

**Growth visibility; Outlook looks Promising**

**CMP: INR 2,128**

**Rating: BUY**

**Target Price: INR 2,676**

**Stock Info**

BSE	531335
NSE	ZYDUSWELL
Bloomberg	ZYWL:IN
Reuters	ZYDS.NS
Sector	Packaged Foods
Face Value (INR)	10
Equity Capital (INR cr)	
Mkt Cap (INR cr)	
52w H/L (INR)	2,325/ 1,540
Avg Yearly Volume (in 000')	6

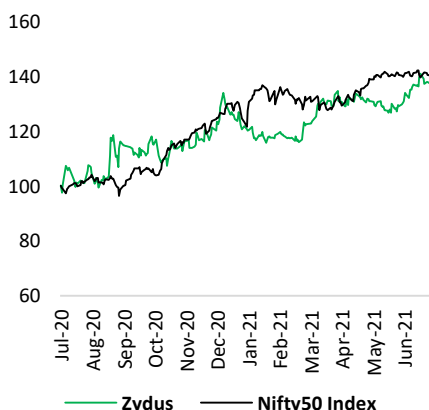
**Shareholding Pattern %**

(As on June, 2021)

Promoters	64.8
FII	3.0
DII	24.7
Public & Others	7.5

Stock Performance (%)	3m	6m	12m
Zydu	1	12	34
Nifty 50	6	16	42

**Zydu Vs Nifty**



Zydu Wellness (ZWL's) revenue grew by 11.2% YoY to INR598cr, almost in line with our estimate of INR602cr driven by leadership position and market share gains across key categories. The revenue include INR5.22cr of one-time GST budgeted support. ZWL maintained its leadership position in five of its brands - Glucon-D, Sugar Free, Ever-Yuth Scrub, Peel off Face Mask & Nycil. Gross margins witnessed a 26bps decline YoY given the company was holding low cost SMP (Skimmed Milk Powder) inventory. With 70bps savings in employee spends and 273bps savings in overhead spends, the company was able to increase marketing spends by 244bps. EBITDA increased by 14.8% to INR140cr against our estimate of INR134cr. EBITDA margin improved by 73bps YoY to 23.5%. Interest cost declined 81.4% in Q1FY22 by repayment of INR130cr debt, which stood at INR435cr. This led to PAT growth of 46.6% YoY to INR131cr against our estimate of INR122cr.

**Lockdown in Summer and early monsoon impacted the revenue growth:** ZWL reported a revenue growth of 11.2% YoY to INR598cr (which includes one time GST budgeted support of INR5.22cr). Excluding which, revenue growth would have been 10.2%. The summer season products was impacted due to extended lockdown owing to Covid 2.0 and early onset of monsoon.

**New launches, distribution expansion to drive growth:** In the last one year, the company focused on product extensions with the launch of 11 new products. It is also supporting new products like Nutralite Doodh Shakti butter spread & Nutralite Choco spread through new ad campaigns. ZWL launched 'Soothing body mist' under Nycil brand in Q1FY22. On the distribution expansion side, the company has increased its direct reach to 5.72 lakh outlets (from 5.5 lakh) and is also driving outreach programmes to increase penetration in hinterland. We believe new product & distribution expansion would drive the growth of the company.

**Major RM cost at higher level; impacted GM:** Though milk prices have moved up since November 2020, the company was covered for increase in milk prices and also swings were manageable. Refined Palm oil (RPO) prices have risen sharply, which impacted margins for Nutralite (contributes 2-3% of sales). The management has taken a price hike but it was not substantial to cover the inflationary pressure. In addition, the crude based packaging material also added burden to the RM cost. However, we believe it would be able to pass on inflationary cost with staggered prices hikes. However we opine that, certain permanent cost saving measures implemented by ZWL and calibrated price hike, would result in improving operating margins, going forward.

**Valuation & Outlook:** ZWL is a unique play on emerging health and wellness category and enjoys a market leadership position in the niche category with a limited competition from the large FMCG companies. Scope and ability to continuously launch product extensions will be the key growth driver going forward. The company's product has an overall penetration in the range of 12-24% (sub-40% urban penetration) signifies growth longevity. In addition, ZWL is aggressively expanding its distribution plans (overall and direct reach at 3.5-4mn/0.85-1mn by FY25E from current 2.25mn/0.57mn) and higher saliency from MT and e-com gives us enough confidence in the company's ability to perform exceedingly going forward.

We expect ZWL to report a Revenue/EBITDA/PAT CAGR of 14%/21.5%/91.3% over FY21-FY23E to INR2,426cr/INR508cr/INR441cr, respectively, on the back of new launches, increasing distribution strength, increasing the presence through existing brands in the sizable opportunity in health & nutrition space and improving strong gross margin gives the company a leeway to spend more on advertisements for brand building exercise. With the strong revenue, improving operating margins, present in top 2 in some of the brands in the market and earnings growth, we believe that the stock can command higher multiple compared to its broader peers.

Hence, we have valued ZWL on a PE basis of 37x in FY23E with a TP of INR2,676 per share, provides an upside of 25.8%. We maintain a BUY rating.

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**Key Concall takeaways**

- Revenue witnessed growth of 11.2% to INR598cr (which includes one-time GST budgeted support of INR5.22cr received in Other operating income). The summer season products witness a negative impact on the back of lockdown in summer and early onset of monsoon coupled with weak consumer sentiment and demand disruptions. The products like Glucose, Nycil got impacted in peak summer season.
- During the quarter, the company witness a faster recovery in EverYuth and Nutralite compared to last year. Glucon D and Nycil got impacted due to lockdown in peak summer season. Nutralite Mayo reported strong performance, Nutralite choco spread faced slowdown.
- Glucon-D has maintained its No.1 position with a market share of 58.2% in the Glucose powder category. Glucon-D Immunovolt, continued to deliver steady business. Complian which has a market share of 5.5% in the malted food (MFD) category delivered a good double digit sales growth during the quarter. Nycil maintained its number one position with a market share of 35.2% in the Prickly heat powder category, which is an increase of 161bps YoY. Nycil Soothing Body Mist was launched during the quarter. Everyuth Scrub continue to rule with a market share of 36.9% in the facial scrub category, which is an increase of 289bps YoY and Everyuth Peel market share of 77.6% in the Peel off category. Everyuth brand now has a market share of 6.3% in the overall facial cleansing segment. Nutralite delivered strong growth both in institutional and retail business during the quarter despite lockdown in key markets. Sugarfree continued its good momentum and delivered a decent growth over a huge base of last year.
- During the quarter, the company launched 'Soothing body Mist' under Nycil brand. The company forayed in the dairy category with Nutralite Doodh Shakti Probiotic butter & Nutralite Doodh Shakti Pure Ghee. The company launched 11 new products in the last one year with new products contributing 3.5% to sales. ZWL intends to achieve 5% contribution from new products.
- Zydus has increased its direct distribution network to 5.72 lakh outlets by June 2021 (5.5 lak outlets in March 2021) under project Vistar. It will continue to expand its organic distribution in future. The company is present in more than 800 towns and will be increasing its rural footprints. ZWL is digitising its sale force and distribution network to improve its inventory replenishment.
- E-commerce sales continues to gain strong traction. The company is looking to leverage the tailwind of growing prominence of the e-commerce channel.
- Export business accounts for 3-3.1% at annualized level. Trailing 4 quarters, the business is doubling. The 7-8 markets forms 80% of the business. Major markets includes: Nigeria, Nepal, GCC, Bangladesh, etc. ZWL is presently catering through Complian and Sugarfree with the brand extensions. The management is also building other portfolio of brands in the export market. The company is considering expanding in the Nigeria and UAE markets. Further, it believes Bangladesh and Nepal provide a fairly large opportunity to expand its sales. ZWL aspires to increase its overseas sales contribution to 8-10% of total sales.
- With regard to Complian, the company is participating in sachets with 75-gram sachet at INR30 price point & 18-gram sachet at INR5 price point. Smaller sachets are seeing very good traction. It is helping it to drive deeper penetration. However, the company believes that larger jar packs would drive the growth.
- The company has enough pricing power with leadership position brands. The company had taken +2% price hike and several cost reduction programs which will be visible from Q2FY22 onwards.
- Commodity prices are on an upswing. However, ZWL is sufficiently covered with milk prices. Palm oil inflation impact would be limited to Nutralite (2-3% of sales). However, packaging related cost could pressurise gross margins in the near term.
- The company has not increased Complian prices since acquisition. As per management, the swings in commodity costs in manageable and its waiting for the brand to achieve certain level for initiating price increase. The company manages the increase in milk price by converting the milk into SMP when the prices are lean.

- Refined Palm Oil or RPO prices have increased more than 90% in a years' time. This has impacted the Nutralite portfolio. To mitigate the impact going forward, the management is building portfolio of brand extensions which will reduce the dependency of palm oil raw-material. This will improve the margins going forward. However, it will take 3-4 years time to build the portfolio.
- Management feels that prices have bottomed out and will witness softening in prices in Q2.
- The company has a vision to achieve 22-23% operating margins by FY23. ZWL would be able to achieve it with judicious price hikes & cost rationalisation measures as integration of acquired brands is complete.
- Margin will be achieved on the back of cost rationalization and volume growth providing operating leverage.
- Management expects double digit revenue growth in FY23 on a normal basis.
- The company has large number of launches in FY21. As per the management, the company has new launches in the pipeline and will launch in the next couple of quarters.
- Income tax rate would remain at zero till FY24 due to accumulated losses, 80i benefits & MAT credits available.
- Debt: The company has repaid INR130cr debt during the quarter. The current gross debt stands at INR435cr. The Net Debt stands at INR225-250cr. In the next 1.5 years time frame, the company expects to be debt free.
- The cost of Debt stands at 5.01%.

Quarterly Result

Q1FY22 Result Analysis

Y/E March (Rscr)	Q1FY21	Q4FY21	Q1FY22	YoY (%)	QoQ (%)
<b>Net sales</b>	<b>537</b>	<b>606</b>	<b>598</b>	<b>11.2</b>	<b>(1.3)</b>
Net raw material & Purchase of finished goods	238	275	267	11.9	(3.1)
% of sales	44.3	45.4	44.6		
Employee expenses	42	40	43	1.3	7.4
% of sales	7.9	6.6	7.2		
Advertisement Expenses	49	73	69	40.9	(5.1)
% of sales	9.1	12.1	11.6		
Other expenses	85	72	78	(8.0)	8.4
% of sales	15.8	11.9	13.1		
<b>Total expenditure</b>	<b>415</b>	<b>460</b>	<b>457</b>	<b>10.2</b>	<b>(0.7)</b>
<b>Operating Profit</b>	<b>122</b>	<b>145</b>	<b>140</b>	<b>14.8</b>	<b>(3.4)</b>
<b>OPM(%)</b>	<b>22.8</b>	<b>24.0</b>	<b>23.5</b>		
Interest	35	9	6	(81.4)	(24.5)
<b>PBDT</b>	<b>88</b>	<b>137</b>	<b>134</b>	<b>52.7</b>	<b>(2.1)</b>
Depreciation	6	6	6	(12.9)	(6.7)
Other income	2	2	2	31.3	33.5
Exceptional item	-	-	-		
<b>PBT</b>	<b>83</b>	<b>133</b>	<b>131</b>	<b>57.3</b>	<b>(1.4)</b>
Tax	(6)	(0)	-		
Effective tax rate (%)	(7.3)	(0.4)	-		
<b>Reported PAT</b>	<b>89</b>	<b>133</b>	<b>131</b>	<b>46.6</b>	<b>(1.8)</b>
Comprehensive income	0	2	-		-
<b>Adjusted PAT</b>	<b>89</b>	<b>135</b>	<b>131</b>	<b>46.2</b>	<b>(3.1)</b>
<b>NPM(%)</b>	<b>16.6</b>	<b>22.3</b>	<b>21.9</b>		
<b>EPS (Rs.)</b>	<b>14.1</b>	<b>21.2</b>	<b>20.6</b>	<b>46.2</b>	<b>(3.1)</b>
Equity	6	6	6	-	-

Source: Company & Arihant Research

Result declared vs Our estimates

Y/E Mar (Rscr)	Q1FY21	Q4FY21	Q1FY22	YoY (%)	QoQ (%)	Arihant Capital estimates	Variation (%)
Net Sales	537	606	598	11.2	(1.3)	602	(0.7)
EBITDA	122	145	140	14.8	(3.4)	134	4.6
EBITDA (%)	22.8	24.0	23.5	73bps	(50)bps	22.3	120bps
Reported PAT	89	133	131	46.6	(1.8)	122	7.6

Source: Company & Arihant Research

**Income statement**

Y/e 31 Mar (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Revenue	843	1,767	1,867	2,109	2,426
Net Raw Materials	298	779	845	954	1092
Advt & Promotion	152	224	230	253	279
Employee Cost	86	156	164	179	206
Other Expenses	122	287	284	302	341
<b>EBITDA</b>	<b>185</b>	<b>321</b>	<b>344</b>	<b>421</b>	<b>508</b>
<b>EBITDA %</b>	<b>22</b>	<b>18</b>	<b>18</b>	<b>20</b>	<b>21</b>
Depreciation	(13)	(26)	(25)	(32)	(42)
Interest expense	(30)	(140)	(84)	(45)	(42)
Other income	39	11	9	11	16
Exceptional items	10	44	132	-	-
<b>Profit before tax</b>	<b>213</b>	<b>228</b>	<b>395</b>	<b>374</b>	<b>462</b>
Taxes	1	20	7	-	-
Minorities and other	-	-	-	-	-
<b>Reported Net profit</b>	<b>214</b>	<b>248</b>	<b>401</b>	<b>374</b>	<b>462</b>
Other Comprehensive income	0	2	2	0	0
<b>Net profit</b>	<b>214</b>	<b>250</b>	<b>403</b>	<b>374</b>	<b>462</b>
<b>EPS</b>	<b>30</b>	<b>25</b>	<b>19</b>	<b>56</b>	<b>69</b>

**Ratio analysis**

Y/e 31 Mar (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
<b>Growth matrix (%)</b>					
Revenue growth	61.7	109.6	5.7	13.0	15.0
Op profit growth	47.5	73.7	7.3	22.2	20.8
Net profit growth	33.3	16.0	61.7	(6.7)	23.4
<b>Profitability ratios (%)</b>					
RoCE	7.4	7.1	6.8	7.5	8.5
RoNW	8.4	4.2	3.0	7.5	8.6
RoA	3.4	2.9	2.3	6.5	7.5
<b>Per share ratios</b>					
Dividend per share	0.4	0.4	0.4	0.2	0.2
Book value per share	587.3	600.2	717.9	773.3	842.4
<b>Valuation ratios</b>					
P/E	57.3	49.4	33.7	36.2	29.3
P/CEPS	54.2	44.7	31.7	33.3	26.9
P/B	3.6	3.5	3.0	2.8	2.5
EV/EBIDTA	74.2	42.8	40.3	32.6	26.4
<b>Payout (%)</b>					
Dividend payout	1.3	1.1	0.7	0.4	0.3
Tax payout	(0.3)	(9.0)	(1.7)	-	-
<b>Liquidity ratios</b>					
Debtor days	41.0	24.1	18.2	18.0	18.0
Inventory days	281.2	135.1	155.4	155.0	155.0
Creditor days	214.6	125.6	103.7	104.0	104.0

Source: Company &amp; Arihant Research

**Balance sheet summary**

Y/e 31 Mar (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Equity capital	58	58	64	64	64
Reserves	3,329	3,403	4,504	4,857	5,297
<b>Net worth</b>	<b>3,386</b>	<b>3,461</b>	<b>4,568</b>	<b>4,921</b>	<b>5,360</b>
Minority Interest	0	0	0	0	0
Debt	1,604	1,556	599	564	509
Other non-current liabilities	0	0	0	0	0
Deferred tax liab (net)	0	0	0	0	0
<b>Total Liabilities</b>	<b>4,990</b>	<b>5,016</b>	<b>5,167</b>	<b>5,485</b>	<b>5,869</b>
Fixed assets	207	205	200	326	439
Capital Work In Progress	10	4	4	5	7
Other Intangible assets	540	549	548	548	548
Goodwill	3,820	3,920	3,920	3,920	3,920
Investments	0	0	0	0	0
Other non current assets	176	127	140	158	182
Inventories	233	292	365	411	470
Sundry debtors	96	118	94	105	121
Loans & Advances	0	0	0	0	0
Other current assets	158	250	117	146	168
Sundry creditors	(392)	(504)	(439)	(488)	(554)
Other current liabilities & Prov	(76)	(69)	(61)	(69)	(79)
Cash	164	82	253	392	613
Other Financial Assets	53	43	27	29	34
<b>Total Assets</b>	<b>4,990</b>	<b>5,016</b>	<b>5,167</b>	<b>5,485</b>	<b>5,869</b>

**Cashflow summary**

Y/e 31 Mar (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Profit before tax	213	228	395	374	462
Depreciation	13	26	25	32	42
Tax paid	1	20	7	-	-
Working capital Δ	(22)	(68)	11	(30)	(20)
Change in Goodwill	(3,797)	(100)	-	-	-
<b>Operating cashflow</b>	<b>(3,592)</b>	<b>106</b>	<b>438</b>	<b>377</b>	<b>483</b>
Capital expenditure	(149)	(17)	(20)	(160)	(157)
<b>Free cash flow</b>	<b>(3,741)</b>	<b>89</b>	<b>418</b>	<b>216</b>	<b>326</b>
Equity raised	2,484	(173)	707	(20)	(21)
Investments	-	-	-	-	-
Others	(544)	51	4	(20)	(28)
Debt financing/disposal	1,568	(48)	(957)	(35)	(55)
Dividends paid	(3)	(3)	(3)	(2)	(2)
Equity Buy back	-	-	-	-	-
Capital subsidy	-	-	-	-	-
Other items	(13)	2	2	-	-
<b>Net Δ in cash</b>	<b>(249)</b>	<b>(82)</b>	<b>170</b>	<b>139</b>	<b>221</b>
<b>Opening Cash Flow</b>	<b>414</b>	<b>164</b>	<b>82</b>	<b>253</b>	<b>392</b>
<b>Closing Cash Flow</b>	<b>164</b>	<b>82</b>	<b>253</b>	<b>392</b>	<b>613</b>

Source: Company &amp; Arihant Research

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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