*50.9*	*54.2*	*43.3*	*43.9*	*50.8*	*52.6*	*45.2*	*48.1*	*54.6*
Staff costs	430	423	382	401	451	436	351	435	473	483	442	536
Other expenses	784	646	637	790	884	744	748	1,076	1,009	829	877	1,175
EBITDA	**1,404**	**305**	**323**	**1,415**	**1,481**	**163**	**282**	**1,446**	**1,165**	**168**	**127**	**1,622**
Y/Y (%)	*14.8*	*12.6*	*-34.8*	*-2.7*	*5.5*	*-46.8*	*-12.7*	*2.2*	*-21.3*	*3.3*	*-54.9*	*12.2*
EBITDA margins (%)	*23.5*	*8.0*	*8.3*	*22.1*	*21.3*	*3.8*	*6.8*	*20.3*	*16.6*	*3.8*	*3.1*	*20.7*
PBT	**1,308**	**211**	**227**	**1,314**	**1,399**	**82**	**193**	**1,335**	**1,076**	**86**	**37**	**1,544**
Y/Y (%)	*57.3*	*-385.5*	*-36.7*	*-0.9*	*7.0*	*-60.9*	*-15.0*	*1.6*	*-23.1*	*4.4*	*-80.8*	*15.7*
PAT	**1,308**	**215**	**233**	**1,333**	**1,370**	**85**	**196**	**1,453**	**1,104**	**59**	**3**	**1,503**
Y/Y (%)	*46.6*	*-390.5*	*-35.1*	*0.1*	*7.0*	*-60.5*	*-16.1*	*14.4*	*-11.0*	*-30.3*	*-98.5*	*-1.4*
Staff cost (% of sales)	*7.2*	*11.0*	*9.8*	*6.3*	*6.5*	*10.2*	*8.4*	*6.1*	*6.7*	*11.0*	*11.0*	*6.8*
Other expenses (% of sales)	*13.1*	*16.8*	*16.4*	*12.3*	*12.7*	*17.3*	*18.0*	*15.1*	*14.4*	*18.8*	*21.8*	*15.0*

Source: Company

Q4 earnings call highlights

Demand trend

- Rural demand rose gradually, growth converging with urban growth.
- Recovery in demand has been seen in most of the company's portfolio, further fuelled by demand in summer-led brands such as Glucon-D and Nycil in anticipation of a scorching summer.
- Good volume momentum has been seen in most of the company's portfolio, which has led to **5.5% overall volume growth in Q4.**
- Its personal care category continued strong double-digit growth in the quarter, with both Everyuth and Nycil seeing good demand traction.
- The food and nutrition category also turned positive and reported mid-single-digit value growth y/y
- The Complan and Sweetener categories have seen demand revive. Nutralite value growth trailed volume growth due to price cuts.
- **Launches:** The brand has entered the Ready-to-Drink beverage category with the pilot launch of Glucon-D Activors Electrolyte Energy drink in aa couple of key states. The company extended its Sweetener portfolio with the launch of I'm lite, a unique formulation of sugar blended with stevia to offer consumers 50% fewer calories than regular sugar and products under the Sugar-Free Delight range for the international business.

Distribution

- The organised channel continues to lead growth, with the share of organised trade at 20%; management expects this to grow to ~21-22%
- **The company now has 3m outlets and targets 3.5m in the next few years**
- It intends to expand its portfolio range to 630,000 direct outlets to sell more SKUs there.

Brand performance

- **Glucon D** maintained its No.1 position with a 59.5% market share (MAT). With continued marketing efforts in driving growth and recruiting consumers, brand penetration has grown 62bps.
- The glucose powder category has grown 4% (MAT)
- **Complan.** The nutrition drink category has started showing signs of revival in the latter half of the year from a slowdown last year. Brand penetration has grown 26bps in FY24. Complan's market share declined 15bps to 4.3%.
- The health-food drink category registered 6.4% growth (MAT).
- The **Sugar Free** brand retained its leadership in the the sugar-substitute category with a 95.9% market share
- The sugar-substitutes category has grown 5.5% (MAT). Sugar Free Green continues to grow in high double digit powered by volume growth

- No significant competition; focusing on building the category as a significant No.1 and recruit consumers. Expects good growth in the sugar-substitute category in the next few years.
- **Everyuth** registered strong growth and continues to outpace segment growth.
- The face-scrub category grew 12.1% (MAT). The company maintained its leading position with a 45.6% market share in facial scrubs (up 370bps y/y).
- The peel-off category grew 14.5% (MAT). It, too, retained its leading position, with an 80.2% market share (up 174 bps y/y) in peel-offs.
- Everyuth is the No.5 brand with a 6.5% market share in the facial cleansing category overall.
- **Nycil** continues to be the No.1brand with a 35% market share (down 41bps y/y) in prickly heat powder. The category has grown 3.7% (MAT).
- Nycil clocked its highest household penetration, 8.5% (MAT) with volume growth ahead of the segment's.

International Business

- **The FY24 contribution from the international business was 3.5-4%.** The company focuses on three markets: Africa led by Nigeria, the Indian subcontinent, (Bangladesh and Nepal), and GCC (the Middle East).
- It registered good double-digit growth in the latter two and believes these will be significant growth drivers for 3-4 years.
- Nigeria, which is one of its largest markets, has been under pressure in the last one year because of the macro-economic, currency issues and de-monetisation. Once these are addressed, it expects Nigeria to be one of its strongest markets because of its brand equity.
- **Management expects to double its international business every three years and increase its share in the overall business to 7-8%.**

Margin trends

- Optimising ad spends has helped in generate demand and deal with competition.
- Inflation would be normal and the company aims at 17-18% EBITDA margins over the next two years
- Milk prices would be stable, improve margins and see reasonable growth
- Along with optimising fixed costs, will balance its EBITDA wish list and investment in its brands
- **Management expects ad-spends to increase FY25 but stay in 13-14% range as % of sales.**

Other highlights, outlook

- The company expects demand to pick up in the hope of a good monsoon and better macro-economic factors.

- It expects double-digit revenue growth in FY25. A lower base, a revived sweetener range & Complan, and healthy growth in Food & Nutrition should help.
- **Tax** It won't be paying any tax in FY25; with deferred tax, no cash outflow for tax. FY26 and FY27 will see partial tax outflow
- **Capex** stood at Rs489m for FY24. Net debt was almost zero for the year.
- Management expects some catch up of Nielsen's reported figures in personal care (by 2-3%), where growth is good, but not reflected in Nielsen's figures.

Valuation

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

Management's efforts to strengthen the salesforce and automate it should aid in scaling up revenue and in focusing on profitability and efficiency. We expect margins to return to 18-20% in the next 2-4 years, aided by pricing power, softer raw material prices, cost-saving measures and operating leverage.

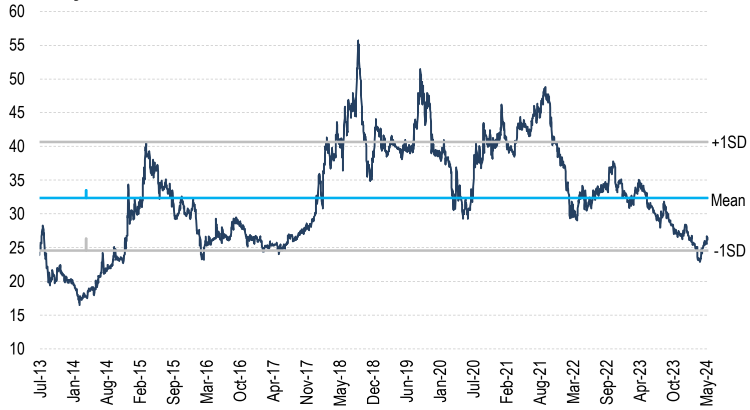
Post-Covid, investor interest shifted from health-focused consumer products, leading to the sharp drop for the company and its de-rating. The stock trades at a 20% discount to its 10-year average PE and 25% to its mid-cap peers. We have tweaked our FY25e/F26e EPS slightly to factor in the Q4 performance and a lower FY25 tax rate. We retain our long-term view of a double-digit revenue CAGR and margins returning to 18-20% over 2-4 years. We retain our Buy with a higher 12-mth TP of Rs2,150, 33x FY26e EPS (earlier Rs1,910). The stock quotes at 27x/26x FY25e/FY26e EPS of Rs64.3/Rs65.

Fig 8 – Change in estimates

	Old estimates		Revised estimates		Change (%)	
(Rs m)	FY25e	FY26e	FY25e	FY26e	FY25e	FY26e
Sales	25,854	28,672	26,025	29,012	0.7	1.2
EBITDA	4,386	5,300	4,236	5,190	-3.4	-2.1
PAT	4,229	4,052	4,093	4,138	-3.2	2.1

Source: Anand Rathi Research

Fig 9 – One-year-forward PE



Source: Bloomberg, Anand Rathi Research

Key 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.

Appendix

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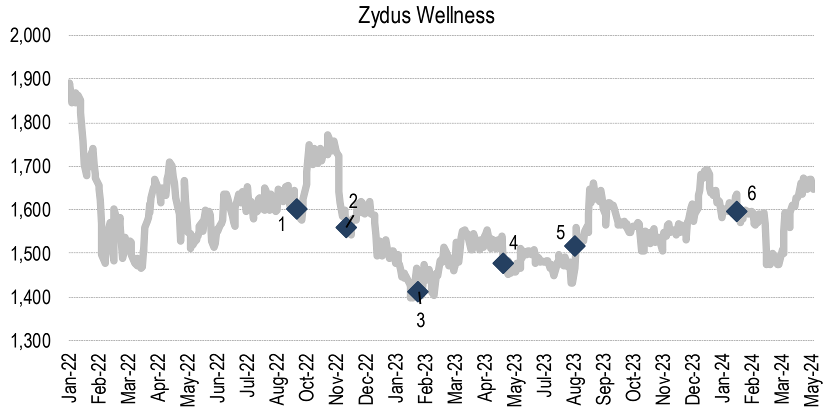
Rating and Target Price History (as of 14 May 2024)



	Date	Rating	TP (Rs)	Share Price (Rs)
1	23-Sep-22	**Buy**	2,140	1,603
2	12-Nov-22	**Buy**	2,100	1,617
3	03-Feb-23	**Buy**	2,065	1,411
4	17-May-23	**Buy**	1,940	1,482
5	05-Aug-23	**Buy**	1,850	1,432
6	09-Feb-24	**Buy**	1,910	1,593

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	Buy	Hold	Sell
Large Caps (Top 100 companies)	>15%	0-15%	<0%
Mid Caps (101st-250th company)	>20%	0-20%	<0%
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