



“Zydus Wellness Limited Post Results Conference
Call”

August 02, 2016



MANAGEMENT: DR. SHARVIL PATEL – CHAIRMAN, ZYDUS WELLNESS LIMITED
MR. TARUN ARORA – COO & WHOLE TIME DIRECTOR, ZYDUS WELLNESS LIMITED
DR. GANESH NAYAK – DIRECTOR, ZYDUS WELLNESS LIMITED
MR. AMIT JAIN – CFO, ZYDUS WELLNESS LIMITED
MR. NITIN PAREKH – CFO, ZYDUS GROUP
MR. VISHAL GOR – HEAD OF INVESTOR RELATIONS, CADILA HEALTHCARE LIMITED

Moderator: Ladies and gentlemen good day and welcome to Zydus Wellness Limited post results Q&A session with analysts and investors. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal for an operator by pressing * followed by 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Tarun Arora – COO & Whole Time Director of Zydus Wellness Limited. Thank you and over to you Mr. Arora.

Tarun Arora: Good afternoon and welcome to the post result teleconference of Zydus Wellness Limited for the first quarter of financial year 2016-17. We have with us Dr. Sharvil Patel, Chairman, Mr. Ganesh Nayak – Director, Mr. Amit Jain – CFO, Mr. Nitin Parekh – CFO of the Zydus Group and Mr. Vishal Gor – Head of Investor Relations at Cadila Healthcare Limited.

The quarter gone by saw a strong performance of the company. We have seen significant improvements in the growth rates of all our brands. As a result, the company registered an overall consolidated growth of 12.6% in total operating income and 20.1% in the net profits for the quarter. During the quarter gone by our key brands namely Sugar Free, Everyuth Scrub and Everyuth Peel-off have maintained leadership positions in their respective categories.

With that let me share some of the highlights of operations for the quarter gone by. We have continued our thrust on marketing initiatives to grow the categories and market share of our brands during the quarter. To narrate a few, to drive the growth of Sugar Free category and market share of our brands a new campaign ‘Smartness Waali Sweetness’ was launched featuring our brand ambassador Parineeti Chopra.

On the Everyuth front we continued the support for scrub and peel off to drive the category penetration. We re-launched facewash range with fresh, new and contemporary looking packaging. This initiative was supported by new communication to drive the awareness of new packaging.

On the Nutralite front we continue to support the “Clean Cities” with various brand building activities. Nutralite campaigns around the ‘World Health Day’ and ‘Mother’s Day’ were amongst the most successful and talked about campaigns on digital platform.

As per May-June 2016 report of Nielsen the artificial sweetener category has grown by 5%. Sugar Free has maintained its #1 position with a market share of 93.8% which is an increase of 90 basis points over the same period last year. The Scrub category has grown by 10%. Everyuth Scrub has maintained its #1 position with a market share of 30.4%. The peel-off mask category has grown by 5.9%. Everyuth’s peel-off mask has gained market share by 30 basis points and maintained its #1 position with a market share of 91.9%.

Coming to the consolidated financial performance of the first quarter of financial year 2016-17:

From this quarter we have started reporting financial numbers as per IndAS and comparative numbers for previous year's corresponding quarter have been revised as per the IndAS. While this has not impacted the reported profit after tax significantly, the reported gross sales numbers have reduced because of netting off certain payments and reimbursements to customers from gross sales as per the requirement of IndAS which under previous gaps were reported as a part of marketing expenses. Detailed analysis of impact and IndAS financial numbers have been provided along with the published results.

Our total income from operations was up by 12.4% year-on-year to Rs. 108.8 crores. Our gross margin as a percentage of total income from operations increased by 370 basis points and stood at 73.1%. The increase was mainly due to reduction in the prices of key material and favorable product mix. Earnings before interest depreciation and tax were up by 17.3% year-on-year to Rs. 197 million. EBITDA margin as a percentage of total income from operations increased by 80 basis points and stood at 18.1%. Profit before tax was up by 20.6% to Rs. 269 million. Net profit was up by 20.1% to Rs. 235 million. Thank you and we will now start the Q&A session. Over to the coordinator for the Q&A.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin with the question and answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please proceed.

Abneesh Roy: My first question is you already have 90% plus market share in your key segments, so in order to grow strongly if you could discuss your pipeline in terms of new products and this 12% growth, how much is volumes and how much is pricing growth?

Tarun Arora: This growth is largely driven by volumes and the future pipeline I think we will share as and when we are launching but we are committed to unleash the future growth by innovations and new product launches as well.

Abneesh Roy: And sir these three segments, could you please share segment wise some growth numbers so that we can understand how is the growth sustainable because in the past few years the growth has been a bit difficult and currently on the overall demand side also things are challenging for every company. So you have managed a decent number after a few years, so wanted to understand what has gone right and so if you could discuss that part and the three segments which one is growing faster, which one is the laggard?

Tarun Arora: So while we do not want to share all the specific details but to give you a sense of it I think last quarter has seen growth across all the three categories and that is really the positive part about it. The actions or the things, the initiatives that have really gone behind it is series of things that we have been talking over the last few quarters. One being sales and distribution coming back on track. It is really demonstrating good results and we have taken initiatives to drive our distribution up by placing more SKUs into the market and within the existing distribution range that we have. Secondly, even for Everyuth we have been able to contemporize packaging that is one of the things that worked on Everyuth and over next few quarters we will

have more such initiatives on the packaging upgradation and relaunches. On the Sugar Free we have had the new campaign where the initial results seem to be very positive and 'Smartness Waali Sweetness' campaign seems to be responding well. So each of these things put together is I think helping us get this growth.

Abneesh Roy: And sir last question distribution wise say 3 years back versus current, the three segments if you could tell us where were you say 3 years back and versus that index where are you right now? If you do not want to share exact numbers, the index will also be fine.

Tarun Arora: We can pick it up offline. I can share that for example, Sugar Free's latest Nielsen reports about 4-4.5% improvement in our distribution which is close to about 4.1 lakh but for 3-year data I think we can pick it up offline and share the progression over the years.

Moderator: The next question is from the line of Sonali Sargaokar from Yes Securities. Please proceed.

Sonali Sargaokar: Sir my first question is what is the market share of Nutralite and how much has the category grown this quarter?

Tarun Arora: We are not taking Nielsen reports anymore because we found it was not matching our – I mean there were challenges with the report being a small category. So we have not had the category reports but like I said I think we have seen good growth across the three categories and that should be a fair estimation of overall space because Nielsen covers only retail which is only 25-30% of the category. So I think we have to look at more comprehensively the whole space.

Sonali Sargaokar: Sir my second question is with reference to your advertisement and sales promotion cost. Now as a percentage to net sales, this quarter we have seen a level which is the highest in the past 5 quarters. So as I understand and as you explained that there was a new campaign which you ruled out for Sugar Free, just wanted to understand for the whole year are we planning to settle at these levels or maybe it will come down in the subsequent quarters?

Tarun Arora: Typically, we spend much higher numbers in this quarter because Everyuth campaigns happen around this time. It is most higher seasons for Everyuth and we also had payments to be made to the new celebrity. So all that put together I think it is higher, I mean traditionally it remains consistent to what we have been maintaining. We do not see a big change in our overall percentages.

Sonali Sargaokar: And my last question is after your distribution overhaul what is the number of outlets that you have PAN India, so any statistics you could share with us that would be helpful.

Tarun Arora: As per Nielsen we are available in about 8-8.3 lakh outlets across all our categories. We do not share the internal numbers, so that is the approximate numbers.

Moderator: The next question is from the line of Kaustubh Pawaskar from Sharekhan. Please proceed.

Kaustubh Pawaskar: Sir my question is again on the distribution, you mentioned that currently it is 8.3 lakh outlet as per the A. C. Nielsen figure. But what is your internal target that distribution should grow by 15-20% per annum. So where do you see your distribution reach over the next 2 years?

Tarun Arora: I think for us it is not just the number of outlets going up or it is the quality of distribution. So one of the main focuses for us on distribution is to have as many of our existing products available across our outlets that we cover. So not to look at just the peak number going up but getting the range of our products going on and therefore the focus is more on your direct distribution reach which allows for all the smaller SKUs, the new product LPDs that we launch get driven very well. And therefore I do not have a huge number that every year 15-20% growth will happen. So that may not be a fair number to keep here to change. But quality of our distribution will be a more critical one. In any case are driving higher reach.

Kaustubh Pawaskar: Sir any update on the Everyuth Facewash because that particular category you are seeing some kind of deceleration in terms of revenues and also in terms of market share you have seen lot of stress on the market share as well. So any update on the facewash whether you have been able to arrest the market share or is there any improvement as such?

Tarun Arora: No, we have not seen any market share improvement but our internal numbers and growth rates over last months have shown a reversal of the past trend. Hopefully over the coming quarters we should be able to demonstrate a market share revive. But, it is clearly contributing to our growth rates now. Earlier it was laggard in pulling down the numbers, now it is contributing positively.

Kaustubh Pawaskar: My third question sir, in your initial comments you mentioned that the gross margin improvement on back of favorable revenue mix and decline in the raw material prices. So what are the inputs where you have seen the decline because now the trend is kind of reversing for other FMCG companies. But you mentioned that you are seeing a decline in the raw material prices.

Tarun Arora: See most of the raw materials which we are buying has shown some sort of downward trend. Largely it has to do with refined palm oil as well as the lactose which we buy. There the prices have corrected sharply and that is where we have got the benefit.

Kaustubh Pawaskar: And this benefit is going to continue in the coming quarters or it is a short term phenomena?

Tarun Arora: As of now we feel that there will not be much fluctuation in this number.

Kaustubh Pawaskar: And sir my last question is that we have seen your revenue growth improving from single digit in quarter 4 to about 12.5% in quarter 1. So will there be any further improvement in terms of revenue growth or we should expect similar kind of growth trends in the near term?

Tarun Arora: We are working to maintain our double digit growths. I think that is all we can share at this moment.

- Kaustubh Pawaskar:** And sir any update on your new manufacturing facility in Sikkim?
- Tarun Arora:** So that is a work in progress and we hope to have this facility up and running in this financial year, before the end of this financial year itself.
- Moderator:** The next question is from the line of Ajay Thakur from Anand Rathi. Please proceed.
- Ajay Thakur:** I have one question on this Edgewell, they are entering into the scrub's category with a premium position St. Ives in the scrub market. So just wanted to get your feel on how you see the competition specifically in the scrubs market and what kind of measures would you be taking in order to defend your turf over here?
- Tarun Arora:** I have not seen any specific thing that you are talking about but Edgewell has had presence in scrubs through one or two brands, so we are focused on growing the category. As a leader I am less anxious about who is going to enter but about how will I grow the category as I have a significant leadership there, this is how we grow the category and most of our actions will be driven by that. So we will await to see what really happens and that is all I can comment at this stage.
- Ajay Thakur:** And secondly we have been seeing most of the companies are actually seeing some kind of slowdown into their growth rates but for you actually we have seen kind of a pleasant surprise with numbers moving in upward trajectory. So from that perspective just wanted to get your sense on the market as to is there some kind of stress which is there and what is in it that is driving actually Zydus good performance versus the rest of the market. So maybe some qualitative aspects that will be pretty helpful.
- Tarun Arora:** So let me acknowledge the stress is there in the market but I think for us there has been a reasonable gap and whole lot of our initiatives are coming together and hopefully that has helped us overcome the stress that has been in the market. So that is really what has probably worked for us at this time. When the whole market is down and then we have been able to pull down to the numbers that really a simple answer for this.
- Moderator:** The next question is from the line of Tejas Shah from Spark Capital. Please proceed.
- Tejas Shah:** Though numbers are not comparable for May, for the previous quarters like except the first but broadly if we see that we have touched this run-rate of 108-109 crores in recent past but we have not been able to actually break that zone and we have hovered around this number for past many quarters now. And though optically the number looks very good on the last year's base but are you seeing any real pickup and demand which actually helps you to at least tell us that there are some real upticks in the demand scenario which can help us to break that zone and we can maintain this momentum for at least a near term future.
- Tarun Arora:** There are two parts to it. I think 108 is the net sales and like-to-like there is no movement up. What we really are seeing is and I shared the Nielsen offtake numbers also, so they remain

muted and that is why we are focused on the fact that how to grow these categories. I think we are not seeing any buildup in our pipeline yet, so hopefully these results are reflective of the right actions resulting in these numbers. Most of our action is to growing these categories and that is what we have talked about across all leadership segments. So I think we should see the results over a longer period of time if these actions lead to demand generation as we want it to.

Tejas Shah: Can you elaborate on the actions because we know the distribution rejig that we have done almost in the last 2 years. Apart from distribution rejig are we trying to do anything else?

Tarun Arora: Clearly there are 2 or 3 things that I can add onto beyond the distribution rejig. And distribution rejig was getting our operations more ready for what we want to do. I think clearly first on the branch side Sugar Free with the new positioning on smarter choice which we have a tagline 'Smartness Waali Sweetness', that has gone through enough iterations and work and the initial feedback seems to be very strong. So that along with our activations on ground which is along with modern treat activations along with press and building the medical marketing route. So all those put together I think we should be able to build the whole category. Similarly, when I look at other categories also, so I am seeing a good traction in the modern trade in this market. So these things come together to show some of these actions. So distribution is just one part of it but clearly focused more on demand generation and also building leading channels both digital as well modern trade. So some of those things will hopefully help us build our brands right.

Tejas Shah: And sir in most of the categories as we understand you are the category leader and the onus of growing category lies on you because market share is pretty dominant in most of the categories. So are we planning to go on a profit holiday or margin holiday for a while and at least be aggressive on A&P spend to drive that kind of demand generation which we want for the category to pick up, just some thoughts on that.

Tarun Arora: I think spending more money is not a constraint but the more important thing is the initiatives have to deliver and I think we are seeing some of these initiatives in place. If we need to accelerate some of our investments, we will be happy to share. So thanks for the suggestion but we will look at how do we accelerate. For us the focus is to grow the categories. If it means more spend then that can give me a surety of it will result to more top line, I think you can be assured that we will push the envelope.

Tejas Shah: And sir last one, bookkeeping question. Would it be possible to share headline numbers based on IndAS for FY16?

Tarun Arora: We can share it offline with you.

Moderator: The next question is from the line of Kashyap Pujara from Axis Capital, please go ahead.

Kashyap Pujara: My question was pertaining to the gross margins. I think you have seen 370 bps increase in gross margins. Could you be able to articulate how much would that be because of raw

material getting better and how much would that be because of product mix structurally doing better?

Tarun Arora: All this detail we can share offline. What we can broadly say here is that large part of this is driven by the lower input cost.

Kashyap Pujara: Second would be that if I look at the kind of expansion and gross margin is not really manifesting into EBITDA margin expansion and while ad spends have definitely moved up but your other expenses, manpower everything seems to be showing up. So could you explain how do you see this trend panning out for the full year?

Management: See if you look at the sequential basis the growth has been around 9%, which is largely due to the increments which we rolled out in this quarter. A&P spend included the cost of new celebrity and the film without which the growth would have been around 13.5%. So as Tarun mentioned in the call we broadly see the range which we have been maintaining for A&P spends on an annualized basis continues.

Kashyap Pujara: Because if you look at I think there was that IndAS adjustment I think and if you look at it your like-to-like comparison for ad spend would be Rs. 34-35 crores this quarter. That would be the right figure maybe to pin it down. So would it mean that in the going forward quarters this would end up going down because your celebrity payout would be more one-time in nature, right? It would not be consistent payout.

Management: Yes, that is why I mentioned that on an annualized basis our spends will be consistent.

Kashyap Pujara: So basically this implies that assuming that since you said that the raw material cost is not fluctuating as much and this gross margin gain or whatever is sustainable then it would imply a better EBITDA margin in the coming quarters hopefully. Another thing was related more to the overall top-line. I think if you look at 10 quarters or 15 quarters on Zydus and if we look at the growth, I think since the last two quarters you are getting a better sense of some uptick being witnessed. So I think most of the participants are in a way trying to ask you that is this growth really sustainable. And I think if you can elaborate something more than what you have done so far, I think in terms of specific aspects that you have tried to rejig your distribution in the past and you kept saying that no, the benefit will keep showing up, benefit will keep showing up, etc. So what is it if you can really quantify that? Is that benefit finally flowing through and is that benefit sustainable? That is one. Second is, is it that the growth is higher because you are spending more on advertising than what you used to do. So what is it that is driving growth and how sustainable does management feel the growth really is going to be?

Tarun Arora: We expect a consistency in our growth as we have committed to earlier and that is what we are working on. For a lot of details that you are asking in terms of what has gone into it, while we have explained some part of it, I think if more discussion is required you could take it offline and we could get into some level of detailing as well, we are not averse to that.

- Moderator:** The next question is from the line of Bhavesh Jain from Envision Capital. Please proceed.
- Bhavesh Jain:** Sir can you tell us anything about our exports because last quarter we were saying that we are planning to enter some export market, so what is the update on that?
- Tarun Arora:** Our focus is mainly Eastern Africa and then South East Asia and SAARC. We are opening few countries as we go along. We have started selling in 3 or 4 of these countries. In other 3 countries we would be in the process of registration. So it is still very small but we expect this to build up and gather pace as we go along.
- Bhavesh Jain:** And sir any color on the products for which we were doing this pilot or test launch?
- Tarun Arora:** So for example, we have done a pilot on the Stevia in Gujarat last year. So that has been we have discussed in the past also that has been fairly useful in terms of our learning and we are preparing for a national launch, whenever we are ready we will obviously be happy to share.
- Bhavesh Jain:** Apart from that any other product, Stevia, apart from that?
- Tarun Arora:** Each of these categories we have work happening and we will share some of these as we go along. For example, even in Nutralite, even in Everyuth we are testing few products. So we will share once they are fully ready to.
- Bhavesh Jain:** And sir any update on ActiLife?
- Tarun Arora:** We are working on that space and we will share in specifics when we are about to launch. Quarter 4 we will be sharing it at that time.
- Moderator:** As there are no further questions, I now hand the conference over to Mr. Arora for closing comments. Over to you sir.
- Tarun Arora:** Thanks a lot ladies and gentlemen. We will meet up next quarter.
- Moderator:** Thank you very much sir. Ladies and gentlemen on behalf of Zydus Wellness Limited that concludes this conference. Thank you all for joining us and you may now disconnect your lines.