

CMP: ₹ 1411

Target: ₹ 2000 (42%)

Target Period: 12 months

BUY

February 3, 2023

Summer brands to propel growth in next six months...

About the stock: Zydus Wellness (ZWL) is one of the FMCG companies present in healthcare, nutrition & related products. The company has six brands i.e. Sugarfree, Complian, Glucon-D, Nycil, Everyuth & Nutrilite.

- It commands dominant market share in sugar substitute (95.8%), Prickly heat powder (35.1%) & Glucose powder (59.9%) categories
- The company has more than 850 distributors with direct reach of 6 lakh retail outlets. Its high gross margins at ~55% give it leeway to spend ~13% of sales on advertisement to support new products

Q3FY23 Results: Zydus saw sales growth of 7.1% entirely led by pricing growth.

- Sales growth led by double digit growth in Everyuth, Sugarfree & Nutralite
- EBITDA was at ₹ 28.2 crore, down 12.7% YoY, with margins at 6.8%
- Consequent adjusted PAT was at ₹ 19.3 crore, down of 13.9%

What should investors do? Zydus Wellness' underperform FMCG index with 23% return in last five years (from ₹ 1147 in February 2018 to ₹ 1411 in February 2023).

- Sustained inflation in milk has adversely impacted HFD growth & gross margin. We expect summer product to drive growth in next two quarters
- We maintain our **BUY** rating on the stock

Target Price and Valuation: We value the stock at ₹ 2000 on ascribing 26x FY25 earnings multiple.

Key triggers for future price performance:

- With softening of crude, aspartame, palm oil prices & 6% price hike taken in December-2022, margins are expected to inch up in peak summer season
- Market share gains in face cleansing, Prickly heat powder & Glucose powder category. Innovation to drive growth in core categories
- Expansion of direct distribution reach to 1 million outlets, focus on chemist channel sales & doctor's advisory to play pivotal role in growing 'Complan'

Alternate Stock Idea: We like Dabur in our FMCG coverage.

- Significant shift in consumption towards healthier, natural & Ayurveda based products & aggressively foray in many big categories (edible oil, carbonated drink, household insecticides, fruit drinks) would be driving growth for Dabur
- Value the business 52x FY25 earnings. BUY with TP of ₹ 700



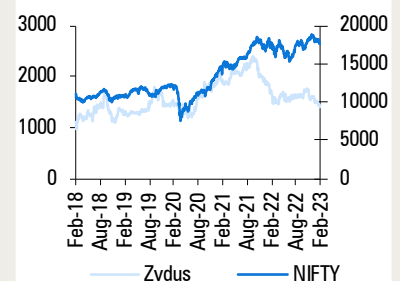
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	8,978.8
Total Debt (FY22)	381.5
Cash and Investments (FY22)	196.8
EV	9,163.5
52 week H/L (₹)	1817/ 1363
Equity capital	57.7
Face value (₹)	10.0

Shareholding pattern

(in %)	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	64.8	65.1	65.4	65.4
FII	2.6	2.4	3.2	3.8
DII	25.1	25.1	23.8	23.4
Others	7.5	7.4	7.6	7.5

Price Chart



Recent event & key risks

- ZWL has taken price increase of 6.5% in December to pass on high inflation in milk
- **Key Risk:** (i) Persistent inflation in milk could continue to pressurise margins in longer run (ii) High competitive intensity in Complan

Research Analyst

Sanjay Manyal
sanjay.manyal@icicisecurities.com

Key Financial Summary

₹ Crore	FY21	FY22	5 Year CAGR (FY17 to FY22)	FY23E	FY24E	FY25E	CAGR FY22-25E
Net Sales	1,866.7	2,009.1	36.1%	2,256.3	2,492.4	2,772.6	11.3%
EBITDA	344.4	344.8	28.3%	390.9	469.0	547.0	16.6%
EBITDA Margin %	18.4	17.2		17.3	18.8	19.7	
Adjusted Net Profit	250.9	308.9	23.2%	352.9	429.0	481.1	15.9%
Adjusted EPS (₹)	39.4	48.5	28.3%	55.5	67.4	75.6	15.9%
Adjusted P/E (x)	35.8	29.1		25.4	20.9	18.7	
RoCE (%)	6.2	6.1		6.8	8.1	9.2	
RoE (%)	5.5	6.4		7.1	8.3	9.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

Q3FY23 Results: Milk prices remain elevated; price hike & cooling down of other commodities to support margins

- Revenue witnessed growth of 7.1% to ₹ 415.6 crore entirely led by pricing growth. High inflation has been adversely impacting rural demand conditions in turn resulting in flat volumes during the quarter
- Some commodity prices like palm oil, crude & aspartame have corrected in the last six months. Key raw material for the company like milk have still remained elevated. Milk prices are up 26% on a YoY basis
- The company gained market share in Glucon-D by 161 bps to 59.9%. Glucose powder category has grown at 8.2% on a MAT basis. Given, it is an off-season for the category, sales have been relatively low. The company has not been able to create demand in the second summer during September-November
- Everyuth brands are growing in double digit on a three-year CAGR basis with gain in market shares. The brand holds market share of 6.4% in face cleansing category
- In sub-categories, Everyuth scrubs gained market share by 160 bps to 41.8% & Everyuth peel-off gained market share by 22 bps to 78.4%. Face Scrubs & Peel-off categories have grown by 6% & 7%, respectively. The company is continuing TV & digital campaigns across core brands along with newly launched body lotions
- Sugar free witnessed double digit growth in secondary sales during the quarter. The three-year CAGR of sugar free has been in high single digit. The company holds market share of 95.8%. Sugar lite & Sugar free green are growing at faster pace with aggressive promotions via digital, TV & print. Sugar free lite & Sugar free green contributes 13% to sugar free brand sales.
- Nutralite brand saw double digit growth with three-year CAGR in high single digit. Dhoodhshakti dairy portfolio, which includes butter, spreads & Ghee saw strong growth during the quarter. Nutralite drives 50% of its sales from food servicing business
- Nycil maintained its number one position with market share of 35.1% in prickly heat powder. The quarter has limited contribution from the category given it is a non-seasonal quarter
- HFD category has been witnessing de-growth in the last seven quarters mainly due to high inflation in barley & milk. The category has de-grown by 2.3% during the quarter. Complian saw mid-single digit growth during the quarter. The company lost market share by 66 bps YoY to 4.5% but market share has been steady sequentially
- The company has been under participating in sachets in HFD category given margins are lower in LUPs. This has resulted in market share loss in the last one year. The competition has reduced prices in the category but the company wants to play with right price architecture
- On 9MFY23, the company saw 13.3% growth with 6.3% volume growth & 7% price hike. With the softening of commodity costs & steady state of business, the company expect double digit sales growth with larger growth is contributed by volumes
- Gross margin continues to slide 440 bps on a YoY basis mainly due to continuous increase in milk prices, which is a key raw material for the company. However, gross margins improved slightly 60 bps sequentially given the company is taking price hike to pass on the impact of high inflation
- Zydus cut advertisement spend by 305 bps during the quarter. Employee spend is also down 140 bps in Q3 due to the closure of Sitarganj facility in Q1FY23. Overhead spends was up 159 bps on account of wage revision in

north eastern facility & higher energy costs. Gross margin in non-milk portfolio increased by 200 bps sequentially

- Operating profit declined 12.7% to ₹ 28.2 crore with margin contraction of 154 bps to 6.8%. Interest cost was down 40.2% to ₹ 3.8 crore due to reduction in debt levels. Net profit de-grew 15% to ₹ 19.6 crore
- With the 6.5% price hike taken in December 2022, most cost inflation has been absorbed. Inventory levels are at normalised level. The company would start building up inventory for the season in February-March 2023
- Channel mix is shifting towards modern trade & e-commerce channel with their sales contribution increasing to 20.3% in 9MFY23 from 17.6% in 9MFY22. The company has direct distribution reach of 6 lakh outlets and it plans to reach 10 lakhs in the next three years. Its overall distribution reach is 25 lakh retail outlets equally divided between rural & urban regions
- Income tax is likely to remain zero in FY23 & FY24. There could be marginal increase in Income tax in FY25

Exhibit 1: Peer Comparison

Sector / Company	CMP	TP	Rating	M Cap (₹ Cr)	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹)			FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Hindustan Unilever (HINLEV)	2574	2800	Hold	604971	11.3	16.3	9.5	24.8	23.5	24.0	68.6	61.2	55.2	18.1	20.3	22.4	20.2	22.9	25.6
Nestle (NESIND)	18955	22400	Hold	190912	10.2	14.3	10.5	24.5	22.3	24.1	85.2	74.1	62.9	111.3	103.6	110.3	58.7	57.1	63.0
Zydus Wellness (ZYDWEL)	1411	2000	Buy	8979	23.1	14.3	21.6	17.2	17.3	18.8	29.1	25.7	20.9	6.4	7.1	8.3	6.1	6.8	8.1

Source: Company, ICICI Direct Research

Zydus Wellness continued to witness dismal demand conditions on the back of high inflation in milk prices. However, Q2 & Q3 is generally low sales quarter for the company as summer brands like Glucon-D & Nycil contributes largely in Q4 & Q1. We believe the company is following a right strategy of increasing distribution reach, extending brands in similar categories (or adjacencies) & investing high amounts towards advertisement. We believe cool down in other commodity prices & price hike taken in December-2022 would bring back gross margins in peak summer season of Q4 & Q1 along with strong volume growth in core categories. We maintain our BUY recommendation of the stock & target price of ₹ 2000/share (earlier ₹ 2100).

Exhibit 2: Variance Analysis

	Q3FY23	Q3FY22E	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
Net Sales	415.6	439.7	388.1	7.1	429.5	-3.2	Net sales witnessed growth of 7.1% led entirely by pricing growth
Raw Material Expenses	233.2	250.5	200.7	16.2	209.2	11.5	Gross margin contracted by 440 bps given milk prices have still remain at elevated levels
Employee Expenses	35.1	41.4	38.2	-8.1	43.6	-19.6	Employee spends were down due to closure of Sitarganj facility earlier in Q1
SG&A Expenses	44.3	48.8	53.2	-16.8	51.7	-14.4	Marketing spends were cut down by 305 bps (as percentage of sales) to safeguard operating margins
Other operating Expenses	74.8	67.3	63.7	17.4	74.4	0.5	Higher overhead spends due to high energy costs & wage revision in north east facility
EBITDA	28.2	31.6	32.3	-12.7	16.3	73.4	
EBITDA Margin (%)	6.8	7.2	8.3	-154 bps	3.8	300 bps	Operating margins impacted by high commodity inflation & impact of gross margins
Depreciation	5.9	8.0	5.8	0.7	6.4	-8.6	
Interest	3.8	3.6	6.4	-40.2	2.9	30.6	Interest cost was down 40.2% on account of debt reduction
Other Income	0.8	3.1	2.7	-68.8	1.4	-37.8	
PBT	19.3	23.0	22.7	-15.0	8.2	134.3	
Exceptional Items	0.0	0.0	0.0	NA	0.0	NA	
Tax Outgo	-0.3	0.0	0.0	NA	0.0		
PAT	19.6	23.0	22.7	-13.9	8.2	137.4	Net profit declined by 13.9% similar to operating profit dip
Adjusted PAT	19.3	23.0	22.7	-15.0	8.2	134.3	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

₹ Crore	FY23E			FY24E			FY25E	Comments
	Old	New	% change	Old	New	% change	New	
Sales	2,289.9	2,256.3	-1.5	2529.6	2492.4	-1.5	2,772.6	We slightly cut down our sales estimates given weak performance by HFD (Complan). We are introducing FY25 numbers
EBITDA	401.8	390.9	-2.7	488.0	469.0	-3.9	547.0	
EBITDA Margin (%)	17.5	17.3	-23 bps	19.3	18.8	-47 bps	19.7	We cut our margin estimate considering inflation cool off slower than earlier expected
Adjusted PAT	367.6	350.0	-4.8	447.1	429.0	-4.0	481.1	
EPS (₹)	57.8	55.5	-4.0	70.3	67.4	-4.0	75.6	

Source: ICICI Direct Research

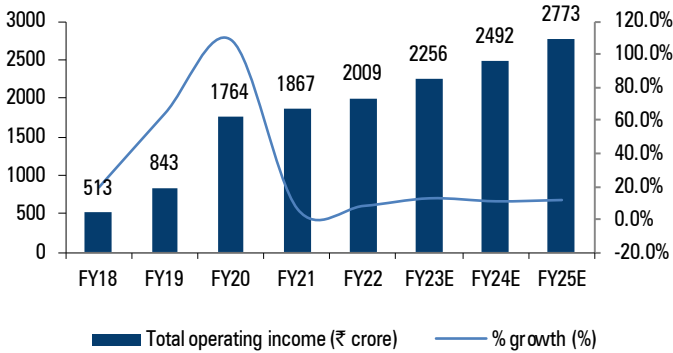
Exhibit 4: Assumptions

	Current					Earlier		Comments
	FY21E	FY22E	FY23E	FY24E	FY25E	FY23E	FY24E	
Sugarfree & others (₹ crore)	386.0	433.6	477.6	521.3	574.2	477.6	521.3	
Everyuth (₹ crore)	169.9	197.6	225.7	250.9	281.7	225.7	250.9	
Glucon D (₹ crore)	505.3	535.9	601.3	674.6	756.9	584.9	656.2	We slightly raise our Glucon-D sales estimate
Complan (₹ crore)	404.5	445.3	463.3	510.3	572.6	486.0	535.3	We cut Complan sales estimate given category has seen a decline
RM / Sales (%)	39.8	44.0	46.0	44.8	44.2	43.4	42.4	

Source: ICICI Direct Research

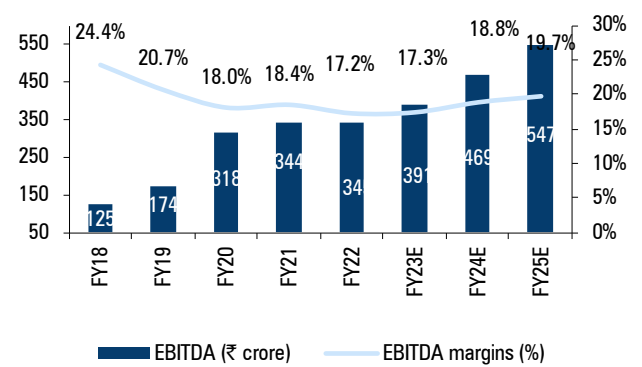
Key Metrics

Exhibit 5: Revenue, revenue growth trend



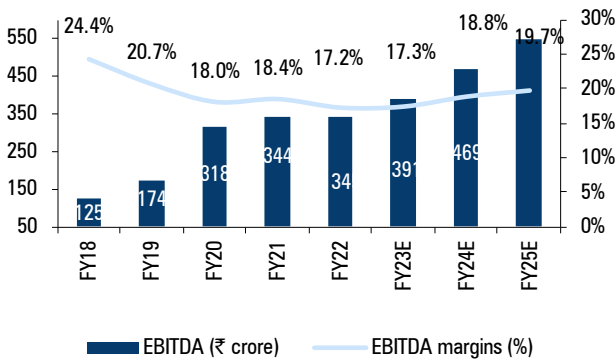
Source: ICICI Direct Research, Company

Exhibit 6: Marketing spend trend



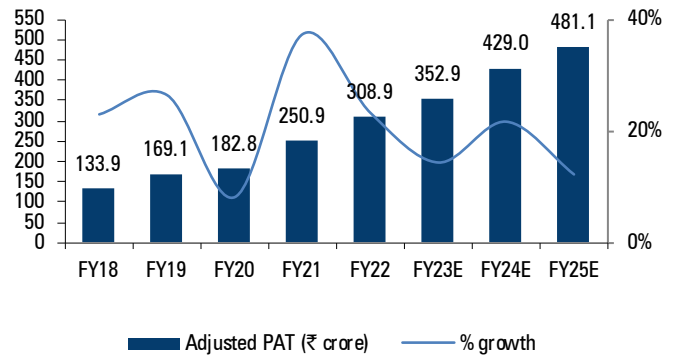
Source: ICICI Direct Research, Company

Exhibit 7: Operating margins trend (%)



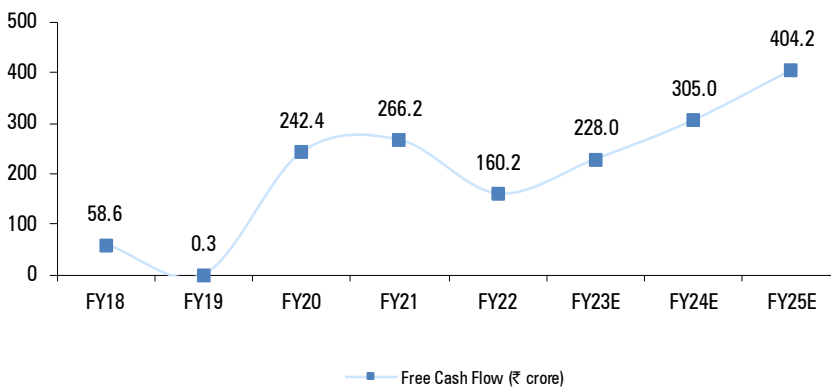
Source: Company, ICICI Direct Research

Exhibit 8: Adjusted PAT growth trend



Source: Company, ICICI Direct Research

Exhibit 9: Free Cash Flow (₹ crore)



Source: ICICI Direct Research

Exhibit 10: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY22	2009.1	7.6	48.5	23.1	29.1	26.7	6.4	6.1
FY23E	2256.3	12.3	55.5	14.3	25.7	23.5	7.1	6.8
FY24E	2492.4	10.5	67.4	21.6	20.9	19.5	8.3	8.1
FY25E	2772.6	11.2	75.6	12.1	18.7	16.6	9.0	9.2

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 11: Profit and loss statement				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Total operating Income	2,009.1	2,256.3	2,492.4	2,772.6
Growth (%)	7.6	12.3	10.5	11.2
Raw Material Expenses	980.4	1,147.4	1,227.6	1,349.0
Employee Expenses	163.6	164.3	178.9	196.1
Marketing Expenses	234.8	262.8	305.9	337.4
Administrative Expenses	0.0	105.6	116.6	124.0
Other expenses	285.7	185.4	194.4	219.1
Total Operating Expenditure	1,664.4	1,865.4	2,023.3	2,225.5
EBITDA	344.8	390.9	469.0	547.0
Growth (%)	6.1	13.4	20.0	16.6
Depreciation	23.6	32.1	34.9	37.6
Interest	25.5	12.0	11.3	9.5
Other Income	10.4	5.9	6.2	6.5
PBT	306.0	352.6	429.0	506.4
Total Tax	-2.9	-0.3	0.0	25.3
Exceptional Item	0.0	0.0	0.0	0.0
PAT	308.9	352.9	429.0	481.1
Adjusted PAT	308.9	352.9	429.0	481.1
Growth (%)	23.1	14.3	21.6	12.1
Adjusted EPS (₹)	48.5	55.5	67.4	75.6

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Profit After Tax	301.9	350.0	429.0	481.1
Add: Depreciation	23.6	32.1	34.9	37.6
(Inc)/dec in Current Assets	-14.0	-160.5	-160.8	-126.1
Inc/(dec) in CL and Provisions	-74.7	47.8	51.9	61.5
CF from operating activities	236.9	269.5	355.0	454.2
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	-10.0	-10.0	-10.0
(Inc)/dec in Fixed Assets	-74.7	-41.4	-50.0	-50.0
Others	15.8	-5.0	-5.0	-5.0
CF from investing activities	-58.9	-56.4	-65.0	-65.0
Inc/(dec) in loan funds	-168.3	-150.0	-42.5	-30.0
Dividend paid & dividend tax	-31.9	-190.9	-254.5	-318.2
Interest Paid	-32.5	-12.0	-11.3	-9.5
Others	0.0	0.0	0.0	0.0
CF from financing activities	-232.6	-352.9	-308.4	-357.7
Net Cash flow	-54.7	-139.8	-18.4	31.5
Opening Cash	252.7	169.8	30.0	11.6
Cash with Bank	0.0	0.0	0.0	0.0
Closing Cash	198.0	30.0	11.6	43.1

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	63.6	63.6	63.6	63.6
Reserve and Surplus	4,780.4	4,939.5	5,114.0	5,277.0
Total Shareholders funds	4,844.0	5,003.1	5,177.7	5,340.6
LT Borrowings & Provisions	62.5	12.5	0.0	0.0
Deferred Tax Liability	319.0	219.0	189.0	159.0
Others Non-current Liabilities	18.8	18.8	18.8	18.8
Total Liabilities	5,244.4	5,253.5	5,385.5	5,518.4
Assets				
Gross Block	452.7	492.7	532.7	572.7
Less: Acc Depreciation	216.8	249.0	283.9	321.4
Net Block	244.5	243.7	248.9	251.3
Capital WIP	11.9	21.9	31.9	41.9
Goodwill	3,920.0	3,920.0	3,920.0	3,920.0
Non-current Investments	5.5	5.5	5.5	5.5
LT loans & advances	0.0	10.0	20.0	30.0
Deferred Tax Assets	129.8	129.8	129.8	129.8
Other Non-Current Assets	566.7	571.7	576.7	581.7
Current Assets				
Inventory	361.6	408.0	450.7	501.3
Debtors	142.3	154.5	170.7	189.9
Loans and Advances	0.0	0.0	0.0	0.0
Other Current Assets	112.9	126.8	140.1	155.8
Cash	169.8	30.0	11.6	43.1
Investments	27.0	127.0	227.0	277.0
Current Liabilities				
Creditors	364.3	401.8	443.8	493.7
Provisions	21.9	24.5	27.1	30.2
Short term debt & other CL	61.7	69.3	76.5	85.1
Application of Funds	5,244.4	5,253.5	5,385.5	5,518.4

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	48.5	55.5	67.4	75.6
Cash EPS	52.3	60.1	72.9	81.5
BV	761.3	786.3	813.7	839.3
DPS	25.0	30.0	40.0	50.0
Cash Per Share	26.7	4.7	1.8	6.8
Operating Ratios (%)				
EBITDA Margin	17.2	17.3	18.8	19.7
PBT / Total Operating income	15.2	15.6	17.2	18.3
PAT Margin	15.4	15.5	17.2	17.4
Inventory days	65.7	66.0	66.0	66.0
Debtor days	25.9	25.0	25.0	25.0
Creditor days	66.2	65.0	65.0	65.0
Return Ratios (%)				
RoE	6.4	7.1	8.3	9.0
RoCE	6.1	6.8	8.1	9.2
Valuation Ratios (x)				
P/E	29.1	25.7	20.9	18.7
EV / EBITDA	26.7	23.5	19.5	16.6
EV / Net Sales	4.6	4.1	3.7	3.3
Market Cap / Sales	4.5	4.0	3.6	3.2
Price to Book Value	1.9	1.8	1.7	1.7
Solvency Ratios				
Debt/EBITDA	1.1	0.6	0.4	0.3
Debt / Equity	0.1	0.0	0.0	0.0
Current Ratio	1.4	1.4	1.4	1.4
Quick Ratio	0.6	0.6	0.6	0.6

Source: Company, ICICI Direct Research

Exhibit 15: ICICI Direct coverage universe (FMCG)

	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹) Rating		(₹ Cr)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Colgate (COLPAL)	1,461	1,440	Hold	39,473	39.6	37.7	40.3	36.9	38.7	36.3	7.8	7.6	7.1	77.8	79.3	84.2	62.2	60.4	64.1
Dabur India (DABIND)	554	700	Buy	97,880	9.9	10.3	12.0	56.3	54.0	46.1	9.0	8.5	7.7	24.9	23.9	26.1	20.8	20.5	22.2
Hindustan Unilever (HINLEV)	2,574	2,800	Hold	6,04,971	37.5	42.0	46.7	68.6	61.2	55.2	12.0	10.3	9.4	20.2	22.9	25.6	18.1	20.3	22.4
ITC Limited (ITC)	379	405	Buy	4,29,858	12.4	14.2	16.7	30.5	26.6	22.7	7.3	6.1	5.7	31.4	35.3	38.8	24.5	27.1	29.7
Jyothy Lab (JYOLAB)	208	215	Hold	7,485	4.3	6.7	7.8	48.9	31.2	26.7	3.5	3.1	2.8	18.7	27.5	31.4	16.6	24.2	27.0
Marico (MARLIM)	500	560	Hold	69,587	9.7	10.2	11.2	51.4	48.9	44.4	7.3	7.1	6.5	41.2	43.6	46.7	37.5	38.3	41.0
Nestle (NESIND)	18,955	22,400	Hold	1,90,912	222.4	255.8	301.1	85.2	74.1	62.9	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	959	1,750	Buy	50,721	27.3	30.9	43.5	35.2	31.0	22.1	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	737	950	Buy	70,169	11.0	13.9	17.1	66.9	53.0	43.0	5.6	5.1	4.6	8.4	9.2	10.8	7.0	8.2	9.7
Varun Beverage (VARBEV)	1,154	1,235	Hold	71,889	17.2	23.2	26.8	67.0	49.7	43.1	8.1	5.6	5.0	17.1	30.3	33.5	18.3	29.0	29.4
VST Industries (VSTIND)	2,993	3,300	Hold	4,807	207.4	214.1	229.4	14.4	14.0	13.0	4.1	3.6	3.4	39.2	41.8	49.1	30.0	31.9	36.9
Zydus Wellness (ZYDWEL)	1,411	2,000	Buy	8,979	48.5	55.0	67.4	29.1	25.7	20.9	4.5	4.0	3.6	6.1	6.8	8.1	6.4	7.1	8.3

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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