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Ipca Bleeds as Street Fears Unichem Acquisition a Likely Earnings Drag

Concerns about buying a low-returns generics business at high valuations

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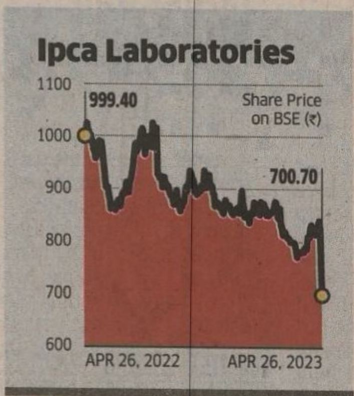
Mumbai: Shares of Ipca Laboratories dropped 5.3% on Thursday, extending losses to the second straight day, as the company's acquisition of Unichem Laboratories has not gone well with investors. Analysts said investors are concerned that the company may have misallocated capital to low-returns generic business at expensive valuations. The stock, which closed at ₹702 on Thursday, has dropped 17% in just two trading sessions after the announcement.

Ipca on Monday announced the acquisition of Unichem by acquiring a 33.38% stake from the promoter at ₹1,034 crore. It will spend another ₹800 crore for the mandatory open offer to buy another 26% stake of Unichem's minority shareholders.

"At 2.3 times sales, the acquisition cost is expensive given challenges and uncertainty associated with the US market," said Param Desai, analyst at Prabhudas Pilladher.



"Even after factoring the positives, the acquisition cost works out to be at ten times EV/Ebitda and is largely EPS neutral in FY 2025. However, return on equity and return on capital employed will be dilutive by 200 bps."

The acquisition will allow Ipca to re-enter the US formulation generics market. The company has guided for ₹300 crore annual Ebitda from the Unichem business within two years of taking management control.

Some analysts believe Ipca has a huge scope to improve the company's operational efficiencies and potentially scale up operating profit margins to 15% plus from the current level of 6-7% in the near term.

Ipca will be taking over management control after the completion of the open offer. Unichem will continue to exist as a separate listed entity.

Unichem has posted about 10% compounded revenue growth in the past five years. The company has struggled to make operating profits in the last few years except in FY22.

"Prima facie, the pay-out appears to be steep given the operational losses reported for nine months ended December 2022, said Cyndrella Carvalho, analyst, JM Financial Services. "The eagerly awaited strong margin recovery will stumble upon the current capital allocation decision, consequently leading to further consensus downgrades."

Motilal Oswa has reduced the estimated PE multiple of Ipca from 24 times to 21 to factor in capital allocation toward the low-returns business.

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