

## Zydus Wellness Ltd.

BUY: Rs 609 Target: Rs 726

Zydus Wellness Ltd. (ZYWL), a subsidiary of Cadila Healthcare Ltd. is into manufacturing and marketing of niche wellness products, having plants at Ahmadabad and Sikkim. It offers wellness products, combines best of healthcare, nutrition and cosmeceuticals. All its products, viz., Sugar free, Nutralite, EverYuth and Actilife; cater to the evolving needs brought about by change in lifestyle and surge in chronic diseases. Being an early entrant, with launch of Sugar Free in 1988, it has successfully gained over 90% of the market share of an artificial sweetener.

Over half of its revenues have been contributed by Sugar Free and EverYuth, we expect these two products continue to drive the revenues and Nutralite to provide some support to the overall margins as vegetable oil prices are cooling off. Between FY08 and FY13, ZYWL's revenue and net profit have grown at a CAGR of 48% and 84%, respectively, due to its play on the rising affluence in the country, increasing conscious about their calories intake and rising number of diabetic patients. We expect to mirror relatively similar growth, going ahead. We initiate coverage with a target price of Rs.726 and BUY rating.

### Investment Rationale

#### Leader in an artificial sweetener - Sugar Free to sweeten overall business

Over the years, Sugar Free brand has successfully captured 92% of the total market share of an artificial sweetener market. If we light-up the history, it was firstly launched in 1988 as an ethical drug and promoted through doctors for diabetic patients. In 1993 it was promoted as an OTC product.

Sugar Free product has very strong brand equity and it is always on the top of the buyers' mind when it comes to the sugar substitute. With launch of Sugar Free in 1988, it had made people aware about an artificial sweetener and created the demand for the product, in a way industry has been created and developed by the Zydus Wellness, in India.

As on 31st December 2012, ZYWL is a market leader with more than 90% of the total market share. Of late, many MNCs and domestic companies have jumped in, to eat the fruits sown by the ZYWL, this has led to single digit growth in the last 3 quarters. To remain competitive, it has rolled out an aggressive ad campaign, roped in many big celebrities and extended its Sugar Free brand, viz., Sugar Free Gold (Aspartame based), Sugar Free Natrura (Sucralose based), Sugar Free Herbvia (Stevia based) and Sugar Free D'lite (Drink).

#### STOCK DATA

BSE Code	531335
NSE Code	ZYDUSWELL
Bloomberg Code	ZYWL:IN
52 Week Low / High (Rs.)	375.3 / 603.7
Face Value (Rs.)	10
Diluted Number of Shares (Cr.)	3.91
Market Cap. (Rs Cr.)	2377.4
Avg. Yearly Volume	37,354

#### SHAREHOLDING PATTERN (%)

Particulars	Mar.13	Dec.12	Sept.12	Jun.12
Promoters	72.5	72.5	72.5	72.5
FII's	4.1	3.2	2.2	1.7
Other Institutions	11.8	12.3	13.2	13.7
Public & Others	11.6	12.0	12.1	12.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

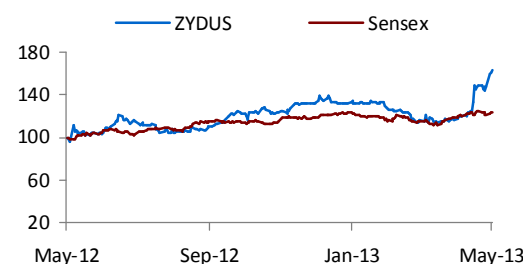
#### RETURNS STATISTICS (%)

	3 M	6 M	12 M
SENSEX	5.6	5.4	23.9
ZYDUS	27.0	30.1	62.6

#### FINANCIAL RATIOS (x)

Particulars	FY11	FY12	FY13E	FY14E
PE	35.1	24.5	22.2	18.5
P/BV	12.7	9.3	7.2	5.7
EV/EBIDTA	26.0	19.5	15.8	12.6
EV/Sales	6.5	5.3	4.3	3.5
Mcap/sales	6.9	5.8	4.9	4.1
Price/sales	1.8	1.5	1.2	1.0
PEG	2.6	0.6	2.2	0.9
Div. Yield (%)	0.8	1.0	1.2	1.3

#### RELATIVE TO SENSEX



#### FINANCIAL SUMMARY

(Rs. in Crs.)

Year	Sales	EBITDA	PBT	PAT	EPS (Rs)	DPS (Rs)	BVPS (Rs)
FY12	344.6	77.2	82.3	67.7	17.3	5.0	47.9
FY13	410.0	96.5	107.7	96.9	24.8	6.0	65.2
FY14E	487.9	117.1	128.2	106.9	27.4	7.0	84.3
FY15E	583.0	140.9	154.3	128.7	32.9	8.0	107.3

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These extensions are available in different forms such as pallets, powder, sachet, sweet drops, ready to drink and powder drink. Sugar Free Gold is the highest selling product followed by Sugar Free Nutra and margins are also superior as compared to other extensions, due to lower input cost i.e. Aspartame.

### Major RM for an artificial sweetener

	Aspartame	Sucralose	Stevia
Price/K.g.	950	7500	10000
Sweetness compared to sugar (times)	200	600	1200
Derived from	Synthetic chemical process	Sugar by adding chlorine to change the structure of sugar molecule.	Vegetable plant (100% natural)

Source: SBICAP Securities Research

### Sugar Free Brand Extensions



### Competition Matrix

Company	Brand	Base ingredient	Price	
			Per Sachet	Per tablet
Zydus Wellness	Sugar Free Gold	Aspartame	1.6	0.6
Zydus Wellness	Sugar Free Nutra	Sucralose	1.4	0.7
Merisant	Equal	Aspartame	1.5	0.7
Alembic	Zero	sucralose	-	0.7
Rigil biotech	Steviocal	Stevia based	2.0	0.9
Mankind pharma	Kalree-1	Aspartame	-	0.5
Herboveda india	So Sweet	stevia based	2.8	0.9
Sweetwell ind products pvt ltd	Sweetwell	Barley, corn	1.7	1.0
Splenda	Splenda	Sucralose	1.5	0.7

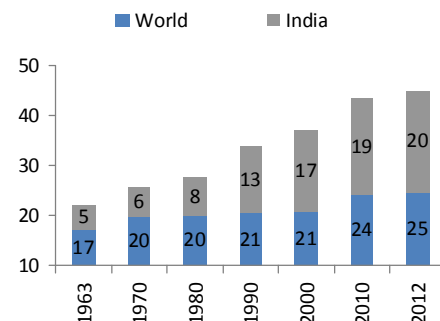
Source: SBICAP Securities Research

## An artificial sweetener industry has a real growth - as sugar consumption is on rise, led to an increase in diabetes population in India

India is the world's biggest sugar consumer, with a population of 1.2bn, consuming one-third more sugar than the EU and over 60% more than China, but still India's per capita consumption of sugar is around 20.2 kg, below the global average of 24.8kg. Of late, we have witnessed the consumption of sugar in India is growing rapidly than the global average consumption. India's sugar consumption would be par with the global average consumption in next 3-4 years.

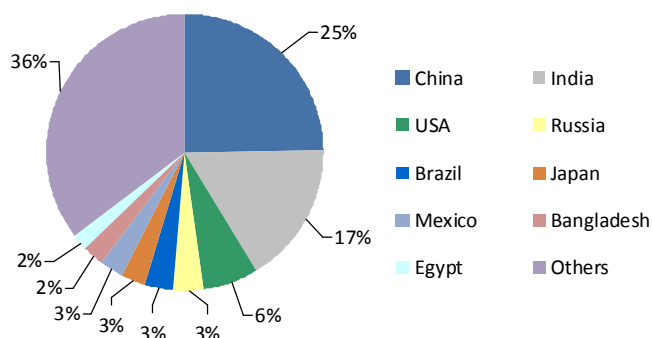
Being the biggest sugar consumer, Indians are more vulnerable to diabetes, of course world's largest diabetic population is in India. An incidence rate of diabetes in India has been on the rise (world's 16% type 2 diabetic patients are in India) and afflicts more than 6% of the population. The main causes are sedentary lifestyle, lack of physical activities, obesity, stress and consumption of diets rich in fat, sugar and calories.

PER CAPITA CONSUMPTION OF SUGAR IN INDIA VIS A VIS GLOBAL AVG. (KGS.)



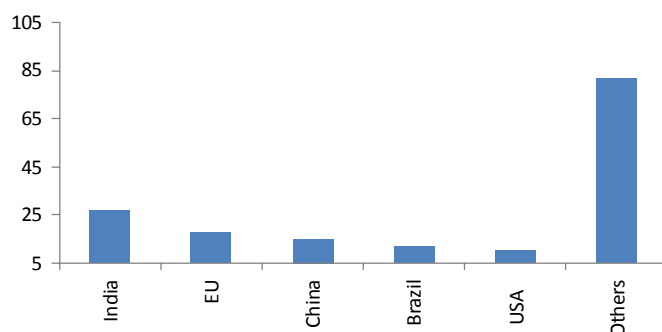
Source: SBICAP Securities Research / USDA

DIABETIC POPULATION IN 2011



Source: SBICAP Securities Research / IDF

SUGAR CONSUMPTION (MT) IN 2012 ('000)



Source: SBICAP Securities Research / USDA

## Consumption of an artificial Sweetener is going to rise

India's new generation is becoming more calorie conscious and on other side, more than 60 million people are suffering from diabetes, this both reasons are enough to auger demand for sugar substitute, sector which is currently at a nascent stage. An artificial sweetener is a healthy substitute of sugar, thus the product can be catered to all people consuming sugar.

**Scalable opportunities** - The market for an artificial sweetener is USD 2bn in the US whereas 10% of their population is diabetic. In comparison, USD 28mn Indian market is small but holds growth potential, more so because about 60 million Indians have type-2 diabetes (where glucose or sugar builds up in the blood instead of being broken down). This depicts that an artificial sweetener industry is poised to grow and ZYWL has a strong footing to further expand its market share.

## Nutralite - yet to see silver lining, but decline in RM prices to provide some impetus

Zydus has placed Nutralite as a premium product which is table margarine, a healthy substitute for butter, as it contains less saturated fats and more unsaturated fats. Market for margarine is approximately about Rs.150Cr and it is dominated by Nutralite, with around 60% of the market share.

Within Nutralite, Zydus Wellness caters to two segments viz., Institutional and Retail, constitutes of 75% and 25% of the total Nutralite's business, respectively. However, on an institution front it does not hold much pricing power while on retail side company earns higher margins, but an institutional segment continue to be a revenue driver.

Basic raw material for the Nutralite is Palm oil. Palm oil prices are on corrective mode after four year high of MYR 3955 in November 2011, due to inventory pill up of 2.6 million tons in December 2012 against modest demand. Going ahead, we expect palm oil price to remain under pressure for next three to four quarters owing to lackluster demand, globally. This will obviously provide the further impetus to overall margins.

### PALM OIL PRICES (MYR - METRIC TONES)



Source: SBICAP Securities Research / Company / Reuters

In recently ended quarter, Nutralite have clocked lower single digit growth. However, in a long run we are optimistic about the response to Nutralite; because of the Company is taking some serious efforts to make Nutralite, a premium product by creating awareness about the low calories margarine.

### **EverYuth - Combating to remain youth through rebranding, which has started receiving positive response**

In skincare segment Zydus has a presence in face wash, scrub and peel-off. In this space, Zydus was at a sweet spot, until MNCs and domestic companies hoped in. The Company is facing intense competition from both MNCs such as Johnson & Johnson (Clean n Clear), L'Oreal (Garnier), Hindustan Unilever (Lakme, Pears, Ponds, Fair & Lovely), Beiersdorf (Nivea) and P & G (Olay) and local rivals Wipro Consumer (Santoor), Ozone (Nomarks), Himalaya and VLCC. This led to decrease in market share of Face-wash to 4% while Zydus has able to fight in Scrub and Peel-off segments with market share of 39% and 88%, respectively.

Recently, under EverYuth brand name, the Company has launched Soaps in three variants - Lemon, Neem and Fruit in 125gm and 75gm pack and earlier it had launched EverYuth Menz. The Company is beating competition with an aggressive ad campaign and foraying into different categories like soaps and Menz. In the last quarter of FY13, ZYWL has roped in actress Nargis Fakhri to relaunch facewash, scrub and peel-off with improved packaging.

**Effects of rebranding:** In Q4FY13, we have witnessed double digit growth in EverYuth - an early sign of resurgence. Going ahead, we believe that brand building exercise and new product launches would definitely enable Zydus to regain the lost market share in skincare category.

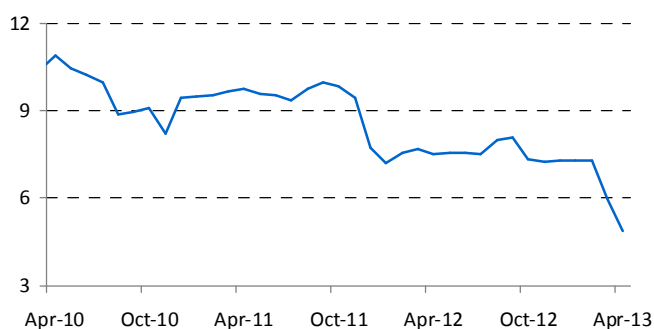
### **ActiLife - Will it be able to replicate the success of Sugar Free?**

The Company is betting big on nutraceuticals and launched ActiLife - a daily nutrition supplement for adults, which contains Prebiotic Actifibres - helps in controlling cholesterol and also improving digestion. Due to zero competition in adult drink category and being an early entrant, we expect this brand to have better response; once the Company is able to generate awareness for the product. Currently, revenue contribution from ActiLife is insignificant.

## Recovery in economy to spur overall demand for consumer products

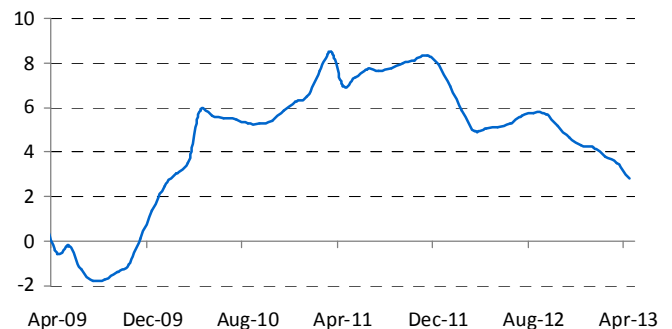
Indian economy is on the recovery mode, after bitter over all economic condition and investment climate, to name a few - stubborn inflation, an acute sense of policy wilderness, apparent disconnect between the executive and the electorate, thwarted investment activities and haunted twin deficits. Now, it seems economy is bottoming out, we can feel the change of winds - with decline in the major commodity prices - Gold and Crude oil, will release some pressure on CAD. This time around the government is standing firm (earlier paralyzed) with slew of reforms and intensions to take some more measures to lure foreign funds.

WPI (%)



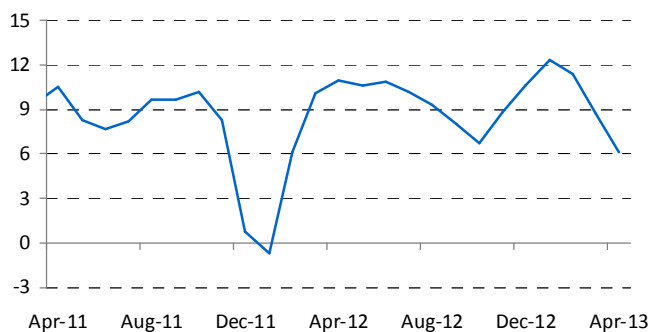
Source: SBICAP Securities Research / RBI

CORE INFLATION (%)



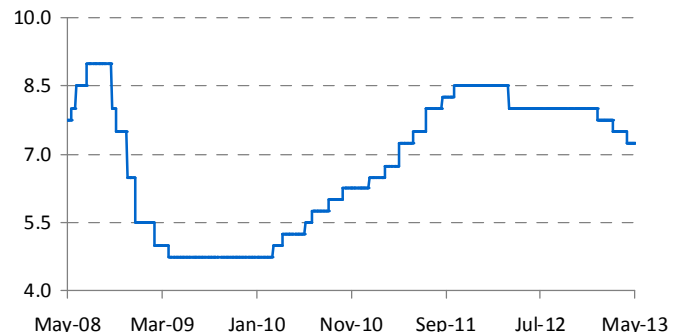
Source: SBICAP Securities Research / RBI

FOOD INFLATION (%)



Source: SBICAP Securities Research / RBI

REPO RATE (%)



Source: SBICAP Securities Research / RBI

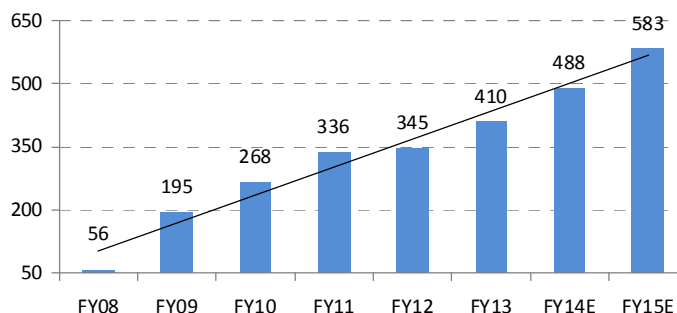
At last RBI's intensions are seemed to be parallel with the government's with rate cut in three consecutive months. We expect RBI to cut rates further, owing to decline in persistent inflation - WPI inflation fell to 4.89% in April 2013; lowest recorded figure in 41 months' and core inflation fell to 2.8% March 2013, 38 months' low. Food inflation is also showing sign of slowing down, which was a bigger concern.

Desire for better standard of living, constant change in lifestyle, higher per capita and disposable income and revival in the economy will definitely lift up consumer sentiments, within the country. Zydus Wellness is well placed to take the advantage of this situation, pertaining to products it offers, with leadership position in respective categories and dealers network of 3,00,000 for Sugar-free and 70,000 for Nutralite and EverYuth.

## Financial Performance

Between FY08 to FY13, topline grew at a CAGR of 48%; we expect it to grow at a CAGR of 21% over next two years.

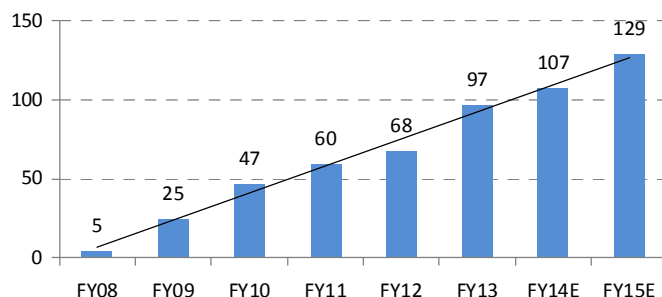
### NET SALES (CRS.)



Source: SBICAP Securities Research

Net profit grew at a CAGR of 84% over FY08 to FY13, for the next two years we expect it to grow by 15%.

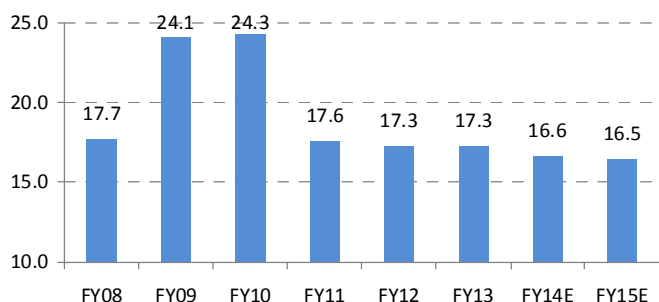
### NET PROFIT (CRS.)



Source: SBICAP Securities Research

Ad-spends were increased in FY09 and FY10, but they were cut back afterwards.

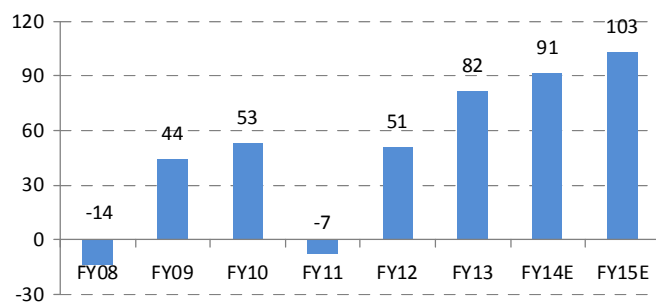
### AD-SPEND (AS A % OF SALES)



Source: SBICAP Securities Research

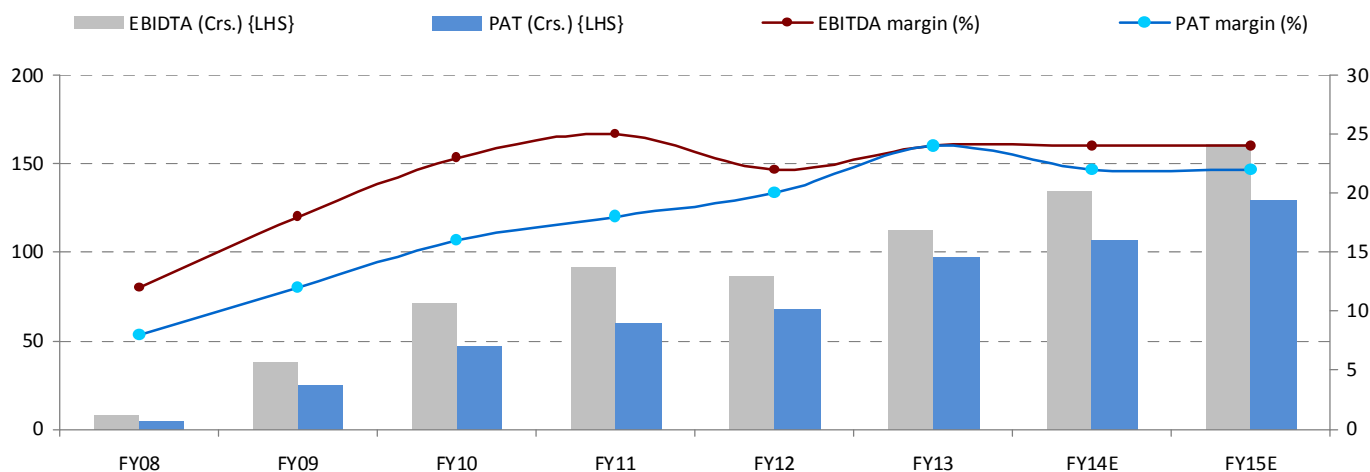
The Company is able to manage its Working capital efficiently, which is evident from free cash flow from operations.

### FREE CASH FLOW FROM OPERATIONS (CRS.)



Source: SBICAP Securities Research

Margins have increased between FY08 to FY11, due to lesser competition for most of its products. We see margins to remain at the same level owing to rising competition which will lead to a pricing pressure.



Source: SBICAP Securities Research

## Peer Comparison and Valuation

Being a niche player in wellness products, Zydus Wellness does not have listed peers, manufacturing similar products. So, we have screened medium to large FMCG players and compared with Zydus Wellness Ltd. because of similar traits like steady growth, higher returns ratios, lower capex and debt free status. Zydus is currently trading at 24.5x of its FY13 earnings, which is at par with the most of FMCG companies. We have compared Zydus Wellness with Bajaj Corp, Marico and Jyothy Labs, on their FY13 numbers, out of which Bajaj Corp is the closest in all the parameters.

Company Name	Net sales (Cr.)	YoY (%)	EBITDA (Cr.)	EBITDAM (%)	PAT (Cr.)	YoY (%)	PATM (%)	EPS (Rs.)	RoCE (%)	RoNW (%)	P/E (x)	P/BV (x)
Zydus Wellness	410.0	18.7	112.3	23.5	96.9	43.2	23.6	24.8	32.3	38.1	24.5	9.3
Bajaj Corp.	605.7	28.3	212.6	35.1	166.2	38.4	27.4	11.3	38.0	34.4	24.3	7.3
Marico	4,584.4	15.5	696.5	15.2	362.7	13.7	8.9	6.2	24.8	22.2	36.1	7.3
Jyothy Laboratories	1,104.2	21.0	91.9	8.3	19.7	(55.9)	1.5	3.0	24.8	2.5	65.9	4.5

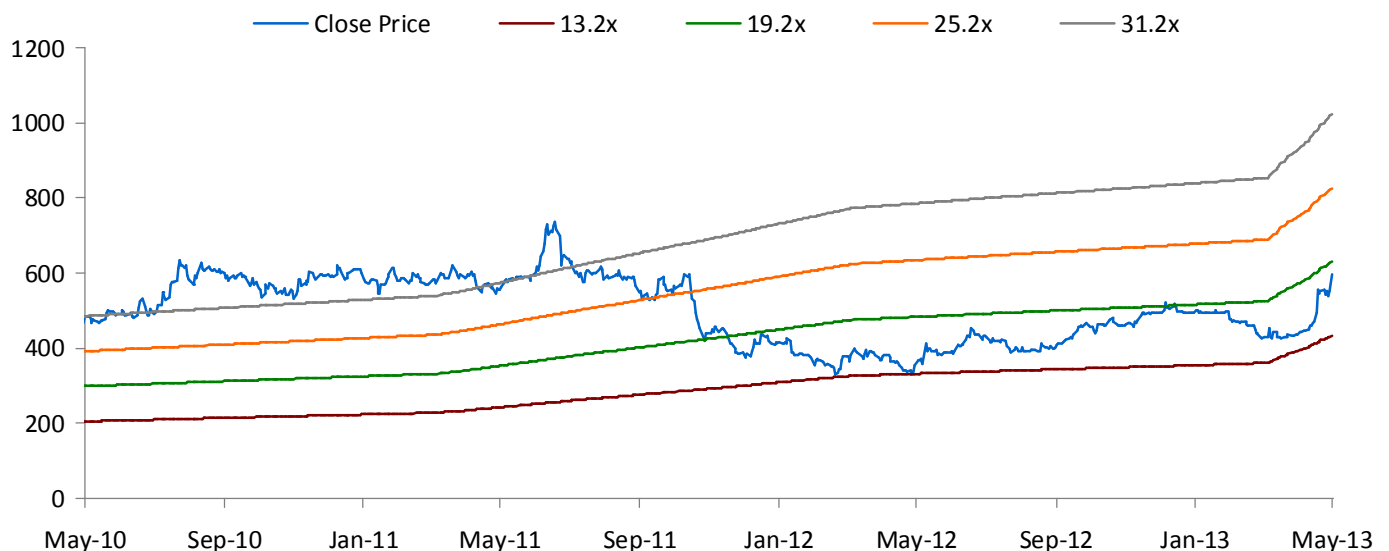
### Valuation and Recommendation

Over the years, Zydus Wellness Ltd., a subsidiary of Cadila Healthcare Ltd has acquired an expertise in manufacturing and marketing of niche wellness products. But in FY12, the Company has posted flat revenue growth, owing to intense competition from domestic as well as MNCs in their skin care segment, single digit sales growth of Nutralite and downturn in economy which has shacked the consumers' sentiment across the country.

FY13 onwards we will see a positive changes, glimpse of which we have already seen in Q4FY13. The Company focuses more on improving sales from its existing products and zeroed on to EverYuth's sales, which was dragging in last fiscal. With rebranding of EverYuth's portfolio, aggressive marketing of Sugar Free and gradual increase in the ad spend would aid to capture the lost sheen. We expect Zydus to grow at a CAGR of 20% over next two years. Tax expense in Q4FY13 and FY13 is net of Alternate Minimum Tax (AMT), this has caused a lower tax rate of around 8%, management has guided for the same tax rate for the next two years, but conservatively we have taken 15%.

After phenomenal Q4FY13 numbers, stock ran up sharply, even at this price stock is lucrative. With Zero debt status and cash per share of Rs.48, we can not neglect the chances of acquiring a company, having visible brand image in life style products, by the ZYWL. At the current market price of Rs.608.5 the stock is trading at a P/E of 22.2x and 18.5x of its FY14E and FY15E earnings, respectively. The value of Zydus Wellness's business is pegged at Rs726 per share by discounting FY14E EPS of Rs27.4 by 26.5x.

### ONE YEAR FORWARD PE BAND





## Key Concerns

### Dependence on institutional customers, in case of Nutralite

Nutralite's 75% business comes from an institutional side, where it doesn't have a pricing power, reduction in the vegetable oil prices may have to pass on to the customers. More dependence on institutional customers may hurt established players like Zydus Wellness.

### Competition

Zydus is the market leader in Sugar Free and Nutralite, with growing market size for these products, many established FMCG players may enter in to the market, which could result into an increased competition. This may pressurise the margins.

### Failure of new launches

Recently launched products like Menz, Actilife and newer variants of Sugar-free, any failure in these products will lead to a lower profitability and our estimates.

### More of aspartame based extensions

If consumed Sugar Free Gold is the highest selling extension amongst others, which is Aspartame based. If taken above certain quantity it may cause many side effects. Aspartame is a synthetic sweetener can actually turn into formaldehyde at normal body temperatures. It is one of the reasons behind weight gain, brain tumors and breast cancer. Awareness for the same amongst users may be a potential threat for the aspartame based products. This may hit the revenues of the Company.

## Financial Statements

### Statement of Profit and Loss

Figures in Cr.

Particulars	FY12	FY13	FY14E	FY15E
Sales	344.6	410.0	487.9	583.0
Other Income	9.0	15.8	17.1	20.4
Total Income	353.7	425.8	504.9	603.4
EBIDTA	77.2	96.5	117.1	140.9
Interest	0.2	0.1	0.1	0.1
Depreciation	3.8	4.5	5.9	6.8
PBT	82.3	107.7	128.2	154.3
Tax	13.7	8.8	19.2	23.1
Minority Interest	0.9	1.9	2.1	2.5
<b>Net Profit</b>	<b>67.7</b>	<b>96.9</b>	<b>106.9</b>	<b>128.7</b>

### Cash Flow Statement

Figures in Cr.

Particulars	FY12	FY13	FY14E	FY15E
<b>Net Profit before Tax</b>	<b>82.3</b>	<b>107.7</b>	<b>128.2</b>	<b>154.3</b>
Depreciation	3.8	4.5	5.9	6.8
Others	-9.1	-0.5	-17.4	-19.9
Optg. Profit before WC Chg.	77.1	111.7	116.7	141.2
Change in Working Capital	-3.7	-10.3	-0.2	-2.1
CF Before Direct Tax	71.6	91.1	122.5	139.4
Cash generated from opt.	59.4	91.7	105.3	118.8
<b>CF From Investing Activities</b>				
Purchase of Fixed Assets	-8.3	-10.0	-13.9	-15.9
Others	9.0	-7.0	8.7	13.7
Net Cash used in Invstg. Act.	0.8	-17.0	-5.2	-2.2
<b>CF from Financial Activities</b>				
Issue of equity shares	0.0	0.0	0.0	0.0
Dividend & tax	-22.7	-29.3	-32.3	-38.9
Others	4.4	11.6	2.2	6.5
Net CF from Fin. Activities	-18.4	-17.7	-30.1	-32.4
Inc./(Dec.) in cash & Cash Equ.	41.8	57.0	70.0	84.1
Cash & Bank Bal. (Opening)	90.1	131.9	189.0	258.9
<b>Cash &amp; Bank Bal. (Closing)</b>	<b>131.9</b>	<b>189.0</b>	<b>258.9</b>	<b>343.1</b>

### Du Pont Analysis - ROE

Particulars	FY12	FY13	FY14E	FY15E
Tax Burden	0.8	0.9	0.8	0.8
Interest Burden	1.0	1.0	1.0	1.0
EBIT Margin	0.3	0.3	0.3	0.3
Asset Turnover Ratio	3.6	4.4	4.4	4.7
Financial Leverage	0.5	0.4	0.3	0.3
<b>Return On Equity (ROE)</b>	<b>36.2</b>	<b>38.1</b>	<b>32.5</b>	<b>30.7</b>

### Balance Sheet

Figures in Cr.

Particulars	FY12	FY13	FY14E	FY15E
<b>EQUITY &amp; LIABILITIES</b>				
Shareholder's Fund	187.0	254.7	329.3	419.1
Capital res. on Consol.	0.0	0.0	0.0	0.0
Minority Interest	0.8	2.9	4.9	7.4
Non-Current Liabilities	5.3	4.7	4.9	4.8
Current Liabilities	74.3	85.1	101.3	122.6
<b>Total</b>	<b>267.5</b>	<b>347.3</b>	<b>440.4</b>	<b>553.8</b>
<b>ASSETS</b>				
Fixed Assets	95.9	94.2	110.7	124.1
Non-Current Inv.	0.0	0.0	0.0	0.0
Deferred Tax Assets	0.0	0.0	0.0	0.0
Long-term loans & adv.	3.6	13.4	9.8	12.8
Other non-current assets	0.0	0.0	0.0	0.0
Cash & Cash Equivalents	131.9	189.0	258.9	343.1
Other Current assets	36.0	50.6	61.0	73.9
<b>Total</b>	<b>267.5</b>	<b>347.3</b>	<b>440.4</b>	<b>553.8</b>

### Ratios

Particulars	FY12	FY13	FY14E	FY15E
<b>Per Share Data</b>				
EPS (Rs.)	17.3	24.8	27.4	32.9
CEPS	16.2	26.3	25.0	30.2
Book Value (Rs.)	47.9	65.2	84.3	107.3
<b>Profitability Ratios (%)</b>				
EBITDA Margin	22.4	23.5	24.0	24.2
Net profit Margin	19.6	23.6	21.9	22.1
ROCE	32.2	32.3	30.5	29.1
ROE	36.2	38.1	32.5	30.7
<b>Turnover Ratios</b>				
Market Cap (Crs)	2377.4	2377.4	2377.4	2377.4
Enterprise Value (Crs)	2246.1	2188.8	2119.1	2034.8
PER (x)	35.1	24.5	22.2	18.5
P/BV (x)	12.7	9.3	7.2	5.7
EV/EBIDTA (x)	26.0	19.5	15.8	12.6
EV/Sales (x)	6.5	5.3	4.3	3.5
Mcap/Sales (x)	6.9	5.8	4.9	4.1
<b>Leverage Ratios (x)</b>				
Debt/Equity	0.0	0.0	0.0	0.0
Interest coverage	0.0	0.0	0.0	0.0

Source: SBICAP Securities Research

Name	Designation
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