



**“Zydus Wellness Limited Q3 FY20 Earnings
Conference Call”**

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MANAGEMENT: DR. SHARVIL PATEL - CHAIRMAN, ZYDUS WELLNESS LIMITED
MR. GANESH NAYAK – DIRECTOR, ZYDUS WELLNESS LIMITED
MR. TARUN ARORA – CEO, ZYDUS WELLNESS LIMITED
MR. UMESH PARIKH – CFO, ZYDUS WELLNESS LIMITED
MR. VISHAL GOR - SENIOR VICE PRESIDENT (CORPORATE FINANCE), CADILA HEALTHCARE LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Zydus Wellness Limited Q3 FY20 Earnings Conference Call. 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, please signal an operator by pressing ‘*’ then ‘0’ on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Tarun Arora – CEO of Zydus Wellness. Thank you and over to you, sir!

Tarun Arora: Good afternoon and welcome to the post results teleconference of Zydus Wellness Limited for Quarter 3, Financial Year 2019-2020. We have with us Dr. Sharvil Patel - Chairman, Mr. Ganesh Nayak – Director, Mr. Umesh Parikh – CFO and Mr. Vishal Gor - Senior Vice President, Corporate Finance at Cadila Healthcare Limited.

The quarter gone by has remained our challenging quarter for the company in view of the overall economic slowdown and also exorbitantly high commodity prices of milk, refined palm oil and dextrose monohydrate putting pressure on gross margins. During the quarter company has taken certain large scale initiatives. Outcome of which is monumental in terms of the various integration projects which had been planned post acquisition of Heinz India Private Limited. We have successfully implemented 3 major projects that will leverage scale and build our organization to be future ready:

- First, building of scaled up go to market – this will increase direct reach to double and reduce distributors from 1,500 to 800 with the reduced cost to serve.
- Second, supply chain. We have been doing our CFA consolidation. It will help us reduce logistics costs through various optimization and straight line consolidation. We are reducing from 65 to 23 CNS for the company.
- Third, implemented our future ready integrated ERP system, SAP S/4HANA, this was one of the fastest implementation done in any FMCG company of this scale. Along with the parallel implementation of various projects, we have been able to deliver and ensure the momentum and steady state of the business.

Our reported total income from operations on a consolidated basis grew by 128.8% to Rs. 3,327 million during the second quarter of financial year 2019-2020. Consolidated reported profit after tax at Rs. 42 million for the third quarter. Since the consolidated financial results for the quarter one of financial year 2019-2020 includes operating results of the acquired business hence the reported results are not comparable with those pertaining to previous period. Also due to seasonality of some of the groups products, groups revenues and profits are stood in favor of the first and the last quarter of the financial year. Hence the performance of one quarter is not representative and cannot be generalized for other quarters. During the quarter gone by our key brands namely Sugar Free, Everyuth scrub, Everyuth peel off, Glucon-D and Nycil have been leading in their respective categories.

Let me take you through the highlights of the consolidated financial performance of Quarter 3, Financial Year 2019-2020:

During the third quarter of financial year 2019-2020, our total income from operations has increased by 128.8% year-on-year to Rs. 3,327 million. EBITDA was down by 13% year-on-year to Rs. 327 million. Profit before tax was down by 112% to minus Rs. 55 million. Net profit was down by 89.3% to Rs. 42 million.

With that, let me share some of the highlights of the operations for the quarter gone by:

We continued our thrust on marketing initiatives to grow the categories and increase market share of our brands during the year. To narrate a few:

on Sugar Free front, during the quarter we activated the safety eco system on the back of 360 degree campaign environment safety TVC on air combined with PR on this subject. We scaled up medical marketing program to 5 cities in visiting more than 2,400 Doctors on a monthly and annualized basis about 6,500. On the Everyuth front, the brand continues to expand its footprint with the launch of ecommerce exclusive products Micellar Cleanser. The brand continues to drive offtakes with TV campaign for peel off.

On the Nutralite front, during the quarter we have seen good volume lead recovery on the brand. We continue to support it through sampling and other below the line activities.

On the Complian front, we continue to invest behind the brand with a consumer validated communication, highlighting Complian's nutritional superiority and by increasing media weightages in the key market through multiple media. Complian partnered with Disney during the release of its film Frozen II in launch consumer offers which was supported by other activities as well, including a TVC.

As per the MAT December 2019 report of Nielsen, the sugar substitute category growth rate is that 8.9%. Sugar Free has maintained its number one position with the market share of 94.6%.

The facial scrub category has grown by 9.1%. Everyuth scrub has maintained its number one position with the market share of 32.4%. The peel off face mask category has grown by 15.3%. Everyuth peel off mask has maintained its number one position with a market share of 80.9%. The prickly heat powder category has grown by 9.9%. Nycil has maintained its number one position with a market share of 34.5%, which is an increase of 255 basis points over the same period last year. The Glucose powder category has grown by 11.9%. Glucon-D has maintained its number one position with a market share of 59%. The MFT category has grown by 9.2%. Complian has a market share of 5.5% in this category. We hereby inform to the investing community that the budgetary support scheme, under GST for our Sitarganj facility has ended on December 2019. As the company approaches the season for Glucon-D and Nycil, it is embarked on season readiness initiatives with the intent to start the season with fresh stocks. The company further plans to consolidate synergy benefits going forward.

Thank you and we will now start the Q&A session. Over to the coordinator for Q&A.

Moderator: Thank you, very much. We will now begin the question and answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: Sir, my first question is on Complian. So, historically this category has had very high gross margin. Now recently we have seen lot of inflation in the food raw material. So, my question is do you need to take pricing hike or you see operating at a lower gross margins so that there can be more off takes. So more focus on the LUP and no price hike because of the inflation?

Tarun Arora: What we have done is right at now we are maintaining the same prices. We are in a recovery phase for Complian as we have reported in the first 6 months of the last calendar year we had seen a decline in this brand. We are seeing a good recovery. We intend to maintain the prices for now. If the commodity inflation persists we will take call in terms of both price increases and cost reductions. But as of now for next one or two quarters we do not want to change the prices.

Abneesh Roy: And in terms of LUP what is the percentage coming at LUP and any plan you have longer term to have a particular number at LUP?

Tarun Arora: For Complian, in fact the whole MFD category is quite questionable on the LUP strategy because there is no margin in LUP and therefore we are staying away from that. And that's how we intend to maintain today unless there is some change in the mix that comes out.

Abneesh Roy: And could you talk about the synergy in chemist channel because historically that is the channel where you can add value. So, any benefits you have seen because of this, are you able to push much stronger because of this benefit?

Tarun Arora: Absolutely, distribution is going to be our big plus point because we have been able to integrate the two sales systems together. We are seeing already a 20%-30% increase in our direct distribution by just integrating the two and over the next couple of quarters we will be in a journey of expanding that. Chemist will certainly be a plus point for us in terms of leveraging it for the acquired products.

Abneesh Roy: My second question is on e-commerce. So, one of the other consumer company highlighted that the growth has slowed down significantly in e-commerce for them. Are you also seeing that you also mention that you are having an exclusive brand for this, exclusive product, SKU for this. So, what is the plan for that? Do you see lot of off take coming because of the exclusive brand?

Tarun Arora: For us, e-commerce we are very bullish about it. We are seeing across the brands are good uptick on that. In fact on Complian, we have a strategy where we believe there is a good upside on this. On Everyuth, in fact we already have 6% to 7% of our sales coming from e-commerce and this Micellar Cleanser which we have launched should only help us. So, in fact in the

Billion Dollar sale of Flipkart, we were amongst the top 2 players in face wash. So, we clearly believe that e-commerce stays important to us. Micellar is just one of the first products we have launched. We have couple of other products in the next 3 to 4 quarters which we shall launch focused on e-commerce and we have been strengthening our capability there.

Abneesh Roy: And sir, last question on personal care lot of the other companies have highlighted slowdown. Of course winter was part of the reason which may not impact your segment that much. But other companies have highlighted that personal care has slowdown. But the numbers you have reported for the category they do not show that slowdown. Is it because of the urban or is it because of Nielsen any specific data issue is there?

Tarun Arora: So, there is a slowdown. There is always a gap between what we witnessed ourselves and what Nielsen reports and I will let that be from a Nielsen but there is, yes, there is a slowdown. But we have been seeing that we have been able to stay ahead of the category growth in volume terms

Dr. Sharvil Patel: Starting from the earlier growth double digit growth of the market, market growths have come down but for us because we are a value players also our volumes have kept up with even though when the markets have come down the volumes are kept up.

Dr. Sharvil Patel:: So, the category has slowed down that is true.

Moderator: Thank you. The next question is from the line of Kinjal Desai from Nippon India Mutual Fund. Please go ahead.

Kinjal Desai: I just wanted to understand, see now it is a new portfolio we have a very different rhythm of our quarter. So this is the first time that we will be also viewing this. Can you just help me understand, you said that Q1, Q4 between Q1 and Q4 which is the heavier quarter for us?

Umesh Parikh: So, I am talking about calendar quarter, calendar quarter, Q1 and Q2 are heavy. So I mean Q1 and Q2 are heavier Q3 and Q4 are the leaner quarters. So, then Jan to June will be heavy.

Kinjal Desai: Would it be right for me to assume that, is that Q1 and Q2 together could make up more than 60% of the revenues and probably the EBITDA as well?

Umesh Parikh: That's right.

Tarun Arora: 50% of revenues EBITDA even larger.

Umesh Parikh: EBITDA is 90%.

Kinjal Desai: And sir, just one more thing on the, we have also been doing a lot of integration, etc. there would be some kind of one-off cost which will not get repeated in the next year. So, for the 9

month number would it be possible for you to ballpark given idea how much are these one-off costs which will not get repeated?

Umesh Parikh: Yes, that one-off cost is to the extent of 44 crores in these 9 months.

Kinjal Desai: 44 crores?

Umesh Parikh: Yes.

Kinjal Desai: And sir lastly, how are we looking at A&P, so I know because we just have about the Q-on-Q idea. But we had seen that A&P cost has come off on a Q-on-Q basis. So, it's just basically some idea some strategy which you could help us understand how are we taking that forward?

Tarun Arora: So, typically for the annualized we have a 15% kind of A-to-S ratio that we have planned to maintain. Now, some of the things that happened in the quarter 3 of financial year is, there is practically no spends on brands like Glucon-D and Nycil which also have a much slower sales. And therefore the mix of the ratios change. Even our Nutralite is relatively low spends. So, it is the bit of mix and we have also taken certain calls because of the commodity price being under pressure. So, we have also taken some temporary calls as well. But our annual guidance you can look at our 15% as a fair ballpark number that we would operate.

Moderator: Thank you. The next question is from the line of Shirish Pardesi from Centrum. Please go ahead.

Shirish Pardesi: I have few questions on Complian business. You have mentioned that 6,726 crores is the category size. This is December exit, or this is MAT 2019?

Tarun Arora: This is MAT 2019.

Shirish Pardesi: And you have said that the category growth is about 9%. Will you be able to help us to understand what is the white versus chocolates growth?

Tarun Arora: Of hand I will not have it available maybe you could reach out us separately I will say that because we really do not look at just white versus chocolates but the issue has become further different segments.

Shirish Pardesi: No, what I am trying to understand is the penetration. Do you have the penetration number handy; I mean obviously there is a lot of penetration ...

Tarun Arora: No, we do not have it separate for whites and chocolates. Separately we will be able to give you.

Shirish Pardesi: No, I am saying HFD penetration at this moment?

- Tarun Arora:** About 24%.
- Srinish Pardesi:** And what would be the Horlicks, for us Complan penetration?
- Tarun Arora:** So, we can discuss a little bit of this brand level details when you meet us and we can catch up on a separate call in brand level details. Because it will be a varying number at our national level but for our focus markets of West Bengal, TN the number is different. And therefore taking a national number, one number may not be the most suitable number to share. So, we work on more focus market.
- Shirish Pardesi:** Basically, I mean, I wanted to understand the Complan has a future ready, I mean you have the brand, we have the background you have chemist coverage which you have displays. I mean what, from 3 years perspective where Complan can fit in if you can tell me in terms of penetration distribution or uptick.
- Tarun Arora:** So, we clearly have I will just put in 1 or 2 lines and we can have a more detailed discussion in a follow up discussion. We clearly putting all the fundamentals and plays to grow this brand. The brand has a strong product story which delivers a superior nutrition. Our go-to-market is now strong like you said in chemist place we believe now we are investing behind it. We believe we are ready for a market share expansion which will happen may not overnight but will take over a while and we will also play in a wider, wider segments as well as we go along and some of which will come over in next few quarters and that is how we will help us gain the share over next 2 to 3 years.
- Shirish Pardesi:** Just one quick question on Sugar Free. What is the volume growth we have got this quarter?
- Tarun Arora:** So, the category like I mentioned we share at a MAT level is 8.9. Major portion of it is volume, there is a small portion of value also involved in this at a MAT level.
- Shirish Pardesi:** And on a 9 month basis what is the price increases blended value growth we have got for 9 months?
- Tarun Arora:** So, we have taken this year price increase about 4% which is almost going back to our 2015 pricing because at GST time we have reduced it from a consumer point of view.
- Shirish Pardesi:** Just one last question on distribution. You mentioned that 3.75 lakh outlet coverage which you are planning, what is the current level of distribution we have?
- Tarun Arora:** So, we used to, if you are talking about direct distribution we used to operate at 2.3 to 2.5 Lacs outlets between both this we already crossed the 300,000 because of the combination we believe. We will be half a million when the whole operations are complete over next few quarters.
- Shirish Pardesi:** And aspirationally, you are saying you will reach 500,000 in first half 2021?

- Tarun Arora:** Yes.
- Moderator:** Thank you. The next question is from the line of Kaustub Pawaskar from Sharekhan. Please go ahead.
- Kaustub Pawaskar:** Sir, my question is on the margins and that for first 9 months now consolidating the Heinz's portfolio we have achieved margins of around 13%. Initially when we acquired this portfolio, the margins were similar to what the base product or a base portfolio margins were or these margins were of about 20%. So, I do not think that in FY20 would be achieving close to 20% margins considering the integration cost and one-off items and all those. But in FY21, can we expect the console margins to reach to base product margins of around 20%.
- Sharvil Patel:** See currently, with our current understanding of the commodity pricing and everything we are expecting between 17% to 18% margins, if the pricing commodity eases down then we could see improvement. But currently our best estimate is between 17% to 18%.
- Kaustub Pawaskar:** For 2021, FY2021, right?
- Sharvil Patel:** Yes.
- Kaustub Pawaskar:** And sir, in this quarter what would be the comparable revenue growth and operating profit growth if you could help us with that?
- Tarun Arora:** You could take it at mid-single digits.
- Kaustub Pawaskar:** Mid-single digit comparable, for the base product, our base portfolio, right?
- Tarun Arora:** For the overall portfolio.
- Kaustub Pawaskar:** For the overall, including the Heinz portfolio?
- Tarun Arora:** Yes, including.
- Kaustub Pawaskar:** So, 8% growth in the revenues and 8% growth in the operating profit?
- Tarun Arora:** No, we said mid-single digits.
- Moderator:** Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.
- Tejas Shah:** I logged in a bit late, sorry, if I am asking something which has been mentioned on the call earlier. But sir, last call we were discussing some plan to launch new variance in Complian. So, any update on this year?
- Tarun Arora:** Yes, the plan is on track. We will update you in the coming quarters.

Tejas Shah: So, it has not been launched yet?

Tarun Arora: Not yet.

Tejas Shah: Sir second, it has been almost a year post consolidation and you updated, you uploaded presentation as well on the same. But we started with 3 major synergy drivers it was distribution infra, employee cost and whole supply chain rationalization. So, if you can give some color on where are we and all those 3 points and is the consolidation exercise behind us and now its organic business going forward?

Tarun Arora: So, I think you missed the initial conversation that I said. So, on the sales integration, we have completed the sales integration. We have integrated the distributors our own fieldforce. We have also consolidated our coverage of the outlets of about 2.5 Lacs outlets each, a 2.5 lakh outlet is close to 300,000 plus outlets from our direct distribution and we intent to take it to 500,000 over next few quarters. From the employee, I think we have put up in our presentation also we have been able to rationalize certain number of employees which is helping us and reducing HR cost to our sales ratio . We have also completed our C&F consolidation. We had 65 cold chain and cold and ambient warehouses we have been able to bring them altogether to 23 which will help us not only reduce cost but also enhance customer service. We had mentioned overall about 40 crores of overall synergy benefits some part of it has been accrued already. We believe the substantial portion will happen over next 3 to 4 quarters because the entire for example, C&F consolidation the lower cost starts operating from now from 1st January. So we will have some of those benefits coming through in the following quarters.

Tarun Arora: So, if I have to summarize on the distribution front and the cost to serve front we have done majority of all the synergies in terms of what we want to do and finish the transformation. In terms of sales force efficiency we are still rolling out some of the digital tools to make that better and also one major step we have taken is integrating our SAP ECC system to the next generation S/4HANA in a record period of less than 4 months. So, among all of these majority of the integration is over and now you would see the improvement in both distribution and fieldforce effectiveness and also cost efficiency.

Tejas Shah: And sir last question, academically usually such acquisitions also brings its own surprises. So, one year done in this marriage are you more surprised by margin volatility because of underlying commodity basket being different or largely on growth front? Just academic question.

Tarun Arora: So, I would say on the growth front we have not had any if you take an overall point of view on the acquired business we have not had major surprises other than Complian which struggled for the first half of the year. But it was overcome by better performance on Glucon-D and Nycil which are more market leaders. So, I would say we are on track in terms of what we have planned for in terms of brands. On the cost, raw material input is that has been a surprise to us. We did assume an increase in cost but we did never assume the substantial cost escalation both on milk pricing as well as oil pricing. I think they are probably at their peak

right now. So, we are hoping that they will ease over the next few quarters. But that is the major surprise so why we had built in some inflation more than market but this has gone way beyond our control.

Moderator: Thank you. The next question is from the line of Akash Oza from Chartered Capital. Please go ahead.

Akash Oza: Sir, I have a few questions on the cash flow. Could you help us with the 9 month operating cash flow numbers and the cash flow generated in 9 months? And I just wanted to know that in a full year operation what is the approximate operating cash flow that the company might generate? Yes, that is it.

Umesh Parikh: 9 months we do not prepare cash flow segments. It is prepared on a half yearly basis. So the numbers which we have given last quarter we have already given the cash flow as well. On an overall year basis if you are asking , the cash flow could be to the extent of 140 crores-150 crores a year.

Akash Oza: Sir, so my second question is on the payback period of the debentures. So, since after FY22, I was reading in the PDF that we are going to do it in 3 yearly tranches of I am assuming it will be 500 crores every year. So, what are your plans on repaying the debt because of the operating cash flow will not be enough. So, how are you planning to pay this money back?

Sharvil Patel: No, we still believe that operating cash flow would be enough to meet the requirement.

Moderator: Thank you. The next question is from the line of Srinish Pardesi from Centrum. Please go ahead

Srinish Pardesi: I have 2 questions. One is on the acquired assets of Aligarh plant and Sitarganj plant. Is this plants need some further refurbishment and what is the capacity realization of these plants?

Tarun Arora: So, both these pants do not need any significant investment. I think we have sufficient capacity in both these plants, specifically in Aligarh, we can use it much more than what we are using and that is one of the ways to manage our cost better. Similarly for Sitarganj, so there is no major CAPEX that is required for ...

Sharvil Patel: Our plan is going forward to have a utilization of close to 75% to 80% on our Aligarh plant.

Srinish Pardesi: The other question I have on Zydus Wellness International DMCC sub what we have created. Just wanted to understand what are the scope and what are the growth plants, what are the strategies which we are seeing we will deploy in next 3 to 4 quarters?

Tarun Arora: So, we have clearly defined markets which this entity will look after. It is Middle East Africa and South East Asia in specifics. We have of our base business, Sugar Free and Everyuth and Nutralite already having started in some of the markets. With the acquisition, we have been

able to take Complan from Kraft Heinz global which is present in New Zealand, Taiwan, Nigeria, Middle East and couple of other countries as we are expanding. And we believe put together this could be a sizeable business which will make it profitable. It will also become our endeavour opening these countries and making us sizeable presence in some of these markets. So, over next 3 to 4 quarters as we are resourcing it, we believe it will be about 3% to 4% of our business in next financial year.

Srinish Pardesi: Any quantitative numbers you would like to put say from 1 year from now what will be the contribution from this?

Tarun Arora: So that is why I said 3% to 4%, of the business will come from there. I am expecting a 100 crores plus business over next 2 to 3 years may be more. We are putting our strategies further if we want to add more products and how can we innovate, support them on specific innovations for international markets beyond where we are.

Moderator: Thank you. The next question is from the line of Govind Sahu from India Nivesh PMS. Please go ahead.

Govind Sahu: Sir, just couple of questions. One is regarding clarification that you are saying that 44 crores was the approximate one-off cost in the first 9 months and in the last concall, if I recall this number was 33 crores. So, is it fair to assume that for the quarter 11 crores is the one-off cost, the integration cost?

Umesh Parikh: Yes, that is right. But we could not foresee any further cost.

Govind Sahu: So, this is the end of we are behind the integration costs?

Umesh Parikh: Hopefully, we have done, yes.

Govind Sahu: Sir, my next question is that since there is a high seasonality in our current business and current product portfolio. Are we planning to get into some winter products was to mitigate this seasonality?

Sharvil Patel: Yes.

Govind Sahu: Can you give little more color on it what would it be like?

Sharvil Patel: So, currently we are not able to tell you because obviously once we have critical launches we can talk about it but for lot of our brands like Nycil and Glucon-D we are looking at seeing opportunity beyond summer. And then we have strong brands like Nutralite which have a very strong base in the winter season. So, extensions on Nutralite also will help balance some of this out. So, I think it is a journey it will take 3 years before we are able to balance out overall revenues. But we do have plans to and like extensions to the ranges of current brands that we have to improve on this skewness of summer versus winter.

- Govind Sahu:** And sir, my last question is regarding the input cost because, I mean do you see this continuing over a period of next 2-3 quarters or how do we because the gross profit is highly impacted because of the input cost?
- Sharvil Patel:** So, there are, so I would say, see there are some external factors that have led to some of this. One is the ban on oil procurement from Malaysia by the Government of India has created a big skew in terms of spikiness in the prices of oil and we hope those will stabilize in the next few quarters. So, that is one I feel it is temporary and not long terms. Also the commodity pricing and procurement pricing on milk which is issue for the whole industry now, because of governments reason to ban import of S&P which is a very unfortunate , so India has the highest S&P price in the world right now because of this initiative or this lack of decision by the government. So, that has also led to a very, exceptionally high pricing of milk as well as S&P. So, I think those 2 are very critical, it's tough to say oil I do believe that it will stabilize. Milk I also feel is that a very high price right now and we are hoping to see if there is any I do not think the very short term there is a chance but I am sure mid-term those will also correct.
- Tarun Arora:** I can give, from a 3 to 4 quarter perspective I think we are not taking any major **reaction**. We have taken some small price increases. We will wait and watch for 1 or 2 quarters and if required through a mix of cost reductions and additional price increases we will be able to absorb it over a 3 to 4 quarters but we will not do it in next 1 or 2 quarters because we will understand.
- Sharvil Patel:** We also have to remain competitive on that.
- Govind Sahu:** Sir, just on this in the short term or the near term, is extended winters having will have any impact this season on our Q4 sales?
- Sharvil Patel:** So, we assume normal summer from April, so yes if the winter is extended which is not the current focus. But if it in then it could have an impact but currently that is not what we are seeing.
- Tarun Arora:** So, last year was an extended winter but I think at between the 2 quarters it usually balances out. So, we believe that the overall season, we still have a positive hoping beyond that.
- Moderator:** Thank you. As there are no further questions, I like to hand the conference back to the management team for closing comments.
- Tarun Arora:** Thank you very much and we will reconnect next quarter with the Quarter 4 Results and Annual Results. Thank you very much.
- Moderator:** Thank you very much. On behalf of Zydus Wellness Limited, that concludes the conference. Thank you for joining us, ladies and gentlemen, you may now disconnect your lines.