Zydus Wellness Limited Q3FY16 Post results Conference Call

February 4, 2016

MANAGEMENT: **MR. TARUN ARORA – COO & WHOLE TIME DIRECTOR, ZYDUS WELLNESS LIMITED**
MR. GANESH NAYAK – DIRECTOR, ZYDUS WELLNESS LIMITED
MR. AMIT JAIN – CHIEF FINANCIAL OFFICER, ZYDUS WELLNESS LIMITED
MR. NITIN PAREKH – CFO, ZYDUS GROUP
MR. VISHAL GOR – HEAD, INVESTOR RELATIONS, CADILA HEALTHCARE LIMITED

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Zydus Wellness Limited Q3FY16 Post Results Conference Call. As a reminder, all participants' line 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 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 -- COO and Whole Time Director of Zydus Wellness Limited. Thank you and over to you, Mr. Arora.

Tarun Arora: Good Evening and Welcome to the Post Result Teleconference of Zydus Wellness Limited for the Third Quarter of FY16. We have with us Mr. Ganesh Nayak -- Director; Mr. Amit Jain, CFO, Zydus Wellness Limited; Mr. Nitin Parekh -- CFO of the Zydus Group; and Mr. Vishal Gor -- Head of Investor Relations at Cadila Healthcare Limited.

During the quarter gone by, on a consolidated basis, our gross sales were up by 3.3% year-on-year to Rs.1,178 million. If we exclude the impact of price reduction in Nutralite and the impact of discontinued products in the last year, then our gross sales were up by 5.2%. The growth is mainly driven by improved volume growth rates in Sugar Free and Everyuth. Our total income from operations has declined by 14.7% year-on-year to Rs.1,102 million. The income from operations of the quarter-ended December 31, 2014 included Rs.223 million related to the additional excise duty credit received for the years 2011-12, 2012-13 and 2013-14 and accrued for the period April-December 2014 based on the order passed by the Office of the Commissioner of Customs, Central Excise and Service Tax for the fixation of special rates of excise duty. After excluding the same, the total income from operations was up by 3%. Our gross margins as a percentage of total income from operations excluding the impact of additional excise duty credit for the period April 2011 to December 2014 increased by 290 basis points and stood at 70.7%. The increase is mainly due to reduction in prices of the key input materials. Earnings before interest, depreciation and tax on a like-to-like basis were up by 5.2% year-on-year to Rs.239 million. EBITDA margins on a like-to-like basis has also increased by 40 basis points and stood at 21.7%. Profit before tax and exceptional item on a like-to-like basis was up by 11.9% to Rs.309 million. Net profit on a like-to-like basis was up by 12.5% to Rs.272 million.

Let me share some of the Highlights of the Operations for the Quarter: To build a strong association for Nutralite we have launched a new campaign towards the end of Q3 focusing on health credentials of the brand and recruiting new user. We have seen step up in the volume growth of Nutralite and hence this campaign should help us build further momentum.

As per the MAT December 2015 Report of Nielsen, the following market shares we would like to share. The Artificial Sweetener category has grown by 6.3%. Sugar Free has maintained its #1 position with 93.3% market share, which is an increase of 110 basis points over last year. The Scrub category has grown by 13.7%. Everyuth Scrub has maintained its #1 position with a market share of 31.3%. The Peel Off Mask category has turned positive and grown by 0.8%. Everyuth, Peel Off Mask has maintained its #1 position with a market share of 91.4% which is an increase of 40 basis points over last year. The Margarine category has declined by 4.5%;

however Nutralite has maintained its #1 position with a market share of 39.8% which is an increase or 380 basis points over last year. Thank you and we will now start the Question-and-Answer Session. Over to the coordinator for the Q&A.

Moderator: Thank you very much. We will now begin the Question-and-Answer Session. The first question is from the line of Sheetal Bhat from Catamaran. Please go ahead.

Sheetal Bhat: Sir, if you could share the industry growth rate for Face Wash as well and how our market share has been in that space? My second question was if you could let us know if there are any new product launches that you are planning in Everyuth? The third question is if you could share what is the rough mix of Aspartame and Sucralose in the Artificial Sweetener space now and how does it compare with what it was a year or two years back?

Tarun Arora: Face Wash has been growing at about close to 20% as reported by Nielsen. Our market share is about 1.8% on a MAT basis.

Sheetal Bhat: What was this number comparable previous quarter?

Tarun Arora: We have lost the market share in Face Wash. For the last two quarters we are stable at 1.8-1.9%, it is lower than last year and in the overall Everyuth which has seen strengthening of the brand bag, but Face Wash still remains to be a challenge for us and we are building back. Scrubs and Peel Off we have seen ramp up of growth for us and that is why in fact Peel Off we have about 91%, we have seen we have been able to get our growth back in the category as well. Getting into Sucralose and Aspartame while we have seen both the parts grow together the ratio has remained consistent at Aspartame being about 70 and Sucralose being about 30.

Sheetal Bhat: How does this compare with a year or two years back… how has the trend been in this sales mix between Aspartame and Sucralose

Tarun Arora: We have seen a consistent trend across both spaces.

Sheetal Bhat: Does that mean that the share of Sucralose continues to be 30%, has the mix not improved in favor of Sucralose?

Tarun Arora: Largely it has remained consistent, minor changes here and there but they happen quarter-on-quarter but overall remain same.

Sheetal Bhat: What about the new product launches in the Everyuth space if you could share any details on that?

Tarun Arora: We are planning to restage Face Wash over next quarter and we will share it once we have done it and we are in a position to share the specific details about it because we believe Face Wash where we have lost some ground we need to do some work there.

Sheetal Bhat: The overall sales of Everyuth for the nine months, would you be able to tell us has it grown or decreased?

Tarun Arora: Since we do not share brand-by-brand details, it would be hard for me, but like we mentioned Everyuth and Sugar Free both have shown a positive trend for us. That is what is driving our 5% growth that we shared.

Moderator: Thank you. The next question is from the line of Sonali Salgaonkar from YES Securities. Please go ahead.

Sonali Salgaonkar: My first question is could you give us an update on your distribution overhaul now more aligning towards the FMCG standards, so if you could share numbers like how many distributors you have pan India or any other metrics that you would like to share with us?

Tarun Arora: We do not share the internal numbers, but I can share very clearly our distribution revamp is reasonably stable now, we are present in about 3.8 lakh outlets for Everyuth as a brand and about close to 3 lakhs for Sugar Free. Our internal numbers have started ramping and we have a reasonably stable sales system in place.

Sonali Salgaonkar: So these 3 lakh and 4 lakh outlets they are more concentrated towards the metros, right. So what about your penetration into the Tier-1 and Tier-2s?

Tarun Arora: Our penetration is reasonably good across all town classes right up to 50000 population towns. Obviously, it is a more urban phenomena. So we are seeing 85% to 90% of our business coming largely from urban spaces and we seem to be reasonably doing good.

Sonali Salgaonkar: My second question is with respect to your Margarine category. Could you give us some sense of how the competition is in the Margarine right now and also a sense as to have you taken any price cuts over the past quarter?

Tarun Arora: We have not taken any new price cuts, we have mentioned about the price cuts which we had taken and that is one of the reasons which continues to show the difference in the volume and value numbers, more so in the institutional space where we have had to take some price cuts. That is one of the reasons. The competition continues to be consistent as has been in the earlier quarters, not new competition that we are seeing.

Sonali Salgaonkar: My last question is with reference to your raw material cost. So going ahead over the coming quarters, do you expect your gross margin to be at current levels around stable or improve a bit from that?

Tarun Arora: At least at this level, if there is any improvement obviously we will be happy to report, but stable is something what we are looking at.

Moderator: Thank you. The next question is from the line of Ajay Thakur from Anand Rathi. Please go ahead.

Ajay Thakur: I had a question on Stevia launch which you have been planning. You have already done some test marketing of the same. So wanted to check, when are we looking for a formal launch of Stevia brand in India?

Tarun Arora: What we have seen from our learnings in this Stevia launch, the response is lower than what we expected but we think the trend will improve especially with the regulators approving this thing, On our side, we are readying ourselves for a national launch, we will share whenever we think it is the right time, but we have used those learnings and we can be ready for the launch at the appropriate time in the next few quarters.

Ajay Thakur: Secondly, on the distribution revamp, can you share some more light on what is the status on that since most are revamped and how this stands now, is it stable right now and what kind of distribution outlets addition we can expect from the same going ahead in FY17

Tarun Arora: The distribution revamp is stable, we are expecting growth of 3-4-5% in distribution which we will see over the next few quarters but we will have to see how the market responds, but it is stable now.

Moderator: Thank you. The next question is from the line of Shalini Gupta from Quantum Securities. Please go ahead.

Shalini Gupta: Sir, if you could just give some sense on your ASP like do you think they will be maintained at current levels or expect them to go up?

Tarun Arora: On an annual basis we have said earlier we intend to keep it at a stable level.

Shalini Gupta: Sir, right now your products are urban-centric and you know the urban economy is going through a lot of stress. So going forward, say financial year '17 or maybe '18 let us say if the economy starts growing at (+8%), what kind of growth can one expect in the two main categories, that is your Sugar Free and your Margarine?

Tarun Arora: While I cannot give you any guidance, we are hopeful that as the economy picks up our own actions to grow the categories are also in place. So we expect to ramp up our growth in line with our expectations and we have talked about a double-digit growth going forward.

Shalini Gupta: Your tax rate is at 10%. So for how long does it remain at this level?

Amit Jain: We have around 10-years holiday in Sikkim till 2021-2022. So we expect that till the time we are there it will probably range between 10% to 12% depending upon the product mix.

Shalini Gupta: Given the kind of product categories you have, could you just discuss how the main raw material ingredients have moved during the quarter, what is your outlook on those?

Amit Jain: In terms of prices, most of the key raw material prices have been down. The downward trend may not continue the way it was, but at least stability in the prices is what we expect going forward.

Moderator: Thank you. The next question is from the line of Devanshi Dhruva from Dolat Capital. Please go ahead.

Amit Dhruva: Amit Dhruva here. Just two things; one, want to understand on this Stevia. You talked about the response was not good. So can you give some more clarity as to what was the customer looking at or some insights into the customer…?

Tarun Arora: There are a couple of points. Stevia as it exists it has a bit of aftertaste and all products have it. New product adoption takes its own time and we are going through that and seeing how the trend will continue. There is a lot of talk about it but the adoption of the new molecule takes time and that is really what we are seeing. So it is not something we launch and we expect a quick ramp up. There is a lot of talk about Stevia. We hope that numbers could also be showing the same thing. That is really what it is. It is more to do with that aftertaste which the typical Stevia product has. We are working on it. It is a problem across the world for Stevia.

Amit Dhruva: So despite this being a more natural, the acceptance level is low because of taste is there?

Tarun Arora: Yes.

Amit Dhruva: Second, we have been talking about this distribution revamp. It is almost like 10-11 quarters that we have been touching about Rs.100 crores of top line plus or minus Rs.5-6 crores. When do we see actually kind of growth because now almost like a couple of quarters the distribution is stable. So what is that is not helping us not to grow especially when we are the category leaders and we decide the growth of Sugar Free… I understand the Margarine and all, but I am just saying the growth was also I presume lower because we were in the distribution restructuring and all, now all that is over, so what is it that why still we cannot grow in double-digit for the last couple of quarters?

Tarun Arora: Your point is valid. For the last couple of quarters as our distribution is getting stabilized, we are clearly expecting the growths to come up. Also you are aware that across the whole economy there has been some challenges. Now ramp up of our brands which we are working on, will show in the next few quarters and we are quite hopeful that with the right space and some support from the economy, we can get back to double digit growth. There is no reason for us not to.

Amit Dhruva: You think that probably this year is gone. So, would you think FY17-18 probably you would see some improvement in growth or you think there is still more restructuring required?

Tarun Arora: We have done with restructuring. Obviously, growth will get better in '17-18 but I am talking about few quarters where we should see the growth coming back. I am not talking about a few years. Clearly, we are seeing our business getting more stable. Restructuring is behind us and more ready to get growth.

Moderator: Thank you. The next question is from the line of Rakesh Naidu from Haitong Securities. Please go ahead.

Rakesh Naidu: Last quarter you talked about renovating your distribution and doing some additional commercial activity. It seems the market share that what you are essentially playing out and reflecting what you are doing, my question is how you are looking at other three categories especially incremental A&P spend clearly now seem to be responding in terms of top line growth, how do you see the other three segments ramping up over FY17?

Tarun Arora: The line is not clear, but what I understand I will give you basis of that if you want to ask more questions may be you could. We are clearly seeing Sugar Free growth, Everyuth also is coming back on growth with good performance on Scrubs and Peel Off. We still remain challenged on Face Wash and that is more of a brand work which we are working on. Nutralite also is showing some improvements on the volume side where we have done some price corrections. So over the next few quarters all the three brands are more equipped to get back to growths.

Rakesh Naidu: So do you want to give any guidance numbers for FY17?

Tarun Arora: That would not be possible as a policy.

Rakesh Naidu: You talked about this quarter seeing benefits of lower cost in terms of raw materials. So why is it that gross margins has not grown and even where there is a contraction, how do you see the situation panning out for you?

Amit Jain: Our margins have gone up by 290 basis points. If I heard you right you were saying that though there are reductions in the material prices why it is not being reflected in the gross margin expansion. Actually our margins on a like-to-like basis has gone up by 290 basis points which is around 3%

Rakesh Naidu: So last quarter it was around 72%, this quarter it is at 70…?.

Amit Jain: It is a product mix as well because this is the winter where Nutralite sells a bit higher as compared to previous quarter, product mix also plays its role.

Tarun Arora: That is the product mix and therefore a better way would be to look at on an annual basis or comparable to last year number rather than sequential quarters.

Rakesh Naidu: On the tax line item, you had guided for 10-11% number for next couple of years in the last quarterly call. How should we actually see this expense line item panning out and when do we see the benefits clearly expiring for you at this…?

Amit Jain: The tax benefit which we enjoy at Sikkim, once that gets over will fall into normal tax rate, which is a few years away from now. After 2020 probably we will get into normal tax rate.

Moderator: Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: If we see our journey of last 10-12 quarters, obviously, numbers are very tepid. But on market we tried everything, we tried changing product packaging, we tried changing brand ambassador, even placement also in our channel check we figure out that we tried our best, we changed our distribution also. Do you believe that is there some limitation of the current portfolio to drive overall company's growth and in that context, because our gross margin allows us to do some organic expansion of portfolio by launching new products, a) and b) are we thinking on lines of inorganic growth to drive overall company's growth?

Tarun Arora: First of all, belief of the management is that the current portfolio itself has more growth potential than we have got. There have been some restructuring and all those changes. They have to give results and that is really what we are committed to getting. Having said this, your question also is quite valid. There are opportunities beyond the existing portfolio, existing business also which we must use and look at building further on growth and clearly two other spaces that we are building on apart from getting growths back on the base business are one is international portfolio where for example we understand the Sweetener space extremely well in India, understand the category and the dynamics of it. We intend to extend our presence beyond India over the next few years and that is the work we are doing. There is clearly opportunity in the international space that we will be working on exploring and that should add to the growth. The second piece which we are adding to the base business growth is the inorganic opportunity. We are actively looking on opportunities in India and abroad which are synergistic with our brand portfolio and our ambitions and we would bank those opportunities and you will see some actions over the next few quarters from that as well. So base business, yes, and as well as the other opportunities.

Tejas Shah: Any check list at this point you would like to share in inorganic what you would not do rather what you will do, you will do it could be a very big list, but what you want to definitely not get into if you can share?

Tarun Arora: Not in this call.

Moderator: Thank you. The next question is from the line of Kaustubh Pawaskar from Sharekhan Limited. Please go ahead.

Kaustubh Pawaskar: Sir, my question is on your Nutralite brand. You have taken the price reduction. So just wanted to know about your branded part of the business, whether we have seen any substantial improvement in the volume growth of the branded part of the business because of this price reduction and do we hope it to continue in the coming quarters?

Tarun Arora: I may not be able to share such details, but we have clearly seen our market share going up over last year and that is tracked by Nielsen on the retail space. That is really what we can share.

Kaustubh Pawaskar: Any further plans of reducing the prices because raw material prices were reduced?

Tarun Arora: No.

Moderator: Thank you. The next question is from the line of Sumeeta Sharma from Axis Capital. Please go ahead.

Sumeeta Sharma: In the last quarter you had guided for a double digit growth in the second half and with 3% growth on a like-to-like basis that we have done in this quarter it seems highly unlikely that we will end with that. So, I guess what I am trying to say is that it seems that the recovery is getting pushed forward every quarter. Can we maybe highlight at a broader level what the major pain points have been?

Tarun Arora: I would look at more operational level and that is the numbers we started sharing. On a like-to-like basis it is more like 5.2% growth in my opening speech that I had shared and we are seeing some of the numbers tracking forward, I think it is going step by step, there are overall challenges in the economy which are also holding us back and some of the growths are lower than what we expected, but there is a clear improvement over last two quarters that we see and that is why we shared this 5.2% number.

Sumeeta Sharma: You mentioned that there have been challenges in the economy, but at a management level, your three main categories are doing well, we know that Face Wash is not doing so well. Any other issues at the business level that you are facing which is why growth has been hard to come by?

Tarun Arora: That is only what we have shared.

Moderator: Thank you. The next question is from the line of Sheetal Bhat from Catamaran. Please go ahead.

Sheetal Bhat: Sir, wanted to check on Nutralite. We believe that in previous call you have mentioned that around 70% of the sales come from institutional sales. I wanted to understand that when you say institutional, would it mean that we sell with the Nutralite brand to customers like Railways, etc., or does it go as an unbranded product?

Tarun Arora: These are branded as Nutralite.

Moderator: Ladies and Gentlemen, as there are no further questions I would now like to hand the conference over to Mr. Tarun Arora for closing comments. Thank you and over to you sir.

Tarun Arora: Thank you very much for the questions asked. We look forward to being on call in the next quarter.

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