BOBCAPS
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FIRST LIGHT

15 March 2022

RESEARCH

Zydus Wellness | Target: Rs 2,185 | +45% | BUY

Robust health and wellness portfolio – initiate with BUY

BOB Economics Research | CPI

Inflation remains a concern

BOB Economics Research | Interest Cover

What does interest cover of industries indicate?

Daily macro indicators

Indicator	10-Mar	11-Mar	Chg (%)
US 10Y yield (%)	1.99	1.99	1
India 10Y yield (%)	6.81	6.86	5
USD/INR	76.31	76.59	(0.4)
Brent Crude (US$/bbl)	109.3	112.7	3.1
Dow	33,174	32,944	(0.7)
Hang Seng	20,890	20,554	(1.6)
Sensex	55,464	55,550	0.2
India FII (US$ mn)	**09-Mar**	**10-Mar**	**Chg ($ mn)**
FII-D	(56.6)	24.6	81.2
FII-E	(582.4)	97.8	680.3

Source: Bank of Baroda Economics Research

SUMMARY

Zydus Wellness

- Product innovation, distribution expansion and Heinz India merger synergies expected to aid brisk PAT CAGR of 11% for FY21-FY24
- Leading niche wellness brands (Sugar Free, Everyuth, Glucon-D, Nycil) and low market penetration rates offer long-term growth opportunity
- Initiate coverage with BUY and TP of Rs 2,185 (45% upside) set at 38x FY24E EPS, ~10% premium to peers

Click here **for the full report.**

India Economics: CPI

CPI inflation rose to 6.1% against market consensus of 6%. Our estimate was also on the higher side of 6.3%. Food inflation inched up at the retail level, driven by vegetables, cereals and meat and fish. Even core inflation remained sticky. Notably, inflation surpassed its Jan'22 level which was supposed to be the peak as said in the RBI's policy statement. Going forward, we expect CPI to be ~5.5-6% in FY23. Upside risks persist with regard to elevated commodity prices and its laggard pass through.

Click here **for the full report.**

BOBCAPS Research
researchreport@bobcaps.in

India Economics: Interest Cover

A quick indicator of solvency of companies is the interest cover. It indicates whether the company has the ability to service the interest component of its debt from the profits earned in a particular period. We have examined the results of 1789 companies excluding financial units and traced the trend of PBDIT/Interest expense, to analyze whether they are in a position service the interest component of debt obligation.

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INITIATING COVERAGE

BUY

TP: Rs 2,185 | ⮝ 45%

ZYDUS WELLNESS | Consumer Staples | 14 March 2022

Robust health and wellness portfolio – initiate with BUY

- **Product innovation, distribution expansion and Heinz India merger synergies expected to aid brisk PAT CAGR of 11% for FY21-FY24**
- **Leading niche wellness brands (Sugar Free, Everyuth, Glucon-D, Nycil) and low market penetration rates offer long-term growth opportunity**
- **Initiate coverage with BUY and TP of Rs 2,185 (45% upside) set at 38x FY24E EPS, ~10% premium to peers**

Ruchitaa Maheshwari
researchreport@bobcaps.in

Synergies from Heinz integration to drive topline and margins: We expect ZYWL's Heinz India acquisition to be value accretive given (a) substantial scale advantages in distribution and media buying alongside higher bargaining power with suppliers, (b) cross-leveraging of distribution strengths (ZYWL's strength in chemist/specialty stores and Heinz's in general trade/wholesale channels), (c) faster product launches backed by blended R&D, (d) warehouse consolidation, (e) benefits of ZYWL's higher A&P spend (~14% of sales), and (f) guided synergies of Rs 400mn-500mn by FY23.

Leadership position and innovation focus to sustain growth: ZYWL is the clear market leader in niche consumer wellness categories such as sugar substitutes (Sugar Free: 96% share), face scrubs/peel-offs (Everyuth: 39.2%/76.4%), glucose powder (Glucon-D: 58.1%) & prickly heat powder (Nycil: 34%). The company has identified white spaces in the market and has the R&D backbone to launch new variants and extensions. Launches (last 36M) contribute ~3% of revenue which management expects to be ~5% in two years. Further, low penetration rates offer a long-term opportunity – reflected in the near-double-digit growth in these categories over the years.

Aggressive distribution expansion: Apart from merger network synergies, ZYWL aims to raise overall/direct reach to 3.5-4mn/0.85-1mn by FY25 from 2.25mn/ 0.57mn. Growth in modern trade and ecommerce channels would further boost sales.

Leaner balance sheet and improving fundamentals: ZYWL acquired Heinz India for Rs 46.7bn (on a pre-acquisition base of Rs 6.5bn), which increased debt, equity dilution and also goodwill on the books. While profit & loss line items strengthened, the balance sheet was negatively impacted with D/E of 0.5x and Rs 25.8bn of equity dilution. This further reduced ROE to 9% in FY19 from 22% in FY18. With an improving revenue trajectory, cost control and minimal increase in capital employed, we expect return ratios to improve from 6% in FY21 to 6.7% in FY24.

Initiate with BUY: We expect a revenue/EBITDA/PAT CAGR of 10%/14.2%/11% over FY21-FY24 to Rs 25bn/Rs 5.1bn/Rs 3.7bn. Initiate with BUY and a TP of Rs 2,185, set at 38x FY24E EPS, for 45% upside potential.

Ticker/Price	ZYWL IN/Rs 1,508
Market cap	US$ 1.3bn
Free float	35%
3M ADV	US$ 1.2mn
52wk high/low	Rs 2,477/Rs 1,430
Promoter/FPI/DII	65%/3%/25%

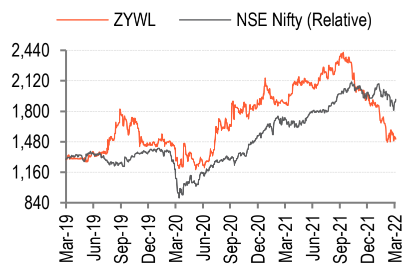
Source: NSE | Price as of 14 Mar 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	18,667	20,018	22,171
EBITDA (Rs mn)	3,444	3,773	4,412
Adj. net profit (Rs mn)	2,677	3,203	4,039
Adj. EPS (Rs)	37.6	50.0	63.2
Consensus EPS (Rs)	37.6	48.8	64.3
Adj. ROAE (%)	4.6	6.0	7.6
Adj. P/E (x)	40.1	30.1	23.9
EV/EBITDA (x)	32.1	27.8	22.2
Adj. EPS growth (%)	25.4	20.5	26.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

CPI

14 March 2022

Inflation remains a concern

CPI inflation rose to 6.1% against market consensus of 6%. Our estimate was also on the higher side of 6.3%. Food inflation inched up at the retail level, driven by vegetables, cereals and meat and fish. Even core inflation remained sticky. Notably, inflation surpassed its Jan'22 level which was supposed to be the peak as said in the RBI's policy statement. Going forward, we expect CPI to be ~5.5-6% in FY23. Upside risks persist with regard to elevated commodity prices and its laggard pass through.

Madan Sabnavis
chief.economist@bankofbaroda.com

Dipanwita Mazumdar

CPI rose to its highest since Jun'21: CPI inflation accelerated further to 6.1% in Feb'22 from 6% in Jan'22 led by a pickup in food inflation (5.9% in Feb'22 versus 5.4% in Jan'22). Notably, food inflation was at its highest since Nov'20. 5 out of 12 food items noted considerable increase in inflation namely cereals (4% in Feb'22 versus 3.5% in Jan'22), meat and fish (7.4% versus 5.5%), vegetables (6.1% versus 5.1%) and spices (6.1% versus 4.7%). Even for items such as oil and fats (16.4%), pulses (3%) and sugar (5.4%), stickiness in inflation is observed. However, in the WPI basket food prices showed slight moderation to 8.2% in Feb'22 from 10.3% in Jan'22. This was on account of moderation in fruits and vegetables (19.7% in Feb'22 versus 27.6% in Jan'22) and protein based items (8.1% versus 9.8%). However for cereals and spices, the trend was increasing as observed in the CPI data. Going forward, we expect slight moderation in both CPI and WPI food as favourable base will come into play. Vegetable prices in Mar'22 are already on a downtrend which would also provide slight comfort.

Core inflation sticky: CPI excluding food and fuel was sticky at 6% in Feb'22. Clothing and footwear (8.9% in Feb'22 versus 8.8% in Jan'22), housing (3.6% versus 3.5%), household goods and services (7.2% versus 7.1%), education (3.6% versus 3.3%) and personal care and effects (5.4% versus 3.5%). Notably, the sharp jump in personal care and effects has been due to increase in gold prices on an average by 6.2% in Feb'22 against 1.3% in Jan'22. However, transport and communication inflation remained unchanged as retail fuel prices was maintained at the same level. However, with oil prices hovering at US$ +110/bbl mark, it will be soon translated into the retail prices as well. We expect moderation in core to start from Q2FY23, only when base effect comes into play.

Fuel inflation a respite: Fuel and light index eased to 8.7% in Feb'22 from 9.3% in Jan'22, in the CPI basket. This was on account of moderation in LPG prices (19.1% from 25.8%). However, the increase in Kerosene-PDS prices were seen translated into the index which rose by 57.7% from 44.8%. In Mar'22 as well, Kerosene-PDS has risen by 18.5% on MoM basis. So the pressure on this index is likely to continue. On the wholesale level, fuel and power inflation has moderated to 31.5% in Feb'22 from 32.3% in Jan'22. This was on account of moderation in petrol and petroleum coke inflation. Similar trend was visible in LPG (26.3% from 51.7%) and kerosene (72.3% from 63.1%) prices.

Inflation overshot RBI's prediction: RBI governor in its Feb'22 policy said that inflation would peak in Jan'22 and thereafter would come within the target range. However, in Feb'22 as well, inflation overshot the level seen in Jan'22. With geopolitical uncertainty and commodity prices still remaining fairly elevated, we believe inflation to be above 5.5-6% in FY23, which is higher than RBI's projection of 4.5%. Global food prices are also on an upswing. Thus the pass through to wholesale and retail inflation is yet to be fully materialised. RBI should take into account of these factors in its upcoming policy, when globally central banks are reiterating their concerns of inflation overheating.

INTEREST COVER

14 March 2022

What does interest cover of industries indicate?

Dipanwita Mazumdar
Economist

A quick indicator of solvency of companies is the interest cover. It indicates whether the company has the ability to service the interest component of its debt from the profits earned in a particular period. We have examined the results of 1789 companies excluding financial units and traced the trend of PBDIT/Interest expense, to analyze whether they are in a position service the interest component of debt obligation.

Some interesting results from the aggregate sample from FY16 onwards:

- Since Mar-16, PBDIT/Interest expense ratio for the sample companies increased from 4.4% in FY16 to 5.0% in FY19.
- In FY20, the ratio deteriorated to 3.6, as profits were impacted partly due to the lockdown announced in the last week of March. The WALR on fresh loans had declined from 9.76% in April 2019 to 8.82% in March 2020. Therefore interest cost was not the cause for lower performance.
- In FY21, the ratio rose to 4.8, reflecting a turnaround in their performance. This was due to a combination of the sharp reduction in interest rates by the RBI which also lowered the borrowing cost. The average WALR on fresh loans of banks declined from 9.26% in February 2020 to 8.03% in March 2021. This combined with improved profit more due to cost cutting helped to improve the interest cover ratio. Further, the moratorium that was given to borrowers also helped in containing interest cost.
- For the 9-month period of FY22, interest cover of companies has dipped marginally to 4.5 from 4.8 in FY21.
- In the current cycle, where oil and other commodity prices are surging, margins of companies may be impacted, due to higher raw material cost. Thus, PBDIT may come under pressure. Further, when market interest rates are rising, interest expenses will also increase. Hence the ratio may decline further in the near term.

Period wise picture:

- FY20 The ratio fell for 72% (1281 out of 1789) of companies. (Table 1) Sectors such as communication, mining, auto ancillaries, rubber products and roads noted considerable decline. Notably, for communications industry the ratio was -0.6 in Mar'20 as the telecom sector grappled with issues related to AGR dues. Only cement, electricity, drugs and pharma and edible oils and vanaspati witnessed increase in the interest cover ratio.

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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