

Investor's Delight: Zydus Wellness Ltd. (ZWL) – "BUY"

"Attractive proposition in health & wellness industry; comfortable valuations"

Investment Summary

A Cadila group Company, "Zydus Wellness Ltd." operates in Indian Health and Wellness industry which is valued over Rs. 590 bn and expected to witness a CAGR of 18%. The Company has presence in niche segments with strong brands like a) Sugar Free: A healthy alternative to sugar – leading the market with over 94% share of the sugar substitutes category, b) Everyuth: Market leader in facial scrub and facial peel off and a strong presence in face wash, c) Nutralite: India's largest selling table spread – a healthier alternative to butter, d) Actilife: First nutritional drink fortified with Prebiotic Actifibers that help manage cholesterol, improve digestion and build immunity. The Company has state of the art facility for Nutralite and set up a new facility in Sikkim for Sugar Free and Everyuth. The Company enjoys widespread distribution network – Coldchain for (Nutralite) and regular. ZWL has very strong brand recall and a healthy market share in each of these niche segments. In the first nine months of FY14, the company delivered an earnings growth of 25 per cent.

ZWL witnessed a yoy growth of 1.5% in topline to touch Rs 973.4mn in Q3FY14. EBITDA margin remained almost flat with minor 10bps y-o-y decline to 27.5%. However, higher other income coupled with lower depreciation and tax outlay resulted into relatively better net profit growth of 18.5% y-o-y to Rs 267.7mn. Gross margin expanded by 230bps but higher staff costs and OPEX restricted the EBITDA margin expansion ZWL registered a yoy expansion of 230bps in gross margin mainly on account of judicial price hike. However, EBITDA margin remained almost flat at 27.5% due to higher staff cost and OPEX. Higher other income coupled with lower depreciation and tax outlay gave relatively better net profit growth.

In the sugar free segment, the Company has leadership positions in variants of Aspartame with Sugar Free Gold and Sucralose with Sugar Free Natura. Present in several forms like pellets, liquid sachets, powders and tablets top enhance consumer experience and offer wide choice. Recently ZWL has initiated a strategic drive with bollywood's famous celebrity – Mr. Akshay Kumar. In Q3FY14, Sugar Free segment maintained its growth trajectory and witnessed a y-o-y double digit growth in revenues. Despite falling in high discretionary category, Sugar Free is maintaining its growth momentum mainly on account of focused brand promotion strategy, lower penetration level, increasing health awareness among the people. Currently 'Sugar Free' is largely available in the urban areas and the large rural market is yet to be tapped. We believe rapidly growing urbanization, large untapped markets, increasing health awareness, changing life styles, celebrity backed brand promotions etc will drive the growth for 'Sugar Free' in the coming years.

Date	March 05, 2014
Industry	Health & Wellness/Consumption/FMCG
CMP	Rs. 483
Target Price	Rs. 580
Upside	20%
BSE/NSE Code	531335/ZYDUSWELL
Bloomberg Code	ZYWL:IN
52 Week High	Rs. 755 (17 th June, 2013)
52 Week Low	Rs. 417 (26 th March, 2013)
Face Value	Rs. 10
Market Capitalization	Rs. 18.87 bn
Networth	Rs. 2,565 mn
Equity Capital	Rs. 390.7 mn
Net Fixed Assets	Rs. 943 mn
Cash and Bank Balance	Rs. 1,908 mn
Book Value	Rs. 66
Price/Book Value (x)	7.3x
Shareholding Pattern (%)	As on Dec 2013
Promoters	72.4
FII's	8.14
DII's	8.07
Public and Others	11.22

On the other hand, performances of EverYuth and Nutralite continued to remain under pressure as both the brands reported a slide in their sales. Increasing competitive landscape putting pressure on Ever Yuth's face wash and peel-offs and resulting in a market share slide in these categories. Sluggish category performance, limited pricing power coupled with high competition from the regional or small players, etc. are affecting Nutralite's performance in the recent times. However, the Company indicated aggressive marketing plans in the coming quarters to boost the market shares of these three brands. Besides, re-launched EverYuth is getting good momentum which will push the sales

Distribution restructuring: The company initiated distribution restructuring to boost the growth trajectory and this distribution restructuring process will complete by Q1FY15. ZWL is expected to see ~25% expansion in the distribution network which will be mainly in to non-chemist channels.

Outlook and Valuation

At current price, ZWL trades at 19x and 16x of FY14E and FY15E consolidated earnings respectively. With due consideration to factors like: a) strong performance of sugar free segment, b) ongoing distribution restructuring to infuse additional growth from Q1FY15, c) expected revenue CAGR of 13%, d) expected revival in Nutralite sales in next 2-3 quarters, e) healthy EBITDA margins of 25.4%, f) minimum working capital requirements as business is done on advance cash collection terms, g) positive operating cashflow, h) debt free status, i) robust return ratios with FY13 ROE at 44.67%, j) strong parentage; we recommend a "BUY" with a target price of Rs. 580 (19x at estimated FY15 EPS of Rs.30 by street) for investors with a horizon of 6-9 months.

Concerns

Zydus Wellness Ltd (ZWL) reported Q3FY14 results lower than street expectations mainly on account of sluggish performances of EverYuth and Nutralite and ongoing distribution restructuring.

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