Honasa Consumer | BUY

JM FINANCIAL

The People-Planet-Profit Playbook

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Honasa Consumer is the fascinating story of husband-wife co-founder duo Varun and Ghazal Alagh. Varun has been a true-blue FMCG marketer (Coca-Cola, HUL, Diageo) and Ghazal started her career as a corporate trainer. The couple stumbled upon a 'large unsolved need' when they had their first child back in 2014. The issue of non-availability of toxin-free baby and skin care products in India got them thinking about the opportunities available therefrom, culminating in the duo building out a unique brand of BPC products focused on a toxin-free proposition. Mamaearth took shape with Ghazal personally speaking to c.700 young mothers to understand their needs and what was missing from the products available in the market. We see three key stock drivers: Mamaearth's success in general-trade elongating the growth runway for the brand, a possible repeat of Mamaearth's success with The Derma Co (INR3.8bn ARR), Aqualogica (INR1.8bn ARR), and continued improvement in margin and cashflow profiles as operating leverage plays out stronger going ahead. We initiate with BUY on Honasa with a DCF-based target price of INR515 – upside of 34%.

- **Bet on the jockey:** A lot of Mamaearth's initial success was predicated on the founders' abilities to spot 'unsolved needs' in the BPC space, but the scale-up was helped to a large extent also by the strong domain knowledge that Varun brought to the table. The founders focused on differentiation of offerings, and on developing a tight go-to-market strategy, whilst keeping profitability and cashflows in mind. Honasa was successful in identifying emerging trends and crafting ranges using "hero-ingredients", some of which have gone on to become sub-categories by themselves.
- **Digital-first but omni-channel all the way:** A digital-first strategy allowed Mamaearth to create a strong brand pull (its approach towards sustainability including planting a tree for every direct order received also created a strong goodwill in consumers' minds), whilst the team's omni-channel focused approach also gave it a head-start in physical distribution in due course. Such a strategy has delivered strong results so far. We estimate Mamaearth would be a c.INR24-25bn brand (consumer spends) by FY24-end with c.49% of sales from physical channels. Interestingly, Varun's initial investor-pitch had estimated net sales of INR1bn in five years; reality was 7-8x better. The founders are now focusing on deploying Mamaearth's playbook to build-out the other brands in the portfolio.
- **Profitability picture now clearer:** Growth remains a key priority for the company, but Honasa has a clear intent to achieve it in a profitable and capital-efficient manner. Honasa's gross margin is superior to listed FMCG players given its pure-play BPC characteristics and its masstige-to-premium space of operation. Whilst the company has delivered positive EBITDA in each of the last three financial years, its scale was small due to disproportionate investments into brand-building and channel-related spends (c.35-42% of sales over FY21-23). As Honasa's brands gain wider acceptance, and with general trade becoming a more dominant channel (we forecast >50% of Mamaearth's sales to be offline from FY25E), we expect channel spends to come off as a % of revenue, even as the company continues to deploy incremental resources into brand-building given its long-term mindset. Part of this is visible in Honasa's recent earnings with intrinsic EBITDA margin now in high single-digit vs sub-2% in last two years. Working capital cycle (core) has been negligible to –ve in recent periods, driving strong cashflow generation.

Recommendation and Price Target	
Current Reco.	BUY
Current Price Target (12M)	515
Upside/(Downside)	33.8%

Key Data – HONASA IN	
Current Market Price	INR385
Market cap (bn)	INR124.7/US$1.5
Free Float	39%
Shares in issue (mn)	136.3
Diluted share (mn)	321.7
3-mon avg daily val (mn)	NA
52-week range	487/256
Sensex/Nifty	69,585/20,926
INR/US$	83.4

Price Performance

%	1M	Since Listing
Absolute	21.9	16.8
Relative*	13.7	8.3

* To the BSE Sensex
Listed on 7 Nov 2023

Financial Summary					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Sales	9,435	14,927	19,263	24,345	30,303
Sales Growth (%)	105.1%	58.2%	29.0%	26.4%	24.5%
EBITDA	115	228	1,275	2,011	3,203
EBITDA Margin (%)	1.2%	1.5%	6.6%	8.3%	10.6%
Adjusted Net Profit	157	119	894	1,470	2,298
Diluted EPS (INR)	0.5	-4.7	2.8	4.6	7.1
Diluted EPS Growth (%)	NM	NM	NM	64.4%	56.4%
ROIC (%)	1.4%	-0.6%	20.8%	30.2%	44.0%
ROE (%)	3.5%	1.8%	10.6%	12.7%	17.4%
P/E (x)	NA	NA	NA	84.3	53.9
P/B (x)	17.6	20.4	11.5	10.0	8.8
EV/EBITDA (x)	NA	NA	91.2	57.3	35.6
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.6%

Source: Company data, JM Financial. Note: Valuations as of 14/Dec/2023

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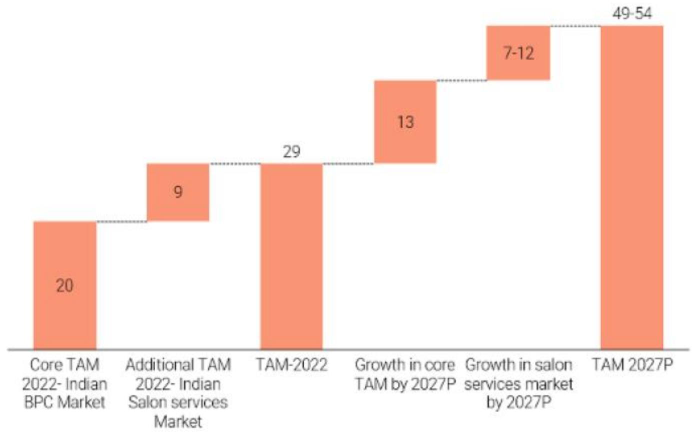
Focus Charts

Exhibit 1. Large industry opportunity: Estimated TAM of USD 49-54bn by 2026

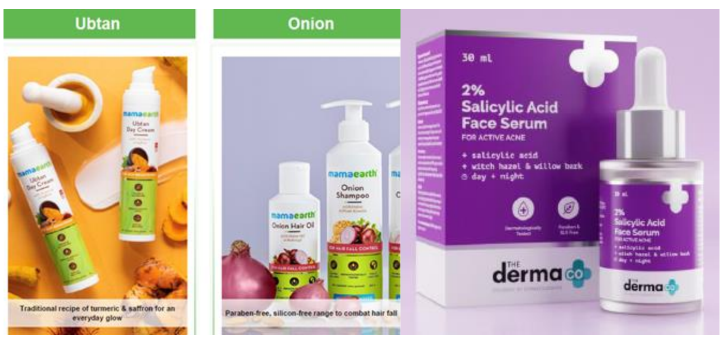


Source: Company, JM Financial
Note: Figures in USD bn

Exhibit 2. Honasa well placed with wide portfolio of brands

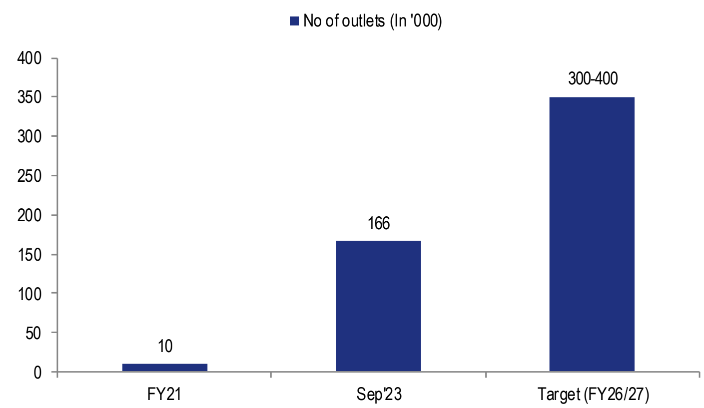
Source: Company, JM Financial

Exhibit 3. Well-oiled innovation engine…



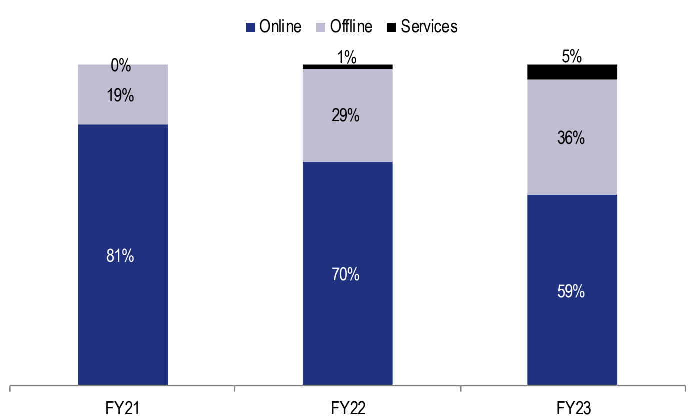
Source: Company, JM Financial

Exhibit 4. …and increased focus on expanding outlet coverage



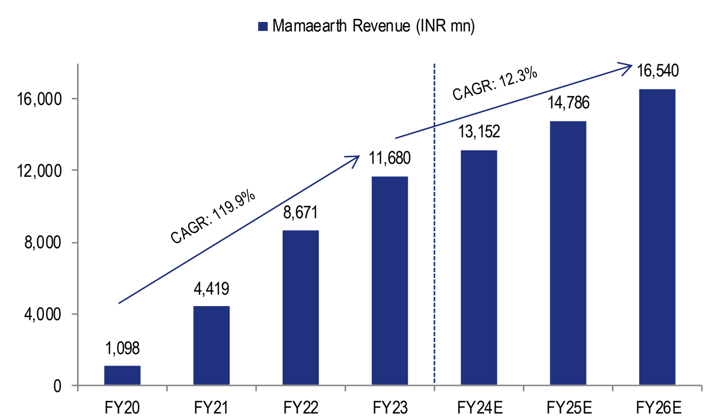
Source: Company, JM Financial

Exhibit 5. Driving healthy scale-up in offline channel…



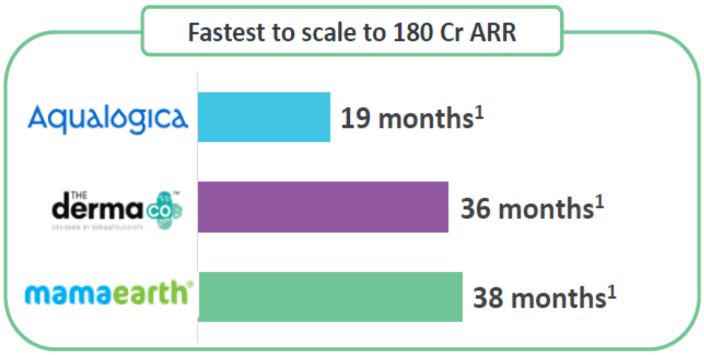
Source: Company, JM Financial

Exhibit 6. …which should elongate growth runway for Mamaearth



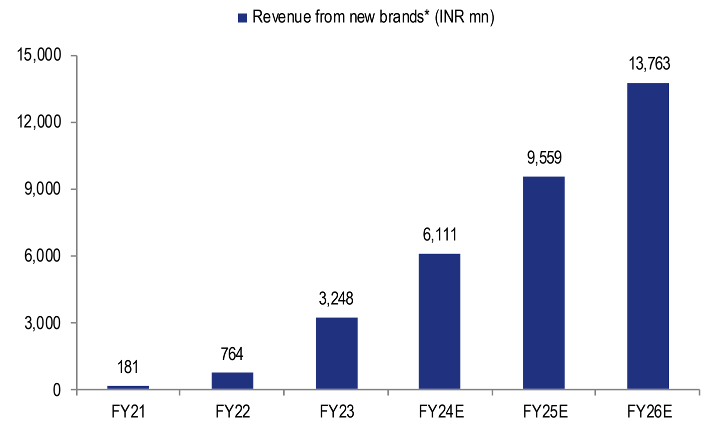
Source: Company, JM Financial

Exhibit 7. Benefitting from Mamaearth playbook, newer brands are clocking better metrics vis-à-vis Mamaearth



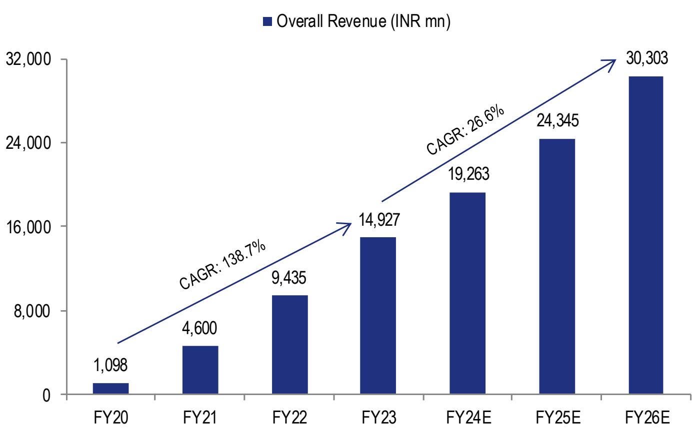
Source: Company, JM Financial,1.months since launch, Note:1cr=10mn

Exhibit 8. Revenue expected to grow at a CAGR of c.62% over FY23-26E



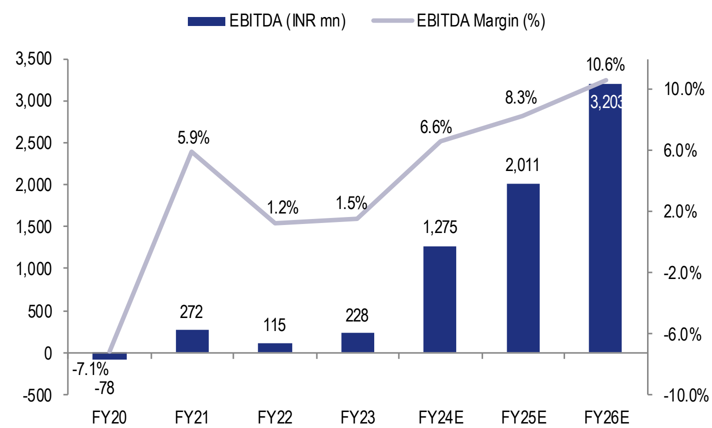
Source: Company, JM Financial,*including service income

Exhibit 9. Revenue growth to be driven by innovations and channel expansion



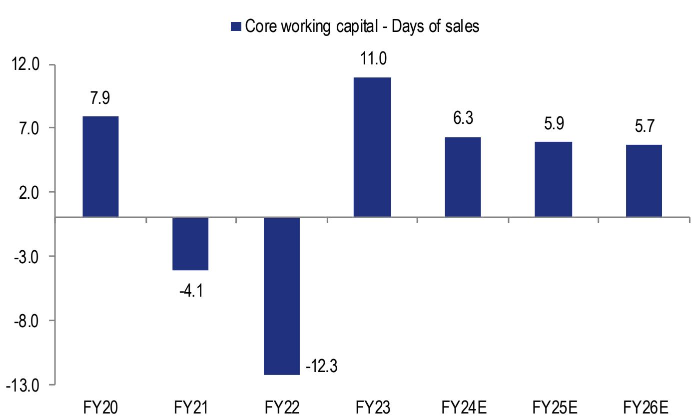
Source: Company, JM Financial

Exhibit 10. Margin expansion to be driven by channel mix, optimisation of channel spends and operating leverage



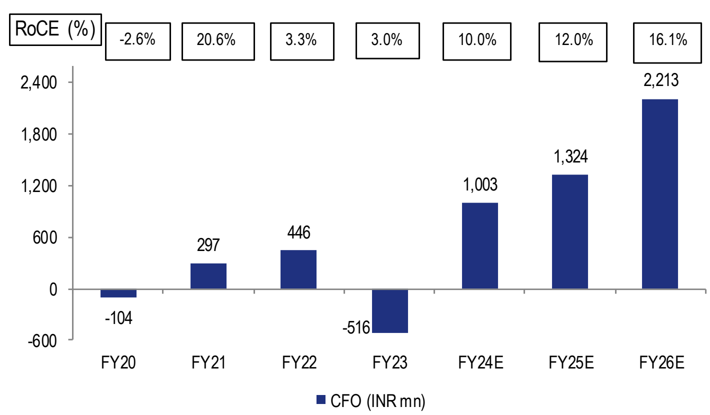
Source: Company, JM Financial

Exhibit 11. Working capital intensity expected to be stable



Source: Company, JM Financial

Exhibit 12. Steady uptick in profitability, lower capex and stable working capital to drive RoCE and cash flows

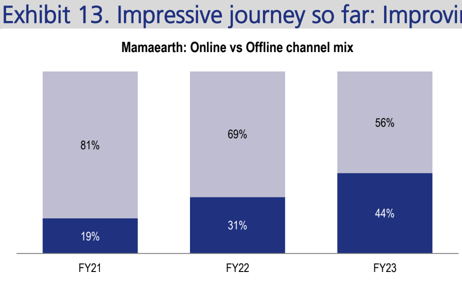


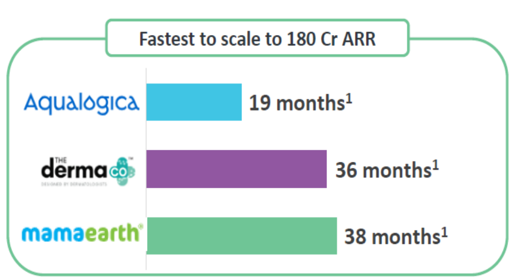
Source: Company, JM Financial

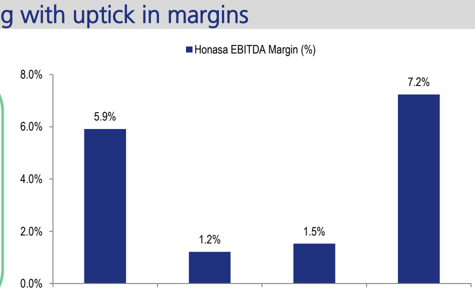
A bet on the jockey: Impressive execution so far, long runway for growth ahead

- **Magnificent journey sketched under leadership of Varun and Ghazal Alagh:** In our view, the husband-wife co-founder duo Varun (CEO) and Ghazal Alagh (CIO) have aptly applied their skillsets to sketch this magnificent journey of Honasa. Varun's experience on various aspects of brand management (sales & marketing, supply chain, distribution & managing innovations) on the back of his professional tenure with FMCG majors (HUL, Coca-Cola India, Diageo India) and Ghazal's strength in terms of driving consumer relationship and her knowledge about traditional Indian do-it-yourself recipes has been instrumental in the execution prowess demonstrated by the company, so far. It all started post the birth of their first child in 2014, when the founders were grappling with the need for safe and toxin-free products for their child but were unable to find them. Fueled by this necessity and their passion for entrepreneurship, the husband-wife duo embarked on a journey to capitalise on this opportunity. The result was Mamaearth, launched in 2016 with just six products in the baby care segment. Two key insights – 'need for non-toxic, natural ingredient based products' and 'moms trust moms' – formed the backbone of their product offering and communication strategy for Mamaearth. The promoters started with small kiosks in malls. Ghazal personally interacted with hundreds of mothers in social circles and whatsapp groups, and tapped c.700 vloggers who were mothers to spread their story, built trust among target consumers and create a brand pull. From then to now, Mamaearth has evolved successfully both from product portfolio (a single category brand to platform BPC brand with a presence across multiple key categories) and channel (from online only to omni-channel) perspective. Interestingly, Varun's initial investor-pitch estimated net sales of INR 1bn in 5 years; the reality is 7-8x better. In fact, with brand size of INR 20bn (in retail spend), Mamaearth is now among the top 15 BPC brands in India.
- **Repeatable brand building playbook backed by strong capabilities now in place:** With success/experience of Mamaearth, the business playbook is now in place for Honasa. The initial focus is to identify emerging consumer needs and capitalise on the insights to innovate (in Varun's words "listening to consumers and innovation are core part of our DNA") to address those needs. This is what powers their innovation engine, which has churned out many differentiated ingredient-based products (Onion, Vit-C, Ubtan range), some of which have themselves become sub-categories. Once the offering is in place, the strategy is to drive discovery of the brand in the online space and scale up in a calibrated manner in the offline channel, which is where their digital-first omni-channel distribution setup comes in play. Innovation and distribution capabilities apart, the founders have also built a formidable professional management team over the years, with varied experience in the consumer sector. Finally, while executing all these aspects, equally important for the company is to ensure it is done in a profitable and capital-efficient manner.
- **Promising start, long growth runway ahead:** The strategy has yielded fascinating results so far, in our view – a) Mamaearth seeing traction in the offline channel (accounted for 44% of brand sales in FY23 vs. <10% in FY20), b) Honasa's transformation from single brand to 'house of brands' with a portfolio of six brands and faster scale-up seen in these brands vs. Mamaearth and c) sharp improvement in EBITDA margin to 7.2% in 1HFY24 vs. losses prior to FY21, which along with tight control over working capital has led to strong cash flow generation. We see more avenues for improvement in all these vectors and delve in detail on each of these aspects in subsequent sections.

Exhibit 13. Impressive journey so far: Improving channel mix, faster scale-up in new brands along with uptick in margins





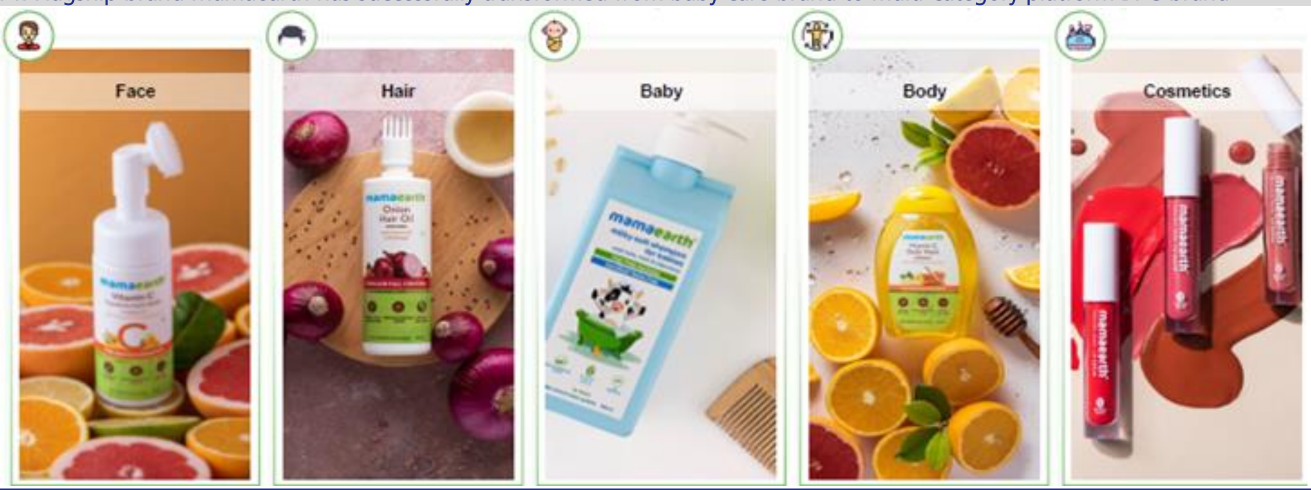


Source: Company, JM Financial, 1. Months since brand launch. Note 1cr = 10mn

Mamaearth: Execution on innovation and traction in offline channel to elongate growth runway for the flagship brand

- **Successful transformation of Mamaearth from single category brand to an established BPC platform brand provides assurance on innovation capabilities**: Honasa started its journey with the launch of safe toxin-free baby care products under the 'Mamaearth' brand in 2016, as the co-founders wanted to solve the problem for babies at that point in time. However, they were quick to realise that it is essential to have broader play across the BPC industry and baby care alone won't help to drive scalability of the business model. Also, Mamaearth's brand construct and proposition (toxin-free products with natural ingredients) allowed it to extend into other BPC categories given the rising consumer preference for non-toxic/natural products. Since then, building on the core insight of providing traditional DIY beauty ingredients in modern and convenient formats, the company introduced product offerings in other BPC categories (body, face, hair, cosmetics), successfully transforming 'Mamaearth' into an established BPC platform brand. A lot of the success of the brand is led by innovations based on cultural nuances of the Indian consumer, by understanding Indian habits, getting the right 'hero ingredient' and translating it into product ranges, like Onion, Ubtan, Multani Mitti, Tea Tree, Rosemary, etc.

Exhibit 14. Flagship brand Mamaearth has successfully transformed from baby care brand to multi-category platform BPC brand



Source: Company, JM Financial

- **Strength of the brand visible from resilient market share despite competition from large incumbents:** Another key point to highlight is that strong acceptance of certain ingredient-based ranges of Mamaearth has led to some of them becoming sub-categories in themselves (for e.g., onion-based hair oil/shampoo). Since then, many large traditional incumbents (Marico, Emami, HUL) have also introduced their own product ranges based on these ingredients. However, despite entry of competition, Mamaearth remains a dominant player in the onion-based hair care segment (market share >50%) and sales of its existing key ranges (Ubtan, Vitamin C, Onion) have not slowed down. As per a Redseer report, the brand has emerged as the market leader in onion- and ubtan-based beauty products and garnered market share of c.8.3% (in revenue terms in CY22) in a highly competitive facewash category, clearly highlighting the strength of the brand and the quality of its offerings.

Exhibit 15. Mamaearth's natural ingredient-based offerings continue to see traction…

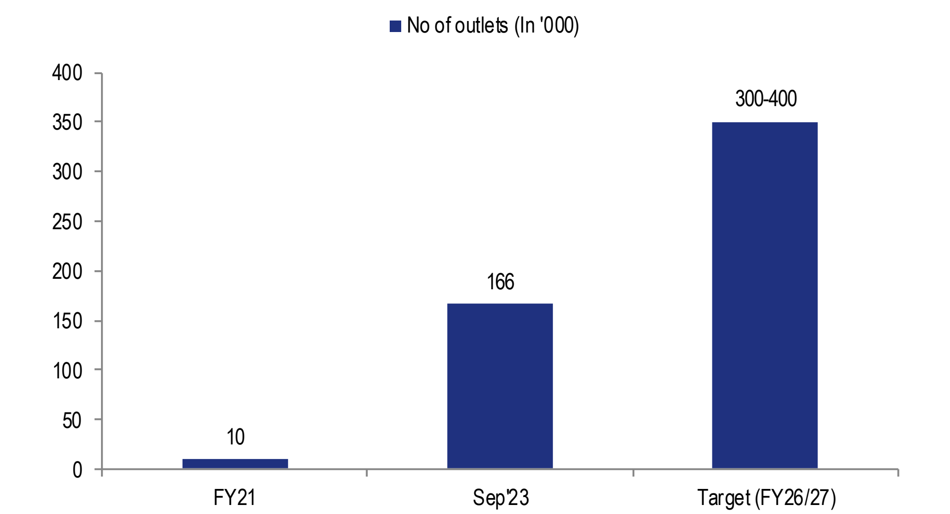
Source: Company, JM Financial

Exhibit 16. …despite entry from traditional incumbents

Source: Company, JM Financial

- **Focus now on distribution expansion in offline channel, traction here can be a huge opportunity for Mamaearth:** The offline channel accounts for 84% of the BPC products market in India. Hence, innovations apart, we see outlet coverage expansion as a massive growth opportunity for Mamaearth. Capitalising on its brand awareness, Honasa is making inroads into the offline channel but in a more calibrated manner. A lot of pin-code level insights, available from the brands website (services 18,640 pin codes) are used to drive a more targeted expansion in the offline channel. Its products are now available in c.166k outlets (vs. just c.10,000 outlets in FY21), of which c.50% of outlets are serviced directly. Going ahead, the company plans to increase overall reach upto c.0.3-0.4mn outlets over the next 3-4 years. Moreover, the focus is also on quality of distribution; hence, it is expanding primarily in beauty and cosmetics-focused outlets, modern trade (31 retail chains), pharmacies (5,000+ stores) and self-service department outlets. This apart, the company also has a network of 97 Mamaearth EBOs retailing its entire product range and 14 BBlunt salons, which allows it to curate a richer brand experience and build trust amongst consumers.

Exhibit 17. Distribution reach: Outlet coverage to double over next 3-4 years

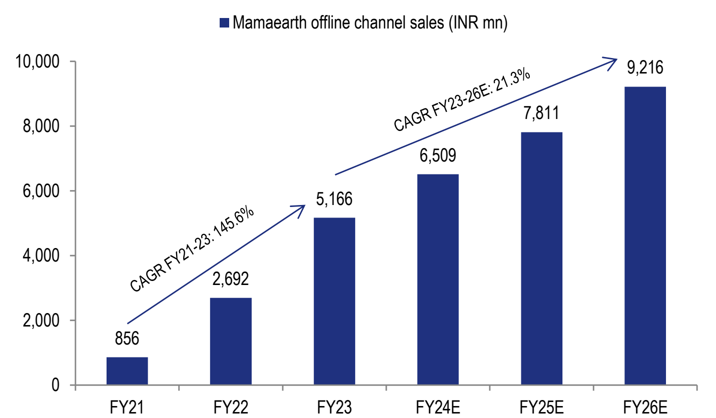


Source: Company, JM Financial

- Channel checks point to wider acceptance of Mamaearth brands in offline channel: We did channel checks across Class A and Class C outlets to ascertain acceptance of the brand in the offline channel. We saw Mamaearth products occupying decent shelf space with all major product lines available. In-store visibility in modern trade and standalone personal care stores was much better due to the presence of a dedicated beauty advisor, resulting in much higher throughput in these outlets. Most of the retailers we spoke to pointed towards strong brand pull for the key ranges of the brand, despite entry of other players. While channel margins for Mamaearth are higher vs. traditional incumbents, they are lower compared to other D2C BPC brands like WoW science. In fact, the company was able to reduce channel margins by c.200bps without any major disruption in sales, which again points to the strong brand equity of Mamaearth.

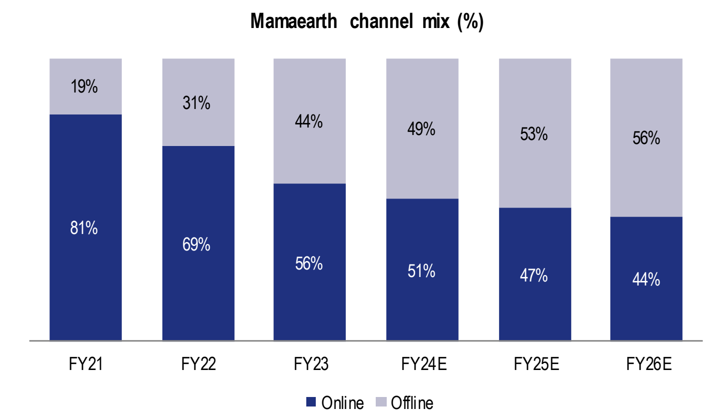
- Offline channel steadily becoming a more dominant channel and a key revenue driver for Mamaearth: Over FY21-23, offline channel sales have increased 6x, much faster than online sales, resulting in salience of the offline channel in overall revenue mix of the brand significantly increasing from c.19% in FY21 to c.44% of brand sales in FY23. Going ahead, with wider acceptance of the Mamaearth brand, we forecast offline sales to grow at a CAGR of 21% over FY23-26E (>50% of brand sales from offline channel from FY25E onwards) while online is expected to grow at a slower pace (which is part of a conscious company strategy on optimising channel mix and driving profitability).

Exhibit 18. Offline channel becoming a key revenue driver



Source: Company, JM Financial

Exhibit 19. Expect >50% of sales from offline channel from FY25E



Source: Company, JM Financial

Replicating success of Mamaearth through new brands can be a massive opportunity

- **Bridging portfolio gaps through additions of brands, thereby creating newer growth engines:** The experience and success with Mamaearth across key aspects (innovation, distribution, marketing, etc.) of brand-building has helped Honasa develop a brand-building playbook that enables it to replicate that success across newer brands either by incubating brands in-house or by acquiring new engines of growth. Over the years, leveraging the same, Honasa has transformed itself from a single-brand company to a 'house of brands' comprising six brands. Over FY20-23, it has launched three in-house brands (The Derma Company, Ayuga, Aqualogica). Moreover, each of these brands has unique propositions, thereby further enhancing Honasa's overall product offering. While Mamaearth tapped the opportunity arising from increasing consumer demand for natural ingredient-based non-toxic products, there were consumers who were looking for science backed/active ingredient-based product for their specific needs. Honasa was quick to pick up that insight in 2020, when the active ingredients proposition was relatively nascent in India, and launched a separate brand 'The Derma Company' given that Mamaearth's brand construct did not resonate with the active ingredient proposition. Aqualogica is another in-house brand, launched in 2021, based on insight that Indian tropical weather needs light hydration while Ayuga was launched to provide ayurvedic beauty products in easy-to-use, modern formats for Indian millennials. Apart from in-house brand launch, the company also acquired two brands – Dr Sheth (Bio actives based skincare range) and BBlunt (Professional hair care products) in 2022 – again with differentiated propositions, thereby further widening its portfolio offering.

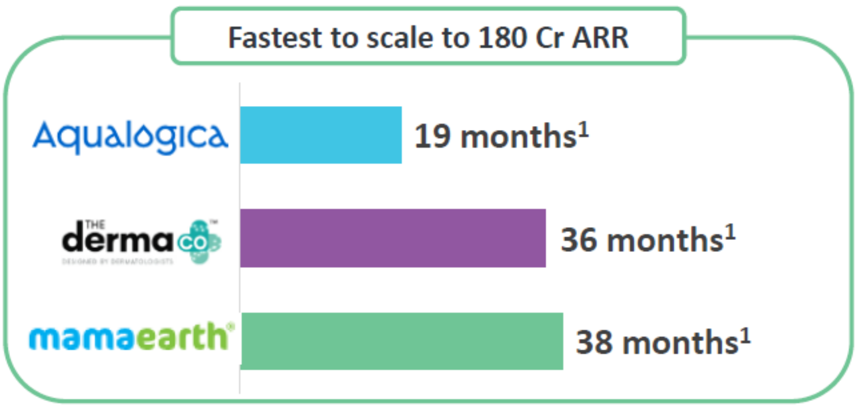
Exhibit 20. Honasa has successfully transformed itself from single brand company to a 'House of brands'

Source: Company, JM Financial

- **House of brands architecture allows accelerating growth:** In our view, having a wider assortment helps capture a consumer's wallet by catering to different needs even within a single household. Moreover, the success of a flagship brand like Mamaearth acts as a vehicle and helps provide entry to new brands in the channel by leveraging existing relationships with partners. This apart, synergy benefits from other integrated support functions help to scale up new brands at a much faster pace.

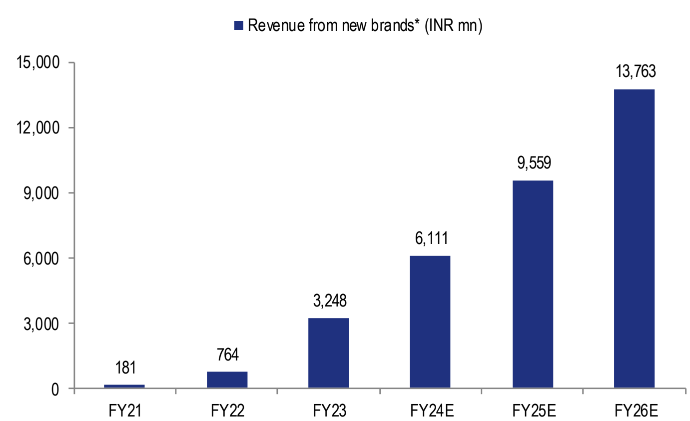
- **Replicating success of Mamaearth through new brands can be a huge opportunity, promising start visible from faster scale-up in 'The Derma Company' and 'Aqualogica':** The benefits are visible with faster scale-up of in-house brands launched after Mamaearth, with three out of five brands having crossed ARR of INR 1.5bn. Leading the pack is The Derma Company where the ramp-up has been pretty strong (from <INR 200mn sales in FY21 the brand is currently clocking ARR of INR 3.8bn). Similarly, Aqualogica was fastest to achieve ARR of INR 1.8bn in just 19 months of launch, which is almost half the time taken by Mamaearth and The Derma Company. Even the acquired brands have seen healthy uptick in revenues from the time of acquisition – Dr Sheth has scaled up 30x post acquisition and is the 4th brand to achieve INR 1.5bn ARR while the product business of Bblunt is up 3x since acquisition. As on FY23, revenue contribution from new brands (excluding service income) has increased to c.18% of overall sales from <5% in FY21. Strong innovation capabilities and online channel expertise apart, we see scope for ramp-up in the offline channel, leveraging existing relationships with distributors/retailers of Mamaearth. We forecast sales from new brands (ex-Mamaearth) to grow at 62% CAGR over FY23-26E, much faster vs. Mamaearth sales (CAGR of 12% over FY23-26E), thereby resulting in revenue contribution from these brands increasing to c.45% of sales by FY26E.

Exhibit 21. Mamaearth playbook and House of brands architecture allows faster scale-up in new brands



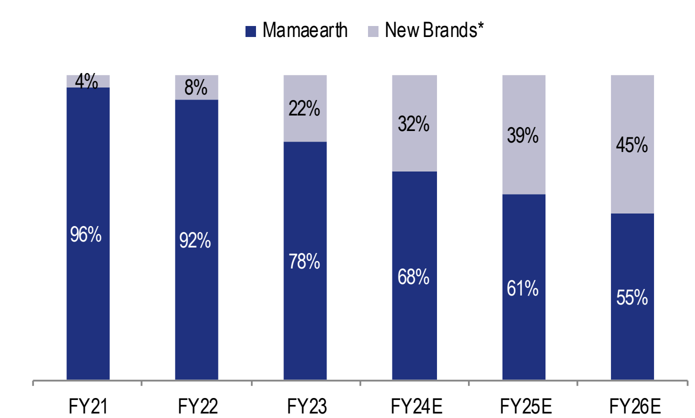
Source: Company, JM Financial
1. Months since brand launch. Note 1cr = 10mn

Exhibit 22. We expect sales from new brands to grow at CAGR of 62% over FY23-26E...



Source: Company, JM Financial
*Includes service income

Exhibit 23. ...resulting in steady improvement in contribution to overall revenue mix to 45% by FY26E

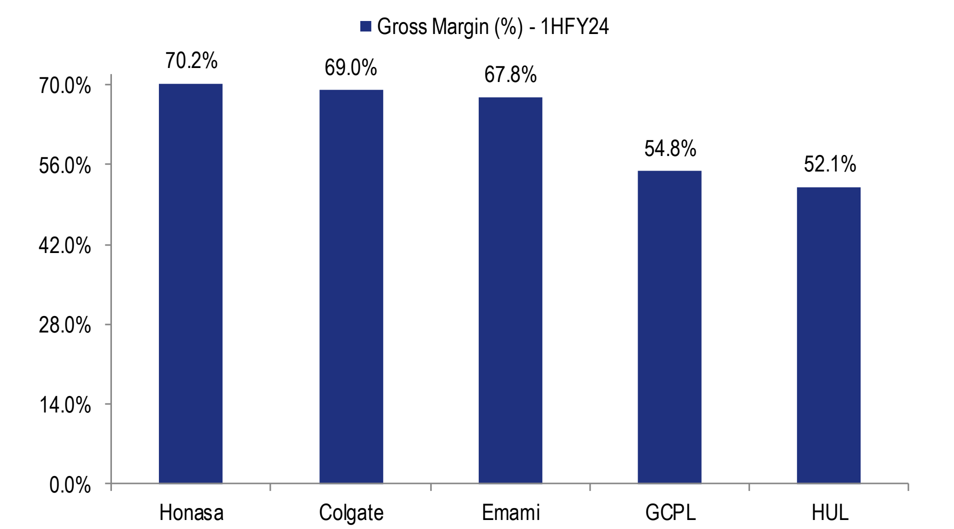


Source: Company, JM Financial
*Includes service income

Increased visibility on path to profitability

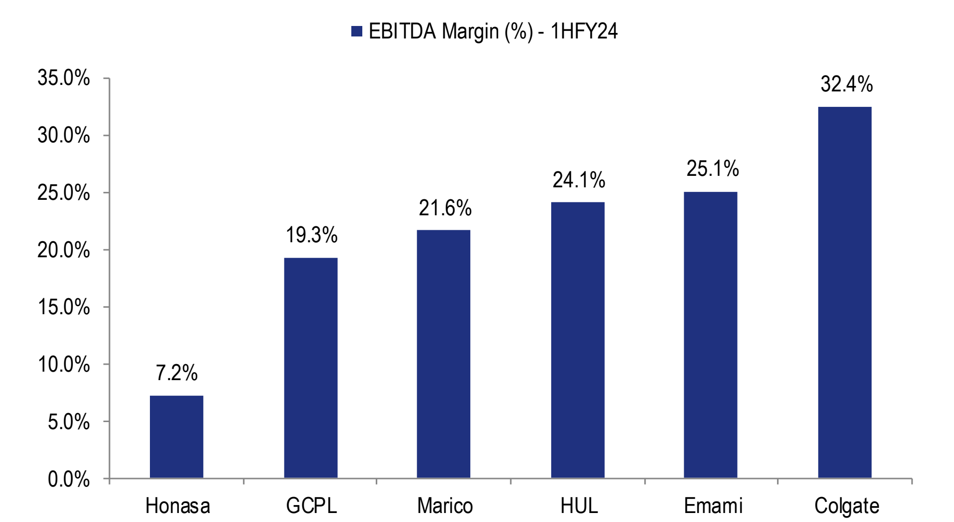
- While Honasa continues to focus on growing the business, doing it in a profitable and capital efficient manner is equally important for the company. The business has strong gross margin of c.70% on account of its presence in the high-margin BPC category, with brands positioned at masstige to premium price points. While gross margin profile is better compared to listed HPC peers and the company has delivered positive EBITDA margins over FY21-23, the same are still much below the inherent potential, primarily on account of disproportionate investments into brand-building and channel-related spends (c.35-42% of sales over FY20-23). We expect Honasa's revenue to grow at a CAGR of 27% to INR 30.3bn over FY23-26E, led by a combination of further scale-up in existing key ranges, innovation and distribution expansion.
- We expect steady uptick in overall EBITDA margin with improvement in margin for the Mamaearth brand and reduction in losses in new brands. In our view, the margin expansion will be a function of a) operating leverage benefit on account of improving scale and b) improving channel mix with scale-up in the higher margin offline channel. Some of that has already started to play out, as seen from margin improvement in 1HFY24. Below, we highlight key margin drivers for the company.

Exhibit 24. Gross margin of Honasa better vis-à-vis listed HPC peers…



Source: Company, JM Financial

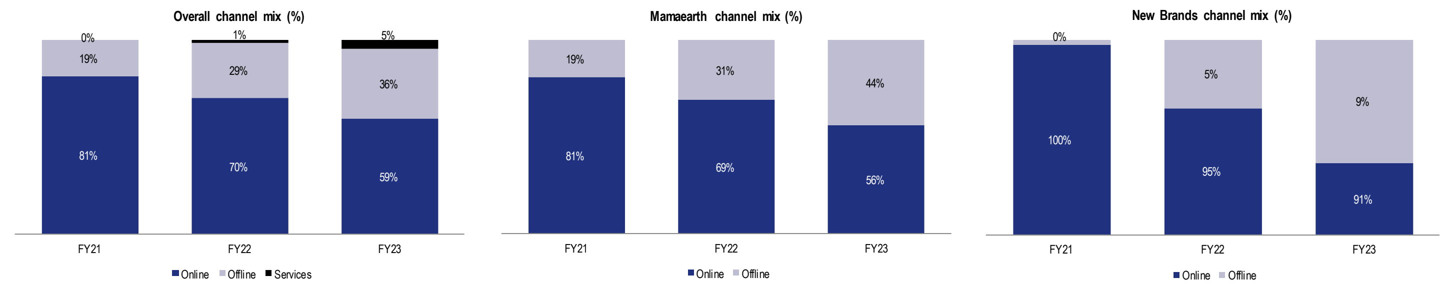
Exhibit 25. ...though EBITDA margin still sub-par due to higher A&P expenses



Source: Company, JM Financial

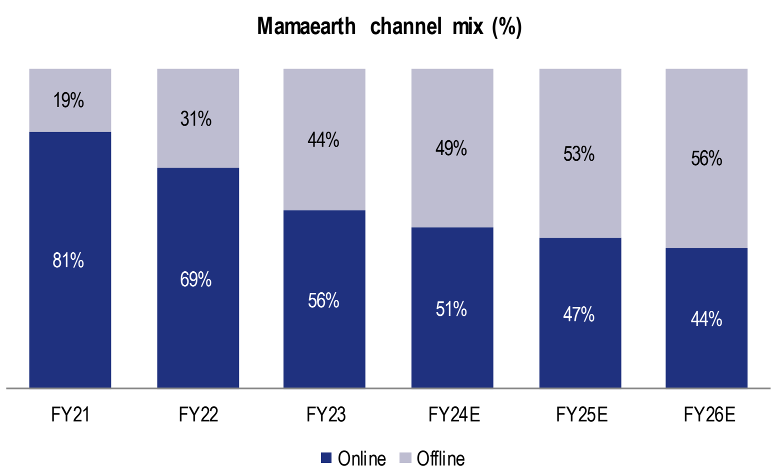
- **Improvement in channel mix with scale-up in high margin offline channel…:** As highlighted earlier, Honasa has developed a digital first omni-channel distribution network. The contribution margin is highest for the offline channel, followed by 3rd party e-commerce marketplaces and DTC channel, primarily on account of distribution partner costs (commissions to Amazon, Nykaa) and higher channel spends in the online channel. As the company continues to make inroads in the offline channel, we have seen steady improvement in channel mix with increasing salience of revenue from the higher-margin offline channel. Revenue from the offline channel accounted for 36% of sales in FY23 vs. <10% of sales in FY20. We expect improvement in channel mix to continue with the offline channel becoming a more dominant channel, especially for the Mamaearth brand (we forecast >50% of Mamaearth's sales to be through GT from FY25E) resulting in lower channel spends and uptick in overall profitability for the company.

Exhibit 26. Channel mix has seen steady improvement in favour of high-margin offline channel across brands



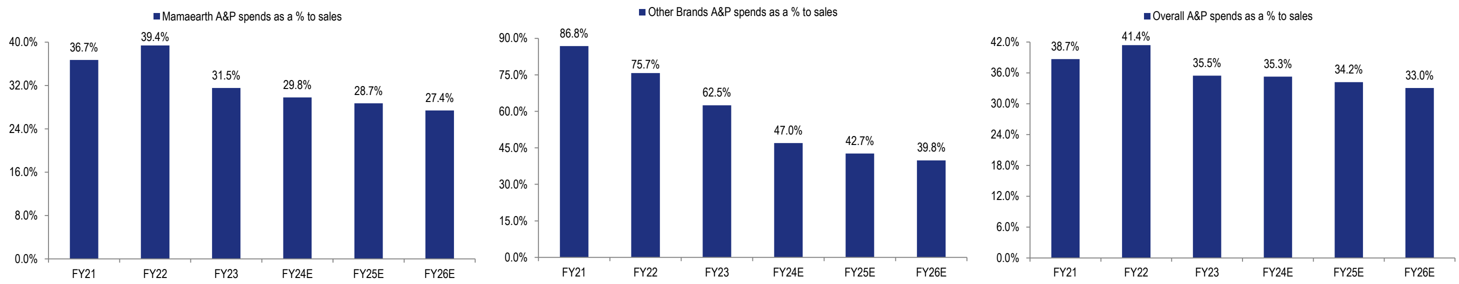
Source: Company, JM Financial

Exhibit 27. Offline channel to become dominant revenue contributor over FY24-26E for Mamaearth



…which along with increasing scale will drive optimisation of A&P spends: Honasa's A&P spend as % to sales (has been c.35-42% over FY21-23) is significantly higher vs. the traditional incumbents (A&P spend is 8-12% of sales. A&P spend comprises D2C performance marketing (directing traffic to website), channel spends for e-commerce (e.g., Amazon keywords, banners) and offline channel (in-store visibility, beauty advisor) and TV/media investments. With increase in scale, we have seen economies of scale kick in, resulting in A&P spend as % to sales moderating for Mamaearth as well as for new brands. As a result, overall A&P spend as % to sales fell by c.700bps to c.35% in FY23 (vs. c.42% in FY21). A large part of this reduction is on account of optimisation in digital marketing spend and e-commerce spend. From a long-term perspective, while the company will continue to invest behind brand building, we forecast overall A&P spend to come off as % of sales from 35.5% in FY23 to 33% in FY26E, primarily on account of reduction in channel spends.

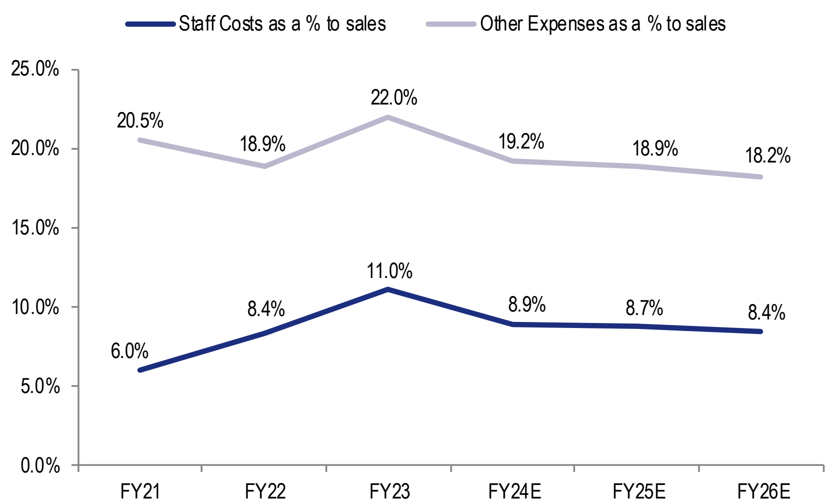
Exhibit 28. Reduction in channel spends across brands to drive down A&P as a % to sales going forward



Source: Company, JM Financial

- Apart from these, benefits of economies of scale should be visible across other fixed costs and operating expenses. For e.g., staff cost rose substantially (+2x YoY to 11% of sales) in FY23 primarily due to acquisitions of BBlunt and Momspresso, increments/bonus payout and higher ESOP expenses. Similarly, other expenses also rose sharply in FY23. We expect growth in employee expenses and staff cost to normalise and grow at a slower pace of 16%/19% respectively vs. sales CAGR of 27% over FY23-26E.

Exhibit 29. Growth in staff costs and Other expenses to normalise over FY23-26E as economies of scale kick in

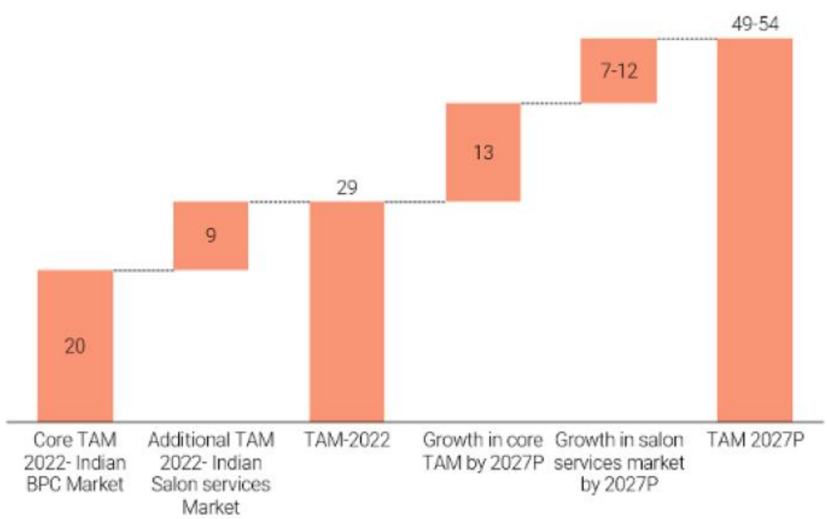


Source: Company, JM Financial

Honasa well placed to tap the opportunity in large TAM

- BPC in India is an approximately USD 20bn market and expected to grow at 11% annually to ~USD 33bn by 2027. The industry is expected to grow faster than Food, Grocery & Consumer electronics owing to convergence of technology, demographic dividend, and growing consumer aspirations. Significant trends that are shaping up consumer demand in BPC are – a) Premiumisation (masstige/premium categories to grow at CAGR of c.14-15% vs. 7% for mass segment over 2022-27E), b) Evolving category-mix, with a focus on face care and makeup, c) Emergence of new need spaces/ propositions in BPC, d) Higher prominence of digital/social media marketing and e) Increasing contribution from beyond the metros.
- Penetration of online BPC in India is at 16%, lower compared to the USA (20-25%) and China (35-40%). It is currently sized as USD 3.1bn and expected to grow at 29% annually to ~USD 11.1bn by 2027, translating to online penetration of 34%. The salon services space is an under-penetrated market and has been growing fast. Between 2016 and 2022, the market has doubled from USD 4bn to USD 9bn. This was driven by proliferation of branded salons across city tiers, increased consumer exposure to new styles and treatments and their willingness to pay a premium for these treatments. The growth momentum is strong and by 2027 the market is projected to be USD 16bn-21bn.
- Hence overall TAM for Honasa is expected to reach USD 49-54bn by 2027 from USD 29bn in 2022.

Exhibit 30. Honasa's TAM expected to be USD 49-54bn by 2026

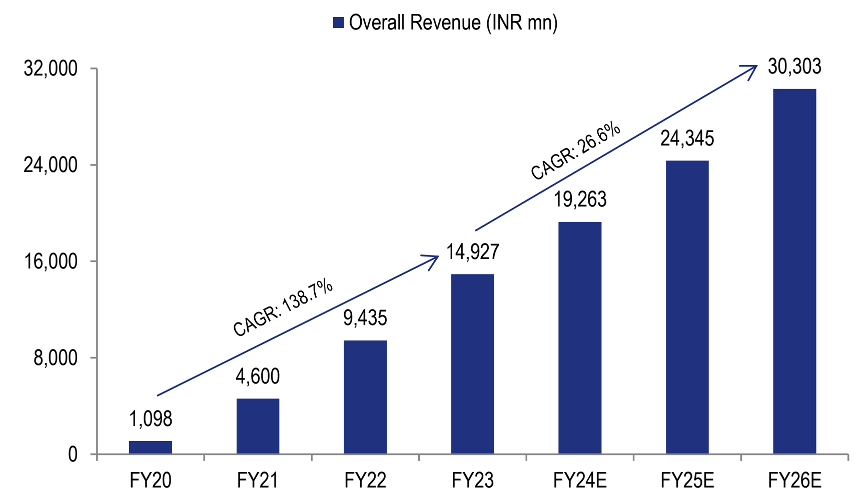


Source: Company RHP, JM Financial
Note: Figures in USD bn

Financial Overview

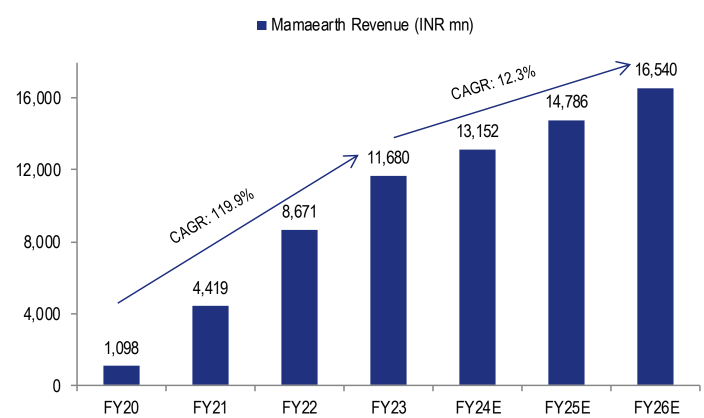
- **Revenue scale to double over FY23-26E:** Honasa clocked strong revenue CAGR of 139% over FY20-23, resulting in c.15x fold increase in revenue from INR 1.1bn in FY20 to INR 14.9bn in FY23. The sales for flagship brand Mamaearth grew by 120% CAGR to INR 11.7bn while sales of newer brands, introduced from FY21 onwards, also grew c.18x to INR 3.2bn by FY23. Going forward, we expect further scale-up in Mamaearth, albeit at a lower pace of 12% over FY23-26E vs. historical rate, owing to higher scale and the company's focus on optimising channel mix by expanding in the offline channel. However, sales of newer brands are expected to scale up at a much faster pace – 62% CAGR led by innovations and ramp-up across channels. Together, these factors are expected to drive industry leading revenue CAGR of 27% over FY23-26E for Honasa, leading to revenue doubling to INR 30.3bn by FY26E.

Exhibit 31. Revenue growth to be driven by innovations and channel expansion



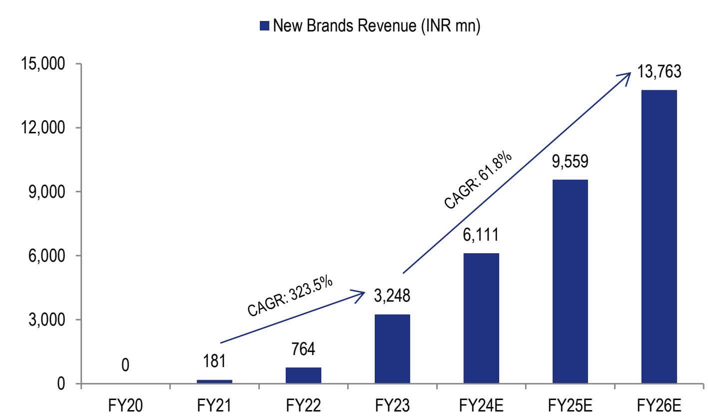
Source: Company, JM Financial

Exhibit 32. Mamaearth's revenue expected to grow at 12.3% CAGR over FY23-26E



Source: Company, JM Financial

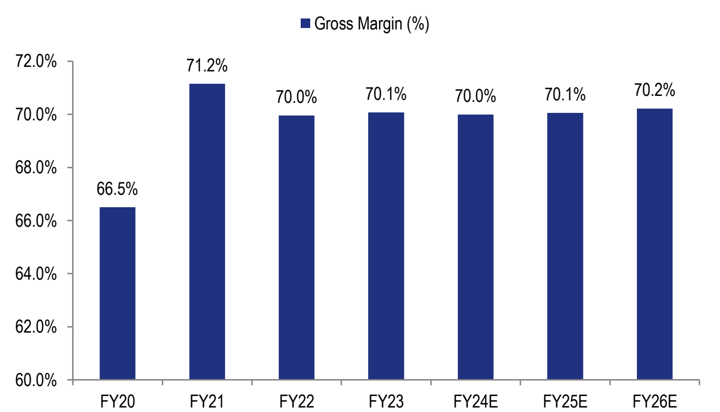
Exhibit 33. New brands to grow at a much higher CAGR of c.62% over the same period



Source: Company, JM Financial

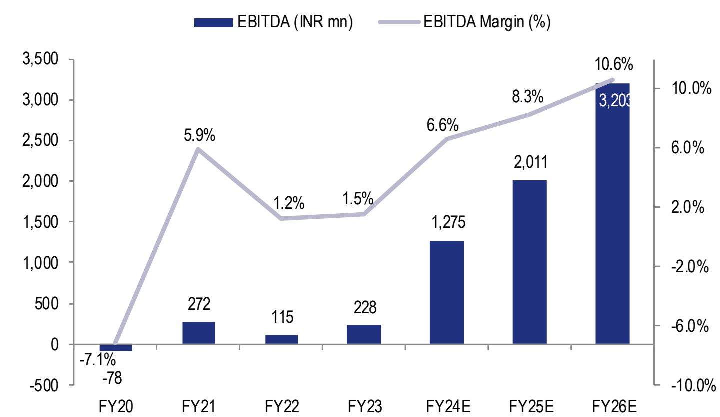
- **Increasing scale led operating leverage and improving channel mix to drive sharp improvement in profitability metrics…:** Honasa enjoys superior gross margin of c.70% given its presence in masstige and premium segments. With sharp increase in revenue scale and optimisation on A&P spend, Honasa clocked positive EBITDA over FY21-23 vs. losses prior to that. While gross margin is expected to be stable, margin expansion is primarily due to operating leverage benefit, optimisation of channel spends and improving channel mix with scale-up in the higher-margin offline channel. We expect A&P spend as % to sales to moderate by 250bps to 33% of sales over FY23-26E. Similarly staff cost and other expenses are expected to grow at a CAGR of 16%/19% over the same period. Going ahead, we forecast EBITDA to grow at a CAGR of 141% over FY23-26E, much higher faster compared to revenue growth. Higher operating profit flowthrough is expected to be contributed by 910 bps cumulative improvement in EBITDA margin over FY23-26E to 10.6% vs. 1.5% in FY23. Some of that has already started to play out, as visible from healthy margin improvement (+530bps YoY to 7.2%) in 1HFY24.

Exhibit 34. Honasa's gross margin to remain at a healthy 70%



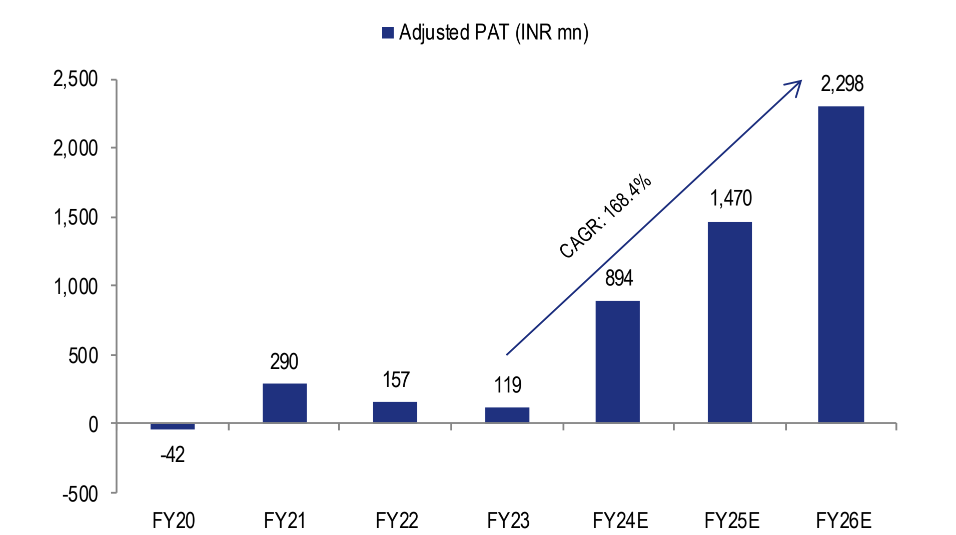
Source: Company, JM Financial

Exhibit 35. Low double-digit margins by FY26E



Source: Company, JM Financial

Exhibit 36. Adjusted profit to improve significantly from FY24E



Source: Company, JM Financial

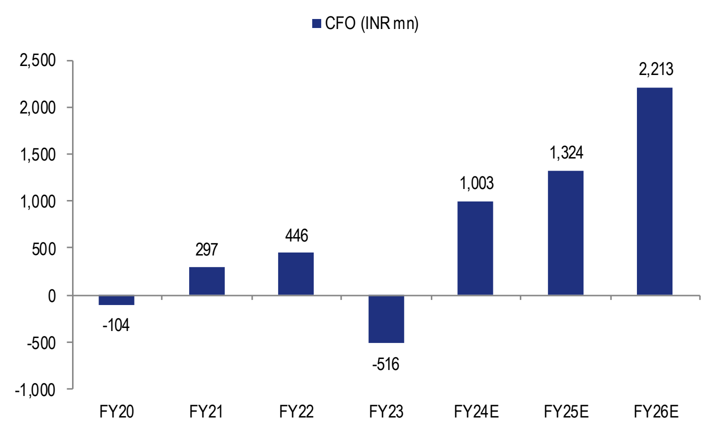
- …as well as lead to healthy cash flow generation: While growth has been the focus, Honasa has also been capital efficient in the process, which is a function of a) asset-light manufacturing setup as the company works entirely through third party manufacturers and b) well-controlled working capital. Honasa has raised c.INR6.5bn over FY20-23 and had net cash balance of > INR3bn as of Mar'23/Sep'23. Net proceeds of INR 3.65bn from its recent IPO will further strengthen the balance sheet. Going ahead, with steady uptick in profitability and working capital intensity largely stable, we expect operating cash flow to improve materially over FY23-26E (INR 4bn on cumulative basis). Capex intensity is unlikely to go up materially, barring some increase primarily due to expansion in EBO channel and Bblunt salons (plans to open 132 EBOs/20 salons over FY25-27E), which would entail a cumulative capex of INR 466mn over FY25-27E. Hence, we expect Honasa to turn FCF positive from FY24E onwards. With improving profitability and stable working capital intensity, RoCE/RoE profile should also improve sharply over FY23-26E.

Exhibit 37. Working capital trend (days of sales) expected to be stable

Days of sales	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Inventory	45	33	25	28	27	27	26
Receivables	35	27	28	31	30	30	30
Payables	73	64	66	48	51	51	51
Net Working Capital	8	-4	-12	11	6	6	6

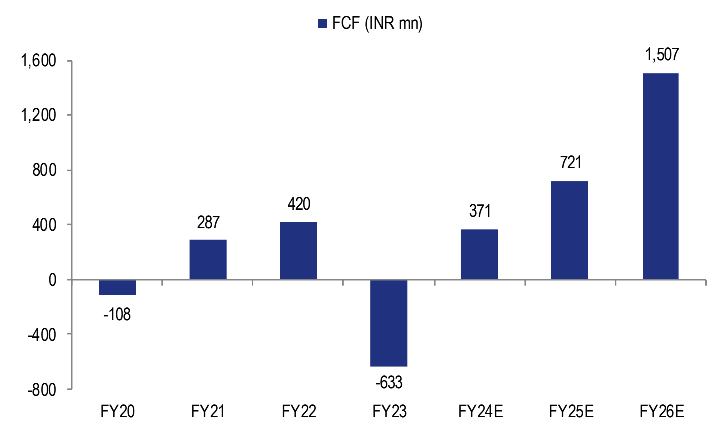
Source: Company, JM Financial

Exhibit 38. Cash flow from operations to improve materially on the back of uptick in profitability and well-controlled working capital…



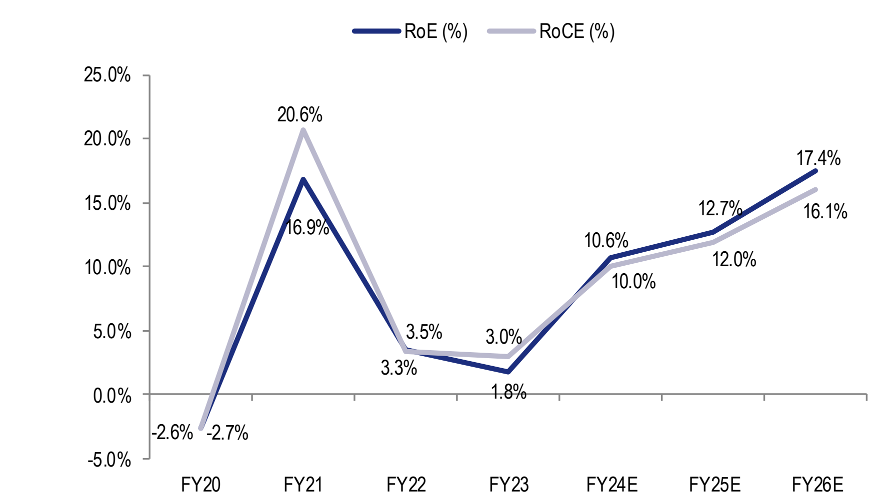
Source: Company, JM Financial

Exhibit 39. …which, along with lower capex intensity should lead to positive free cash flows from FY24E onwards



Source: Company, JM Financial

Exhibit 40. Improvement in profitability and working capital to drive return ratios



Source: Company, JM Financial

Valuation methodology

We initiate coverage on Honasa with a 'BUY' rating, TP of INR 515 per share

- Honasa's execution prowess is clearly visible from its performance since launch in 2016 – a) Flagship brand 'Mamaearth' is among the top 15 brands with a size of INR 20bn (in terms of retail spend), b) Successfully transformed itself into House of brands with a portfolio of six brands with unique proposition and c) largest and fastest growing D2C player that has turned profitable in the BPC space. The company's journey has seen impressive so far and with a repeatable brand-building playbook now in place and strong capabilities (well-oiled innovation engine, digital first distribution channel and capable professional team), we believe it is well-placed to tap the large (USD 49-54bn) and attractive (high growth & high margin) overall TAM.

- The execution machinery put in place by the company provides assurance on runway for growth – a) Offline channel expansion, especially for Mamaearth which can clearly elongate growth runway for the brand even from current levels., b) execution machinery put in place is already resulting in faster scale-up in newer brands, possible repeat of Mamaearth's success through The Derma Co (ARR of INR3.8bn) and Aqualogica (INR1.8 bn ARR) can be another key trigger, and c) continued improvement in margin and cash flow profiles with improved channel mix, optimisation of channel spends and operating leverage.

  We prefer to use DCF as the methodology for valuation in this case as it better captures the growth potential through a longer lifecycle as well as the steady-state profitability potential of the business model. Near-term numbers are impacted by the higher brand investments relating to scaling up the business. Our DCF for Honasa factors in explicit model forecasts till FY35 driven by the factors listed in the previous section, factoring sales/EBITDA CAGR of 18%/45.5% over FY23-35E. We use a discount rate of 11% and use a terminal growth rate of 6.0%, roughly in line with India's long-term GDP growth forecasts. Our analysis yields an intrinsic value of INR 515/share, implying 34% upside on the stock. At our target price, the stock would be trading at an FY26 EV to sales of 5.1x, EV-EBITDA of 48.6x and 72x on PE basis. We see huge headroom for growth for the company, on both topline and profitability, which, in our view, justifies the premium valuation.

- We expect Honasa to deliver sector-leading growth for our coverage universe (Sales/EBITDA CAGR of 27%/141% over FY23-26E). Hence, we suggest comparing Honasa to growth-adjusted multiples for these companies, which clearly implies that Honasa's multiples are taking into cognisance faster growth rates and margin expansion potential. Given superior growth profile, we believe Honasa can trade at a premium to the sector average.

Exhibit 41. Our DCF-based target price is INR 515

(INR mn)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY33E	FY34E	FY35E	CAGR
Revenue	1,098	4,600	9,435	14,927	19,263	24,345	30,303	36,474	43,974	52,309	60,311	69,177	78,064	87,521	97,189	108,002	17.9%
yoy growth		319.0%	105.1%	58.2%	29.0%	26.4%	24.5%	20.4%	20.6%	19.0%	15.3%	14.7%	12.8%	12.1%	11.0%	11.1%	
EBITDA	-78	272	115	228	1,275	2,011	3,203	4,333	5,861	7,442	9,086	10,957	12,987	15,272	17,209	19,394	44.8%
EBITDA margin %	-7.1%	5.9%	1.2%	1.5%	6.6%	8.3%	10.6%	11.9%	13.3%	14.2%	15.1%	15.8%	16.6%	17.5%	17.7%	18.0%	
EBIT	-85	255	46	-22	993	1,640	2,733	3,784	5,220	6,692	8,230	9,960	11,831	13,972	15,715	17,686	
EBIT margin %	-7.7%	5.5%	0.5%	-0.1%	5.2%	6.7%	9.0%	10.4%	11.9%	12.8%	13.6%	14.4%	15.2%	16.0%	16.2%	16.4%	
Tax Rate	0.0%	-0.6%	35.6%	-7.0%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	25.3%	
NOPAT	**-85**	**256**	**29**	**-24**	**742**	**1,225**	**2,042**	**2,827**	**3,900**	**4,999**	**6,148**	**7,440**	**8,838**	**10,437**	**11,739**	**13,212**	
Depreciation	6	17	69	250	281	371	469	548	641	750	855	996	1,156	1,301	1,494	1,708	
Capex	-4	-10	-1,176	-285	-424	-487	-606	-729	-879	-1,046	-1,206	-1,384	-1,561	-1,750	-1,944	-2,160	
Net working capital investment	-42	-1	2	-1,187	-94	-323	-410	-273	-422	-393	-261	-401	-487	-322	-403	-438	
Free Cash Flow	**-125**	**262**	**-1,075**	**-1,246**	**505**	**786**	**1,495**	**2,373**	**3,239**	**4,309**	**5,536**	**6,652**	**7,946**	**9,665**	**10,887**	**12,322**	
YoY Growth - %						55.7%	90.2%	58.7%	36.5%	33.1%	28.5%	20.2%	19.4%	21.6%	12.6%	13.2%	
Discounting Factor						1.00	0.90	0.81	0.73	0.66	0.59	0.53	0.48	0.43	0.39	0.35	
Present Value of FCF						**786**	**1,347**	**1,926**	**2,368**	**2,839**	**3,286**	**3,556**	**3,827**	**4,194**	**4,256**	**4,339**	

Fade period forecast	**FY37E**	**FY38E**	**FY39E**	**FY40E**	**FY41E**	**FY42E**	**FY43E**	**FY44E**	**FY45E**	**FY36-45 CAGR**
FCF	**15,526**	**17,285**	**19,136**	**21,067**	**23,062**	**25,104**	**27,172**	**29,242**	**31,289**	**9.5%**
Discounting Factor	0.29	0.26	0.23	0.21	0.19	0.17	0.15	0.14	0.12	
Present Value of FCF	4,438	4,451	4,439	4,403	4,342	4,258	4,152	4,026	3,881	

12M Forward Equity Valuation	
PV of Cash Flow - Explicit Period	31,938
PV of Cash Flow - Fade Period	42,792
PV of Terminal Value	82,274
Enterprise Value	**157,004**
Debt	0
Cash	8,710
Net Debt	-8,710
Equity value	**165,715**
No of Shares (mn)	322
Target price (INR per share)	**515**

Source: Company, JM Financial

Exhibit 42. Valuation metrics – We expect Honasa to significantly outpace FMCG peers on Sales & EBITDA growth

	CMP	FY23-26E Sales CAGR	FY23-26E EBITDA CAGR	PE (x)				EV/EBITDA (x)				EV/SALES (X)			
	INR			FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E
Britannia	4,951	8.0%	11.7%	61.3	52.7	47.9	42.9	41.7	36.2	32.8	29.5	7.4	7.1	6.4	5.8
Colgate	2,377	8.4%	12.2%	61.3	50.9	47.0	42.5	41.1	34.8	32.1	29.1	12.3	11.4	10.5	9.6
Dabur	548	11.1%	14.5%	56.9	48.8	43.5	39.2	42.3	34.6	30.8	27.4	8.0	7.0	6.3	5.7
GCPL	1,045	10.2%	14.1%	61.5	54.7	45.3	39.4	41.1	35.9	30.9	27.3	7.9	7.3	6.5	5.8
HUL	2,519	8.8%	10.6%	59.9	55.4	49.0	43.9	41.3	38.1	33.8	30.2	9.8	9.3	8.4	7.6
Marico	537	8.8%	12.2%	53.2	46.8	42.2	38.4	37.5	32.6	29.2	26.2	7.0	6.8	6.0	5.4
Nestle	24,786	11.1%	15.2%	100.0	79.8	70.5	63.5	63.1	52.2	45.7	41.2	14.1	12.3	11.2	10.2
TCPL	951	10.8%	15.2%	80.2	62.7	53.6	47.0	46.0	36.6	32.7	29.4	6.2	5.5	5.0	4.5
Sector Average				68.0	58.8	51.9	46.5	45.3	39.5	35.0	31.3	9.8	9.1	8.2	7.4
Honasa	385	26.6%	141.4%	NA	NA	84.3	53.9	NA	91.2	57.3	35.6	8.1	6.0	4.7	3.8

Source: Company, JM Financial

Key Risks

- Strong brands like Dove, Ponds, Lux, etc. that are also in more than one category are just about INR 18-20bn in brand size in terms of retail spends. Mamaearth is already large enough in size at INR 20bn in consumer spends - execution on offline scale-up and expanding width of the portfolio through innovations under the Mamaearth umbrella will be key along with scale-up in other new age brands. Slower-than-expected execution here can impact the overall earnings profile.

- High growth rates apart, a lot of the earnings progression is also premised upon operating margin reaching double-digit level by FY26 (vs. 1.5% in FY23). Part of this is premised on channel spends and brand-building spends coming down as % of sales once revenue scales up. These plans may not be achieved if competitive intensity heats up in the space, which could derail the margin expansion plan of the company.

- Objects of offer include proceeds of funds to be used for acquisitions – Any unrelated acquisition, over-payment for acquisition, or inability to successfully integrate the same can impact profitability.

- Overhang of supply of shares in the market post IPO - PE entities still hold c.44% stake in the company.

Financial Tables (Consolidated)

Profit & Loss Statement					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Sales	**9,435**	**14,927**	**19,263**	**24,345**	**30,303**
Sales Growth	105.1%	58.2%	29.0%	26.4%	24.5%
Other Operating Income	0	0	0	0	0
Total Revenue	**9,435**	**14,927**	**19,263**	**24,345**	**30,303**
Cost of Goods Sold/Op. Exp.	2,834	4,467	5,780	7,291	9,026
Personnel cost	788	1,649	1,719	2,120	2,555
Other expenses	5,697	8,584	10,489	12,923	15,520
EBITDA	**115**	**228**	**1,275**	**2,011**	**3,203**
EBITDA (%)	1.2%	1.5%	6.6%	8.3%	10.6%
EBITDA Growth (%)	-57.9%	98.7%	459.9%	57.8%	59.3%
Depn & Amort	69	250	281	371	469
EBIT	46	-22	993	1,640	2,733
Other Income	209	225	286	446	504
Finance Cost	30	67	82	118	161
PBT before Excep & Forex	224	137	1,197	1,967	3,076
Excep & forex Inc/Loss(-)	0	-1,547	0	0	0
PBT	224	-1,410	1,197	1,967	3,076
Taxes	80	99	303	498	778
Extraordinary Inc/Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	13	82	0	0	0
Reported Net profit	157	-1,428	894	1,470	2,298
Adjusted Net Profit	**157**	**119**	**894**	**1,470**	**2,298**
Net Margin (%)	1.7%	0.8%	4.6%	6.0%	7.6%
Diluted share capital (mn)	322	322	322	322	322
Diluted EPS (Rs)	**0.5**	**(4.7)**	**2.8**	**4.6**	**7.1**
Diluted EPS Growth	NM	NM	NM	64.4%	56.4%
Total Dividend + Tax	0	0	0	0	689
Dividend Per Share (Rs)	0.0	0.0	0.0	0.0	2.1

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Shareholders' Fund	7,056	6,059	10,741	12,332	14,013
Share capital	0	1,363	3,217	3,217	3,217
Reserves & Surplus	-10,873	-13,234	7,524	9,114	10,796
Preference Share Capital	17,929	17,929	0	0	0
Minority Interest	0	0	0	0	0
Total Loans	36	36	0	0	0
Def. Tax Liab / Assets (-)	86	14	42	87	158
Total - Equity & Liab	**7,178**	**6,109**	**10,783**	**12,419**	**14,171**
Net Fixed Assets	2,874	1,639	1,966	2,289	2,527
Gross Fixed Assets	2,904	2,002	2,426	2,913	3,519
Intangible Assets					
Less: Depn. & Amort.	20	304	585	955	1,425
Capital WIP & Net lease asset	-9	-60	125	331	432
Investments	3,385	2,600	2,600	2,600	2,600
Current Assets	3,530	4,539	9,907	12,166	14,748
Inventories	659	1,139	1,444	1,791	2,188
Sundry Debtors	728	1,277	1,583	2,001	2,491
Cash & Bank Balances	877	681	5,031	6,110	7,342
Loans & Advances	941	1,096	1,079	1,302	1,545
Other Current Assets	326	347	771	962	1,182
Current Liab. & Prov.	2,612	2,669	3,691	4,637	5,704
Current Liabilities	2,553	2,529	3,450	4,283	5,197
Provisions & Others	59	140	241	353	507
Net Current Assets	918	1,870	6,216	7,529	9,044
Application of Funds	**7,178**	**6,109**	**10,783**	**12,419**	**14,171**

Source: Company, JM Financial

Cash Flow statement					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Profit before Tax	224	-1,410	1,197	1,967	3,076
Depn. & Amort.	69	250	281	371	469
Net Interest Exp. / Inc. (-)	-179	-159	-203	-327	-343
Inc (-) / Dec in WCap.	213	-1,048	-94	-323	-410
Others	212	1,977	28	45	71
Taxes Paid	-95	-125	-205	-409	-651
Operating Cash Flow	**446**	**-516**	**1,003**	**1,324**	**2,213**
Capex	-26	-117	-632	-603	-706
Free Cash Flow	420	-633	371	721	1,507
-Inc/dec in investments	-2,804	929	0	0	0
Other current assets	-2,168	-383	286	446	504
Investing Cash Flow	**-4,998**	**429**	**-347**	**-158**	**-201**
Inc/(dec) in capital	4,865	49	3,788	121	73
Dividend+Tax Thereon	0	0	0	0	-689
Inc/dec in loans	0	-25	-36	0	0
Other assets	-57	-165	-58	-209	-163
Financing Cash Flow	**4,808**	**-141**	**3,694**	**-88**	**-779**
Inc / Dec (-) in Cash	256	-227	4,350	1,079	1,232
Opening cash balance	621	908	681	5,031	6,110
Closing cash balance	877	681	5,031	6,110	7,342

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Margin	1.7%	0.8%	4.6%	6.0%	7.6%
Asset Turnover (x)	2.1	2.2	2.3	2.1	2.3
Leverage Factor (x)	-0.9	1.0	1.0	1.0	1.0
RoE	-3.0%	1.8%	10.6%	12.7%	17.4%

Key Ratios					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
BV/Share (Rs)	21.9	18.8	33.4	38.3	43.6
ROIC (%)	1.4%	-0.6%	20.8%	30.2%	44.0%
ROCE (%)	3.3%	3.0%	10.0%	12.0%	16.1%
ROE (%)	3.5%	1.8%	10.6%	12.7%	17.4%
Net Debt-equity ratio (x)	1.9	2.4	-0.7	-0.7	-0.7
PER	NA	NA	NA	84.3	53.9
PBV	17.6	20.4	11.5	10.0	8.8
EV/EBITDA	NA	NA	91.2	57.3	35.6
EV/Net Sales	12.7	8.1	6.0	4.7	3.8
Debtor days	28	31	30	30	30
Inventory days	25	28	27	27	26
Creditor days	219	161	170	170	170

Source: Company, JM Financial

APPENDIX I

JM Financial Institutional Securities Limited

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Rating	Meaning
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Hold	Price expected to move in the range of 10% downside to 10% upside from the current market price for stocks with market capitalisation in excess of INR 200 billion and REITs* and in the range of 10% downside to 15% upside from the current market price for all other stocks, over the next twelve months.
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