

## Expanding distribution, new products to aid revenues

Zydus Wellness (ZWL) reported 17.2% growth in sales with two months of acquisition sales in base quarter (acquisition of Heinz India effective from January 30, 2019). Hence, numbers are not comparable. However, it lost ~₹ 100 crore sales in March due to lockdown. The month contributes substantial summer product sales (Glucon D, Nycil). Gross margins were down 587 bps mainly due to higher milk prices & change in composition of products due to acquisition. However, ZWL reduced marketing spend by 30% (650 bps) & other overheads by 9% (390 bps) leading to operating profit growth of 38.1%. Operating margins improved 325 bps to 21.5%. Despite strong growth in operating profit, net profit grew 11.5% with lower other income, higher interest cost & integration related exceptional expense.

## Strong acquired brands; enhanced distribution to aid sales

After the acquisition of Heinz, ZWL now has five brands (Sugarfree, Everyuth, Glucon D, Complian, Nycil) in different categories with strong recall value. It would look to double the direct distribution reach in general trade & further enhance its chemist channel. It has a presence in 75% of 5 lakh chemists in India. Further, ZWL has enhanced its e-commerce capabilities by investing in channel early. It is driving 3-3.5% of its sales from e-commerce channel from 1% earlier. We also believe it would be able to leverage its strong relations with medical practitioner to grow Complian sales. The focus of management would remain on brand extensions in related categories, which could drive growth in future. It has launched sanitisers under Nycil brand and would be launching immunity booster product in FY21. We believe lockdown impact would be substantial (~₹ 300 crore loss of sales in April-May 2020) given Q1 contributes a third of sales. However, with new product development, enhanced reach & effective A&P spend, we expect the company to witness strong 22.2% growth in FY22E.

## Benign RM cost, savings in overhead expenses to aid margins

We expect operating margins to improve 240 bps in next two years largely on the back of benign raw material cost. In last two months, milk prices have fallen sharply. Further with fall in crude prices, ZWL would benefit from lower packaging cost. Moreover, it looks to save ₹ 40 crore in warehousing, manpower & other overheads after integration of Heinz business. The management also indicated A&P spend would be curtailed considerably in the near term. We expect earnings CAGR of 24.9% during FY20-22E.

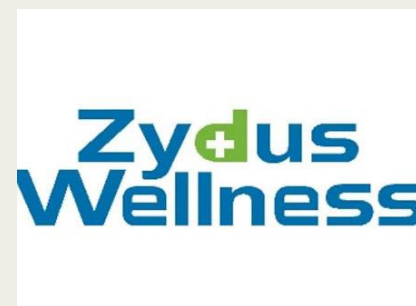
## Valuation & Outlook

With the acquisition of Heinz India brands, ZWL has created goodwill of ₹ 3900 crore. With huge goodwill on books, return ratios would remain depressed for the next three to five years. However, we believe the company would be able to grow the earnings faster in this period with a repayment of ₹ 1500 crore debt and substantial reduction in interest. The stock is available at 26.5x FY22E earnings. We upgrade the stock from REDUCE to **BUY** with a revised target price of ₹ 1530/share.

### Key Financial Summary

₹ Crore	FY17	FY18	FY19	FY20	FY21E	FY22E	CAGR FY20-22E
Net Sales	430.6	512.6	842.8	1,766.8	1,669.5	2,040.6	7.5
EBITDA	99.1	125.3	174.4	321.1	321.3	421.1	14.5
EBITDA Margin %	23.0	24.4	20.7	18.2	19.2	20.6	
Adjusted Net Profit	109.0	133.9	169.1	185.9	182.5	289.8	24.9
Adjusted EPS (₹)	13.9	17.1	29.3	32.2	31.6	50.3	
Adjusted P/E (x)	95.4	77.6	45.3	41.2	42.0	26.5	
RoCE (%)	15.5	15.9	3.2	5.9	5.7	7.4	
RoE (%)	19.6	19.4	5.0	5.4	5.1	7.5	

Source: Company, ICICI Direct Research



### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	7,668.8
Total Debt (FY20)	1,519.1
Cash and Investments (FY20)	192.8
EV	8,995.0
52 week H/L (₹)	1860 / 1100
Equity capital	57.7
Face value (₹)	10.0

### Key Highlights

- Zydus Wellness reported 17.2% sales growth. The company lost ₹ 100 crore sales due to lockdown
- Operating profit grew 38.1% & operating margins improved 325 bps with substantial reduction in marketing & overhead spends
- Net profit witnessed growth of 11.5% with lower other income, higher interest cost & integration related exceptional expenses
- Upgrade from REDUCE to BUY with revised target price of ₹ 1530 /share

### Research Analyst

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**Exhibit 1: Change in estimates**

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Comments
Net Sales	487.9	416.2	17.2	332.7	46.7	Net sales witnessed growth of 17.2%. However, on a comparable basis, sales declined 6% on account of ~₹ 100 crore loss of sales due to lockdown at the end of March
Raw Material Expenses	301.2	162.6	85.3	217.1	38.7	
Employee Expenses	46.8	34.6	35.2	42.0	11.3	
SG&A Expenses	46.4	66.4	-30.2	34.4	34.7	The company reduced marketing spend by 650 bps, which offset the almost 590 bps contraction in gross margins
Other operating Expenses	65.2	71.7	-9.1	63.9	2.0	
EBITDA	105.0	76.0	38.1	32.7	221.0	
EBITDA Margin (%)	21.5	18.3	325 bps	9.8	1169 bps	Operating margins expanded 325 bps as the company looks to reduce overhead spends by bringing synergies in merged entity
Depreciation	6.9	6.3	9.6	5.3	28.8	
Interest	34.7	28.8	20.7	35.3	-1.6	
Other Income	1.3	8.5	-84.7	2.4	-46.5	Substantial reduction in other income as company became net debt company after acquisition
PBT	64.7	49.5	30.7	-5.5	-1,284.8	
Exceptional Items	-2.8	0.0	NA	0.0	NA	
Tax Outgo	0.0	5.2	-100.0	0.0		
PAT	69.5	62.3	11.5	4.2	1,539.0	Net profit increased 11.5% led by growth in operating profit

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

(₹ Crore)	FY21E			FY22E			Comments
	Old	New	% change	Old	New	% change	
Sales	1,986.2	1,669.5	-15.9	2,208.5	2,040.6	-7.6	We cut our FY21E numbers due to loss of sale in the peak summer season for the company
EBITDA	402.0	321.3	-20.1	491.4	421.1	-14.3	
EBITDA Margin (%)	20.2	19.2	-99 bps	22.3	20.6	-161 bps	We cut our operating margins estimate due to lockdown impact in April-May 2020
PAT	269.5	182.5	-32.3	341.9	289.8	-15.2	
EPS (₹)	46.7	31.6	-32.2	59.3	50.3	-15.2	

Source: Company, ICICI Direct Research

**Exhibit 3: Assumptions**

	Current				Earlier		Comments
	FY19E	FY20E	FY21E	FY22E	FY21E	FY22E	
Sugarfree (₹ crore)	318.9	344.7	334.3	434.6	386.0	455.7	We cut our sales estimate due to loss of sales in April-May 2020
Everyuth (₹ crore)	167.9	193.1	173.8	221.6	242.2	298.0	
Glucon D (₹ crore)	102.3	427.8	410.4	489.1	487.6	541.8	
Complan (₹ crore)	99.0	396.0	407.9	473.8	435.6	475.2	
RM / Sales (%)	34.7	42.7	41.0	40.9	35.5	34.7	

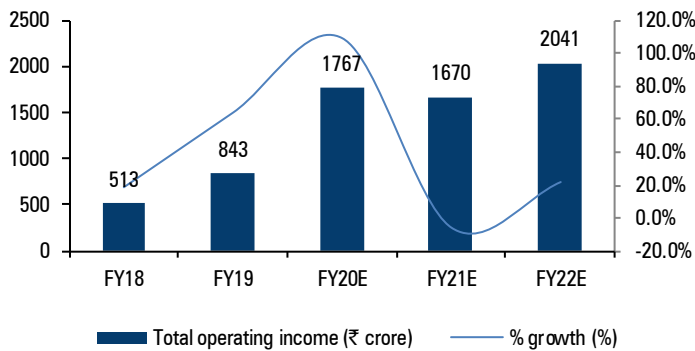
Source: Company, ICICI Direct Research

## Conference Call Highlights

- ZWL witnessed sales growth of 17.2% with base quarter consisting of two months of sales of Heinz India (acquisition effective from January 30, 2019). The company lost ₹ 100 crore sales in March due to lockdown across the country. The decline looks sharp given March is an important month due to pre-summer inventory build-up by channel
- The operation remained standstill for a good part of April with recovery in May and almost reaching previous levels in June. This would negatively impact sales in Q1 given it is a large quarter for the company
- The glucose category is growing at 9.8% with market share of 58%. Talcum powder category is growing at 8.3% with the company's market share at 34.4%
- The company lost market share in malt based beverage category after the acquisition but regained it again in last six months. The other challenge for the company after the acquisition was steep increase in milk prices
- With restaurants, malls, cafes closed during lockdown, Nutralite brand sales were negatively impacted given two-third of its sales contributed by 'out of home' consumption
- The company made early investments in building e-commerce channel, which is now contributing 3-3.5% of the sales from the 1% earlier. The channel is important for Everyuth brand sales
- ZWL gained 230 bps market share in Nycil. Market share of most of the other brands remained stable
- The company is looking to save ₹ 40 crore in warehousing, manpower & other overheads by bringing synergies with the integration of Heinz Business. Marketing spend, which is ~13% of sales, is expected to be curtailed in the near term
- The company forayed into sanitiser category with Nycil brands. It is looking to introduce some immunity boosting products in few weeks
- The wholesale channel is slowly recovering. Tier 2, 3 cities are witnessing good traction. The company does not have much sales contribution from rural
- The company would focus on health & wellness, new product development, strong go to market & R&D capabilities
- ZWL believes if the market leader grows in the malt beverage category, it is advantageous for Complian as well
- On an overall (direct & indirect) distribution, ZWL has 1.7-2.0 million retail outlets reach. The company is looking to double direct distribution network by enhancing general trade & chemist network. It has a reach of ~75% of total 5 lakh chemist channel. The company is looking to drive Complian sale through the chemist channel
- Operating margins improved 325 bps to 21.5% due to ~640 bps cut in marketing spend & 390 bps cut in overhead spend
- The company has gross debt of ₹ 1500 crore & net debt of ₹ 1300 crore, which it is looking to repay from FY22 onwards

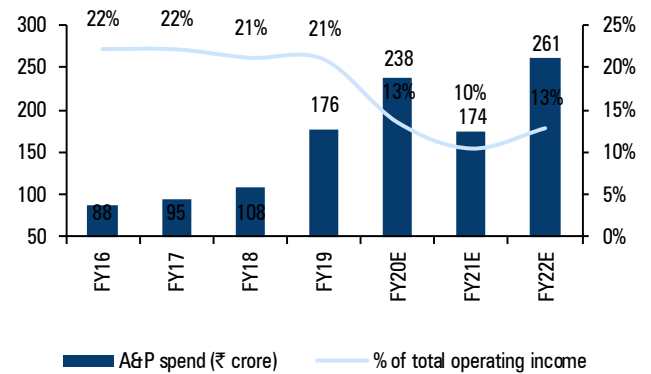
## Key Metrics

Exhibit 4: Revenue & revenue growth trend



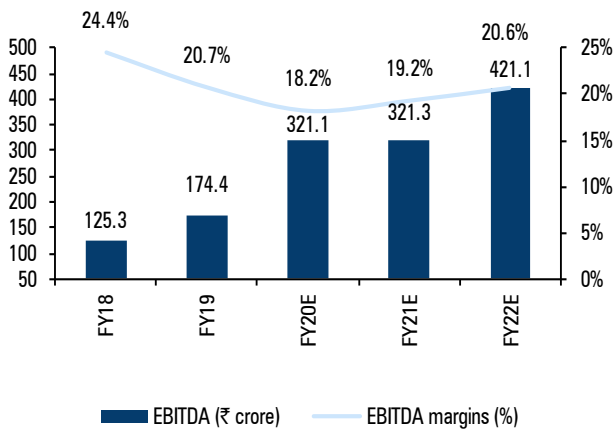
Source: ICICI Direct Research, Company

Exhibit 5: Marketing spend trend



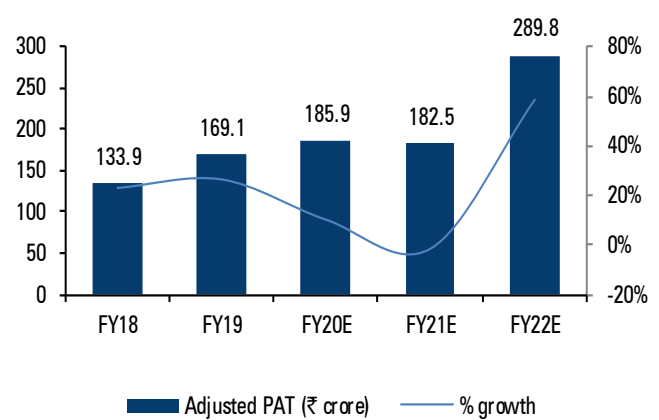
Source: ICICI Direct Research, Company

Exhibit 6: Operating margins trend (%)



Source: Company, ICICI Direct Research

Exhibit 7: Adjusted PAT growth to recover in FY22E



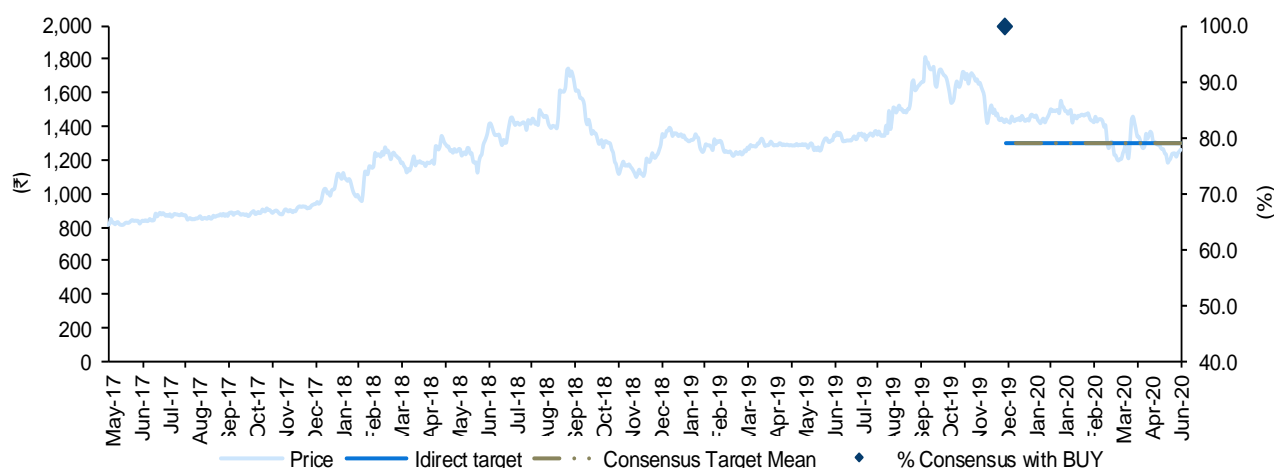
Source: Company, ICICI Direct Research

Exhibit 8: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY19	842.8	64.4	29.3	-14.4	45.3	52.0	5.0	3.2
FY20	1766.8	109.6	32.2	9.9	54.1	28.4	5.4	5.9
FY21E	1669.5	-5.5	31.6	-1.9	42.0	28.2	5.1	5.7
FY22E	2040.6	22.2	50.3	58.8	26.5	21.1	7.5	7.5

Source: Company, ICICI Direct Research

Exhibit 9: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 10: Top 10 Shareholders

Rank	Investor Name	Filing Date	% O/S	Position (%)	Change
1	Cadila Healthcare Lt	31-Mar-20	63.6	36.65m	0.00m
2	Threpsi Llp	31-Dec-19	12.5	7.22m	0.00m
3	Zydus Family Trust	31-Mar-20	4.3	2.47m	0.02m
4	Matthews Intl Capita	30-Apr-20	2.6	1.48m	(0.43)m
5	Life Insurance Corp	31-Dec-19	2.1	1.20m	(0.04)m
6	Reliance Capital Tru	30-Apr-20	1.9	1.09m	(0.03)m
7	Prazim Trading & Inv	31-Dec-19	1.4	0.82m	0.00m
8	Ppfas Asset Manageme	30-Apr-20	1.2	0.70m	0.00m
9	First State Investme	31-Oct-19	0.3	0.18m	(0.03)m
10	Dimensional Fund Adv	31-Mar-20	0.2	0.13m	(0.01)m

Source: Reuters, ICICI Direct Research

Exhibit 11: Shareholding Pattern

(in %)	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Promoter	67.6	67.6	67.6	67.6	67.6
FII	3.7	4.3	4.4	4.1	3.3
DII	7.1	19.1	19.3	20.7	21.5
Others	21.7	9.0	8.7	7.5	7.6

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 12: Profit and loss statement				
	₹ crore			
	FY19	FY20	FY21E	FY22E
<b>Total operating income</b>	<b>842.8</b>	<b>1,766.8</b>	<b>1,669.5</b>	<b>2,040.6</b>
Growth (%)	64.4	109.6	-5.5	22.2
Raw Material Expenses	298.4	778.8	763.1	929.8
Employee Expenses	85.6	174.7	182.3	197.4
Marketing Expenses	176.1	238.0	173.6	261.0
Administrative Expenses	39.7	0.0	78.1	87.0
Other expenses	68.7	254.3	151.1	144.3
Total Operating Expenditure	668.5	1,445.8	1,348.2	1,619.5
<b>EBITDA</b>	<b>174.4</b>	<b>321.1</b>	<b>321.3</b>	<b>421.1</b>
Growth (%)	39.2	84.1	0.1	31.1
Depreciation	12.5	26.4	26.0	27.2
Interest	30.1	139.9	124.1	115.9
Other Income	38.9	10.7	11.2	11.8
PBT	170.6	165.5	182.5	289.8
Total Tax	-0.6	-20.5	0.0	0.0
PAT before MI	171.2	185.9	182.5	289.8
Minority Interest	2.1	0.0	0.0	0.0
<b>PAT</b>	<b>169.1</b>	<b>185.9</b>	<b>182.5</b>	<b>289.8</b>
Growth (%)	25.4	8.6	-1.9	58.8
Adjusted EPS (₹)	40.10	32.24	31.64	50.26

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Profit After Tax	107.6	119.7	182.5	289.8
Add: Depreciation	12.5	26.4	26.0	27.2
(Inc)/dec in Current Assets	-42.7	16.0	-12.3	-64.9
Inc/(dec) in CL and Provisions	71.9	97.1	35.5	126.2
<b>CF from operating activities</b>	<b>149.4</b>	<b>259.2</b>	<b>231.8</b>	<b>378.3</b>
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	-64.0	-10.0	-10.0
(Inc)/dec in Fixed Assets	-17.1	-5.1	-30.0	-25.0
Others	-4,144.6	-14.1	-5.0	-5.0
<b>CF from investing activities</b>	<b>-4,161.7</b>	<b>-83.2</b>	<b>-45.0</b>	<b>-40.0</b>
Issue/(Buy back) of Equity	18.6	0.0	0.0	0.0
Inc/(dec) in loan funds	1,544.3	-50.2	0.0	-100.0
Dividend paid & dividend tax	-37.6	-69.4	-34.8	-34.8
Interest Paid	-30.1	-140.1	-124.1	-115.9
Others	2,556.4	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>4,051.5</b>	<b>-259.7</b>	<b>-158.8</b>	<b>-250.7</b>
Net Cash flow	39.3	-83.7	27.9	87.7
Opening Cash	29.6	138.2	82.4	110.3
Cash with Bank	95.4	27.9	0.0	0.0
<b>Closing Cash</b>	<b>164.3</b>	<b>82.4</b>	<b>110.3</b>	<b>198.0</b>

Source: Company, ICICI Direct Research

Exhibit 14: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Liabilities</b>				
Equity Capital	57.7	57.7	57.7	57.7
Reserve and Surplus	3,328.6	3,403.0	3,550.7	3,805.8
Total Shareholders funds	3,386.3	3,460.7	3,608.4	3,863.4
LT Borrowings & Provisions	1500.0	1500.0	1500.0	1400.0
Deferred Tax Liability	69.3	19.1	19.1	19.1
Others Non-current Liabilities	26.0	27.2	27.2	27.2
<b>Total Liabilities</b>	<b>4,981.5</b>	<b>5,006.9</b>	<b>5,154.6</b>	<b>5,309.7</b>
<b>Assets</b>				
Gross Block	349.1	372.7	392.7	407.7
Less: Acc Depreciation	141.7	168.1	194.1	221.3
Net Block	207.4	204.7	198.6	186.4
Capital WIP	10.3	3.5	13.5	23.5
Goodwill	3,819.7	3,920.0	3,920.0	3,920.0
Non-current Investments	32.9	1.6	1.6	1.6
LT loans & advances	41.0	4.7	14.7	24.7
Deferred Tax Assets	103.0	120.8	120.8	120.8
Other Non-Current Assets	546.2	558.6	563.6	568.6
<b>Current Assets</b>				
Inventory	233.1	292.3	269.9	341.0
Debtors	96.0	118.2	118.9	139.8
Loans and Advances	2.8	0.0	5.5	6.8
Other Current Assets	155.7	172.4	308.4	377.0
Cash	164.3	82.4	110.3	198.0
Investments	46.1	110.4	127.0	146.0
<b>Current Liabilities</b>				
Creditors	398.1	491.1	462.0	553.5
Provisions	2.3	0.0	4.5	5.5
Short term debt & other CL	76.6	91.7	151.8	185.5
<b>Application of Funds</b>	<b>4,981.5</b>	<b>5,006.9</b>	<b>5,154.6</b>	<b>5,309.7</b>

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
<b>Per share data (₹)</b>				
EPS	29.3	32.2	31.6	50.3
Cash EPS	31.5	29.2	36.2	55.0
BV	587.3	600.2	625.8	670.0
DPS	5.4	5.0	5.0	5.0
Cash Per Share	28.5	14.3	19.1	34.3
<b>Operating Ratios (%)</b>				
EBITDA Margin	20.7	18.2	19.2	20.6
PBT / Total Operating income	20.2	9.4	10.9	14.2
PAT Margin	20.1	8.0	10.9	14.2
Inventory days	100.9	60.4	59.0	61.0
Debtor days	41.6	24.4	26.0	25.0
Creditor days	172.4	101.5	101.0	99.0
<b>Return Ratios (%)</b>				
RoE	5.0	5.4	5.1	7.5
RoCE	3.2	5.9	5.7	7.4
<b>Valuation Ratios (x)</b>				
P/E	45.3	54.1	42.0	26.5
EV / EBITDA	52.0	28.4	28.2	21.1
EV / Net Sales	10.8	5.2	5.4	4.4
Market Cap / Sales	9.1	4.3	4.6	3.8
Price to Book Value	2.3	2.2	2.1	2.0
<b>Solvency Ratios</b>				
Debt/EBITDA	9.0	4.7	4.7	3.4
Debt / Equity	0.5	0.4	0.4	0.4
Current Ratio	1.0	1.0	1.1	1.2
Quick Ratio	0.5	0.5	0.7	0.7

Source: Company, ICICI Direct Research

**Exhibit 16: ICICI Direct coverage universe (FMCG)**

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Colgate (COLPAL)	1,377	1,350	Hold	35,712	30.0	29.3	33.6	45.9	46.9	41.0	8.0	7.8	7.2	60.7	66.2	77.5	52.2	51.2	50.8
Dabur India (DABIND)	465	520	Buy	75,530	8.2	8.8	10.3	56.8	52.8	45.3	8.7	8.6	7.4	26.1	25.7	28.3	21.9	22.5	24.8
Hindustan Unilever (HINLEV)	2,101	2,250	Hold	468,000	31.2	33.5	41.3	67.4	62.6	50.8	12.2	11.6	9.7	82.5	24.4	30.3	85.7	20.2	25.0
ITC Limited (ITC)	200	230	Buy	225,942	12.8	12.0	13.7	15.6	16.7	14.6	4.7	4.9	4.3	30.4	27.0	28.3	24.1	20.7	21.7
Jyothy Lab (JYOLAB)	110	110	Hold	4,113	5.3	3.2	4.4	20.9	34.4	25.2	2.3	2.2	2.0	28.6	18.6	23.9	22.6	14.0	18.5
Marico (MARLIM)	333	300	Hold	36,513	8.1	7.8	9.5	41.2	42.4	35.2	5.0	5.2	4.4	41.0	40.1	46.9	34.5	33.8	40.3
Nestle (NESIND)	17,378	18,000	Hold	161,127	204.3	230.9	269.4	85.1	75.3	64.5	13.1	12.1	10.7	56.9	59.3	65.9	101.9	114.1	123.1
Tata Consumer Product (TATGLO)	368	440	Buy	33,433	5.0	8.7	10.9	73.7	42.4	33.8	3.5	3.2	3.0	6.9	7.9	8.8	4.6	5.9	7.1
VST Industries (VSTIND)	3,396	4,000	Buy	4,826	196.9	124.8	216.3	17.2	27.2	15.7	3.9	4.4	3.4	52.1	32.9	45.6	38.6	24.3	33.7
Varun Beverage (VARBEV)	618	580	Reduce	17,662	16.6	9.9	18.1	37.2	62.4	34.1	4.4	3.5	2.5	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,330	1,530	Buy	7,669	32.2	31.6	50.3	41.2	42.0	26.5	4.3	4.6	3.8	5.9	5.7	7.4	5.4	5.1	7.5

Source: Company, ICICI Direct Research

## RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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## ANALYST CERTIFICATION

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