

## Debt reduction, benign RM cost to aid profit...

Zydus Wellness (ZWL) reported mixed results with 9.3% growth in gross sales led by strong growth in Sugarfree, Nycli & revival in Everyuth. Net sales grew at slower 4.8%, mainly as GST related benefits for one of the plants expired in January 2020. Gross margins fell 300 bps, mainly due to expiry of GST benefits, utilisation of high priced milk inventory & 10% increase in palm oil prices. The company held high cost inventory of skimmed milk powder (SMP) in February-March. However, advertisement spends to sales & other overhead spends to sales were down 182 bps & 58 bps, respectively, which partially offset the contraction in gross margins. Operating margins contracted 142 bps to 7.9%. The company raised ₹ 650 crore through QIP for early re-payment of debt. ZWL redeemed non-convertible debentures (NCDs), which led to extraordinary spend of ₹ 98 crore as premium for early redemption. This led to net loss of ₹ 105 crore. Adjusting for extraordinary spend, loss was at ₹ 7.9 crore vs. ₹ 4.5 crore in corresponding quarter.

## New launches, increase in direct distribution to propel growth

The company has been specifically focusing on increasing direct distribution from 0.35 million (mn) outlets to 0.5 mn outlets by March 2021. Further, e-commerce channel sales have seen growth of 130% in Q2. It is contributing 4.5% to sales. ZWL is also leveraging its strong footing with doctor's advisory & pharmacy channel. We believe the company is focusing on new product launches, variants & SKUs to fill the white spaces in its product line. It launched Complian in 75 gram sachet at ₹ 30. It has also launched variants in Everyuth & Nutralite brand. We expect the company to see revenue CAGR of 9.1% during FY20-22E.

## Lower milk prices, cost cutting measure to aid margins

The company was holding high cost milk inventory in February-March 2020, which negatively impacted gross margins in H1FY21. However, milk prices have significantly declined in the last three to four months that would result in higher gross margins in H2FY21. Moreover, many synergistic benefits in terms of rationalisation of distribution, employees & operational cost would result in considerable reduction in overall spends in next two years. We expect operating margins to improve 240 bps to 21.1% by FY22E.

## Valuation & Outlook

With the reduction of debt & margin improvement, the company would see strong earnings growth in FY20-23E. We expect 33% CAGR adjusted earnings growth in FY20-22E (FY20 base impacted by exceptional expense of ₹ 44 crore related to acquisition & earnings were also negatively impacted by Covid related disruption). Though return ratios would remain in single digits for the next three to four years, we see strong growth potential in categories through increasing penetration, new product launches & brand building. The stock is available at 24.9x FY23E earnings. We value the stock at 32x FY23E EPS and maintain **BUY** with a revised target price of ₹ 2300.



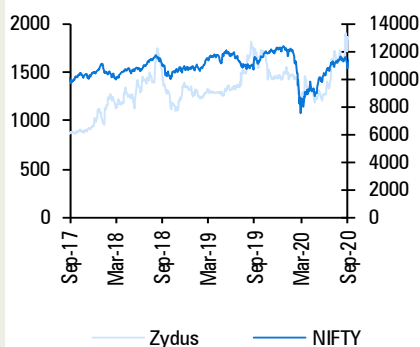
### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	11,474.5
Total Debt (FY20)	1,519.1
Cash and Investments (FY20)	192.8
EV	12,800.7
52 week H/L (₹)	1950 / 1070
Equity capital	57.7
Face value (₹)	10.0

### Key Highlights

- ZWL reported 9.3% growth in gross sales led by strong traction in Sugarfree, Complian, Glucon-D sales. Gross margins contracted 300 bps largely due to expiry of GST budgetary benefits
- Maintain BUY with target price of ₹ 2300 /share

### Price Chart



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### Key Financial Summary

₹ Crore	FY18	FY19	FY20	FY21E	FY22E	FY23E	CAGR FY20-23E
Net Sales	512.6	842.8	1,766.8	1,855.1	2,093.0	2,294.2	9.1
EBITDA	125.3	174.4	321.1	363.9	442.2	482.5	14.5
EBITDA Margin %	24.4	20.7	18.2	19.6	21.1	21.0	
Adjusted Net Profit	133.9	169.1	185.9	276.7	423.0	461.2	35.4
Adjusted EPS (₹)	17.1	29.3	32.2	43.0	65.7	71.7	
Adjusted P/E (x)	104.0	60.8	55.3	41.5	27.1	24.9	
RoCE (%)	15.9	3.2	5.9	6.9	8.3	8.9	
RoE (%)	19.4	5.0	5.4	5.9	8.6	9.2	

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
Net Sales	342.0	326.0	4.9	537.4	-36.4	Gross sales increased by 9.3% led by strong sales in Sugarfree, Nycil. Moreover, Everyuth & Nutralite recovered to pre-covid levels. Net of GST sales witnessed a growth of 4.8% given GST related benefited expired in Jan 2020
Raw Material Expenses	133.6	106.2	25.8	109.5	22.0	Gross margins contracted by 300 bps mainly on account of expiry of GST benefits, utilisation of high cost SMP inventory & increase in palm oil prices
Employee Expenses	43.0	38.4	12.1	52.7	-18.3	
SG&A Expenses	50.7	54.2	-6.6	49.1	3.1	
Other operating Expenses	62.8	61.7	1.7	74.9	-16.2	
EBITDA	27.1	30.5	-11.0	122.4	-77.8	
EBITDA Margin (%)	7.9	9.4	-142 bps	22.8	1484 bps	Operating margins contracted by 142 bps to 7.9% mainly due to lower gross margins
Depreciation	6.5	3.8	69.9	6.4	1.1	
Interest	30.8	35.1	-12.2	34.6	-10.9	
Other Income	2.8	4.0	-28.9	1.8	54.4	
PBT	-7.4	-4.5	64.4	83.2	-108.9	
Exceptional Items	-98.0	-10.1	NA	0.0	NA	
Tax Outgo	0.0	-2.6	NA	-6.1		
PAT	-105.3	-12.0	778.9	89.2	-218.1	Exceptional spends mainly due to premium paid for the earlier redemption of NCD (Non-Convertible Debentures)
Adjusted PAT	-7.4	-4.5		89.2		The company reported loss of 7.4 crore as against loss of 4.5 crore

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

₹ Crore)	FY21E			FY22E			FY23E	Comments
	Old	New	% change	Old	New	% change	New	
Sales	1,856.2	1,855.1	-0.1	2,093.0	2,093.0	0.0	2,294.2	There is no change in our estimate. We are introducing FY23E numbers
EBITDA	371.2	363.9	-2.0	446.8	442.2	-1.0	482.5	
EBITDA Margin (%)	20.0	19.6	-38 bps	21.3	21.1	-22 bps	21.0	Minor change in operating margin estimate
Adjusted PAT	279.1	276.7	-0.9	427.6	423.0	-1.1	461.2	
EPS (₹)	43.4	43.0	-0.9	66.4	65.7	-1.0	71.7	

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

	Current					Earlier		Comments
	FY19E	FY20E	FY21E	FY22E	FY23E	FY21E	FY22E	
Sugarfree (₹ crore)	318.9	344.7	379.1	425.8	469.1	379.1	425.8	No major change in our estimates
Everyuth (₹ crore)	167.9	178.3	164.1	200.9	229.5	164.1	200.9	
Glucon D (₹ crore)	102.3	472.0	500.6	556.1	606.9	500.6	556.1	
Complan (₹ crore)	99.0	378.0	400.7	445.2	485.8	400.7	445.2	
RM / Sales (%)	34.7	42.7	44.4	40.1	40.7	39.2	39.2	

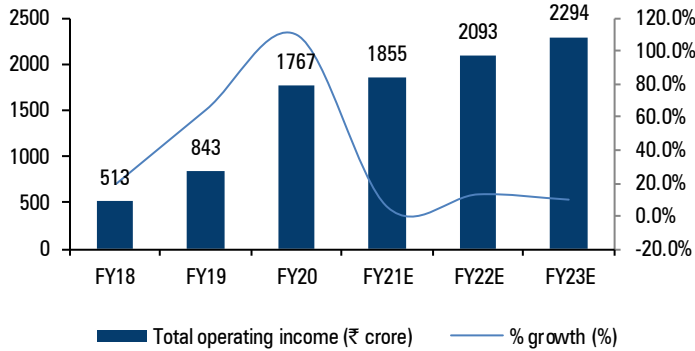
Source: Company, ICICI Direct Research

## Conference call highlight

- Gross revenue increased 9.3% led by strong growth in Sugarfree with rising health caution. Further, Nycil & Glucon-D also saw healthy growth in non-season quarter. Net of GST, sales witnessed growth of 4.9% to ₹ 342 crore. The slower growth was mainly due to expiry of GST budgetary support
- ZWL is focusing on launch of various news products, SKUs & extensions to fill the white spaces in its product line. It launched Glucon-D immunoVolt as immunity boosting proposition. The company also launched 75 gm Complian sachet at ₹ 30 price point. The new variant of Everyuth was launched in the face moisturisers segment as 'Everyuth Aloe Vera & Cucumber Gel'. The company also launched Nutralite Choco Spread on the e-commerce and modern trade platforms. Nutralite Choco Spread is available in two healthier variants - Crunchy Quinoa & Calcium. The company is trying to leverage the immunity boosting & 'at-home' consumption trend. Sugarlite (variant of Sugarfree) contributes ~5% to the sales
- Everyuth & Nutralite brands were negatively impacted due to Covid induced lockdown. They witnessed a recovery in sales during the quarter. Everyuth sales reached pre-Covid levels whereas Nutralite sales improved after cafes, restaurants were allowed to open
- The e-commerce sales witnessed growth of 130% with Sugarfree & Complian the most prominent brands sold through the channel. Sugarfree grew 100% & Complian by 200% in e-commerce channel. E-com contributes 4.5% to overall sales. Modern trade & CSD channel sales continued to remain sluggish with double digit sales decline
- The company is going to increase its direct distribution network from 0.35 mn outlets to 0.50 mn outlets in the next six months. Moreover, ZWL is also focusing on pharmacy channel to increase the brands' (Complian Nutrigrow) presence
- The company raised ₹ 650 crore during the quarter through QIP, which has been utilised for the pre-payment of non-convertible debentures (NCD). It incurred expense of ₹ 98 crore for the pre-payment premium
- The company is looking to increase the sales of Glucon-D & Nycil during second summer (Q2 & Q3) through new variant launches, which would even out the sale throughout years. ZWL expects to implement the strategy in the next year or two
- Rural markets in UP & Bihar are witnessing double digit growth. It is looking to increase the distribution network in these states. The company is targeting sustainable double digit growth
- High cost SMP inventory was exhausted in Q2FY21. The next two quarters should see benefit of lower milk prices. The company would continue to spend 13-14% of sales as advertisements & promotions
- The company would continue to remain at 0% income tax rate for the next five to six years due to amortisation of Goodwill

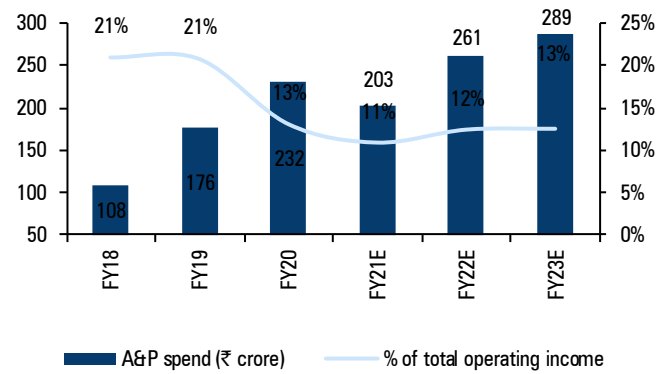
## Key Metrics

Exhibit 4: Revenue & revenue growth trend



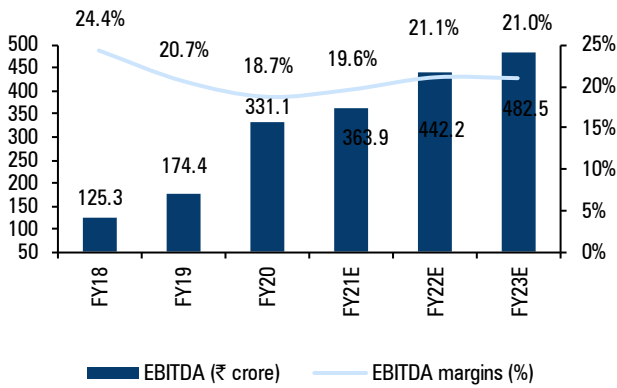
Source: ICICI Direct Research, Company

Exhibit 5: Marketing spend trend



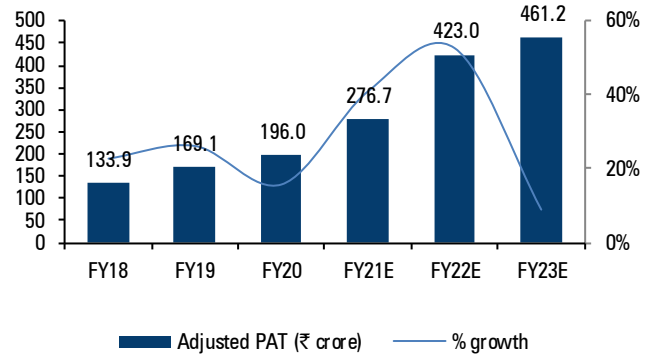
Source: ICICI Direct Research, Company

Exhibit 6: Operating margins trend (%)



Source: Company, ICICI Direct Research

Exhibit 7: Adjusted PAT growth to recover in FY22E



Source: Company, ICICI Direct Research

Exhibit 8: Brand wise revenues (I-direct Estimate)

₹ crore	FY20 Revenues
Sugar Free	344.7
Everyuth	178.3
Complan	378.0
Glucon D	472.0
Nycil	297.5
Nutralite	40.7
Others	58.8

Source: ICICI Direct Research

Exhibit 9: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY20	1766.8	109.6	32.2	9.9	72.5	40.2	5.4	5.9
FY21E	1855.1	5.0	43.0	33.3	64.2	32.0	5.9	6.9
FY22E	2093.0	12.8	65.7	52.9	27.1	26.0	8.6	8.3
FY23E	2294.2	9.6	71.7	9.0	24.9	23.8	9.2	8.9

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 10: Profit and loss statement				
	₹ crore			
	FY20	FY21E	FY22E	FY23E
<b>Total operating Income</b>	<b>1,766.8</b>	<b>1,855.1</b>	<b>2,093.0</b>	<b>2,294.2</b>
Growth (%)	109.6	5.0	12.8	9.6
Raw Material Expenses	778.8	824.5	939.0	1,043.4
Employee Expenses	156.0	189.8	213.3	238.6
Marketing Expenses	224.3	202.9	261.2	288.7
Administrative Expenses	0.0	86.9	89.2	93.1
Other expenses	286.7	187.3	148.0	147.9
Total Operating Expenditure	1,445.8	1,491.3	1,650.8	1,811.7
<b>EBITDA</b>	<b>321.1</b>	<b>363.8</b>	<b>442.2</b>	<b>482.5</b>
Growth (%)	84.1	13.3	21.5	9.1
Depreciation	26.4	26.7	29.4	32.1
Interest	139.9	75.6	1.5	1.5
Other Income	10.7	8.7	11.8	12.4
PBT	165.5	270.2	423.0	461.2
Total Tax	-20.5	-6.1	0.0	0.0
PAT before MI	185.9	276.2	423.0	461.2
Minority Interest	0.0	0.0	0.0	0.0
<b>Adjusted PAT</b>	<b>185.9</b>	<b>276.2</b>	<b>423.0</b>	<b>461.2</b>
Growth (%)	8.6	48.6	53.1	9.0
Adjusted EPS (₹)	32.24	42.99	65.73	71.66

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit After Tax	119.7	178.7	423.0	461.2
Add: Depreciation	26.4	26.7	29.4	32.1
(Inc)/dec in Current Assets	16.0	44.0	-125.8	-99.3
Inc/(dec) in CL and Provisions	97.1	124.6	67.8	74.5
<b>CF from operating activities</b>	<b>259.2</b>	<b>374.1</b>	<b>394.4</b>	<b>468.6</b>
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	-64.0	-10.0	-10.0	-10.0
(Inc)/dec in Fixed Assets	-5.1	-50.0	-50.0	-50.0
Others	-14.1	-5.0	-5.0	-5.0
<b>CF from investing activities</b>	<b>-83.2</b>	<b>-65.0</b>	<b>-65.0</b>	<b>-65.0</b>
Issue/(Buy back) of Equity	0.0	1,100.0	0.0	0.0
Inc/(dec) in loan funds	-50.2	-1,330.0	-170.0	0.0
Dividend paid & dividend tax	-69.4	-64.4	-160.9	-386.1
Interest Paid	-140.1	-75.6	-1.5	-1.5
Others	0.0	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>-259.7</b>	<b>-370.0</b>	<b>-332.4</b>	<b>-387.7</b>
Net Cash flow	-83.7	-60.9	-3.0	15.9
Opening Cash	138.2	82.4	21.5	18.5
Cash with Bank	27.9	0.0	0.0	0.0
<b>Closing Cash</b>	<b>82.4</b>	<b>21.5</b>	<b>18.5</b>	<b>34.4</b>

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
<b>Liabilities</b>				
Equity Capital	57.7	64.4	64.4	64.4
Reserve and Surplus	3,403.0	4,610.7	4,872.8	4,947.9
Total Shareholders funds	3,460.7	4,675.1	4,937.2	5,012.3
LT Borrowings & Provisions	1500.0	170.0	0.0	0.0
Deferred Tax Liability	19.1	19.1	19.1	19.1
Others Non-current Liabilities	27.2	27.2	27.2	27.2
<b>Total Liabilities</b>	<b>5,006.9</b>	<b>4,891.3</b>	<b>4,983.4</b>	<b>5,058.5</b>
<b>Assets</b>				
Gross Block	372.7	412.7	452.7	492.7
Less: Acc Depreciation	168.1	194.8	224.2	256.3
Net Block	204.7	218.0	228.5	236.4
Capital WIP	3.5	13.5	23.5	33.5
Goodwill	3,920.0	3,920.0	3,920.0	3,920.0
Non-current Investments	1.6	1.6	1.6	1.6
LT loans & advances	4.7	14.7	24.7	34.7
Deferred Tax Assets	120.8	120.8	120.8	120.8
Other Non-Current Assets	558.6	563.6	568.6	573.6
<b>Current Assets</b>				
Inventory	292.3	254.1	315.4	364.6
Debtors	118.2	122.0	143.4	157.1
Loans and Advances	0.0	6.1	6.9	7.6
Other Current Assets	172.4	342.7	386.7	423.8
Cash	82.4	21.5	18.5	34.4
Investments	110.4	0.0	0.0	0.0
<b>Current Liabilities</b>				
Creditors	491.1	533.7	579.2	634.8
Provisions	0.0	5.0	5.7	6.2
Short term debt & other CL	91.7	168.7	190.3	208.6
<b>Application of Funds</b>	<b>5,006.9</b>	<b>4,891.3</b>	<b>4,983.4</b>	<b>5,058.5</b>

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
<b>Per share data (₹)</b>				
EPS	32.2	43.0	65.7	71.7
Cash EPS	29.2	31.9	70.3	76.7
BV	600.2	726.4	767.2	778.8
DPS	10.0	10.0	25.0	60.0
Cash Per Share	14.3	3.3	2.9	5.3
<b>Operating Ratios (%)</b>				
EBITDA Margin	18.2	19.6	21.1	21.0
PBT / Total Operating income	9.4	14.6	20.2	20.1
PAT Margin	8.0	9.6	20.2	20.1
Inventory days	60.4	50.0	55.0	58.0
Debtor days	24.4	24.0	25.0	25.0
Creditor days	101.5	105.0	101.0	101.0
<b>Return Ratios (%)</b>				
RoE	5.4	5.9	8.6	9.2
RoCE	5.9	6.9	8.3	8.9
<b>Valuation Ratios (x)</b>				
P/E	72.5	64.2	27.1	24.9
EV / EBITDA	40.2	32.0	26.0	23.8
EV / Net Sales	7.3	6.3	5.5	5.0
Market Cap / Sales	6.5	6.2	5.5	5.0
Price to Book Value	3.0	2.5	2.3	2.3
<b>Solvency Ratios</b>				
Debt/EBITDA	4.7	0.5	0.0	0.0
Debt / Equity	0.4	0.0	0.0	0.0
Current Ratio	1.0	1.0	1.1	1.1
Quick Ratio	0.5	0.7	0.7	0.7

Source: Company, ICICI Direct Research

**Exhibit 14: ICICI Direct coverage universe (FMCG)**

	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹)		Rating	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Colgate (COLPAL)	1,511	1,700	Buy	38,812	30.0	33.4	35.4	50.3	45.3	42.7	8.6	8.4	7.7	60.7	83.5	100.8	51.2	64.2	78.0
Dabur India (DABIND)	506	565	Buy	88,708	8.2	8.8	10.3	61.8	57.4	49.4	10.2	10.1	8.7	26.1	24.0	24.7	21.9	20.9	21.4
Hindustan Unilever (HINLEV)	2,072	2,500	Buy	510,548	31.2	32.4	38.8	66.4	64.0	53.4	13.3	12.0	10.4	89.5	24.5	28.5	85.7	18.6	21.9
ITC Limited (ITC)	167	250	Buy	218,801	12.5	11.7	13.0	13.4	14.2	12.8	4.7	4.6	4.1	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	133	150	Hold	5,141	4.3	5.3	5.8	31.0	25.1	22.8	3.1	2.9	2.6	24.3	29.7	29.9	21.7	24.2	24.1
Marico (MARLIM)	367	440	Buy	46,834	8.1	8.8	9.5	45.4	41.7	38.5	6.4	6.2	5.6	41.0	42.3	45.1	34.5	36.3	38.5
Nestle (NESIND)	17,114	18,000	Hold	152,970	204.3	223.4	253.4	83.8	76.6	67.5	12.4	11.5	10.4	56.9	59.9	66.6	101.9	119.1	139.2
Tata Consumer Products (TATGLO)	494	525	Buy	49,578	5.0	9.8	11.7	98.9	50.5	42.3	5.1	4.6	4.3	6.9	8.8	9.4	4.6	6.6	7.5
VST Industries (VSTIND)	3,440	3,850	Hold	5,307	196.9	206.0	211.9	17.5	16.7	16.2	4.3	4.5	4.2	52.1	45.3	46.1	38.6	33.6	34.2
Varun Beverage (VARBEV)	670	700	Hold	19,948	16.4	9.7	17.8	41.0	68.8	37.6	2.8	3.3	2.7	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,783	2,300	Buy	11,475	24.6	27.8	65.7	72.5	64.2	27.1	6.5	6.2	5.5	5.9	6.9	8.3	5.4	5.9	8.6

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: < -15%



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