



“Zydus Wellness Limited Q3 FY15 Post Results
Conference Call”

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Moderator:

Ladies and gentlemen, good day and welcome to the Zydus Wellness Limited's Q3FY15 post results conference call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Elkana Ezekiel – Managing Director of Zydus Wellness Limited. Thank you and over to you sir.

Elkana Ezekiel:

Good evening and welcome to the post results teleconference of Zydus Wellness Limited for the third quarter of FY15. We have with us Dr. Sharvil Patel – Chairman, Dr. Ganesh Nayak – Director, Mr. Nitin Parekh – CFO, Zydus Group, Mr. Amit Jain, CFO, Zydus Wellness Ltd. and Mr. Vishal Gor – Head of Investor Relations at Cadila Healthcare Limited.

During the quarter gone by, on a consolidated basis, our gross sales was up by 10.3% year-on-year to Rs. 1,140 million. Our total income from operations was up by 16.8% year-on-year to Rs. 1,137 million. This includes Rs. 67 million recognized under the head excise duty which refers to the additional excise duty credit accrued for the period April-December 2014 based on the order passed by the Office of the Commissioner of Customs, Central Excise & Service Tax for the fixation of special rates of excise duty for the years 2011-2012, 2012-2013 and 2013-2014. Out of this, Rs. 21 million pertained to the current quarter and Rs. 46 million pertained to the period April-September 2014, excluding which the total income from operations was up at 12.1%. Our gross margins as a percentage to total income from operations, excluding the impact of additional excise duty credit for the period April-September 2014 stood at 68.5%.

Earnings before interest, depreciation, and tax were up by 10.1% year-on-year to Rs. 295 million. EBITDA margin stood at 25.9%. Exceptional item of Rs. 155 million refers to the amount recognized for the credit of additional excise duty for the years 2011-2012, 2012-2013 and 2013-2014 received by our partnership firm Zydus Wellness, Sikkim pursuant to the order passed by the Office of the Commissioner of Customs, Central Excise & Service Tax for the fixation of special rates of excise duty. Profit before tax and exceptional items was up 13.3% to Rs. 343 million. Excluding the impact of increase in depreciation charge due to revision in useful life of the assets, growth in PBT was 15.7% year-on-year. Net profit excluding exceptional items was up by 13.3% to Rs. 303 million excluding the impact of increase in depreciation charge due to revision in useful life of the assets, growth in net profit was 15.8% year-on-year.

Let me share some of the highlights of the operations for the quarter. During the quarter, Everyuth Naturals Advanced Hydro-Active Walnut Apricot Scrub was launched. It was the first scrub in India with revolutionary hydrogen technology. Hence unlike ordinary scrubs which leave the skin dry, Everyuth Natural Advanced Scrub gives the skin superior moisturization for up to 8 hours. The initial response has been encouraging.

As per the MAT December 2014 report of AC Nielsen, the artificial sweetener category has grown by 9.7%. Sugar Free has maintained its number one position with a market share of 92.2%. The scrub category has grown by 10.2%. Everyuth Scrub has maintained its number one position with a market share of 31.9%. The peel-off mask category has declined by 6.7%; however, Everyuth Peel-Off Mask has maintained its number one position with a market share of 91%. The margarine category has declined by 6.9%. However, Nutralite has maintained its number one position with a market share of 36%. Thank you and we will now start the Q&A session. Over to the coordinator for the Q&A.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We have our first question which is from the line of Amit Purohit from Dolat Capital. Please go ahead.

Amit Purohit: Sir, two things, one is just want to understand the growth rate of the Sugar Free, sugar substitute as a category, so you said 9%. Is it for the quarter or this is 9-month number?

Management: It is on a 12-month basis of the calendar year January-December 2014.

Amit Purohit: Okay and are you seeing significant slowdown in this category or what is the reason for lower growth or is it because as a market leader we have been going through restructuring and that is impacting the overall category growth?

Management: That is partially the reason.

Amit Purohit: And how is our distribution restructuring now shaping up actually?

Management: The distribution restructuring is practically complete. As I had said in earlier calls, we have basically moved to a model which has an industry standard. From our point of view, it is new so, there is a certain amount of learning that is taking place. In terms of our investments in marketing spending, those will continue and we have new campaigns planned on most of our businesses including Sugar Free which you were asking about.

Amit Purohit: And actually considering gross sales growth of 10% and given the fact that we have done the distribution expansion and all, so is there something more which will come in the coming quarters because I was just thinking that since our first half number were muted because of distribution restructuring, second half should have been very strong right at the gross level.

Management: See, the new distribution model, which is the change in distribution got implemented as of August 2014, which is basically just moving the distribution from direct distribution to the distributors who are going to have sales reps. Now the real benefit of increase in distribution will start from this year onwards, by which, we will be able to add more points of distribution or expansion and at the same time, I think last year, there has not been a very high off-take. When we have new campaigns coming out from the month of February onwards, we hope that higher off-take will happen.

Amit Purohit: And any guidance on the overall advertising spend, sir?

Management: For this year?

Amit Purohit: Yes, this quarter has been very strong, so is that World Cup or so probably?

Management: No. This quarter, it is very high because last year we had a very low base. In fact, we had a de-growth in advertisement expenses, we had curtailed a lot of expenses last year. This year, the advertisement expense ratio will be remaining the same and it will be around 18%.

Amit Purohit: And lastly on this excise duty, can you throw some light, I mean what would be the excise rate going ahead and that will be helpful sir.

Management: See, excise rate is the normal rate which is prescribed under the Excise Act. Sikkim being the industrially backward state, government has announced certain tax incentives. What the rule says is that once you pay the excise duty, you have to file your claim for refund or re-credit of the excise duty to the Excise Authorities. Accordingly we have been filing our claims for last 3 financial years. In this quarter we have got the favorable order which is by way of increase in the recredit rate which is prescribed by the notification at 36% to 73.45% in the case of Sugar Free. That rate has given us the exceptional income. Based on that order it is very much certain that the facts which have been mentioned by us to the Excise Authority have been accepted. We are confident that these rates will continue for the future as well.

- Amit Purohit:** So you will be continuing to pay 6.5 kind of an excise duty and then claim later, is that the case going forward also again?
- Management:** For example, for this financial year which is FY14-15, we have already made our claim to the Excise Authorities. So based on the past order which we have received which states that the excise re-credit rate has been increased, we have taken that order into account and accordingly we have booked the additional re-credit which we are likely to get for the future years. So for April to December period, we have booked based on the past order and we will continue to book in every quarter based on that order or the new order whichever it comes.
- Amit Purohit:** So what would be the effective rate based on the calculation that you said, would it be 2% now I mean excise duty?
- Management:** Again based on that order, re-credit is around 2%, so our excise duty rate right now on an average is around 7% which will come down to 5%.
- Moderator:** Thank you. Our next question is from the line of Koustubh Pawaskar from Sharekhan. Please go ahead.
- Koustubh Pawaskar:** Sir my question pertains to quarter 3 performance where the revenue growth has been 10%. So that is after your excise duty of 6.7 crores whatever credit you are getting in gross sales, so this 10% growth, it has improved on sequential basis. So we can understand there is a base effect of quarter 3 FY2014 but on a category front, have you seen any improvement for example scrubs or face wash, any kind of improvement in terms of sales?
- Management:** We have seen an improvement in the market shares in peel-off and in scrub, face wash although remained competitive.
- Koustubh Pawaskar:** Okay and in terms of growth rates?
- Management:** In terms of growth rate, it is pretty much the same.
- Koustubh Pawaskar:** So the 10% growth, is it fair to assume that the large part of growth is because of the Sugar Free?
- Management:** Sugar Free, Nutralite, entire portfolio has grown in a fairly balanced way.

- Koustubh Pawaskar:** Okay, got your point sir, and sir this gross margin improvement whatever it is there for the quarter, it is mainly because of the better revenue mix or you have also seen any decline in the input prices?
- Management:** See gross margin increase was mainly because of the excise credit which we have booked in this quarter. Even if we exclude that impact, it is more or less flat and this quarter being the season for Nutralite business, it was expected to go down but we could maintain the gross margin at the last year level.
- Koustubh Pawaskar:** And sir, going ahead because the prices are falling, so any expectation in terms of improvement in gross margins from current level, maybe FY2016?
- Management:** No, we will be maintaining at this gross margin levels and we do not see any pricing pressure right now.
- Moderator:** Thank you. Our next question is from the line of Sandip Sen from Credit Suisse. Please go ahead.
- Sandip Sen:** What is the reason for decline in this margarine and peel-off segment even in this quarter?
- Management:** So on a sequential basis, the market becomes typically very competitive in terms of margins in the winter months. So, overall we have seen favorable growth in the absolute volumes as well as in the sales value, but the market does get competitive at this time of the year and peel-off is a category which genuinely needs a lot more stimulation which is why there are new campaign plans in the forthcoming months.
- Moderator:** Thank you. Our next question is from the line of Grishma Shah from Malabar Investments. Please go ahead.
- Grishma Shah:** My question is pertaining to Nutralite; given that the raw material prices have fallen significantly, have we corrected our prices one in the retail and two in the institutional segment if you could highlight that?
- Management:** Retail, we have not corrected our prices but in institutional segment, we have corrected the prices by 8%.
- Grishma Shah:** And within the Everyuth portfolio, especially on the face wash, as you mentioned that the category has remained competitive, just wanted to check that the last launch which is the Tulsi Turmeric launch, did that help us stem the market share loss, how do you read that?

- Management:** So that is a big part of the reasons why our market share is what it is today. That launch contributed positively to the overall volume of the business. Without that launch, we would have probably been somewhat on the backward.
- Grishma Shah:** How about introducing more products within the Everyuth portfolio apart from the scrub that we have launched, are there more products in the pipeline?
- Management:** So if you are referring to new categories, as of now we are not planning to enter any new categories, but if you are referring to new products within the existing categories, there are plans and you will see some of that in the market in the near future.
- Grishma Shah:** Okay and within the artificial sweetener, any particular reason apart from the distribution restructuring reason that we have not been able to grow in this category?
- Management:** No, firstly we have been growing in this category and secondly distribution is one of the challenges. In any case, to complement the distribution, we are creating new campaigns which will go live by the end of February.
- Grishma Shah:** And any price increases that we plan both for the Sugar Free and the Everyuth portfolio going ahead or have we taken any in the 9 months?
- Management:** So as of now, no price increases are planned.
- Grishma Shah:** Okay and in the 9 month, was entire growth led by volumes or there was some price increase in the beginning of the year?
- Management:** So, there was some price increase on Sugar Free but going forward, there are no price increases we have planned.
- Management:** It is marginal.
- Moderator:** Thank you. Next question is from the line of Ashish Urganlawar from Elara Capital. Please go ahead.
- Ashish Urganlawar:** Sir just wanted to understand given the fact that sweetener category growth that you have mentioned about 10% and the market share has remained at the same levels, does it mean that all the three key products for us delivered approximately same kind of topline growth in this quarter?
- Management:** That is right.

- Ashish Uppanlawar:** And sir just to get my numbers right, if you adjust for the excise thing on the topline, so does that mean that our like-to-like profits would have come down this quarter if I adjust for that excise part on the next year?
- Management:** It would have gone up by 15.8% if we exclude the exceptional item and the change in depreciation rates.
- Ashish Uppanlawar:** Sir, actually I am getting a negative figure. I do not know on the EBITDA in terms of de-growth basically because if I add back the 6.7 crores on the excise line, so I am getting a decline, so I do not know where is it going wrong?
- Management:** I was referring to profit after tax. At the EBITDA level, yes because of significant growth in the advertisement and sales promotion, etc.
- Ashish Uppanlawar:** Sir, on the distribution restructuring, just wanted to understand why is it taking so much time because I think you said somewhere around August-September this thing was over, so what is happening on the ground if you could help us understand as to why it takes so much time in order to deliver the numbers, I mean just a sense of where things are headed actually?
- Management:** So the model like I said is not new to the industry but it is new to us. So we have a set of distributors who are accustomed to working in a certain way and we have a set of company people who are also accustomed to working in a certain way. We have inducted more than 700 distributor reps across the country Getting them to settle down and work as per company norms and service to the level of intensity which existed when our company reps were in the market is something which is taking time.
- Ashish Uppanlawar:** But you are absolutely confident that couple of quarters' time, the growth rates will definitely improve big time, is it??
- Management:** If you see on a sequential basis i.e. on a q-o-q basis, the growth rates are improving and we expect that trend to continue.
- Ashish Uppanlawar:** So you are saying that our problem was more of push rather than the pull factor, is it because we are banking more on distribution to get us growth, though we are making efforts on the pull factor plus new launches of the same products. So are you seeing that this was the major problem and this will sort out issues as far as sales growth is concerned?
- Management:** No, I think just to be clear, the efforts are maintained on both fronts. One is off-take generation which is through consumer programs, direct to consumer advertising, sales

promotion and so on and the second is distribution expansion. We have changed the distribution model which has impacted our availability to some extent and the level of servicing in the market. As the model settles down and as our new off-take generation programs come on air, growth will improve.

Ashish Urganlawar: Sir finally one small thing. On the ROI promise that you would have made to the distributors, is it something coming on the P&L this quarter itself in the other expenditure line probably?

Management: Yes, it is there in the other expenditure.

Ashish Urganlawar: So what was the quantum of that sir?

Management: Sorry, we are not disclosing that particular figure but we can discuss this later in the separate call.

Moderator: Thank you. Our next question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.

Sonali: Just one question or clarification on the excise duty bit that you said, so currently annually the excise duty is about 6.2% as of FY14. So are we seeing it to come down to about 5% annually? I am sorry, I did not understand.

Management: Yes, you are right. Your understanding is right.

Sonali: So from which year?

Management: From this financial year.

Sonali: So from FY15, the excise duty annually to gross sales would be about 5%.

Management: Yes.

Sonali: Sure and it would continue to be similar in 2016-2017 as well.

Management: Yes.

Sonali: So secondly what would be the cash position right now that is 9 months ending?

Management: It is around 240 crores.

- Sonali:** Sir, any specific, any acquisition or what are we planning to do with the cash, any sense that we can get?
- Management:** Mostly, we are going to use this cash for acquisition but currently we do not have anything in site but we are actively looking at acquisitions.
- Sonali:** Sir but just to get a sense are you planning to enter into a niche segment already, the present segments that you are in?
- Management:** It will be tough to say because there is nothing on the table right now. So it is difficult to say as to where we will enter into, but it will be obviously in the health and wellness category which we are present in.
- Moderator:** Thank you. Our next question is from the line of Abdul Kareem from Narnolia Securities, please go ahead.
- Abdul Kareem:** Sir can you suggest about the new product launches across the categories in next couple of quarters?
- Management:** Yes, we are planning new products across categories. In fact some have already gone into markets. Stevia has been rolled out in Gujarat and there are some launches which are planned under Everyuth which will come in the next 4-6 months.
- Abdul Kareem:** Sir could you put some color on market share and what is the current level of market share of Sugar Free and Everyuth, can you suggest me?
- Management:** The Sugar Free is at about 92% and in the case of scrub, we are at about 31%, in peel-off we are at 91%, and in face wash we are at 2.5.
- Moderator:** Thank you. Our next question is from the line of Lakshmi Narayanan from Catamaran. Please go ahead.
- Lakshmi Narayanan:** My first question is recently I read an article saying that Johnson & Johnson is globally selling the Splenda brand. Now being in the industry, do you think this is something that is taking place and any thoughts around that. This is the first question and second you mentioned that Stevia product has been rolled out in Gujarat. Now are there any other player like Merisant or J&J who is having the capability to make Stevia because I remember that there have been some government permission or regulation which is actually kind of has to be tackled to sell this particular thing and the third is if you broadly look at the split between aspartame and sucralose in India, what is the kind of

split the market has between aspartame and sucralose? These are the 3 questions that I have.

Management: So firstly, we have read the news like you about J&J hiving off the Splenda brand. We have no confirmation at this point of time so it is difficult to say. On Stevia, the issue is that the notification has not yet come from the FSSAI. The law at this point of time is fairly clear. If you launch in 2 or more states, you need a Central Government FSSAI product approval which is not possible because the notifications are not out. We are launching only in the state of Gujarat. As far as aspartame and sucralose is concerned, it is about 70:30.

Lakshmi Narayanan: And is there a transition between the 70:30 when you look at say couple of years back when we first launch the two variants, has there been a gradual shift in the way in which consumer approaches it or something like that?

Management: So earlier obviously we gained market share but currently both categories are growing equally well, both molecules.

Lakshmi Narayanan: Five years back, the split was around the same 70:30 or is it?

Management: Five years back, we don't have information right now, it may have increased but both categories have been growing and now they are growing at equal rate.

Lakshmi Narayanan: In the competitive intensity, there was a talk that J&J want to get into the start selling in the B2C segment much heavily, right? Now do you see on the ground any changes in the way in which J&J is approaching it or anyone else, any activity you see? Your market seems to say that there is no activity but I just want to hear from you.

Management: So, we have heard about intense activity being conducted but nothing has happened so far. So most of the competitors are not doing anything aggressively on this category.

Lakshmi Narayanan: Got it. Now one thing on distribution given that we have changed the distribution model if you can just throw light on how many outlets you think your entire product range is kept, I mean assuming that India has around 7-8 million outlets where things are being sold? How much you think we are actually touching across India?

Management: So in the interest of time if you want the details, we can have a chat separately.

Management: Because each category will have different coverage. So we need to explain to you separately.

- Lakshmi Narayanan:** I think I will take it offline.
- Moderator:** Thank you. Our next question is a follow up question from the line of Ashish Uppanlawar from Elara Capital. Please go ahead.
- Ashish Uppanlawar:** Yes, actually I had the same question on distribution, how the current reach is of all the products and how do you expect it to improve going ahead? So I know if time permits you can dwell some time on that maybe?
- Management:** So maybe we can setup a separate call.
- Moderator:** Thank you. Our next question is from the line of Pulkit Agarwal from Karma Capital. Please go ahead.
- Pulkit Agarwal:** Just wanted to know if you give any forward guidance?
- Management:** No, actually we do not.
- Pulkit Agarwal:** What would be the key revenue and margin drivers for the company in the coming 2 to 3 years?
- Management:** If you look at the category that we compete today, Sugar Free being the best example of that, there is a very low category penetration level. We have a 92% market share, so the challenge here and growth driver for the business is expanding category penetration. The same is applicable in categories like scrub and peel-off where household penetration is very low. Face wash is the best example of a highly competitive category where obviously the intent would be to regain share. So that in a nutshell summarizes what the growth levers would be.
- Pulkit Agarwal:** Sir also pardon me if this question seems to be a bit basic, I am looking at the company for the first time. Could you throw some light on what kind of a benefit you are looking from the restructuring of the distribution channels and how is it different from what it was previously?
- Management:** So, maybe, we can have this conversation separately because we met several analysts and explained the model, it will take a lot of time for me to go through it. So maybe we can set up a separate conversation.
- Pulkit Agarwal:** Definitely sir. I will reach out to you separately.

- Moderator:** Thank you. Our next question is a followup question from the line of Koustubh Pawaskar from Sharekhan. Please go ahead.
- Koustubh Pawaskar:** Sir as you mentioned that in this quarter, the entire restructuring of distribution has been completed. So I believe that in the coming quarters, we should see some kind of a decline in the other expenditures because almost all the costs have been done by quarter 3, so from quarter 4 should we expect other expenditures coming down by some percent?
- Management:** See though the restructuring has been done, but we will continue reimbursing the subsidy burden to the distributor for some more time.
- Koustubh Pawaskar:** Okay, so similar kind of a range in the other expenditure growth should be there?
- Management:** So it is difficult to estimate right now but the cost of reimbursing the subsidy will continue and it is not that much material.
- Moderator:** Thank you. As there are no further questions, I would now like to hand the floor over to Mr. Elkana Ezekiel for closing comments.
- Elkana Ezekiel:** Thank you everyone and see you in the next quarter.
- Moderator:** Thank you. Ladies and gentlemen on behalf of Zydus Wellness Limited that concludes the conference call. Thank you for joining us. You may now disconnect your lines.