# Zydus Wellness Limited

January 02, 2020

**Ratings**

| Instrument | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Non-convertible debenture issue | 1,500 (Rupees One Thousand Five Hundred Crore only) | **CARE AA+; Stable (Double A Plus; Outlook: Stable)** | **Reaffirmed** |

*Details of Instruments in Annexure-1*

**Detailed Rationale & Key Rating Drivers**

*The rating assigned to the Non-Convertible Debenture (NCD) issue of Zydus Wellness Limited (ZWL) continues to derive strength from its strong parentage of Cadila Healthcare Limited (CHL) which provides significant financial flexibility, ZWL's strategic importance to CHL leading to expectation of strong support from its parent, its professional and experienced management, strengthening of its product portfolio of market-leading brands in the Indian Fast Moving Consumer Goods (FMCG) industry after the acquisition of Heinz India Private Limited (HIPL) along with its established marketing and distribution network and expected synergy benefits from the acquisition. The rating is also underpinned by the comfortable leverage of ZWL on account of infusion of equity share capital during FY19 (refers to the period April 1 to March 31) for the acquisition.*

*The rating is, however, constrained due to lower than envisaged revenue and profitability during H1FY20 leading to moderation in the debt coverage indicators along with low return indicators and susceptibility of its profit margin to intense competition in the FMCG industry and volatility in raw material prices.*

**Rating Sensitivities**

**Positive Factors**

- Significant increase in market share of its key products resulting in significant improvement in its profitability and debt coverage indicators
- Improvement in Return on Capital Employed (ROCE) to more than 12% on sustained basis

**Negative Factors**

- PBILDT margin remaining less than 15% from FY21 onwards on a sustained basis.
- Any large size debt-funded capex or acquisition adversely impacting credit metrics of ZWL or its parent, CHL or lower than envisaged support from its parent

**Detailed description of the key rating drivers**

**Key Rating Strengths**

**Strong parentage:** ZWL is a part of the Zydus Cadila group promoted by Ahmedabad-based Pankaj Patel and his family. The promoter group has significant experience of more than six decades in the pharmaceutical industry. Flagship entity of Zydus Cadila group, CHL is the 4th largest pharmaceutical company in India and the 7th biggest pharmaceutical company in the United States of America (USA) based on prescription (source: Company). CHL is among the top 3 players in pain management, Oncology, Respiratory and Gynaecology therapeutic segments. CHL along with the promoter group holds around 67.62% equity share capital in ZWL as on September 30, 2019. Apart from ZWL being a majority-owned subsidiary of CHL, it is also strategically important to CHL in terms of diversifying the group's business risk profile. During FY19, CHL along with promoter family infused equity share capital of Rs.1,475 crore to fund the acquisition of HIPL. Due to its strong financial profile, CHL is capable of providing any need-based financial assistance to ZWL.

**Strengthening of portfolio of market-leading brands after the acquisition of HIPL:** Before acquisition of HIPL, ZWL's brand portfolio consisted of three brands i.e. "Sugar-Free" (Sugar substitute), "Everyuth" (Skin Care) and "Nutralite" (Health foods). Products under "Sugar-Free" brand are market leaders in the low-calorie sugar substitute category with around 94% market share. Table Spread under "Nutralite" and scrub and peel off under "Everyuth" brand are also market leaders in their respective product categories. During FY19, ZWL acquired HIPL with its four brands i.e. "Glucon-D", "Nycil", "Complan" and "Sampriti Ghee". Products under "Glucon-D" and "Nycil" brands are market leaders in their respective categories. "Complan" despite not being a market leader and with relatively subdued performance, has strong brand recall value.

Strong R&D capabilities of ZWL can provide necessary innovation and impetus to HIPL's brands while the large pharmacy channel of ZWL and strong grocery channel of acquired HIPL can complement each other, thereby enabling distribution level synergies.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

**Established marketing and distribution network:** After the acquisition of HIPL, ZWL's marketing and distribution network has expanded to 46 ambient warehouses, 20 cold chain warehouses, around 65 C&F agents, over 1,500 distributors, over 2,000 field force and over 2 million customer touch points all over India. Also, presence of HIPL in the neighboring countries provides opportunity to ZWL to push its product through the same distribution channel. ZWL is working on supply chain management to rationalize its warehouses and distributor count without impacting its overall reach to gain maximum synergy benefits.

**Low leverage:** ZWL's leverage remains low marked by an overall gearing ratio of 0.46 times as on March 31, 2019. During FY19, ZWL acquired HIPL for a consideration of around Rs.4,600 crore. ZWL issued NCDs of Rs.1,500 crore to part-fund the acquisition. However, promoters along with institutional investors infused equity share capital of around Rs.2,575 crore which led to strengthening of the tangible net-worth base to Rs.3,365 crore as on March 31, 2019 (including acquired goodwill of Rs.3,797 crore as on March 31, 2019). Leverage of ZWL is expected to remain healthy as the company does not envisage any debt-funded capex in near to medium term.

**Key Rating Weaknesses**

**Lower than envisaged total income and profitability during H1FY20 along with modest debt coverage and return indicators:** Total income of ZWL grew by 216% during H1FY20 over H1FY19 mainly due to additional revenue from the acquired brands of HIPL. On a full-year basis for FY20, the total income of ZWL is expected to remain lower than what was previously envisaged. Moreover, the PBILDT margin also remained lower than envisaged at 15.67% during H1FY20 which was mainly due to one-time expense of around Rs.38 crore related to the acquisition of HIPL and increase in the raw material prices (i.e. milk and palm oil) which the company was unable to fully pass on to the consumers.

Further, due to decline in profitability, ZWL's debt coverage indicators are expected to remain moderate marked by interest coverage and Total debt/PBILDT of around 1.71x and 6.25 years respectively during FY20. Return indicators marked by ROCE is also expected to remain modest at around 4% to 5% respectively during FY20 due to lower blended profitability post acquisition which led to large addition in the total capital employed during FY19. However, comfort is derived from the fact that as per the terms of debenture trustee agreement for the rated NCD, ZWL is required to maintain ratio of financial indebtedness net off cash and cash equivalents to PBILDT on a consolidated half yearly (last twelve months) basis at 4.25x and 3.75x as on March 31, 2020 and March 31, 2021 respectively and thereafter 3.25x till March 31, 2024 which will entail build-up of liquidity in the company till the moratorium period on the NCD. ZWL is also required to maintained interest coverage ratio at over 2 times.

**Susceptibility of profitability margin to fluctuation in raw material prices and intense competition:** ZWL faces intense competition in most of its product categories from many reputed Multi-National Companies (MNC) and domestic companies who have presence in multiple product categories. Although the majority of its products have retained their market share, the "Complan" brand has been gradually losing its market share (from 12% in FY15 to 6% in FY19) during last few years. Due to intense competition, the marketing expense of the company is expected to remain high. Palm Oil, Sucralose, Aspartame, Stevia, Milk, Barley and Sugar are the major raw materials used by ZWL. Palm Oil prices and sugar prices are highly volatile and their direction is determined by various government policies. Further, the price of milk also remained volatile in H1FY20 which partly impacted the operating profitability of ZWL during H1FY20. The intense competition restricts ZWL's ability to fully pass-on the increase in the raw material prices to the customers.

**Liquidity: Strong**

Liquidity of ZWL is marked by current ratio of around 1.29 times as on March 31, 2019, efficient operating cycle along with adequate cash and bank balance of around 170 crore as on September 30, 2019. Further, the repayment of NCDs issued by ZWL starts from January 14, 2022 thereby giving it time to build-up sufficient cash accruals to service the debt. The liquidity of the company is envisaged to be strong on the expectation of its access to timely need-based support from its parent /promoters.

**Analytical Approach: Consolidated along with ZWL's strong linkages with its parent, CHL.**

CHL holds 63.55% equity share capital in ZWL as on September 30, 2019. Promoters of CHL also held 4.06% equity share capital in ZWL as on September 30, 2019. ZWL is strategically important for CHL to de-risk and diversify its operations. CHL, having a strong credit risk profile, is capable of providing need-based financial assistance to ZWL in a timely manner and the same has been articulated by the management of CHL. *The companies considered in ZWL's consolidation are shown in **Annexure-4**.*

**Applicable Criteria:**

Criteria on assigning Rating Outlook and Credit Watch
CARE's Policy on Default Recognition
CARE's methodology for manufacturing companies
Financial ratios – Non-Financial Sector

[Rating Methodology: Factoring Linkages in Ratings]

**About the company**
ZWL is engaged in the manufacturing, branding and distribution of health food and personal care products. Earlier ZWL operated as a consumer product division of CHL. During June 2006, CHL acquired a majority equity stake in an already-listed entity Carnation Nutra Analogue Foods Limited (Carnation). After acquisition of Carnation, CHL's consumer product division was de-merged from CHL and hived off to Carnation. Carnation was renamed as ZWL in 2009. ZWL sells its products under three brands i.e. "Sugar-Free" (Sugar substitute), "Everyuth" (Skin Care) and "Nutralite" (Table spread) which are well-established brands in their respective category.
In January 2019, ZWL, acquired HIPL, a wholly owned subsidiary of Heinz Italia SPA for a consideration of around Rs.4,600 crore. The deal comprised the acquisition of business of HIPL's four brands Complan, Glucon-D, Nycil and Sampriti Ghee, its two manufacturing units in Aligarh (Uttar Pradesh) and Sitarganj (Uttarakhand) and all operational assets and liabilities along-with associated distribution network. The acquisition was funded through NCDs of Rs.1,500 crore and rest through a mix of equity infusion and internal accruals.

*(Rs. Crore)*

| Brief Financials (Consolidated) | FY18 (A) | FY19 (A) |
|---|---|---|
| Total Operating Income | 535.51 | *863.28 |
| PBILDT | 144.86 | 194.81 |
| PAT | 136.51 | 171.24 |
| Overall Gearing (times) | 0.04 | 0.46 |
| Interest Coverage (times) | 85.21 | 6.47 |

*A: Audited; *FY19 includes only around 2 months of revenue from the acquired brands portfolio from HIPL*
ZWL reported total operating income of Rs.953 crore and PAT of Rs.68 crore during H1FY20 (Un-Audited; UA) as against total operating income of Rs.301 crore and PAT of Rs.68 crore during H1FY19 (UA).

**Covenants of rated instrument/facility:** Detailed explanation of covenants of rated instruments is given in **Annexure-3**

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

**Any other information:** Not Applicable

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

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

| Name of the Instrument | Date of Issuance | ISIN No. | Coupon Rate | Maturity Date | Size of the Issue (Rs. crore) | Rating assigned along with Rating Outlook |
|---|---|---|---|---|---|---|
| Non-Convertible Debentures | January 16, 2019 | INE768C07017 | 9.14% | January 14, 2022 | 500.00 | CARE AA+; Stable |
| Non-Convertible Debentures | | INE768C07025 | | January 16, 2023 | 500.00 | |
| Non-Convertible Debentures | | INE768C07033 | | January 16, 2024 | 500.00 | |

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

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating history | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (Rs. crore) | Rating | Date(s) & Rating(s) assigned in 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 |
| 1. | Debentures-Non Convertible Debentures | LT | 1500.00 | CARE AA+; Stable | - | 1)CARE AA+; Stable (31-Dec-18) | - | - |

**Annexure-3: Covenants of rated instrument**

<table>
<tr><td>Financial Covenants</td><td>1. The ratio of financial indebtedness net off cash and cash equivalents to PBILDT (on a consolidated half yearly (last twelve months) basis shall be as below
<table>
<tr><th>Date</th><th>Net debt/PBILDT</th></tr>
<tr><td>March 31, 2020</td><td>4.25x</td></tr>
<tr><td>March 31, 2021</td><td>3.75x</td></tr>
<tr><td>March 31, 2022</td><td>3.25x</td></tr>
<tr><td>March 31, 2023</td><td>3.25x</td></tr>
<tr><td>March 31, 2024</td><td>3.25x</td></tr>
</table>
2. Interest service coverage ratio (on a consolidated half yearly LTM (last twelve month) basis) shall be maintained above 2 times.<br>
3. The ratio of financial indebtedness net-off cash and cash equivalents to shareholders' fund (gearing) (on a consolidated basis) shall always be under 0.75 times.<br>
The issuer shall pay penal interest at a rate of 0.25% on the outstanding amount of debentures for the breach of the financial covenants.</td></tr>
<tr><td>Other Covenants</td><td>1. In the event of a rating downgrade in the credit rating of the debentures or the issuer below 'AA+' by any rating agency having an outstanding rating on the debentures or the issuers, the coupon of the debentures shall be revised upward by 0.25% for each notch of such downgrade from the date of such downgrade.<br>
2. Upon an event of default, the majority debenture holders shall have right to accelerate the payment obligation of the issuer under the transaction documents, including principal, accrued but unpaid interest, default interest, and any other amount due under the transaction documents.</td></tr>
</table>

**Annexure 4: List of entities Consolidated in ZWL**

| Sr. No. | Name of the entity | % Shareholding by ZWL as on September 30, 2019 | Nature of relationship |
|---|---|---|---|
| 1 | Liva Nutritions Limited | 100.00% | Subsidiary |
| 2 | Liva Investments Limited | 100.00% | Subsidiary |
| 3 | Zydus Wellness Products Limited | 98.16% | Subsidiary |
| 4 | Zydus Wellness International DMCC | 100.00% | Subsidiary |

***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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