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# Zydus Wellness

Reco: Reduce

## Stock Update

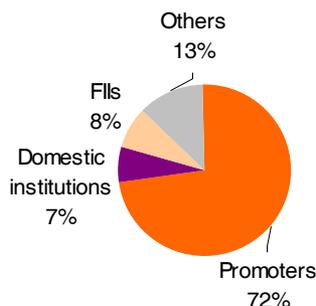
Heightened competition in skincare segment to affect Everyuth sales

CMP: Rs598

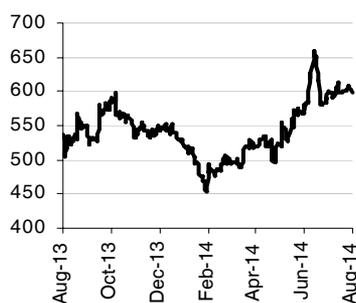
### Company details

Price target:	Rs520
Market cap:	Rs2,336 cr
52 week high/low:	Rs676/435
NSE volume: (no. of shares)	38,211
BSE code:	531335
NSE code:	ZYDUSWELL
Sharekhan code:	ZYDUSWELL
Free float: (no. of shares)	1.1 cr

### Shareholding pattern



### Price chart



### Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	16.2	33.6	13.5
Relative to Sensex	1.6	6.0	3.4	-22.7

### Key points

- ◆ Multinational Johnson & Johnson India (J&J) has decided to become aggressive in the domestic skincare market after the discontinuance of the sales of some of its baby care products (following an FDI order) in the domestic market. J&J has a presence in the domestic skin care segment through its brand *Clean & Clear*. It is the fourth largest player in the domestic face wash category (HUL is no.1 with more than 30% market share, Zydus Wellness has less than 5% market share).
- ◆ J&J might launch some of the products from its international portfolio in the face wash, scrub and skin cleansing categories, which are currently at a nascent stage in India but have a strong potential to grow in strong double digits in the medium to long term.
- ◆ J&J's move to become aggressive in the domestic skin care market would heighten the competition for smaller players like Zydus Wellness, which is bearing the brunt of a limited portfolio in the domestic market. Zydus Wellness' *Everyuth* brand is the market leader in the domestic peel-off (over a 90% market share) and scrub categories. If J&J and other multinationals become aggressive in the scrub category it would put significant pressure on Zydus Wellness' market share in the coming years.
- ◆ Zydus Wellness' revenues have stood flat or marginally declined in the past three to four quarters as increased competition and cut in spending in the discretionary categories have affected the sales of its *Everyuth* brand while *Nutralite* (its margarine brand) continues to get a lower preference amongst domestic consumers. Also, the margins of its skincare portfolio have come under pressure due to increased competition from HUL and other players.
- ◆ Though the company is banking big on its new "Go to market" distribution strategy, but its limited product portfolio and inability to add successive products and variants make it difficult for it to compete with the large players. Hence, we believe growth uncertainties would remain in the near term unless Zydus Wellness gets aggressive (ie launches new products or enters new categories). We maintain our Reduce rating on the stock with an unchanged price target of Rs520. The stock is currently trading at 24.1x its FY2015E EPS of Rs24.8 and 20.8x its FY2016E EPS of Rs28.7.
- ◆ **Key risk to our rating:** Any significant improvement in the revenue growth and profitability in the coming quarters.

### Valuations

Particulars	FY2012	FY2013	FY2014	FY2015E	FY2016E
Net sales (Rs cr)	336.8	388.0	403.6	419.1	484.2
Adjusted net profit (Rs cr)	68.6	99.0	98.3	96.9	112.2
Adjusted EPS (Rs)	17.6	25.3	25.2	24.8	28.7
Change Y-o-Y (%)	15.3	44.4	-0.7	-1.4	15.7
PER (x)	34.1	23.6	23.8	24.1	20.8
EV/EBIDTA(x)	29.9	23.9	25.9	26.0	21.9
RoCE (%)	49.1	47.4	34.7	29.3	28.2
RoNW (%)	41.7	44.7	33.8	27.0	25.8
OPM (%)	22.9	24.9	22.2	21.3	21.9

## Zydus Wellness' limited product portfolio

Category	Market Size	Comments
Face wash	A Rs1,380-crore category, Zydus Wellness has less than 5% market share	Multinationals like HUL and J&J have become aggressive in the category, while a new entrant such as Emami is aiming at a better share  J&J might launch new variants in the category
Scrub and peel-off	Less than Rs100-crore categories, Zydus Wellness is market leader in both the segments	We might see J&J launching some of the scrub variants from its international portfolio
Men's face wash	Close to Rs200-crore category, potential to grow faster	Zydus Wellness has presence in the category under the brand name of <i>Everyuth Menz</i>  It has recently shifted focus to improving growth prospects of scrub and peel-off segments  On the other hand, players like Garnier and HUL have become aggressive in the segment
<i>Nutralite</i>	Butter market size is close to Rs2,000 crore	Zydus Wellness is prototyping <i>Nutralite</i> as healthier substitute for butter but has received poor response in the domestic market  Zydus Wellness has recently launched new and healthier variants in the segment and increased distribution to get a better response
<i>Sugarfree</i>	Healthier substitute for sugar, Zydus Wellness is market leader  The category has strong potential to grow in double digits in the near to medium term	The only segment where Zydus Wellness has gained a good acceptance and remained market leader in the domestic market

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# Marico Kaya Enterprise

View: Positive

## Viewpoint

Cash-rich company in a fast growing niche segment

CMP: Rs488

## Key points

- Leading player in the fast growing attractive skin care segment:** Marico Kaya Enterprise Ltd (MaKE) is a leading player in the fast growing skin care segment in India and the Middle-East. The company has a strong presence in the Indian market with its 86 Kaya Skin clinics spread over 26 cities. It is also present in three Middle-Eastern countries with 18 clinics under its namesake brand, Kaya. The skin care category is growing at over 25% in India as well as in the Middle-East and MaKE with its strong brand equity and dominant presence is well placed to capitalise on this opportunity.
- High leveraged business enables disproportionate returns during upturn:** The nature of the business requires the company to hire dermatologists and skin specialists; it has a rich pool of over 140 dermatologists spread across India. The cost of this high quality and trained personnel is largely fixed in nature and whenever the revenues improve (due to an improvement in the same-store sales) the company would gain employee leverage leading to higher margins. Currently, the employee cost constitutes 34-35% of the total turnover and going forward we expect the cost to come down to 20-25%, thereby providing huge operating leverage to the company. Thus, the OPM is expected to double from the current levels of 5-6% to 10-12% in good times.
- Entered into asset-light Kaya Skin Bar segment to boost volumes:** In order to improve the sales of its products (the company earns revenues through its range of services as well as products), which currently form 15-20% of the portfolio, and increase the contribution to 30-35% in the next three years, MaKE has entered into an asset-light model called Kaya Skin Bar. Under this format the area ranges from 100sq ft to 250sq ft in high-footfall locations like malls, high streets etc, with only one sales personnel. Thus, this model would boost its revenues and thereby expand the margins and returns. Currently, the company has three Kaya Skin Bars and going forward it aims to add another ten to twelve Kaya Skin Bars in a year's time.
- Strong Q1 results spell turn-around; expect strong earnings growth ahead:** For Q1FY2015, the company reported a strong revenue performance, with a top line growth of 17% YoY. Both the Indian and the international business reported a robust double-digit same-store sales growth of 10% and 16% YoY respectively. On a consolidated basis, the company posted an operating profit of Rs4.2 crore compared with a loss posted in the same quarter of the last year. We expect the same-store sales growth momentum to pick up which is likely to have a positive impact on the margins and earnings ahead.
- Well capitalised business; with zero debt and cash surplus, we have a positive view:** Despite operating in a capital intensive business, the company is debt-free and is sitting on surplus cash of close to Rs175 crore (close to 30% of its market cap). Along with this the business runs on negative working capital of 60 days (MaKE collects cash in advance from customers for the services to be rendered in future) which provides comfort on the cash generation ability of the business. As per our rough estimates, the stock is available at 12-13x FY2016 estimates of Rs27-28 per share. Consequently, we believe the stock could potentially provide 18-20% returns from here and should be accumulated on every decline.

## Key consolidated financial position of MaKE

Rs cr

Particulars	FY2012	FY2013	FY2014	Q1FY2015
Net revenue	213.8	258.1	290.3	75.2
PBT before exception	-56.1	-26.1	4.7	5.9
Exceptional items	11.7	-22.2	19	-4.8
Reported PAT post exception	-44.4	-48.4	18.2	0.63
Adjusted PAT	-56.1	-26.2	-0.8	5.43
Net worth	-106.6	30.8	330.2	330.6
Gross contribution (%)	74.0	77.0	81.0	88.0
EBITDA (%)	-18.0	-3.0	5.0	5.7

Source: Company presentation July 2014 and Q1FY2015 results

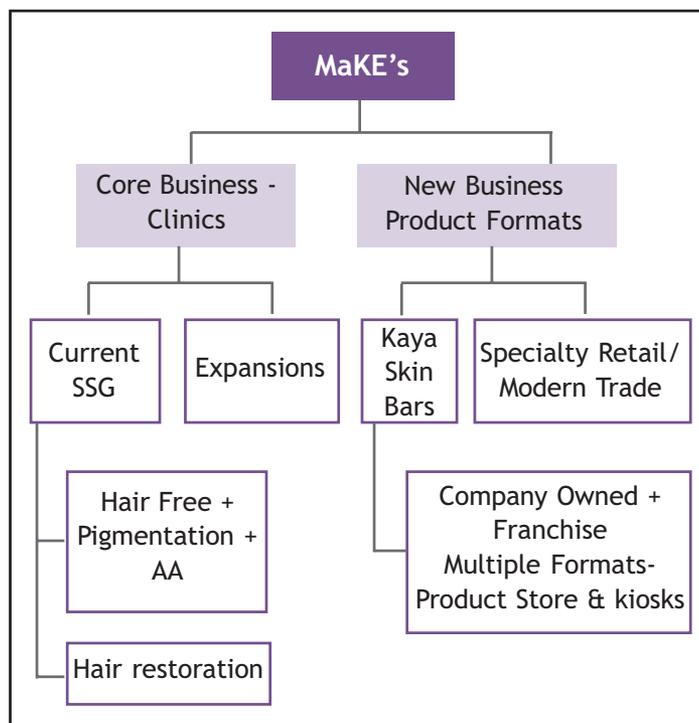
## About the company

MaKE was formed in January 2013 to house the demerged Kaya business of the Marico group. The company got listed on the domestic bourses on July 2014. It offers cosmetic dermatology solutions in skin and hair care segments; it has 106 touch points across India and the Middle-East. In FY2014 the company garnered consolidated revenues of Rs290 crore (53% in India and 47% in the Middle-East). It also had a subsidiary called Derma Rx in Singapore which was sold off in January 2014 for Rs168 crore.

## MaKE's Indian business

- The market segment and the business:** MaKE is present in the fast growing beauty and wellness services market (market size = Rs6,000 crore) and the premium skin care market (market size = Rs700 crore), with its advanced skin care and hair care services and premium beauty products marketed under the brand *Kaya*. Both the segments in the beauty and wellness industry are growing at 25% and hence offer immense potential for a pan-India player like MaKE.
- Reach and presence:** The company is spread across 26 cities with 86 clinics in India and has over 600,000 satisfied customers. Kaya Skin Clinic, India has the largest pool of dermatologists in the country with over 140 dermatologists.
- Asset-light concept—Kaya Skin Bar:** The Kaya Skin Bar is a new retail format, which is largely asset-light in nature. It is a product store with an open and inviting lay-out. The Kaya Skin Bar houses 13 specialised skin care and hair care ranges with over 50 products catering to everyday hair care and skin care needs for specific skin concerns like acne, sensitive skin, pigmentation, aging, fairness, etc. The Kaya Skin Bar also has a state-of-the-art interactive skin diagnostic tool which provides a complete skin health report. The first Kaya Skin Bar was launched on January 1, 2013 in Bengaluru. Today, MaKE has three Kaya Skin Bars spread across Bengaluru at high-footfall areas. Further, the company aims to expand this offering and has plans to launch around 10-12 stores in the next 12 months.

## MaKE's Indian business model



## MaKE's Indian business matrix

### Operational matrix

Particulars	FY12	FY13	FY14
Collection SSG (%)	13	2	10
Net revenue SSG (%)	4	8	7
Customer count growth (%)	-1	-3	3
Average ticket size per customer	>6000	>6500	>7000

SSG: same-store sales growth

### Financial performance of MaKE's Indian business (Rs cr)

Particulars	FY12	FY13	FY14
Collection	155.6	162.3	179.8
Net revenue	129.6	143.7	153.4
PBT before exception	-14.6	-14.9	-1.1
Exceptional items	11.7	-14.9	40.7
PAT post-exceptional items	-3	-29.8	34
Net worth	-44.6	34.4	68.4
Gross contribution (%)	75	74	79
EBITDA (%)	-4.0	-3.0	2.0

### MaKE's business in Middle East

The company entered the Middle-Eastern market in 2004 with its first clinic in Dubai. Today, Kaya Skin Clinic is the largest international chain of skincare clinics in the Middle-East with 18 clinics across the UAE, Saudi Arabia and Oman. Backed by a panel of 26 esteemed dermatologists and

over 100,000 satisfied customers, Kaya Skin Clinic has been successfully delivering complete skin care solutions for over ten years. The market size in each of the countries is substantial (the UAE at Rs800 crore and Saudi Arabia at Rs2,800 crore).

#### MaKE's Middle-Eastern business—number of stores

Middle-Eastern business	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
<i>No. of clinics</i>	6	10	11	14	17	19	18	18
UAE	4	7	8	10	12	14	13	13
KSA	1	2	2	3	4	4	4	4
Oman	1	1	1	1	1	1	1	1

#### MaKE's Middle-Eastern business: Operational matrix

Operational matrix	FY13	FY14
Collection SSG (%)	5	8
Net revenue SSG (%)	16	8
Customer count growth (%)	4	1
Average ticket size per customer (\$)	350	380

#### Performance of MaKE's Middle-Eastern business (Rs cr)

Particulars	FY12	FY13	FY14
Collection	94.4	114.6	136.6
Net revenue	85.0	115.5	137.7
PBT before exception	(41.4)	(11.2)	5.9
Exceptional items	-	(7.3)	-
PAT post exception	(41.4)	(18.6)	5.9
Networth	(62.1)	(3.6)	1.8
Gross contribution (%)	72.0	79.0	82.0
EBITDA (%)	-40.0	-3.0	8.0

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## Automobiles

Apollo Tyres  
Ashok Leyland  
Bajaj Auto  
Gabriel India  
M&M  
Maruti Suzuki India  
TVS Motor Company

## Banks &amp; Finance

Allahabad Bank  
Andhra Bank  
Axis (UTI) Bank  
Bajaj Finserv  
Bajaj Finance  
Bank of Baroda  
Bank of India  
Capital First  
Corp Bank  
Federal Bank  
HDFC  
HDFC Bank  
ICICI Bank  
IDBI Bank  
LIC Housing Finance  
Punjab National Bank  
PTC India Financial Services  
SBI  
Union Bank of India  
Yes Bank

## Consumer goods

Bajaj Corp  
GSK Consumers  
Godrej Consumer Products  
Hindustan Unilever  
ITC  
Jyothy Laboratories  
Marico  
McLeod Russel India  
TGBL (Tata Tea)  
Zydus Wellness

## IT / IT services

CMC  
Firstsource Solutions  
HCL Technologies  
Infosys  
NIIT Technologies  
Persistent Systems  
Tata Consultancy Services  
Wipro

## Capital goods / Power

Bharat Heavy Electricals  
CESC  
Crompton Greaves  
Finolex Cables  
Greaves Cotton  
Kalpataru Power Transmission  
PTC India  
Thermax  
V-Guard Industries

## Infrastructure / Real estate

Gayatri Projects  
ITNL  
IRB Infra  
Jaiprakash Associates  
Larsen & Toubro  
Pratibha Industries  
Punj Lloyd

## Oil &amp; gas

Oil India  
Reliance Ind  
Selan Exploration Technology

## Pharmaceuticals

Aurobindo Pharma  
Cadila Healthcare  
Cipla  
Dishman Pharma  
Divi's Labs  
JB Chemicals & Pharmaceuticals  
Glenmark Pharmaceuticals  
Ipca Laboratories  
Lupin  
Sun Pharmaceutical Industries  
Torrent Pharma

## Agri-Inputs

UPL

## Building materials

Grasim  
Orient Paper and Industries  
Shree Cement  
The Ramco Cements  
UltraTech Cement

## Discretionary consumption

Eros International Media  
Indian Hotel Company  
KKCL  
Raymond  
Relaxo Footwears  
Speciality Restaurants  
Sun TV Network  
Zee Entertainment Enterprises

## Diversified / Miscellaneous

Aditya Birla Nuvo  
Bajaj Holdings  
Bharti Airtel  
Bharat Electronics  
Gateway Distriparks  
Max India  
Ratnamani Metals and Tubes  
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