



“Zydus Wellness Q1-FY16 Post-Results Conference Call”

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MANAGEMENT: **DR. SHARVIL PATEL – CHAIRMAN, ZYDUS WELLNESS LIMITED**
MR. TARUN ARORA – CHIEF OPERATING OFFICER & WHOLE-TIME DIRECTOR, ZYDUS WELLNESS LIMITED
DR. GANESH NAYAK – DIRECTOR, ZYDUS WELLNESS LIMITED
MR. AMIT JAIN – CHIEF FINANCIAL OFFICER, ZYDUS WELLNESS LIMITED
MR. VISHAL GOR – HEAD OF INVESTOR RELATIONS AT CADILA HEALTHCARE LIMITED

Moderator

Ladies and Gentlemen, Good day and Welcome to Zydus Wellness Limited Q1 FY16 Post Results Conference Call. As a remainder, all participant lines are in listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Tarun Arora – The COO and Whole-time Director of Zydus Wellness Limited. Thank you and over to you, Mr. Arora.

Tarun Arora:

Thanks you. Good afternoon and welcome to the post result teleconference of Zydus Wellness Limited for the first quarter of financial year 2015-16. We have with us Dr. Sharvil Patel – Chairman, Dr. Ganesh Nayak – Director, Mr. Amit Jain – CFO, Zydus Wellness and Mr. Vishal Gor – Head of Investor Relations at Cadila Healthcare Limited.

Coming to the financial highlights during the quarter gone by, on a consolidated basis, our total income from operations was up by 3.1% year-on-year to Rs. 1,040 million. We have reduced the prices of Nutrilite in the institutional segment to achieve the higher volume and hence, sales numbers are not comparable with the same quarter last year. On a like-to-like basis the growth in income from operations would have been 4.8%. Our gross margins as a percentage of total income from operations have reduced to 71.5% for the quarter from 72% during the same quarter previous year mainly due to product mix.

Earnings Before Interest Depreciation and Tax was up by 8.8% year-on-year to Rs.168 million. EBITDA margin increased by 80 basis points year-on-year and now stands at 16.1%. Profit before tax was up by 14.7% year-on-year to Rs.223 million. Net profit was up by 14.6% year-on-year to Rs.195 million.

With that let me share some of the highlights of the operations for the quarter gone by. We continued our thrust on new product launches and launched Advance Golden Glow Peel-Off Mask which is a 15 minute home facial with a 24 carat gold collagen booster and orange peel extracts, it peels away dead skin cells and dirt from within the skin pore stimulates blood circulation and oxygen supplies and helps in boosting the production of collagen. As per MAT June 2015 report of Nielsen, the artificial sweetener category has grown by 9.1%, Sugar Free has maintained its number one position with a market share of 92.5%. The scrub category has grown by 6.7%, Everyuth Scrub has maintained its number one position with the market share of 31.6%. The Peel-Off mask category has declined by 6%, however Everyuth Peel-Off Mask has gained market share by 100 basis points and maintained its number one position with a market share of about 91%. The margarine category has grown by 6.5%, the Nutrilite has gained market share by 660 basis points and maintained its number one position with a market share of 40.1%. Thank you and we will now start the Q&A session, over to the coordinator for Q&A.

- Moderator:** Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Sonali Salgaokar from Axis Capital. Please go ahead.
- Sonali Salgaokar:** My first question is, could you please highlight what is the breakup of your other expenses and as a percentage to net sales why they have come down year-on-year precisely from 21.5% in Q1 FY15 to 19.1% as a percentage to net sales?
- Amit Jain:** The other expenditure includes all expenses like production, administrative, S&D and all that stuff. The reason behind that being lower than the last year same quarter is there were certain one-off last year because we have changed and we have adopted a new go to market strategy and for that we have paid some professional fees which is not there in this year.
- Sonali Salgaokar:** Okay. Sir my second question is, just an update of your go to market strategy, precisely in the last con-call it was highlighted that the procedure the overall of the distribution network has completed and the full benefits will start accruing from FY16 onwards. Any update you would like to share with us as to how the progress is?
- Tarun Arora:** Yes, so that process has been completed and we are clearly seeing that we are better equipped to handle growth and expansion for our product categories and that's why we see some market share improvements at least in Nutrilite. You are seeing we are already there and the task remains consistent as we have explained in terms of growing some of the categories we are in, we are quite well equipped, processes has settled down. This is a new process, we have adopted last year. They will be part of the learning curve but we are quite comfortable. The organization is pretty comfortable with the way we run it. The benefits we see going ahead and that's the only really the benefit we see in this financial year coming as we are looking at expanding our direct reach using this model and that clearly will be the driver for us going ahead. So driving distribution would be one of the benefits that we expect this model to do. We are already seeing for example in last quarter we have seen a distribution or reach for Sugar Free going up by 5% reported by Nielsen, even other categories also we have seen our distribution reach going up but Sugar Free our flagship brand has increased by 5%, our market share for Nutrilite has gone up. So we are seeing some of those results coming out as we speak.
- Sonali Salgaokar:** Okay, sure. Sir regarding your first initial commentary that you have reduced the prices in Nutrilite in order to thrust volumes especially in the institutional segment, so I understand that you do not share exact segment wise growth numbers but qualitative can you at least highlight as to off your three segments that is Everyuth, Nutrilite and Sugar Free which segment has grown the highest in terms of volumes, it would be better for us to understand the product mix.
- Tarun Arora:** We can clearly say that Nutrilite has done very well for us, it is showing in the market share and some of our actions are showing quick results there.

- Sonali Salgaokar:** Sure sir. And the last question from my side, in terms of ad spends, sir if I look at the quarterly data say over the last 10, 12 quarters your Q1 has always registered the highest ad spends, sir any particular seasonality in ad spends that you follow?
- Tarun Arora:** Yes, so yes we clearly see that it is a season for cleansing category and therefore we have traditionally spent a lot more.
- Sonali Salgaokar:** Sorry I did not get that, it is the season for...?
- Tarun Arora:** For Everyuth.
- Sonali Salgaokar:** Okay, so basically the higher ad spends is because of seasonality especially in the Everyuth category?
- Tarun Arora:** Yes.
- Moderator:** Thank you. Our next question is from the line of Lakshmi Narayanan from Catamaran. Please go ahead.
- Lakshmi Narayanan:** Just pertaining to Nutrilite business, now what is your broad, I mean you talk about market share increase, is it you are taking both institutional and the non-institutional part or how is it calculated? And second, what is the split of the market between institutional and non-institutional for industry as well as for us?
- Tarun Arora:** Okay. First of all I think your first question is the markets share, this was captured through Nielsen and Nielsen is focused only on retail, so when I am sharing the market share we are sharing the retail market share, so retail market share has gone up as I have reported earlier. Overall, institutional versus retail we have a 70-30 split of the industry.
- Lakshmi Narayanan:** And this as a percentage of the total spreads market, so I mean how large this can actually go up to that will be very helpful to understand because you have the butter category which is one, and second one is the margarine one, so what could be the growth or it can actually achieve in the next couple of years?
- Tarun Arora:** So overall butter and table spreads all those categories put together Nielsen reports a 1000 crores as a category and that is largely retail.
- Lakshmi Narayanan:** And institutional how large it could be in your opinion?
- Tarun Arora:** Look, if you want to get a lot more detail I think, typically institutions should be three times but I think we can get into more details later on.
- Moderator:** Thank you. Our next question is from the line of Ashish from Elara Capital. Please go ahead.

Ashish: Sir I just wanted to understand on the distribution, now that it is settled and probably this quarter we would be running with kind of stable setup overall and you said that the reach has increased by 5% but still we are looking at numbers of say 3% kind of top-line growth, so any comments to offer on that, why it would be such a small number because at least the sugar free category has been demonstrating pretty good growth all these years?

Tarun Arora: So realistically speaking we have got about close to 4.8% growth but what we are building forward is for a higher growth and I think just to give you a sense of what we are believing is the key drivers of growth is more on the distribution, expansion and the investment on the category development that we are doing and these are two fundamental drivers of growth. We are clearly seeing one or two categories responding faster, couple of other categories will respond over a period of time but I think our actions remain consistent on two fronts, if I may repeat, distribution expansion and category development through communication to the consumer and reaching across various touch points.

Ashish: Sir category you said a couple of categories are responding to the new system, so these would be categories or sub-categories that you are seeing within the three kind of platforms that we have for three categories?

Management: So I think we are getting good response across the board, let me just say, it may not show, for example we do not give a brand wise breakup but clearly in each of our three brands we have seen our distribution reach expanding, I have given you example of Sugar Free it is going up, Nutrilite we have seen growing up and Everyuth specifically in sub segments we see expanding of distribution, we believe we need to expand even more aggressively and like I mentioned we have significant market share so therefore the battle is not at the market share level but more at getting more consumers in and therefore it has to be a balance of both.

Ashish: Okay. Sir finally what is the outlook on reach expansion, overall distribution expansion if you could give maybe a year or two year down the line where you were right now and what do you target this reach to go to?

Tarun Arora: So look, individually each of our brands are at about 300,000 outlets as reported by Nielsen, if I were to look at Zydus Wellness that number will be much-much higher because there may not be an overlap of outlets, we can share those numbers over a later period of time. We are expecting that distribution reach to go up significantly and I think I do not want to give a formal exact number but we are working on a significant expansion on that base because for us this category to grow it is very important to make them more accessible to both consumers and really therefore our thrust would be and I can give you an insight, one level lower is that we have had a legacy of being very strong in chemist and pharma channels, we are also going to be looking at how do we expand our growth, reach and all those various parts to it. So we are really working on distribution expansion beyond where we are currently.

Ashish: Sir but was the earlier setup of distributions such kind of bottleneck that we could not plan increasing our reach to this extent, I mean just some flavor on definitely how the distribution

restructuring is helping you in this because you could have taken that call of maybe doubling that reach otherwise also, isn't it?

Tarun Arora: Yes, so the reason of changing the distribution was not that there was a problem but in distribution I think this is the model which is more equipped to handle expansion, it allows expansion at a faster pace and execute far more quickly and that is the logic of changing this model, it is a model followed across FMCG industry. It is not just our model but it is a proven model which really works. We could have done that even with an earlier setup, we would have hired on rolls larger number of people, I am not even talking about resources yet but just the execution resources require to do that would have been far higher. Right now since we are using outsourced model working with our distributors to expand our reach and having processes to enforce it allows us the faster expansion. I am not saying that the earlier system there was something wrong and I could not have expanded. We could have very well done it, it is just that this is a model so from FMCG point of view it works, it is proven and we can name a list of host of FMCG companies who follow this model, so that is it.

Ashish: Sir the point that I am trying to understand is whether the problem was on retailers accepting our brands to keep it with them and that is why probably our reach has to number our outlets was expanding, probably that was one of the major reasons, not the distribution setup, if I am correct on that?

Tarun Arora: I do not think it is that kind of a problem, I think we can get into more details, I don't think it is just a retailer acceptance, it also about there are multiple factors that we will have to look at and it could be the throughput per retailer. It could be also when you are expanding more retailers what kind of cost of sales and various other KPIs that we will have to work on and all these model allows us to work on those process parameters. I think that is really what it is. We can get into a lot more details on a separate time.

Moderator: Thank you. Our next question is from the line of Umesh Patel from Sharekhan. Please go ahead.

Umesh Patel: I just wanted to know sir how many new products that we are planning to launch across three categories, as you have rightly said that we have increased our distribution reach by 5% and also investing across categories so if you can give us some sense by each category about the product mix or new product launches that is expected in coming quarters?

Tarun Arora: I think we have several products in our innovation pipeline and we have a dedicated R&D which works on various products, but it would be premature to share any products at this stage that we are going to launch. We would be only happy to share at an appropriate time when they are ready to go to the market.

Umesh Patel: Okay sir. And how many products we launched for the full year in FY15?

Dr. Ganesh Nayak: So we launched five products in FY15.

- Umesh Patel:** Okay. So can we expect it in FY16 to be in similar line?
- Tarun Arora:** It would be hard for me to give you a number because what is important is not just a number of products we launch but also the quality of our launches and it is not very difficult for us to match that number but I think it will not be fair for me to share that number.
- Umesh Patel:** Okay. And the last one is sir, I missed the earlier one, actually you gave some growth across the categories if you can share it again like in Sugar Free what was the growth during the quarter, Nutrilite and Everyuth?
- Tarun Arora:** So we do not share brand wise growth numbers.
- Umesh Patel:** Earlier you said that Nutrilite grew by around 6%, peel-off declined by 6%?
- Tarun Arora:** All those were category growth rate. These are the category growth numbers we have given, our market share in Nutrilite grew by 6.5% in the margarine category, this is the subset of the overall spread including butter and margarine.
- Moderator:** Thank you. Our next question is from the line of Amit Purohit from Dolat Capital. Please go ahead.
- Amit Purohit:** Sir just want to check you indicated about product launches and new initiatives in each of the categories, would it also change your ad spend to sales ratio in terms of going forward or should it be?
- Tarun Arora:** We right now have plans to maintain our ad spend ratio of 21%.
- Amit Purohit:** Okay. And sir any update on Stevia, you had kind of a test launch in Gujarat market and you were waiting for some approvals.
- Tarun Arora:** It is too early, I think it is too early to talk about it, we are test marketing, and we will study and come back to you.
- Amit Purohit:** Okay. And when do you expect the growth prospect, I know it is a difficult question but generally I wanted to understand is that now couple of quarters you have been indicating that there has been some issues at the distribution side more from a push by the marketing team of the distributor to expand the reach, so that communication has been settled and now coming quarters could see strong growth or what you see?
- Tarun Arora:** Yes, coming quarters should see better growth.
- Moderator:** Thank you. Our next question is from the line of Ankit Gor from Systematix. Please go ahead.
- Ankit Gor:** If you can throw some light on how the Actilite and Everyuth Men is doing, if you can just give some highlights on that.

- Tarun Arora:** So while I cannot give you specific brand wise details, overall I think Actilite we are anyways relooking at the franchise and Everyuth I think we have always explained scrubs and peel-off has done very well, has grown share.
- Ankit Gor:** Okay. And sir we had allotted some of money for acquisitions and everything, so have we planned out to do something on it or how it is?
- Tarun Arora:** Yes we have planned to work on acquisitions.
- Ankit Gor:** Okay sir. And one last question from my side sir, if we can have some breakup on Sugar Free, likewise in institution and retail business if you can give some breakup?
- Tarun Arora:** Sugar Free is largely a retail business.
- Ankit Gor:** It is largely a retail business?
- Tarun Arora:** Yes.
- Ankit Gor:** And globally this Sugar Free artificial sweetener market is de-growing so what is your take on the Indian business, is it likely to follow that texture or how it is if you can just share your thoughts on it.
- Tarun Arora:** No, Indian market is not likely to follow the global market. There is still potential to get growth there.
- Moderator:** Thank you. Our next question is from the line of Jinal Sheth from Multi Act. Please go ahead.
- Jinal Sheth:** Continuing the question on the Sugar Free, just wanted to understand that what is the growth potential over the next there to five years, I mean just sort of trajectory that and considering that we had already seen, correct me if I am wrong, not strong growth or sir just wanted to get a feel of growth potential in Sugar Free in the market.
- Tarun Arora:** So while we cannot share our future guidance, we can only share with you is that the penetration levels are low and we still see a lot of opportunity to drive penetration and consumption.
- Participant:** Okay. Can you at least share the fact that what has been the growth in the last couple of two to three years roughly and considering we are majority of the market so has the market really been growing, are we doing anything, or are we seeing that penetration improve, any thoughts on the same?
- Tarun Arora:** So I will not be able to share those specific numbers because we do not share the brand wise levels but as I have clearly mentioned we are focusing on category expansion, we have seen

some of those response coming through and it should show over a period of time in results as well.

Participant: Okay, sorry but are we seeing single-digit growth in that brand or we are seeing double-digit growth just if you could share that?

Tarun Arora: It will be unfair for me to share.

Participant: Okay that's fine. And just last question, what would new products as a percentage of sales be, can you share that?

Tarun Arora: So we do not really report new products as a percentage of sale. It is part of the overall portfolio till we decide to start sharing it I think it will be unfair to put that on the call.

Moderator: Thank you. Our next question is from the line of Lakshmi Narayanan from Catamaran. Please go ahead.

Lakshmi Narayanan: I have two follow-up questions, one is, Sugar Free has two parts, one is the aspartame the other one is the sucralose one and is the market number one, moving towards a more sucralose than an aspartame, what are the trend you are seeing? And second, do the customer make decision based on I mean are they intelligent enough to make decision, if so what efforts we are doing to ensure that they are actually picking aspartame or sucralose, right because both have a different positioning as well as a different pricing, that's one on the mix of those two.

And the second question is or the third question is that somewhere in December last year there was a news that floated around saying that Splenda is up for sale and I remember you had mentioned two or three quarters back that there isn't anything you have actually heard off from there, so just wanted to hear what has happened there, if you have any insights to that. So these are my three questions sir.

Tarun Arora: Sorry, on the aspartame and sucralose I do not think consumers see it as aspartame, sucralose; just to give you a very quick answer on this, I think we are building it as a different application and we are seeing good traction on both side, I cannot say that we are getting in to trend of one shifting to another, I do not think consumers look at it and we are seeing good...

Lakshmi Narayanan: Consumer getting educated at the point of sale, because anecdotally if I walk into any of these malls even if both are present and customer has just picked one over the other then how do you ensure that the customer understands the right product and he is picking it?

Tarun Arora: So instead of telling customers that aspartame and sucralose and getting into technicals, we are clearly positioning it separate, one is for table top, tea, coffee, more consumption and the other one is more for culinary application and that is how we are building our brand and I think consumers are responding positively around that and we are therefore seeing positive traction around both of them on that.

- Lakshmi Narayanan:** Is it right to say that the sucralose percentage is actually going up in the overall pie for the industry?
- Tarun Arora:** Yes, but I would not be able to share more details on that, yes you are right. Coming back to your question on Splenda, I do not think we have any update on that.
- Moderator:** Thank you. Our next question is from the line of Deep Master from Enam holdings. Please go ahead.
- Deep Master:** Sorry sir. I missed the part about your comments on Stevia so when are you planning a nation-wide launch?
- Tarun Arora:** We have not really put a date to it because we need to first test market, check how the response comes, too early to even have an idea on that. It is still early because a lot is written in the media on Stevia but actual adoption maybe a far distant so we will first learn about it and when we are ready to launch we will be happy to share.
- Deep Master:** Has the response been as your expectations?
- Tarun Arora:** It is initial days, too early to share that with you.
- Deep Master:** Okay and lastly, just on co-branding, globally Splenda does quite a bit of co-branding with other sort of brands, drinks and popcorn and sauces and spreads, would you be willing to enter the segment and explore that?
- Tarun Arora:** Yes, we are willing to explore and there are one or two small things we have even explored, so obviously we are willing to explore.
- Deep Master:** And the sucralose is mainly for table top, right?
- Tarun Arora:** Table top is largely aspartame that's now being used, sucralose is right now going more for culinary applications.
- Moderator:** Thank you. Our next question is from the line of Tejas Shah from Spark Capital. Please go ahead.
- Tejas Shah:** In past sir management has shared this insight that on Sugar Free distribution alone can drive brand and category growth rate, so just wanted to check if there is any new insight on the same first. And second, if not then what additional measures we are taking this time around to increase brand's acceptance and category's acceptance?
- Tarun Arora:** Sorry, I think you have been misconstrued unfortunately because distribution expansion is a very critical element but not the only thing to drive category. There are multiple ways of growing this category and distribution expansion obviously is important factor, the other factor

which we are working on and we are investing behind is Sugar Free brand building and communicating to consumer the benefits of switching to sweetener from sugar and that communication will help us in growing the category. So we are doing it through various touch points through TV but as well as digital and other measure, so various touch points and making it more accessible through multi-distribution reach, that clearly sums up the overall approach to grow the business.

Tejas Shah: Would Sugar Free be your most distributed brand in your portfolio?

Tarun Arora: Yes, almost, yes.

Moderator: Thank you. As there are no further questions from the participants I now hand the conference over to Mr. Tarun Arora for his closing comments.

Tarun Arora: Thank you very much. I look forward to seeing from all of you over the next quarter, thank you.

Moderator: Thank you very much members of the management. Ladies and Gentlemen, on behalf of Zydus Wellness Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.