

Stock Update

Earnings dilution risk recedes; Upgrade to Buy

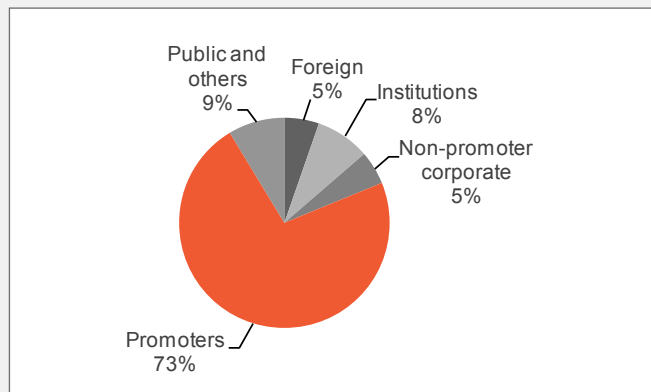
Zydus Wellness

Reco: Buy | CMP: Rs1,250

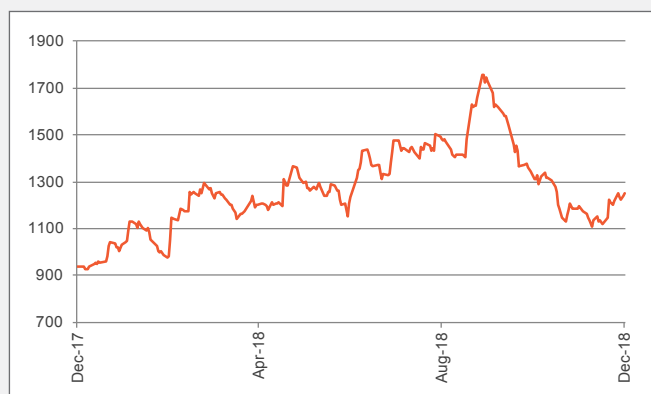
Company details

Price target:	Rs1,472
Market cap:	Rs4,884 cr
52-week high/low:	Rs1,830/918
NSE volume: (No of shares)	21,760
BSE code:	531335
NSE code:	ZYDUSWELL
Sharekhan code:	ZYDUSWELL
Free float: (No of shares)	1.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.2	-29.0	3.3	33.3
Relative to Sensex	4.3	-23.3	2.1	21.6

Key points

- Funding of Heinz India acquisition will be done through a mix of equity and debt in the ratio 1.7:1:** Zydus Wellness (Zydus) is planning to raise Rs. 4,075 crore through a mix of preferential allotment of equity shares and issue of non-convertible debentures for funding the acquisition of the entire shareholding of Heinz India Pvt. Ltd. valued at ~Rs. 4,600 crore. The company will raise Rs. 2,575 crore by issuing 1.86 crore shares of face value of Rs. 10 each on a preferential basis to Cadila Healthcare, True North, Pioneer Investment Fund and Zydus Family Trust at an issue price of Rs. 1,382 per share (~11% premium to CMP), resulting in an equity dilution of ~5%. The company will also raise Rs. 1,500 crore by issuing secured, redeemable and non-convertible debentures on a private placement basis anytime within one year. The balance payment will be made through the ~Rs. 550 crore cash available with the company.
- Heinz India acquisition will be marginally earnings dilutive but will add value to Zydus product portfolio:** Heinz India acquisition will result in earnings dilution of 6% for FY2020 and we expect it to be earnings neutral from FY2021. Post the consolidation, the combined revenue of Zydus will be close to Rs. 1,700 crore and OPM will be about 21% (as per FY2018 financials). We expect operating margins to be slightly lower in FY2020 at 19-20%, as we expect Zydus to spend more on brand building, advertisement and promotional activities of acquired brands. However, this should help the acquired brand penetration to improve and achieve double-digit revenue growth during FY2020/FY2021. The expected finance cost of Rs. 140 crore-150 crore and equity dilution of ~5% would result in earnings dilution of 6% for FY2020. However, the same is expected to be lower in FY2021 to 1-2% as revenue growth and OPM will gradually improve over the medium term. Moreover, the acquisition is expected to be positive for Zydus from the long-term perspective as it is getting access to a strong brand portfolio (including brands such as Complian, Nycil, Sampriti Ghee and Glucon D), which will enhance its health and wellness portfolio in the domestic market.

- ◆ **Upgraded to Buy as significant earnings dilution risk recedes:** Zydus prudent fund raising plans through a mix of debt and equity reduces the risk of significant earnings dilution in the coming years. The acquisition will enhance the overall product portfolio of Zydus and will make it a formidable play in the health and wellness space. Further, the stock price of Zydus has corrected by ~10% since the announcement of

acquisition due to non-availability of funding details of acquisition. Hence, we upgrade our rating on the stock from Hold to Buy with a revised price target (PT) of Rs. 1,472 (rolling it over to FY2021 earnings, valuing at 28x). We have not incorporated the financials of Heinz India in our earnings estimates for FY2019/FY2020/FY2021, waiting for more financial details.

Valuation (Consolidated)

Particulars	Rs cr				
	FY2017	FY2018	*FY2019E	*FY2020E	*FY2021E
Net sales	462.6	503.2	575.4	674.0	775.1
Adjusted net profit	111.3	136.5	146.1	183.8	208.5
Adjusted EPS (Rs)	28.5	34.9	37.4	47.1	53.4
PER (x)	43.9	35.8	33.4	26.6	23.4
EV/EBIDTA(x)	48.8	37.6	32.0	26.0	21.9
RoCE (%)	23.0	22.9	23.7	25.5	24.4
RoNW (%)	21.5	21.9	19.5	20.8	19.9
OPM (%)	21.4	24.9	25.7	27.0	26.7

*Earnings estimates are excluding Heinz India's financials

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