

17 November 2024

India | Equity Research | Q2FY25 results review

Honasa Consumer

Consumer Staples & Discretionary

Tabletop airport landing in turbulent conditions. We trust the Captain and Co-pilots.

Three debates: [1] higher-than-consensus expected inventory write-off in 2QFY25. We are fine with this small estimation error [INR 0.2bn]. Importantly, a company in metamorphosis [building offline distribution on a zero base is bound to face demand planning errors as overstocking is a better scenario than product unavailability at point of purchase in a 70% gross margin business]. [2] Remodelling of [almost everything] for Mamaearth - online strategy, media mix, offline strategy (requirement of hero SKUs, target of 0.2mn (relevant) reach (only)). [3] While disclosures in the results presentation were in-depth and an honest assessment of reality, most investors believe that there's a huge opportunity to improve ongoing data flow in future. We recommend publication of monthly KPIs [e.g., AngelOne] until the strategy and iterations stabilise.

Clearly, Honasa is now a 95% "show me" story and 5% "trust me" story. New brands [The Derma Co, Aqualogica, Dr. Sheth's] are performing well [35% of revenue, ~30% growth] and consensus appears to be ignoring this good performance. The implicit revenue growth expectation is likely getting reset to low-to-mid teens (from 20%), in our opinion. We reckon the stock faces near-term tussle of emotions vs. long-term (probabilistic) fundamentals. We stay believers in the Honasa team. Moving our rating with earnings cut, recommend **ADD** (Buy earlier) with TP of INR 400.

HONASA's revenue (-7% YoY; ~6% YoY normalised) was below expectations: 1) higher inventory returns while moving to direct distribution in top 50 cities, and 2) scale-up of Mamaearth (ME) due to execution challenges across functions (media, product, distribution), particularly due to replication of their long-tail strategy (which worked for online business) to offline business. However, we would have expected ME to a) have relatively smoother journey in offline business given the consumer insights from online business (that said a very young brand going offline with zero demand planning history will do mistakes) and b) respond quickly to changing consumer behaviour in ME (key advantage for an online-first company). Positively, it continues to 1) scale-up and improve profitability of younger brands (~30% YoY in 1HFY25; expect double-digit EBITDA margin in FY26) and 2) gain market shares for ME in focused categories. Management expects gradual revenue growth recovery with a few pilot projects to revive faster growth in ME which is a key monitorable) as a) ME is >50% of revenues, b) provides investments and offline playbook for faster scale-up of younger brands.

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	14,927	19,199	20,620	23,178
EBITDA	228	1,371	731	1,854
EBITDA Margin (%)	1.5	7.1	3.5	8.0
Net Profit	119	1,118	742	1,708
EPS (INR)	0.9	3.5	2.3	5.3
EPS % Chg YoY	(74.2)	1,155.3	(32.9)	130.2
P/E (x)	1,357.7	108.2	161.1	70.0
EV/EBITDA (x)	208.3	81.5	151.5	58.8
RoCE (%)	(0.1)	9.4	2.1	8.5
RoE (%)	1.8	13.1	6.6	13.6

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Market Data

Market Cap (INR)	121bn
Market Cap (USD)	1,429mn
Bloomberg Code	HONASA IN
Reuters Code	HONA.BO
52-week Range (INR)	547 /309
Free Float (%)	35.0
ADTV-3M (mn) (USD)	14.7

Price Performance (%)	3m	6m	12m
Absolute	(21.0)	(11.0)	16.9
Relative to Sensex	(19.0)	(17.1)	(2.6)

ESG Score	2023	2024	Change
ESG score	NA	NA	NA
Environment	NA	NA	NA
Social	NA	NA	NA
Governance	NA	NA	NA

Note - Score ranges from 0 - 100 with a higher number indicating a higher ESG score.

Source: SES ESG, I-sec research

Earnings Revisions (%)	FY25E	FY26E
Revenue	(10.6)	(17.7)
EBITDA	(62.7)	(37.4)
EPS	(55.2)	(32.1)

Previous Reports

11-08-20204: [Q1FY25 results review](#)

24-05-20204: [Q4FY24 results review](#)

Write-off and slowdown in Mamaearth impacts growth

HONASA's Q2FY25 revenue / GP / EBITDA / recurring PAT decline (YoY) were 7 / 8 / 176 / 163 (%). Revenue declined 7% YoY to INR 4.6bn. Decline was primarily due to inventory loss on transition from super-stockist to distributor in the offline (GT) space for INR 630mn and slowdown in Mamaearth. Adjusting for the loss, revenue growth was 5.7% to INR 5,250mn and adj.UVG of 7.1%. Mamaearth continues to gain market share in face wash and shampoo by +125bps YoY. It continues to scale its presence in Modern Trade (10,000+ stores). Overall distribution reach grew 25% YoY to ~0.2mn+ retail outlet. Younger brands (TDC, Aqualogica, Dr. Sheth's, BBlunt) continue to scale with 30+% YoY growth and improved margins. The management expects TDC to deliver double-digit EBITDA in FY26. Through House of Brands, it's leveraging innovation in Moisturizer as category as a right to win.

Project Neev (distribution transition) impacts margins

Gross margin contracted 70bps YoY (-289bps QoQ) to 68.8% (normalized GM at 71.1%, +163bps YoY) impacted by one-time GT inventory loss (distribution transition) and further driven by improving brand mix and scale benefits. Similarly, EBITDA margin declined 401bps YoY (-423bps QoQ) largely driven by inventory loss while other expenses have increased 22% YoY (+12% QoQ; +584bps YoY). Adjusting for the inventory loss EBITDA margin declined 401bps YoY at 4.1%. Management expects EBITDA margin expansion to lag for a few quarters and expects to revive by early quarters of FY26. Recurring PAT declined by 163% YoY at INR 186mn.

Temporary slowdown in Mamaearth; Strategy refresh

Key reasons for impact: 1) The transition from Super-Stockist to distributor model impacting the supply chain (few unidentified pockets at sub-stockist level) led to higher inventory loss of INR 630mn; 2) In Mamaearth, faced resistance on brand scalability in offline from INR 10bn to 20bn requiring a different a playbook versus the <INR 10bn playbook; 3) Consumer shift and preference towards active based product ingredient on the online channel contributed to the weakness; 4) Lag and lower mix in Investment allocation towards brands in the offline channel; 5) Focus required on brand mix refresh across product, price and consumer communication. The management stays confident on reviving Mamaearth back to growth path and is acting on above structural levers with few pilot runs.

Key initiatives to revive: 1) Focus towards building category growth and leadership through marketing investments and innovation (a new playbook for INR 10bn-20bn); 2) Placing in the market with right products to revive the consumer partitions (concentrated SKU's); 3) Intervention and filling gaps in portfolio and pack-price; 4) Strengthening offline distribution; 5) Investments in R&D to improve product superiority and performance.

Valuations and risks

We cut our earnings estimates by ~55%/32% adjusting for impact from one-time GT inventory loss (distribution transition), modelling in revenue / EBITDA / PAT CAGR of 10 / 16 / 24 (%) over FY24-26E. Downgrade to **ADD** from Buy with a DCF-based revised target price of INR 400 (vs INR 550). At our TP, the stock will trade at 57x Sep-26E EPS and 4.4x EV/Sales Sep-26E. Key risks include excessive competition, execution miss, low success in scale-up of new brands and continued slowdown in Mamaearth.

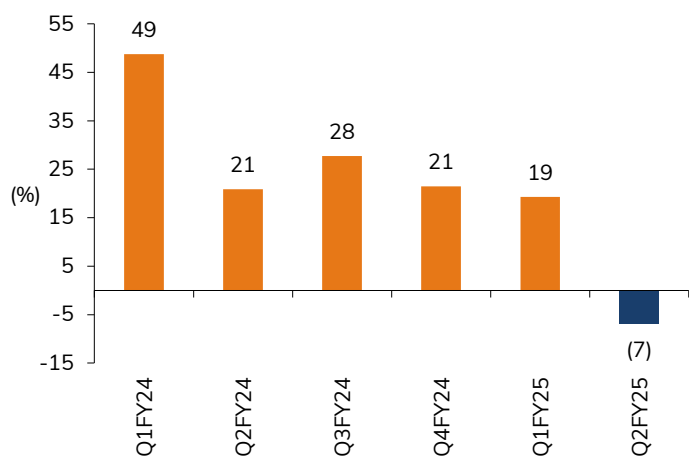
Exhibit 1: Q2FY25 result review

INR mn	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	1HFY25	1HFY24	YoY (%)
Net Revenue	4,618	4,961	(7)	5,541	(17)	10,159	9,606	6
COGS	(1,442)	(1,515)	(5)	(1,570)	(8)	(3,012)	(2,860)	5
Gross profit	3,176	3,446	(8)	3,970	(20)	7,147	6,745	6
Staff cost	(515)	(371)	39	(494)	4	(1,009)	(816)	24
A&SP	(1,830)	(1,740)	5	(2,000)	(9)	(3,830)	(3,370)	14
Other opex	(1,139)	(933)	22	(1,015)	12	(2,154)	(1,864)	16
Total opex	(3,483)	(3,044)	14	(3,509)	(1)	(6,992)	(6,050)	16
EBITDA	(307)	402	(176)	461	(167)	154	695	(78)
Other income	200	71	183	187	7	387	197	97
Finance cost	(31)	(18)		(30)	4	(62)	(33)	
D&A	(106)	(63)	68	(94)	12	(200)	(128)	56
PBT	(244)	392	(162)	524	(147)	280	732	(62)
Tax	58	(98)	(159)	(121)	(148)	(63)	(190)	(67)
Recurring PAT	(186)	294	(163)	403	(146)	217	542	(60)
Extraordinary items	-	-		-		-	-	
Net profit (reported)	(186)	294	(163)	403	(146)	217	542	(60)
EPS	(0.6)	2.2	(127)	1.3	(146)	0.7	4.1	(83)

Costs as a % of sales								
COGS	31.2	30.5	69 bps	28.3	288 bps	29.7	29.8	-13 bps
Gross margin (%)	68.8	69.5	-70 bps	71.7	-289 bps	70.3	70.2	12 bps
Staff cost	11.1	7.5	366 bps	8.9	222 bps	9.9	8.5	143 bps
A&SP	39.6	35.1	455 bps	36.1	352 bps	37.7	35.1	261 bps
Other opex	24.7	18.8	584 bps	18.3	633 bps	21.2	19.4	179 bps
EBITDA margin (%)	4.1	8.1	-401 bps	8.3	-423 bps	1.5	7.2	-572 bps
Income tax rate (%)	23.8	24.9	-113 bps	23.2	62 bps	22.6	26.0	-336 bps

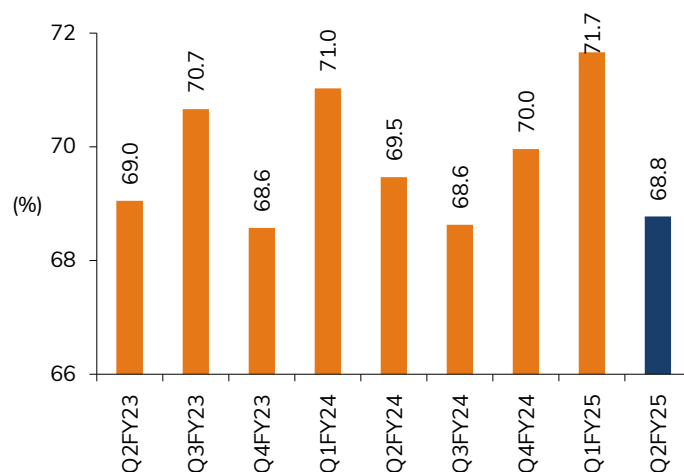
Source: Company data, I-Sec research

Exhibit 2: Revenue growth



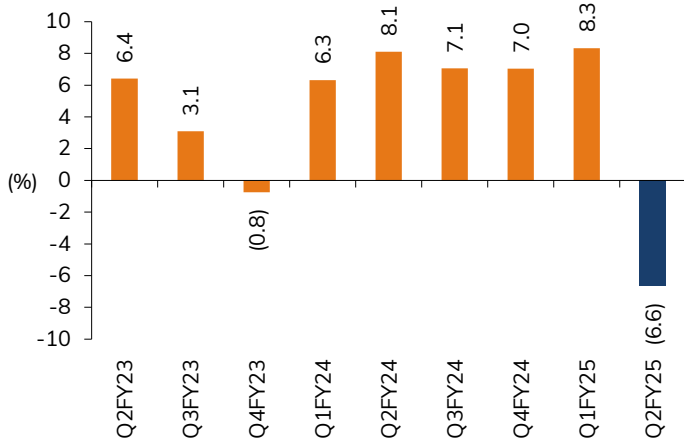
Source: Company data, I-Sec research

Exhibit 3: Gross margin



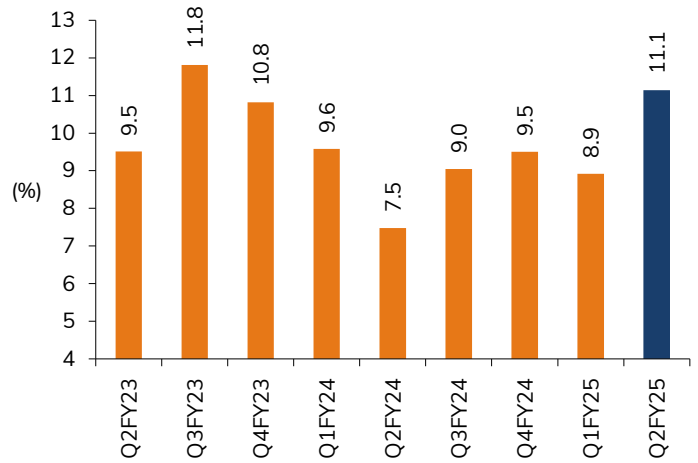
Source: Company data, I-Sec research

Exhibit 4: EBITDA margin



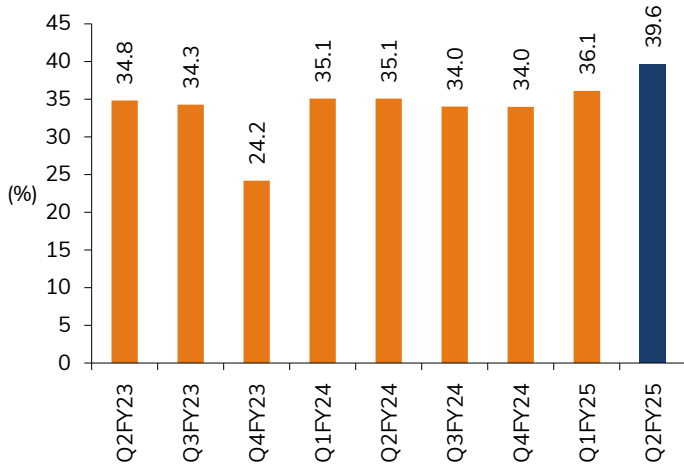
Source: Company data, I-Sec research

Exhibit 5: Staff cost as a % of sales



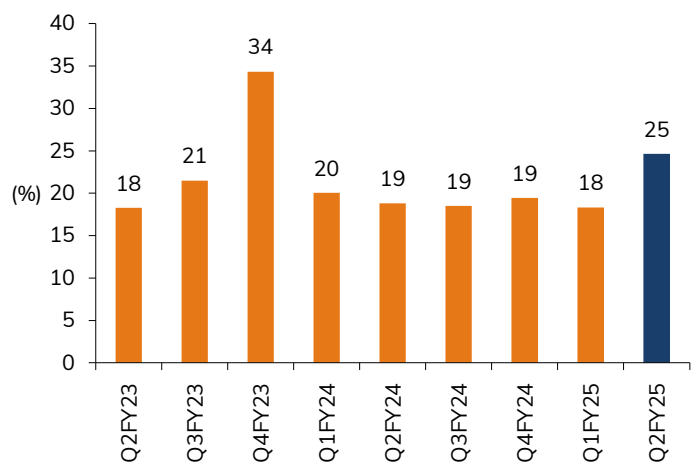
Source: Company data, I-Sec research

Exhibit 6: A&SP as a % of sales



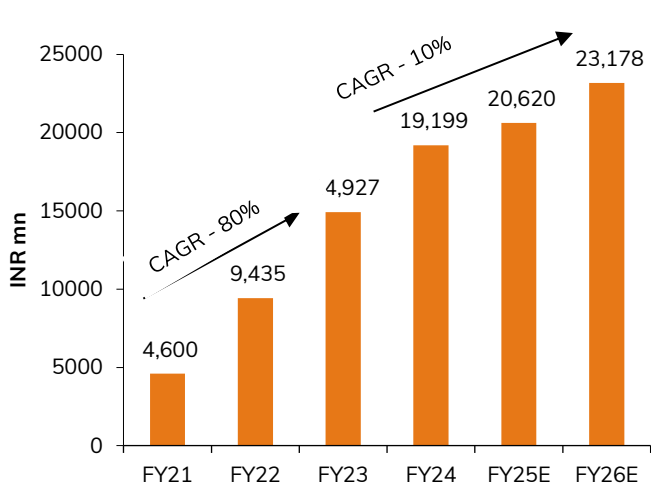
Source: Company data, I-Sec research

Exhibit 7: Other Exps as a % of sales



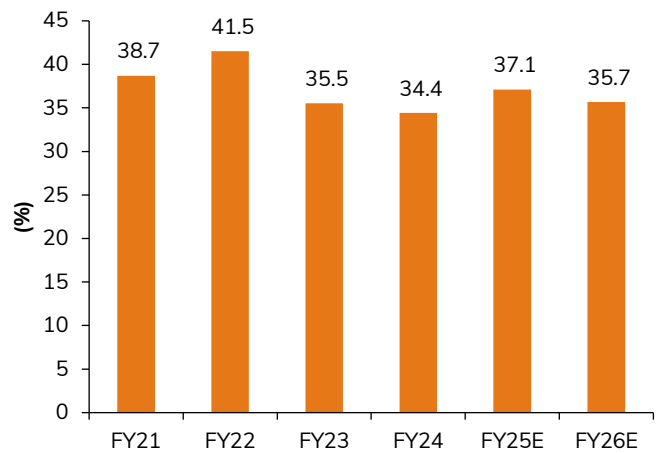
Source: Company data, I-Sec research

Exhibit 8: Revenue and growth rates



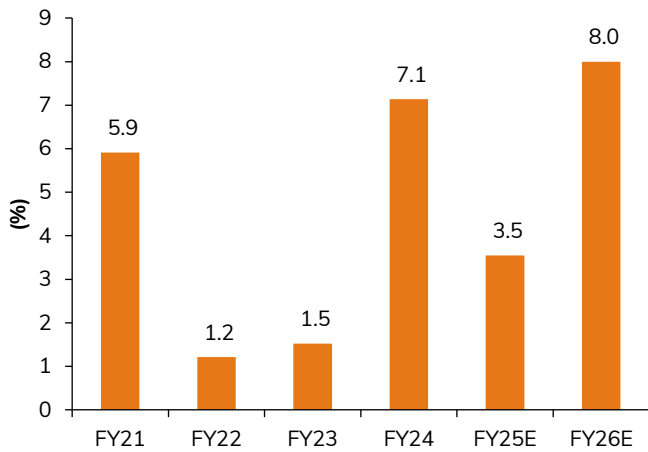
Source: Company data, I-Sec research

Exhibit 9: A&P expenses as a % of revenues



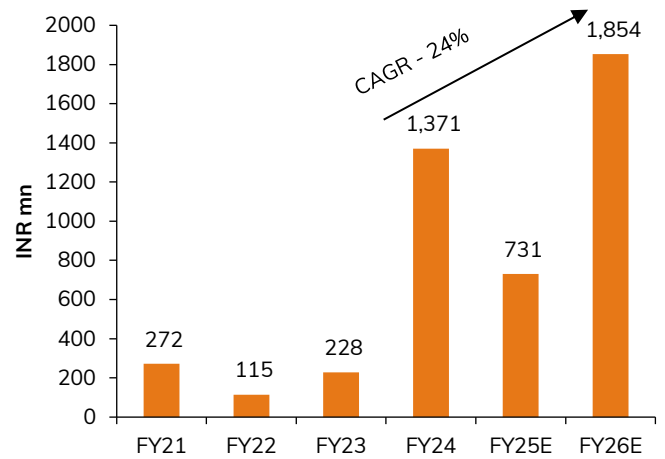
Source: Company data, I-Sec research

Exhibit 10: EBITDA margin



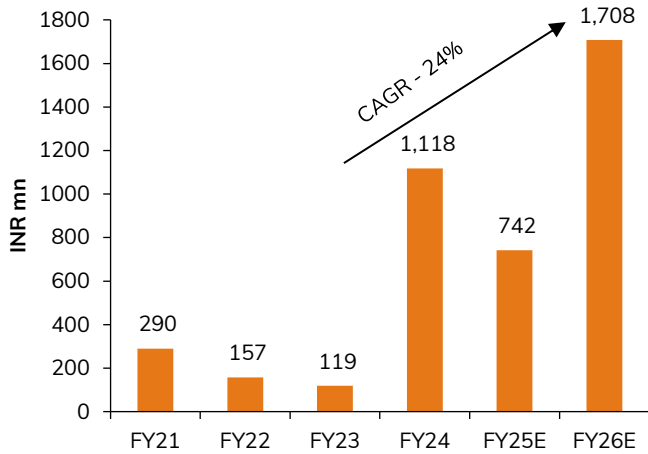
Source: Company data, I-Sec research

Exhibit 11: EBITDA and growth rates



Source: Company data, I-Sec research

Exhibit 12: PAT and growth rates



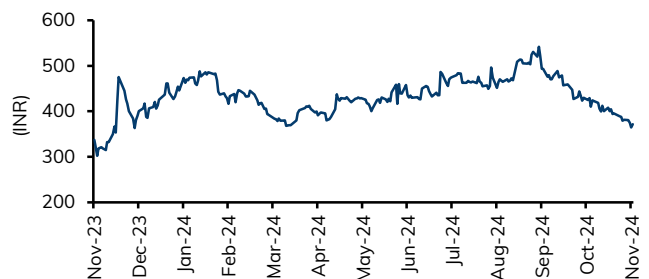
Source: Company data, I-Sec research

Exhibit 13: Shareholding pattern

%	Mar'24	Jun'24	Sep'24
Promoters	35.1	35.1	35.0
Institutional investors	28.1	31.3	37.4
MFs and others	3.1	3.6	3.9
FIs/Banks	0.0	0.0	0.0
Insurance	2.6	4.5	8.6
FIIIs	22.4	23.2	24.9
Others	36.8	33.6	27.6

Source: Bloomberg

Exhibit 14: Price chart



Source: Bloomberg

Financial Summary

Exhibit 15: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Net Sales	14,927	19,199	20,620	23,178
Operating Expenses	14,700	17,828	19,890	21,325
EBITDA	228	1,371	731	1,854
EBITDA Margin (%)	1.5	7.1	3.5	8.0
Depreciation & Amortization	250	306	421	458
EBIT	(22)	1,065	310	1,396
Interest expenditure	67	90	120	132
Other Non-operating Income	-	-	-	-
Recurring PBT	137	1,471	976	2,247
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	99	366	234	539
PAT	37	1,105	742	1,708
Less: Minority Interest	82	12	-	-
Extraordinaries (Net)	(1,547)	-	-	-
Net Income (Reported)	(1,510)	1,105	742	1,708
Net Income (Adjusted)	119	1,118	742	1,708

Source Company data, I-Sec research

Exhibit 16: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Total Current Assets	6,406	11,283	12,520	14,798
of which cash & cash eqv.	3,281	7,774	8,802	10,619
Total Current Liabilities & Provisions	2,710	3,954	4,172	4,689
Net Current Assets	3,696	7,329	8,348	10,109
Investments	-	-	-	-
Net Fixed Assets	1,171	1,217	941	645
ROU Assets	826	1,243	1,243	1,243
Capital Work-in-Progress	-	5	5	5
Total Intangible Assets	528	528	528	528
Long Term Loans & Advances	790	2,008	2,008	2,257
Deferred Tax assets	-	-	-	-
Total Assets	7,056	12,348	13,090	14,808
Liabilities				
Borrowings	36	-	-	-
Deferred Tax Liability	14	13	13	13
Provisions	61	73	73	82
Other Liabilities	-	-	-	-
Equity Share Capital	1,363	3,242	3,242	3,242
Reserves & Surplus	4,696	7,710	8,452	10,160
Total Net Worth	6,059	10,953	11,695	13,403
Minority Interest	-	-	-	-
Total Liabilities	7,056	12,348	13,090	14,808

Source Company data, I-Sec research

Exhibit 17: Quarterly trend

(INR mn, year ending March)

	Dec-23	Mar-24	Jun-24	Sep-24
Net Sales	4,882	4,711	5,541	4,618
% growth (YOY)	27.8	21.5	19.3	(6.9)
EBITDA	345	331	461	(307)
Margin %	7.1	7.0	8.3	(6.6)
Other Income	110	190	187	200
Extraordinaries	-	-	-	-
Adjusted Net Profit	259	305	403	(186)

Source Company data, I-Sec research

Exhibit 18: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Operating Cashflow	(516)	2,353	505	1,128
Working Capital Changes	(1,048)	1,025	9	(186)
Capital Commitments	673	(4,599)	(144)	(162)
Free Cashflow	157	(2,246)	361	966
Other investing cashflow	(244)	(99)	787	983
Cashflow from Investing Activities	429	(4,698)	642	821
Issue of Share Capital	49	3,633	-	-
Interest Cost	(11)	(8)	(120)	(132)
Inc (Dec) in Borrowings	-	-	-	-
Dividend paid	-	-	-	-
Others	(25)	-	-	-
Cash flow from Financing Activities	(141)	3,369	(120)	(132)
Chg. in Cash & Bank balance	(227)	1,024	1,027	1,817
Closing cash & balance	649	1,704	5,884	7,701

Source Company data, I-Sec research

Exhibit 19: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
Per Share Data (INR)				
Reported EPS	0.3	3.4	2.3	5.3
Adjusted EPS (Diluted)	0.9	3.5	2.3	5.3
Cash EPS	2.7	4.4	3.6	6.7
Dividend per share (DPS)	-	-	-	-
Book Value per share (BV)	44.4	34.0	36.3	41.7
Dividend Payout (%)	-	-	-	-
Growth (%)				
Net Sales	58.2	28.6	7.4	12.4
EBITDA	98.7	502.2	(46.7)	153.6
EPS (INR)	(74.2)	1,155.3	(32.9)	130.2
Valuation Ratios (x)				
P/E	1,357.7	108.2	161.1	70.0
P/CEPS	137.5	84.0	102.8	55.2
P/BV	8.4	10.9	10.2	8.9
EV / EBITDA	208.3	81.5	151.5	58.8
P / Sales	3.4	6.2	5.8	5.2
Dividend Yield (%)	-	-	-	-
Operating Ratios				
Gross Profit Margins (%)	70.1	69.8	70.4	70.6
EBITDA Margins (%)	1.5	7.1	3.5	8.0
Effective Tax Rate (%)	72.7	24.9	24.0	24.0
Net Profit Margins (%)	0.2	5.8	3.6	7.4
Net Debt / Equity (x)	(0.5)	(0.7)	(0.8)	(0.8)
Net Debt / EBITDA (x)	(14.3)	(5.7)	(12.0)	(5.7)
Fixed Asset Turnover (x)	12.6	15.3	15.0	15.1
Working Capital Days	16	(11)	(9)	(9)
Inventory Turnover Days	33	26	24	25
Receivables Days	39	34	31	32
Payables Days	59	63	58	59
Profitability Ratios				
RoCE (%)	(0.1)	9.4	2.1	8.5
RoE (%)	1.8	13.1	6.6	13.6
RoIC (%)	(0.1)	9.4	2.1	8.5

Source Company data, I-Sec research

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