

## ZYDUS WELLNESS

MIDCAPS

15 JUL 2014

Quarterly Update

**BUY**

Target Price: Rs 690

### Muted sales but product mix improving

Zydus' Q1FY15 revenue at Rs 1 bn (down 6% YoY) was lower than estimated (Rs 1.2 bn). However, gross margin (72.0% in Q1FY15) improved YoY (70.5% in Q1FY14) and QoQ (68.5% in Q4FY14). Thus, we believe sales mix has improved, with likely growth in Sugar Free and muted sales in other segments, especially Nutralite. EBITDA margin, at 15.3%, was lower than our estimate of ~17% due to higher advertisement and sales promotion. A tax write back of Rs 33 mn in Q1FY14 vs. tax expense of Rs 20 mn in Q1FY15 also impacted PAT (down 25% at Rs 171 mn vs. our est. of ~ Rs 230 mn).

With the overhaul of Zydus' distribution network almost complete (now aligning to FMCG industry norms), the benefits are expected to kick-in from coming quarters. **Maintain estimates and TP of Rs 690. BUY.**

CMP : Rs 584  
Potential Upside : 18%  
Relative to Sector : Neutral

#### MARKET DATA

No. of Shares : 39 mn  
Free Float : 27%  
Market Cap : Rs 23 bn  
52-week High / Low : Rs 736 / Rs 435  
Avg. Daily vol. (6mth) : 55,790 shares  
Bloomberg Code : ZYWL IB Equity  
Promoters Holding : 73%  
FII / DII : 8% / 7%

### Annual General Meeting highlights

- ♦ **Strategy going forward:** Strengthen existing brands and new product launches in existing categories; explore business partners and possible acquisitions; innovation in communication and media; capitalize on benefits of new distribution model
- ♦ **Overhaul of Zydus' distribution network:** As per the earlier setup, there were a large number of distributors (~3,000), but most of the servicing was done by Zydus' personnel. This was not cost efficient and customer engagement was not as per expectations. Under the new set up, number of distributors (~1,000) has reduced, but they have been channelized and aligned territory wise. Now, most of the servicing and customer engagement will be done by distributors themselves and Zydus' personnel will supervise. The new distribution set up is in line with the FMCG industry. The distribution overhaul is almost complete and the benefits are expected to kick-in from coming quarters

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### Financial summary (Consolidated)

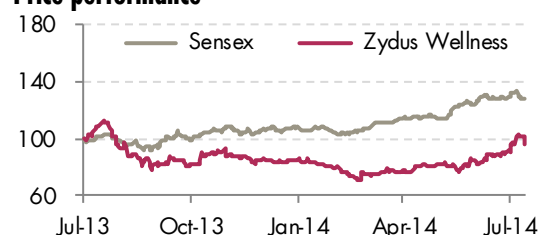
Y/E March	FY13	FY14	FY15E	FY16E
Sales (Rs mn)	3,880	4,036	4,537	5,201
Adj PAT (Rs mn)	971	965	1,119	1,348
Con. EPS* (Rs.)	-	-	28.8	33.4
EPS (Rs.)	24.9	24.7	28.6	34.5
Change YOY (%)	41.1	(0.7)	16.0	20.4
P/E (x)	17.5	20.1	20.4	16.9
RoE (%)	43.8	33.1	30.3	29.0
RoCE (%)	47.2	34.6	33.0	31.6
EV/EBITDA (x)	15.6	18.8	18.1	14.4
DPS	6.0	6.0	7.0	8.0

Source: \*Consensus broker estimates, Company, Axis Capital

### Key drivers

	FY14	FY15E	FY16E
Revenue (Rs bn)	4.3	4.8	5.5
Gross margin (%)	69.3	70.4	72.3
Core EBITDA margin (%)	22.2	23.7	24.7

### Price performance



**Exhibit 1: Results update (consolidated)**

(Rs. mn)	Quarter ended					12 months ended		
	Jun-14	Jun-13	% Chg	Mar-14	% Chg	FY15E	FY14	% Chg
<b>Net Sales</b>	<b>1,009</b>	<b>1,075</b>	<b>(6.1)</b>	<b>1,011</b>	<b>(0.1)</b>	<b>4,537</b>	<b>4,036</b>	<b>12.4</b>
EBITDA	154	172	(10.1)	200	(22.9)	1,073	895	19.9
Other income	60	38	58.9	56	8.4	227	189	20.0
<b>PBIDT</b>	<b>215</b>	<b>210</b>	<b>2.4</b>	<b>256</b>	<b>(16.1)</b>	<b>1,300</b>	<b>1,084</b>	<b>19.9</b>
Depreciation	20	11	75.4	13	57.5	49	47	5.8
Interest	0	0	(33.3)	0	(50.0)	1	1	0.0
<b>PBT</b>	<b>195</b>	<b>198</b>	<b>(1.7)</b>	<b>243</b>	<b>(19.9)</b>	<b>1,250</b>	<b>1,036</b>	<b>20.6</b>
Tax	20	(33)	(160.1)	21	(3.9)	110	53	106.9
Minority Interest	4	4	7.9	5	(16.3)	20	19	10.0
<b>Adjusted PAT</b>	<b>171</b>	<b>227</b>	<b>(25.0)</b>	<b>217</b>	<b>(21.5)</b>	<b>1,119</b>	<b>965</b>	<b>16.0</b>
Extra ordinary income/ (exp.)	0	0	-	0	-	0	0	-
<b>Reported PAT</b>	<b>171</b>	<b>227</b>	<b>(25.0)</b>	<b>217</b>	<b>(21.5)</b>	<b>1,119</b>	<b>964</b>	<b>16.1</b>
No. of shares (mn)	39	39	-	39	-	39	39	0.0
EBITDA margin (%)	15.3	16.0	-	19.8	-	23.7	22.2	6.7
PBIDT margin (%)	21.3	19.5	-	25.3	-	28.7	26.9	6.7
<b>EPS - annualized (Rs.)</b>	<b>17.5</b>	<b>23.3</b>	<b>(25.0)</b>	<b>22.2</b>	<b>(21.5)</b>	<b>28.6</b>	<b>24.7</b>	<b>16.0</b>

Source: Company, Axis Capital

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- ◆ **Marketing spend to remain at current levels:** Advertisement and promotional expense is high as the company requires to spend for improving the awareness of the wellness market in India, particularly in the artificial sweetener segment. This spend is less focused on countering competition, since Sugar Free already enjoys ~93% market share in the artificial sweetener market in India. Thus, we believe advertising and promotional spend (~27% of net sales) will continue to be at current levels
- ◆ **Focus on domestic market:** Though the company has ventured into select export markets over the past 6-8 months, the focus continues to be on domestic wellness market, since it believes the market opportunity is significant in India
- ◆ **R&D spend:** Zydus has a strong pipeline of products in existing categories. The company has already launched products like Neem Face Pack, Fairness peel Off, Tulsi Turmeric Face Wash in the EverYuth segment and 'Yummy' in the Nutralite segment

## Financial summary (Consolidated)

### Profit & loss (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
<b>Net sales</b>	<b>3,880</b>	<b>4,036</b>	<b>4,537</b>	<b>5,201</b>
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>3,880</b>	<b>4,036</b>	<b>4,537</b>	<b>5,201</b>
Cost of goods sold	(1,316)	(1,342)	(1,460)	(1,573)
Gross profit	2,564	2,694	3,077	3,628
<i>Gross margin (%)</i>	<i>66.1</i>	<i>66.8</i>	<i>67.8</i>	<i>69.8</i>
Total operating expenses	(1,597)	(1,799)	(2,004)	(2,346)
<b>EBITDA</b>	<b>967</b>	<b>895</b>	<b>1,073</b>	<b>1,282</b>
<i>EBITDA margin (%)</i>	<i>24.9</i>	<i>22.2</i>	<i>23.7</i>	<i>24.7</i>
Depreciation	(45)	(47)	(49)	(53)
<b>EBIT</b>	<b>922</b>	<b>849</b>	<b>1,024</b>	<b>1,229</b>
Net interest	(1)	(1)	(1)	(1)
Other income	158	189	227	272
<b>Profit before tax</b>	<b>1,079</b>	<b>1,036</b>	<b>1,250</b>	<b>1,500</b>
Total taxation	(88)	(53)	(110)	(130)
<i>Tax rate (%)</i>	<i>8.2</i>	<i>5.1</i>	<i>8.8</i>	<i>8.7</i>
Profit after tax	990	983	1,140	1,370
Minorities	(19)	(19)	(20)	(23)
Profit/ Loss associate co(s)	-	-	-	-
<b>Adjusted net profit</b>	<b>971</b>	<b>965</b>	<b>1,119</b>	<b>1,348</b>
<i>Adj. PAT margin (%)</i>	<i>25.0</i>	<i>23.9</i>	<i>24.7</i>	<i>25.9</i>
Net non-recurring items	-	-	-	-
<b>Reported net profit</b>	<b>971</b>	<b>964</b>	<b>1,119</b>	<b>1,348</b>

### Balance sheet (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
Paid-up capital	391	391	391	391
Reserves & surplus	2,175	2,865	3,731	4,789
Net worth	2,594	3,303	4,169	5,226
Borrowing	-	-	-	-
Other non-current liabilities	47	57	57	57
<b>Total liabilities</b>	<b>3,491</b>	<b>4,249</b>	<b>5,179</b>	<b>6,334</b>
Gross fixed assets	1,103	1,160	1,235	1,310
Less: Depreciation	(161)	(206)	(255)	(308)
Net fixed assets	943	954	980	1,002
Add: Capital WIP	-	-	-	-
Total fixed assets	943	954	980	1,002
Total Investment	-	50	50	50
Inventory	409	279	304	331
Debtors	15	26	30	34
Cash & bank	1,908	2,628	3,407	4,398
Loans & advances	218	310	408	520
Current liabilities	851	889	954	1,052
Net current assets	1,698	2,355	3,195	4,231
Other non-current assets	-	-	-	-
<b>Total assets</b>	<b>3,491</b>	<b>4,249</b>	<b>5,179</b>	<b>6,334</b>

Source: Company, Axis Capital

### Cash flow (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
Profit before tax	1,079	1,036	1,250	1,500
Depreciation & Amortisation	(45)	(47)	(49)	(53)
<i>Chg in working capital</i>	<i>(233)</i>	<i>91</i>	<i>(62)</i>	<i>(45)</i>
<b>Cash flow from operations</b>	<b>684</b>	<b>911</b>	<b>1,135</b>	<b>1,387</b>
<i>Capital expenditure</i>	<i>(23)</i>	<i>(55)</i>	<i>(75)</i>	<i>(75)</i>
<b>Cash flow from investing</b>	<b>136</b>	<b>134</b>	<b>152</b>	<b>197</b>
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Dividend paid</i>	<i>(195)</i>	<i>(233)</i>	<i>(273)</i>	<i>(313)</i>
<b>Cash flow from financing</b>	<b>(227)</b>	<b>(325)</b>	<b>(509)</b>	<b>(594)</b>
Net chg in cash	593	720	778	991

### Key ratios

Y/E March	FY13	FY14	FY15E	FY16E
<b>OPERATIONAL</b>				
FDEPS (Rs)	24.9	24.7	28.6	34.5
CEPS (Rs)	26.0	25.9	29.9	35.8
DPS (Rs)	6.0	6.0	7.0	8.0
Dividend payout ratio (%)	24.1	24.3	24.4	23.2
<b>GROWTH</b>				
Net sales (%)	15.2	4.0	12.4	14.6
EBITDA (%)	23.3	(7.4)	19.9	19.5
Adj net profit (%)	41.1	(0.7)	16.0	20.4
FDEPS (%)	41.1	(0.7)	16.0	20.4
<b>PERFORMANCE</b>				
RoE (%)	43.8	33.1	30.3	29.0
RoCE (%)	47.2	34.6	33.0	31.6
<b>EFFICIENCY</b>				
Asset turnover (x)	6.2	5.9	6.3	6.5
Sales/ total assets (x)	1.3	1.0	1.0	0.9
Working capital/ sales (x)	(0.1)	(0.1)	(0.1)	-
Receivable days	1.4	2.4	2.4	2.4
Inventory days	51.2	32.5	32.1	30.8
Payable days	69.0	71.0	70.1	67.3
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.9)	(0.9)	(0.9)	(0.9)
Current ratio (x)	3.0	3.6	4.4	5.0
Interest cover (x)	921.7	652.8	787.8	945.7
<b>VALUATION</b>				
PE (x)	17.5	20.1	20.4	16.9
EV/ EBITDA (x)	15.6	18.8	18.1	14.4
EV/ Net sales (x)	3.9	4.2	4.3	3.5
PB (x)	6.6	6.0	5.5	4.4
Dividend yield (%)	1.4	1.2	1.2	1.4
Free cash flow yield (%)	3.9	4.4	4.7	5.8

Source: Company, Axis Capital

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