# Zydus Wellness Limited

December 31, 2018

**Rating**

| Instruments | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Proposed Non-Convertible Debentures Issue | 1,500.00 **(Rupees One Thousand Five Hundred Crore only)** | **CARE AA+; Stable (Double A plus; Outlook: Stable)** | Assigned |

*Details of Instruments in Anneuxre-1*

**Detailed Rationale & Key Rating Drivers**

The rating assigned to the proposed Non-Convertible Debenture (NCD) issue of Zydus Wellness Limited (ZWL) derives strength from its strong parentage in the form of Cadila Healthcare Limited (CHL) and its experienced management, leading market position in some of the niche products with category defining brands in growing Indian Fast Moving Consumer Goods (FMCG) industry along with proposed acquisition of Heinz India Private Limited (HIPL) leading to inclusion of few leading brands having strong recall value in its portfolio, established marketing and distribution network which is further expected to strengthen with acquisition of HIPL's distribution network and associated synergetic benefits. The rating also derives strength from comfortable funding pattern for the proposed acquisition of HIPL resulting in low reliance on external debt and need based support expected from parent and promoters.

However, the rating is constrained due to inherent challenges associated with mergers and acquisitions i.e. timely integration of operation and realization of envisaged benefits especially on the backdrop of declining market share of few key brands under acquisition, expected moderation in return indicators given the large size acquisition, susceptibility of its profitability margin to competition and volatility in raw material prices.

Ability of ZWL to scale up the operations of under acquisition brands while expanding market for its existing products, timely integration of operations to achieve anticipated benefits and need based support from promoters would be the key rating sensitivities.

**Detailed description of the key rating drivers**

**Key Rating Strengths**

**Strong parentage:** ZWL is a part of Zydus Cadila group promoted by Patel family of Ahmedabad. The promoter group has experience of more than six decades in the pharmaceuticals industry. Flagship entity of Zydus Cadila group, CHL is the 4$^{th}$ largest pharmaceutical company in India and 9$^{th}$ biggest United State (US) generic player (based on prescription) with approximate market share of 4.1% and 3.1% in respective markets (source: Company). Sixteen of CHL's brands rank amongst the top 300 pharmaceutical brands in India with five brands having sales of more than Rs.100 crore. Promoter group including CHL holds 72.54% of equity share capital of ZWL as on September 30, 2018. Even post acquisition of HIPL, the promoters holding in ZWL is expected to remain above 65%. Due to its strong financial profile, CHL is capable of providing any financial assistance to ZWL.

**Portfolio of category defining brands in niche segment with healthy profitability margins:** Brand portfolio of ZWL includes "Sugar Free" (Sugar substitute), "Everyuth" (Skin Care) and "Nutralite" (Health foods). Products under "Sugar Free" brands are market leader in the low calorie sugar substitute category with "Sugar Free" becoming synonym for the product category itself. Products under "Nutralite" and scrub and peel off under "Everyuth" brand are also market leaders in their respective product categories. ZWL enjoys healthy profitability margins despite higher selling expenses, which demonstrate its operating efficiency and higher pricing flexibility of its products due to limited competition for these brands portfolio.

**Established marketing and distribution network in growing FMCG industry:** Indian FMCG industry is expected to grow at healthy pace due to factors like favourable demographics, rising income levels & growing per capita expenditure, rapid urbanization, increasing number of nuclear families, growing female working population etc. which will provide impetus to revenues of FMCG companies going forward. ZWL has wide marketing and distribution network comprising sales force of over 1,000 marketing executives which covers over 1,000 distributors and 8,25,000 outlets reaching directly to end consumers. ZWL has three manufacturing units (one in Gujarat and two in Sikkim), 21 cold chain warehouses and 27 ambient warehouses across India for smooth movement of its products.

**Acquisition of brands and access to wide distribution network of HIPL provides growth opportunity:** ZWL is in process of acquiring 100% equity stake in HIPL. Proposed acquisition includes global Intellectual Property (IP) rights of "Glucon-D", "Nycil" and "Sampriti Ghee" and IP rights of "Complan" for India, Bangladesh, Nepal and certain other countries, along with two manufacturing plants (Aligarh & Sitarganj), all operational assets & liabilities and marketing & distribution network of HIPL. All brands of HIPL have strong recall value. Further, "Glucon-D" and "Nycil" are the market leaders in their respective categories.

[1] *Complete definition of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and other CARE publications*

Post-acquisition of HIPL, ZWL will have portfolio of seven brands, out of which five brands are market leaders in their respective categories. Further, acquisition will result in brand diversification in health food category (from two brands to five brands) and in skin care category (from one brand to two brands). Proposed acquisition provides opportunity to ZWL to drive higher growth and create value by leveraging strengths of ZWL and HIPL. Strong R&D capabilities of ZWL can provide necessary innovation and impetus to HIPL's brands while large pharmacy channel of ZWL and strong grocery channel of HIPL can complement each other enabling distribution level synergies. Presently, HIPL has distribution reach of over 17 lakh stores which is being catered via over 1,000 field force. Also, presence of HIPL in the neighboring countries provides opportunity to ZWL to push its product in the same distribution channel.

**Comfortable funding pattern of proposed acquisition:** Historically, ZWL has remained a term debt free company with healthy cash and liquid investment as on March 31, 2018. ZWL is expected to pay consideration of around Rs.4,600 crore for the proposed acquisition which is proposed to be funded in debt/equity ratio of 0.5:1. Out of equity portion of Rs.3,100 crore, promoter family, CHL and two private equity firms are expected to infuse fresh equity of Rs.2,575 crore while the rest is proposed to be funded through existing cash/bank balance of ZWL. ZWL has proposed to issue Non-Convertible Debentures (NCD) of Rs.1,500 crore for the proposed acquisition. However, capital structure of ZWL is expected to remain comfortable due to substantial capital infusion.

**Adequate liquidity:** Liquidity of ZWL is expected to remain adequate with strong cash accruals, low near term repayment obligation, comfortable operating cycle and need based support from parent /promoters. The company holds cash and liquid investment of around Rs.560 crore as on September 30, 2018 out of which Rs.525 crore is expected to be utilized for proposed acquisition. Moreover, ZWL's reliance on external borrowing remains low due to efficient operating cycle. Further, as per the term sheet of the proposed NCD issue, repayment of NCD should start from March 2022, providing sufficient cushion during the business integration period.

**Key Rating Weaknesses**

**Challenges associated with proposed acquisition with expectation of moderation in profitability and return indicators in medium term:** The performance of under acquisition brands of HIPL has shown muted to negative revenue growth over past three years ended FY18 with erosion of market share in one of its key brands i.e. Complan. Hence, scaling up the operations of under acquisition brands to achieve desired synergy and returns remain crucial. Normally, business acquisitions are inherently prone to the risk due to integration of business process, IT processes, distribution network and cultural differences. Though CHL, parent of ZWL has demonstrated its ability to manage such acquisition in past provides some comfort. Also, as informed by the management, they have appointed a reputed strategy firm to help in pre and post integration activities to ensure smooth integration and faster realization of synergy benefits.

It is to be noted that the brands under acquisition have relatively low profitability margins compared to ZWL's existing products and hence going forward, the profitability margin on blended basis is expected to remain lower compared to historical average of ZWL. Also, the proposed acquisition of HIPL is relatively large compared to the present capital employed of ZWL and with expectation of lower profitability margin, the return and debt service coverage indicators of ZWL are expected to remain moderate in medium term till the time ZWL achieve complete synergy benefits and scale up the operation.

**Susceptibility of profitability margin to fluctuation in raw material prices and competition:** ZWL's existing brands cater to niche consumer categories and majorly insulated against intense competition. However, under acquisition brands of HIPL may face stiff competition from reputed Multi-National Companies (MNC) and domestic companies in health food and skin care categories. Palm Oil (for Nutralite), Sucralose, Aspartame and Stevia (for Sugarfree) are the major raw materials used by ZWL while Milk, Skimmed milk powder, Barley and Sugar are the major raw materials used by the HIPL. Palm Oil prices and sugar prices are highly volatile and their direction is determined by various government policies. Adverse movement in raw material prices puts pricing pressure due to intense competition which may ultimately impact the profitability of combined entity.

**Analytical approach:** For the purpose of analysis, CARE Ratings has considered the present consolidated financials of ZWL (including its partnership firm, M/s Zydus Wellness Sikkim, where ZWL holds 98% stake) as on March 31, 2018. Moreover, CARE Ratings has factored in potential acquisition of HIPL which is expected to be funded through mix of debt and equity. CARE also takes cognizance of financial linkages with its parent i.e. CHL having strong financials which is expected to provide need-based financial assistance in case of contingencies.

**Applicable Criteria**

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology-Manufacturing Companies
Rating Methodology: Factoring Linkages in Rating
Financial ratios – Non-Financial Sector

**About the Company**

Established as consumer products division of CHL in 1991, ZWL is engaged in the manufacturing, branding and distribution of health food and personal care products. Consumer healthcare division of CHL was carved out during 2009 and was listed on securities exchange in November 2009.
At present, ZWL sells its products under three brands i.e. "Sugar Free" (Sugar substitute), "Everyuth" (Skin Care) and "Nutralite" (Fat spread) which are well established brands in their respective categories. ZWL has 100% in-house manufacturing facilities comprised of one unit in Gujarat and two units in Sikkim. Further, ZWL is under process of acquiring 100% equity stake in HIPL. Proposed acquisition includes global IP rights of "Glucon-D", "Nycil" and "Sampriti Ghee" and IP rights of "Complan" for India, Bangladesh, Nepal and certain other countries, along with two manufacturing plants (Aligarh & Sitarganj), all operational assets and liabilities and marketing and distribution network of HIPL. The acquisition of HIPL is expected to be completed shortly as per management. As on September 30, 2018, promoter group holds 72.54% equity share capital in ZWL.

*(Rs. Crore)*

| Brief Financials (Consolidated) | FY17 (A) | FY18 (A) |
|---|---|---|
| Total Operating Income | 457.18 | 535.51 |
| PBILDT | 127.62 | 144.86 |
| PAT | 111.28 | 136.51 |
| Overall Gearing (times) | 0.05 | 0.04 |
| Interest Coverage (times) | 232.04 | 85.21 |

*A – Audited*

ZWL reported total operating income of Rs.301.23 crore and PAT of Rs.68.51 crore during H1FY19 (Un-audited) as against total operating income of Rs.273.85 crore and PAT of Rs.62.82 crore during H1FY18.

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History (Last three years):** Please refer Annexure-2

***Note on complexity levels of the rated instrument:*** *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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**About CARE Ratings:**

CARE Ratings commenced operations in April 1993 and over nearly two decades; it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

**Annexure-1: Details of Instruments/Facilities**

| Name of the Instrument | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|
| Non-convertible Debentures (Proposed) | NA | NA | NA | 1500.00 | CARE AA+; Stable |

*NA= Not Available*

**Annexure-2: Rating History of last three years**

| Sr. No. | Name of the Instrument | Current Ratings | | | Rating history | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 | Date(s) & Rating(s) assigned in 2015-2016 |
| 1. | Non-convertible Debentures (Proposed) | LT | 1500.00 | CARE AA+; Stable | - | - | - | - |

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