

Market share loss in MFD a drag on volumes...

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, Complan, 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 0.6 million retail outlets. Its high gross margins at ~55% give it a leeway to spend 12-13% of sales on advertisement to support new products

Q4FY23 Results: Zydus saw sales growth of 11.4% led by 7.8% pricing growth.

- Volume growth was 3.5% in Q4; FY23 volume growth was 4.8%
- EBITDA was at ₹ 144.6 crore, up 2.2% YoY, with margins at 20.3%
- Consequent adjusted PAT was at ₹ 145.3 crore

What should investors do? Zydus Wellness underperformed the FMCG index with 15% return in last five years (from ₹ 1282 in May 2018 to ₹ 1482 in May 2023).

- Low volume growth along with market share loss in some key categories is a concern
- We downgrade the stock from BUY to **HOLD**

Target Price and Valuation: We value the stock at ₹ 1690 on ascribing 25x FY25 earnings multiple

Key triggers for future price performance:

- With the softening of crude, aspartame, palm oil prices & price hikes taken in last one-year, gross margins to inch up to 280 bps in the next two years. However, milk prices continue to remain elevated
- Though the company is gaining market share in prickly heat powder & Glucose powder category, it is losing market share in MFD (Complan) category, which is a drag on growth
- Zydus would be expanding overall distribution network to 3 million retail outlets. Distribution expansion along with innovation is key for successful execution

Alternate Stock Idea: We like Tata Consumer in our FMCG coverage.

- Strong innovation & premiumisation strategy in salt, tea, Sampaan & Soulful in the Indian market expected to drive sales & margins
- We value the stock at ₹ 980 with a BUY rating



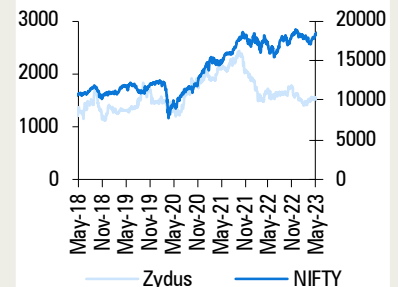
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	9,430.0
Total Debt (FY23)	292.5
Cash and Investments (FY23)	108.2
EV	9,614.3
52 week H/L (₹)	1791/ 1183
Equity capital	57.7
Face value (₹)	10.0

Shareholding pattern

(in %)	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	65.1	65.4	65.4	66.5
FII	2.4	3.2	3.8	3.9
DII	25.1	23.8	23.4	22.2
Others	7.4	7.6	7.5	7.5

Price Chart



Recent event & key risks

- New product contribution is 3.5% to overall sales
- **Key Risk:** (i) Any major dip in mill prices could increase margins more than our estimate (ii) High competition in Complan is dragging overall volume growth

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Key Financial Summary

₹ Crore	FY21	FY22	FY23	5 Year CAGR (FY18 to FY23)	FY24E	FY25E	CAGR FY23-25E
Net Sales	1,866.7	2,009.1	2,254.8	34.5%	2,473.3	2,725.8	9.9%
EBITDA	344.4	344.8	337.2	21.9%	429.5	484.3	19.9%
EBITDA Margin %	18.4	17.2	15.0		17.4	17.8	
Adjusted Net Profit	250.9	308.9	320.4	19.1%	384.3	439.1	17.1%
Adjusted EPS (₹)	39.4	48.5	50.4	24.1%	60.4	69.0	17.1%
Adjusted P/E (x)	37.6	30.5	29.4		24.5	21.5	
RoCE (%)	6.2	6.1	5.7		6.8	7.4	
RoE (%)	5.5	6.4	6.3		7.0	7.5	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

Q4FY23 Results: Softening of commodity prices, price hike to help in restoring margins; low volume growth a concern

- Net sales witnessed growth of 11.8% to ₹ 713 crore led by 4% volume growth and 7.8% pricing growth. Full year volume growth was 4.8%. High inflation in milk resulted in strong pricing growth for the company during the quarter but it is continuing to impact volume growth of malt based beverage brand 'Complan'
- With price hikes in earlier quarters & improved product mix, the company was able to maintain its gross margins at 50.8% (3 bps lower). Employee & Marketing spends were lower by 16 bps & 79 bps, respectively
- Overhead spends were higher by 275 bps mainly on account of higher third-party manufacturing outsourcing for Glucon-D, wage hike in north eastern states (manufacturing facilities are located) & high fuel inflation. The high spends of ~ ₹14 crore is one-off because of above mentioned reasons
- High overhead spends resulted in operating profit growth of mere 2.2% to ₹ 144.6 crore with operating margin contraction of 184 bps to 20.3%. Interest cost was down 13.7% to ₹ 5.2 crore. Net profit witnessed growth of 9% to ₹ 145.3 crore mainly on account of tax reversal of ₹ 19 crore
- Glucon-D witnessed good traction in summer months despite adverse weather for some days in March. It launched Mango variant in Glucose Powder category in Q4. Glucose powder category has grown by 10.7% & Glucon-D gained market share by 159 bps to 60.1%
- MFD category de-grew 1.1% and Complan lost market share by 50 bps to 4.5%. The category has seen shift from bigger packs to sachets, which has led to wider penetration for the category & the brand. The company ran media campaign & highlighted highest protein proposition & nutritional differentiation of the brand
- Sugarfree brand has grown in mid-single digit during the quarter. The company is driving growth in Sugar free green franchise. It maintained market share of 96%
- In personal care category, facial scrub category has grown at 9.1% & the company gained market share by 68 bps to 41.9%. Peel-off category has seen growth of 4.5% & the company gained market share by 7 bps to 78.4%. The company lost market share by 30 bps in face cleansing category given face wash & face mask sub category has grown at faster pace
- Pricky heat powder category has grown at 13.4% mainly led by strong traction before summer season. The company also gained market share in this category by 157 bps to 35.4%
- Nutralite brand witnessed strong growth during the quarter. The company is running print & digital media campaigns for dairy products under Nutralite Doodhshakti brand
- International business contributes 7-8% of the overall business. The company has presence in 25 countries with top five countries contribute 2/3rd of business. Sugarfree & Complan contribute ~90% of international business. In FY23, this business witnessed flat growth due to supply issue in New-Zeeland & local economic issues in Nigeria
- Everyuth has grown in double digit growth over the years except for disruptive years like Covid. With foray in face cleaning & body lotions, the brand has potential to grow in double digit in future
- Ecommerce & Modern trade channel sales contributes was 19.6% in FY23 compared to 17.5% in FY22. These channels can contribute 25% to the sales in next few years. Ecommerce is contribution is 7% compare to 6% in previous years

Zydus wellness - ESG Disclosure Score*			
ESG Disclosure Score			
Score	FY20	FY21	FY22
Environmental	0.4	0.4	0.4
Social	15.8	21.6	20.0
Governance	73.1	82.4	82.4
Overall ESG Score	29.8	34.8	34.3

- The company would be increasing its direct reach from current 0.6 million outlets to 0.7 million outlets. It is also planning to increase its overall availability from current 2.5 million outlets to 3.0 million outlets
- Milk prices have been higher by 21% in last one year whereas refined palm oil & Aspartame prices have come down by 31% & 15% in last one year respectively. The company would take selective price increase & some cost controls to reach to the gross margins of FY21 levels
- With expectation of gross margin recovery, the company would take the advertisement spends to 12.5% to 13% of the sales

Exhibit 1: Peer Comparison

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹ Cr)	Sales growth (%)				EBITDA Margins (%)				P/E(x)			RoE (%)				RoCE (%)				
					FY22E	FY23E	FY24E	FY25E	FY22E	FY23E	FY24E	FY25E	FY22E	FY23E	FY24E	FY25E	FY22E	FY23E	FY24E	FY25E	FY22E	FY23E	FY24E	FY25E
Hindustan Unilever (HINDLEV)	2662	2780	Hold	579879	11.3	15.5	8.0	10.1	24.8	23.4	23.8	24.2	70.9	62.8	58.6	52.1	18.1	19.9	20.6	22.5	20.2	22.0	23.7	25.9
Nestle (NESIND)	21799	23000	Hold	199195	10.2	14.9	12.8	10.5	24.5	22.1	23.0	24.7	98.0	87.9	72.7	61.8	104.1	87.0	84.5	86.5	57.3	54.4	57.0	61.6
Zydus Wellness (ZYDWEL)	1482	1690	Hold	9430	7.6	12.2	9.7	10.2	17.2	15.0	17.4	17.8	30.5	30.4	24.5	21.5	6.4	6.3	7.0	7.5	6.1	5.7	6.8	7.4

Source: Company, ICICI Direct Research

Zydus Wellness saw 4.8% volume growth in FY23 on account of slower demand due to high inflation in milk & other major commodities. We believe milk prices have peaked out & could see moderation in next few quarters. Moreover, some more price hikes along with cost control measures would bring back gross margins to FY21 levels. However, we believe brand extensions & foray in high growth categories is warranted for high single digit / double digit volume growth in the longer run. Though, the company would be able to regain margins from low base but we remain cautious on volume growth outlook. We downgrade the stock to HOLD recommendation with revised target price of ₹ 1690 / share (earlier ₹ 2000).

Exhibit 2: Variance Analysis

	Q4FY23	Q4FY22E	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
Net Sales	713.0	714.5	639.8	11.4	415.6	71.6	Net sales witnessed a growth of 11.4% led by 7.8% pricing growth & 3.5% volume growth during the quarter of price hikes taken in last one year & softening of some of the commodities
Raw Material Expenses	350.6	368.5	314.4	11.5	266.0	31.8	
Employee Expenses	43.5	42.8	40.1	8.5	35.1	23.9	Overhead spends were up mainly on account of one-off expense due to outsourcing manufacturing of summer products, wage increase in north eastern facilities
SG&A Expenses	66.7	63.7	64.8	2.8	44.3	50.6	
Other operating Expenses	107.6	76.5	79.0	36.3	74.8	43.9	
EBITDA	144.6	163.0	141.5	2.2	28.2	412.9	Operating margins contracted mainly on account of higher overhead spends
EBITDA Margin (%)	20.3	22.8	22.1	-184 bps	6.8	1349 bps	
Depreciation	6.7	6.2	6.1	9.7	5.9	13.4	
Interest	5.2	3.2	6.0	-13.7	3.8	34.4	
Other Income	0.7	1.8	2.0	-63.3	0.8	-14.3	
PBT	133.5	155.3	131.4	1.6	19.3	591.2	
Exceptional Items	-7.1	0.0	0.0	NA	0.0	NA	
Tax Outgo	-19.0	0.0	-1.9	NA	-0.3		
PAT	145.3	155.3	133.3	9.0	19.6	643.0	Net profit grew by 9% led by deferred tax assets
Adjusted PAT	133.5	155.3	133.3	0.1	19.6	582.4	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY24E			FY25E			Comments
	Old	New	% change	Old	New	% change	
Sales	2492.4	2473.3	-0.8	2,772.6	2,725.8	-1.7	We cut our volume growth estimates considering lower sales of complan
EBITDA	453.1	429.5	-5.2	531.9	484.3	-9.0	We cut our operating margin estimate factoring in higher overhead & marketing spends required to bring back volume growth
EBITDA Margin (%)	18.2	17.4	-81 bps	19.2	17.8	-142 bps	
Adjusted PAT	413.1	384.3	-7.0	466.7	439.1	-5.9	We cut our other income estimate in FY24 & income tax is likely to remain zero in FY25 as well
EPS (₹)	64.9	60.4	-7.0	73.4	69.0	-5.9	

Source: ICICI Direct Research

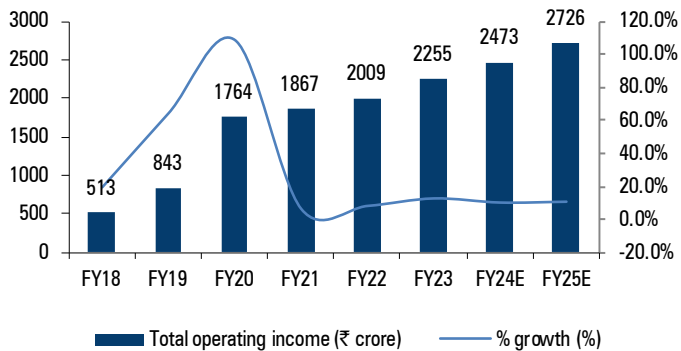
Exhibit 4: Assumptions

	Correct					Earlier		Comments
	FY21E	FY22E	FY23E	FY24E	FY25E	FY24E	FY25E	
Sugarfree & others (₹ crore)	386.0	433.6	477.6	516.4	563.6	521.3	574.2	Slight cut in Sugar free sales estimates
Everyuth (₹ crore)	169.9	197.6	225.7	250.9	281.7	250.9	281.7	
Glucon D (₹ crore)	505.3	535.9	601.3	674.6	756.9	674.6	756.9	
Complan (₹ crore)	404.5	445.3	463.3	496.2	536.4	510.3	572.6	We cut our sales estimate for Complan
RM / Sales (%)	39.8	44.0	48.8	44.1	43.7	45.4	44.7	

Source: ICICI Direct Research

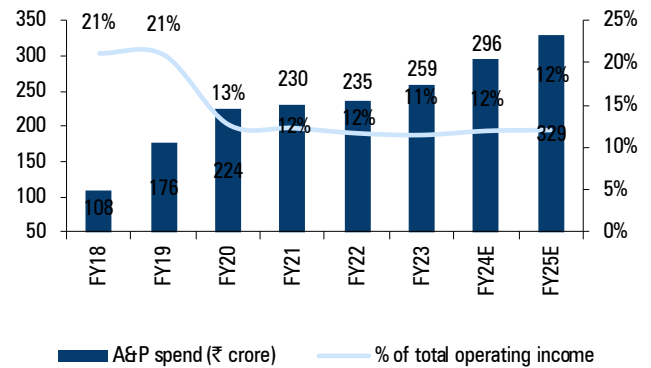
Key Metrics

Exhibit 5: Revenue & revenue growth trend



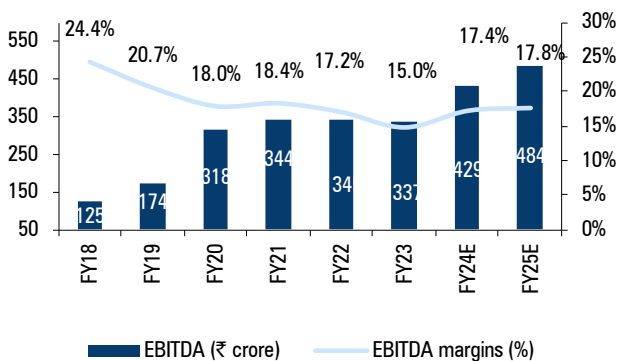
Source: ICICI Direct Research, Company

Exhibit 6: Marketing spend trend



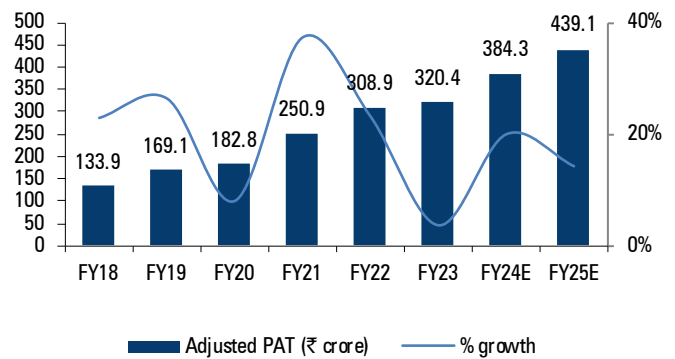
Source: ICICI Direct Research, Company

Exhibit 7: Operating margins trend (%)



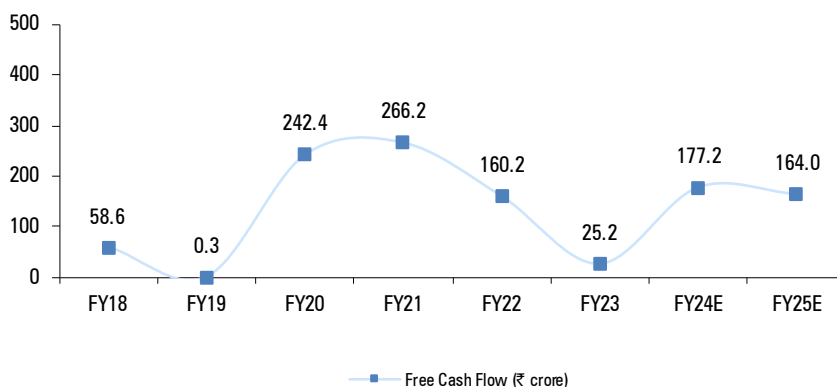
Source: Company, ICICI Direct Research

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	30.5	28.0	6.4	6.1
FY23	2254.8	12.2	50.4	3.7	30.4	28.7	6.3	5.7
FY24E	2473.3	9.7	60.4	19.9	24.5	22.3	7.0	6.8
FY25E	2725.8	10.2	69.0	14.3	21.5	19.7	7.5	7.4

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 11: Profit and loss statement		₹ crore			
	FY22	FY23	FY24E	FY25E	
Total operating Income	2,009.1	2,254.8	2,473.3	2,725.8	
Growth (%)	7.6	12.2	9.7	10.2	
Raw Material Expenses	980.4	1,146.0	1,202.7	1,314.5	
Employee Expenses	163.6	167.3	180.1	195.6	
Marketing Expenses	234.8	258.8	295.8	328.8	
Administrative Expenses	0.0	0.0	133.8	144.6	
Other expenses	285.7	345.6	231.5	258.0	
Total Operating Expenditure	1,664.4	1,917.6	2,043.8	2,241.5	
EBITDA	344.8	337.2	429.5	484.3	
Growth (%)	6.1	-2.2	27.4	12.8	
Depreciation	23.6	25.0	36.2	38.9	
Interest	25.5	16.1	15.2	12.8	
Other Income	10.4	4.9	6.2	6.5	
PBT	306.0	300.9	384.3	439.1	
Total Tax	-2.9	-19.5	0.0	0.0	
Exceptional Item	0.0	0.0	0.0	0.0	
PAT	308.9	320.4	384.3	439.1	
Adjusted PAT	308.9	320.4	384.3	439.1	
Growth (%)	23.1	3.7	19.9	14.3	
Adjusted EPS (₹)	48.5	50.4	60.4	69.0	

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement		₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E	
Profit After Tax	301.9	310.4	384.3	439.1	
Add: Depreciation	23.6	25.0	51.3	38.9	
(Inc)/dec in Current Assets	-14.0	-209.7	-263.7	-318.0	
Inc/(dec) in CL and Provisions	-74.7	-47.9	55.3	53.9	
CF from operating activities	236.9	77.8	227.2	214.0	
(Inc)/dec in Investments	0.0	-19.5	0.0	0.0	
(Inc)/dec in LT loans & advances	0.0	-2.0	-10.0	-10.0	
(Inc)/dec in Fixed Assets	-74.7	-52.0	-50.0	-50.0	
Others	15.8	1.5	-5.0	-5.0	
CF from investing activities	-58.9	-72.0	-65.0	-65.0	
Inc/(dec) in loan funds	-168.3	-89.0	-40.0	-40.0	
Dividend paid & dividend tax	-31.9	-31.8	-31.8	-95.4	
Interest Paid	-32.5	-16.1	-15.2	-12.8	
Others	-1.2	0.0	0.0	0.0	
CF from financing activities	-233.8	-136.9	-87.0	-148.2	
Net Cash flow	-55.9	-131.0	75.3	0.8	
Opening Cash	252.7	169.8	38.2	113.5	
Investment in MF	-27.0	0.0	0.0	0.0	
Closing Cash	169.8	38.8	113.5	114.3	

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	5,059.0	5,411.5	5,755.2	
Total Shareholders funds	4,844.0	5,122.7	5,475.2	5,818.9	
LT Borrowings & Provisions	62.5	0.0	0.0	0.0	
Deferred Tax Liability	319.0	292.5	252.5	212.5	
Others Non-current Liabilities	18.8	18.0	18.0	18.0	
Total Liabilities	5,244.4	5,433.2	5,745.7	6,049.4	
Assets					
Gross Block	461.3	512.2	552.2	592.2	
Less: Acc Depreciation	216.8	241.9	278.1	317.0	
Net Block	244.5	270.4	274.2	275.3	
Capital WIP	11.9	13.0	23.0	33.0	
Goodwill	3,920.0	3,920.0	3,920.0	3,920.0	
Non-current Investments	5.5	6.8	6.8	6.8	
LT loans & advances	0.0	2.0	12.0	22.0	
Deferred Tax Assets	129.8	149.3	149.3	149.3	
Other Non-Current Assets	566.7	563.1	568.1	573.1	
Current Assets					
Inventory	361.6	457.5	508.2	552.6	
Debtors	142.3	207.8	216.8	239.0	
Loans and Advances	0.0	0.4	0.0	0.0	
Other Current Assets	112.9	134.0	139.0	153.2	
Cash	169.8	38.2	113.5	114.3	
Investments	27.0	70.6	270.0	520.0	
Current Liabilities					
Creditors	364.3	313.3	352.4	395.8	
Provisions	21.9	27.7	26.9	29.6	
Short term debt & other CL	61.7	58.9	75.9	83.7	
Application of Funds	5,244.4	5,433.2	5,745.7	6,049.4	

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios					
(Year-end March)	FY22	FY23	FY24E	FY25E	
Per share data (₹)					
EPS	48.5	50.4	60.4	69.0	
Cash EPS	52.3	52.7	66.1	75.1	
BV	761.3	805.1	860.5	914.5	
DPS	5.0	5.0	5.0	15.0	
Cash Per Share	26.7	6.0	17.8	18.0	
Operating Ratios (%)					
EBITDA Margin	17.2	15.0	17.4	17.8	
PBT / Total Operating income	15.2	13.3	15.5	16.1	
PAT Margin	15.4	13.8	15.5	16.1	
Inventory days	65.7	74.1	75.0	74.0	
Debtor days	25.9	33.6	32.0	32.0	
Creditor days	66.2	50.7	52.0	53.0	
Return Ratios (%)					
RoE	6.4	6.3	7.0	7.5	
RoCE	6.1	5.7	6.8	7.4	
Valuation Ratios (x)					
P/E	30.5	30.4	24.5	21.5	
EV / EBITDA	28.0	28.7	22.3	19.7	
EV / Net Sales	4.8	4.3	3.9	3.5	
Market Cap / Sales	4.7	4.2	3.8	3.5	
Price to Book Value	1.9	1.8	1.7	1.6	
Solvency Ratios					
Debt/EBITDA	1.1	0.9	0.6	0.4	
Debt / Equity	0.1	0.1	0.0	0.0	
Current Ratio	1.4	2.0	1.9	1.9	
Quick Ratio	0.6	0.9	0.8	0.8	

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	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
Colgate (COLPAL)	1,663	1,560	Hold	44,233	39.6	38.5	41.4	44.0	41.9	43.2	40.2	37.8	8.7	8.5	8.0	7.5	77.8	79.3	89.6	100.0	62.2	61.5	68.4	76.5
Dabur India (DABIND)	524	675	Buy	93,745	9.9	9.6	11.3	12.9	53.2	54.6	46.2	40.6	8.6	8.1	7.4	6.6	24.9	21.3	23.0	24.4	20.8	19.0	20.4	21.3
Hindustan Unilever (HINLEV)	2,662	2,780	Hold	5,79,879	37.5	42.4	45.4	51.1	70.9	62.8	58.6	52.1	11.5	10.0	9.2	8.4	20.2	22.0	23.7	25.9	18.1	19.9	20.6	22.5
ITC Limited (ITC)	428	450	Buy	4,67,841	12.4	14.7	16.0	17.4	34.5	29.1	26.7	24.6	7.9	6.8	6.2	5.7	31.4	36.0	37.5	39.1	24.5	27.7	28.7	29.9
Jyothy Lab (JYOLAB)	209	215	Hold	7,485	4.3	6.7	7.8	8.5	49.2	31.4	26.9	24.6	3.5	3.1	2.8	2.6	18.7	27.5	31.4	32.6	16.6	24.2	27.0	27.9
Marico (MARLIM)	527	570	Buy	63,691	9.7	10.2	11.6	12.6	54.2	51.4	45.5	41.9	6.7	6.5	6.1	5.7	41.2	38.1	41.2	43.3	37.5	34.8	37.3	38.6
Nestle (NESIND)	21,799	23,000	Hold	1,99,195	222.4	247.9	299.9	352.7	98.0	87.9	72.7	61.8	13.6	11.9	10.5	9.5	57.3	54.4	57.0	61.6	104.1	87.0	84.5	86.5
Patanjali Foods (RUCSOY)	949	1,750	Buy	50,721	27.3	30.9	43.5	52.7	34.8	30.7	21.8	18.0	2.1	1.7	1.5	1.4	13.2	15.6	17.3	19.0	13.1	11.3	14.2	15.3
Tata Consumer Products (TAT)	778	980	Buy	68,740	11.0	14.2	16.4	19.0	70.6	54.8	47.6	41.0	5.5	5.0	4.5	4.1	8.4	8.7	10.5	11.6	7.0	7.4	9.0	10.1
Varun Beverage (VARBEV)	1,588	1,470	Hold	92,041	17.2	23.9	27.5	32.3	92.2	66.5	57.7	49.1	10.4	7.0	6.1	5.4	17.1	23.8	28.7	32.2	18.3	30.4	27.8	26.9
VST Industries (VSTIND)	3,280	3,300	Hold	5,059	207.4	211.8	210.0	245.5	15.8	15.5	15.6	13.4	4.3	3.9	3.7	3.4	39.0	35.7	39.0	50.9	29.8	27.7	29.3	38.2
Zydus Wellness (ZYDWEL)	1,482	1,690	Hold	9,430	48.5	48.8	60.4	69.0	30.5	30.4	24.5	21.5	4.7	4.2	3.8	3.5	6.1	5.7	6.8	7.4	6.4	6.3	7.0	7.5

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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